HSBC Bank plc

Annual Report and Accounts 2017

HSBC

Contents

	Page
Strategic Report	
Highlights	**2**
Purpose and strategy	**3**
Products and services	**4**
How we do business	**5**
Key performance indicators	**7**
Economic background and outlook	**8**
Financial summary	**9**
Risk overview	**19**
Report of the Directors	
Risk	**20**
– Our conservative risk appetite	**20**
– Top and emerging risks	**20**
– Areas of special interest	**23**
– Risk management	**23**
– Other material risks	**35**
– Key developments and risk profile	**36**
Capital	**56**
– Capital management	**56**
– Capital overview	**56**
Corporate Governance Report	**59**
– Directors	**59**
– Company Secretary	**60**
– Board of Directors	**60**
– Directors' emoluments	**60**
– Board committees	**60**
– Internal control	**61**
– Employees	**62**
– Auditor	**64**
– Conflicts of interest and indemnification of directors	**64**
– Statement on going concern	**64**
– Disclosure of information to the auditor	**65**
– Statement of Directors' Responsibilities	**65**
Financial Statements	
Independent Auditors' Report	**66**
Financial Statements	**75**
Notes on the Financial Statements	**84**

Presentation of Information

This document comprises the *Annual Report and Accounts 2017* for HSBC Bank plc ('the bank') and its subsidiaries (together 'the group'). 'We', 'us' and 'our' refer to HSBC Bank plc together with its subsidiaries. It contains the Strategic Report, the Report of the Directors, the Statement of Directors' Responsibilities and Financial Statements, together with the Independent Auditors' Report, as required by the UK Companies Act 2006. References to 'HSBC' or 'the Group' within this document mean HSBC Holdings plc together with its subsidiaries.

HSBC Bank plc is exempt from publishing information required by The Capital Requirements Country-by-Country Reporting Regulations 2013, as this information is published by its parent, HSBC Holdings plc. This information will be available in June 2018 on HSBC's website: www.hsbc.com.

Pillar 3 disclosures for the group are also available on www.hsbc.com, under Investor Relations.

All narrative disclosures, tables and graphs within the Strategic Report and Report of the Directors are unaudited unless otherwise stated.

Our reporting currency is £ sterling.

Unless otherwise specified, all $ symbols represent US dollars.

Cautionary Statement Regarding Forward-Looking Statements

This *Annual Report and Accounts 2017* contains certain forward-looking statements with respect to the financial condition, results of operations and business of the group.

Statements that are not historical facts, including statements about the group's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential' and 'reasonably possible', variations of these words and similar expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made. HSBC Bank plc makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statement.

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

Highlights

	Footnotes	2017	2016
For the year (£m)			
Profit before tax (reported basis)		**2,370**	874
Profit before tax (adjusted basis)	1	**3,832**	4,234
Net operating income before loan impairment charges and other credit risk provisions	2	**13,052**	13,305
Profit/(loss) attributable to shareholders of the parent company		**1,809**	(212)
At year-end (£m)			
Total equity attributable to shareholders of the parent company		**43,462**	39,930
Total assets		**818,868**	816,829
Risk-weighted assets		**233,073**	245,237
Loans and advances to customers (net of impairment allowances)		**280,402**	272,760
Customer accounts		**381,546**	375,252
Capital ratios (%)	3		
Common equity tier 1		**11.8**	10.2
Tier 1		**13.8**	12.3
Total capital		**16.9**	15.7
Performance, efficiency and other ratios (annualised %)			
Return on average ordinary shareholders' equity	4	**4.2**	(1.2)
Return on average risk-weighted assets		**1.0**	0.4
Adjusted return on average risk-weighted assets		**1.6**	1.7
Cost efficiency ratio (reported basis)	5	**78.2**	90.3
Cost efficiency ratio (adjusted basis)	5	**67.5**	63.9
Jaws (adjusted basis)	6	**(5.8)**	0.4
Ratio of customer advances to customer accounts		**73.5**	72.7

1 *Adjusted performance is computed by adjusting reported results for the effect of significant items as detailed on pages 10 to 12.*
2 *Net operating income before loan impairment charges and other credit risk provisions is also referred to as revenue.*
3 *Capital ratios as detailed on the capital section on pages 56 to 58.*
4 *The return on average ordinary shareholders' equity is defined as profit attributable to shareholders of the parent company divided by the average total shareholders' equity.*
5 *Reported cost efficiency ratio is defined as total operating expenses (reported) divided by net operating income before loan impairment charges and other credit risk provisions (reported), while adjusted cost efficiency ratio is defined as total operating expenses (adjusted) divided by net operating income before loan impairment charges and other credit risk provisions (adjusted). Net operating income before loan impairment charges and other credit risk provisions (adjusted) is also referred to as revenue (adjusted).*
6 *Adjusted jaws measures the difference between adjusted revenue and adjusted cost growth rates.*

Purpose and strategy

Our purpose

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

Geographical presence

In the group, we operate in 18 countries. Our operating entities represent the group to customers, regulators, employees and other stakeholders. Our priority markets are the UK, France and Germany.

As at 31 December 2017, the bank had 625 branches in the United Kingdom, and 13 located in the Isle of Man and the Channel Islands. The bank and its subsidiaries had further banks, branches and offices in Armenia, Belgium, Czech Republic, France, Germany, Greece, Ireland, Israel, Italy, Luxembourg, Malta, The Netherlands, Poland, Russia, South Africa, Spain and Switzerland.

On 29 June 2017, HSBC Bank plc transferred its shareholding in HSBC Bank A.S. to HSBC Middle East Holdings B.V. (89.99%) and HSBC Bank Middle East Limited (10.01%). The transfer was made as a dividend in-specie to HSBC Holdings plc.

The results of HSBC Bank A.S. for the period up to the transfer are included in the group results. To the date of transfer, HSBC Bank A.S. contributed £116m operating income (2016: £356m), and incurred £10m in loan impairment and other charges (2016: £108m) and £86m in operating expenses (2016: £324m). HSBC Bank A.S.'s contribution to the group's profit before tax in the year up the date of its transfer was £20m (2016: £76m loss).

As a result of the transfer, the total assets excluding goodwill of the group reduced by £4,831m and the total liabilities reduced by £4,265m. Total risk-weighted assets reduced by £4,080m and the common equity tier 1 reduced by £530m.

The transfer passes through equity as a dividend in-specie that reduces reserves by £643m. This comprises HSBC Bank A.S.'s net asset value of £566m plus attributable goodwill of £77m.

There was no gain or loss recognised in the group as a result of this transfer.

HSBC worldwide

The group is part of HSBC, which has approximately 229,000 employees working around the world to provide more than 37 million customers with a broad range of banking products and services to meet their financial needs.

HSBC values

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

Open

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

Connected

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

Dependable

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

Our role in society

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

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

Our strategy

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

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

Long-term trends

Increasing global connectivity

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

Distinctive advantages

Unrivalled global presence

We enable clients to participate in global growth opportunities and offer leading product capabilities to build deeper and more enduring relationships with businesses and individuals with international needs.

Universal banking model

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

Long-term strategy

Develop our international network

To facilitate international trade and capital flows and serve our clients as they grow from small enterprises into large multinationals.

Invest in wealth and retail businesses with local scale

To make the most of global social mobility, wealth creation and long-term demographic changes in our priority markets.

Our network is underpinned by our four interconnected, global businesses that share balance sheets and liquidity, in addition to strong commercial links; our businesses allow us to support clients, from retail customers to the world's largest companies.

Value of the network

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

Services around the world

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

Business synergies

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

Ring-fence implementation

HSBC has made steady progress in preparing for the separation of the qualifying components of the UK retail banking activities from the wholesale and investment banking activities into the UK ring-fenced bank in the second half of 2018, ahead of the 1 January 2019 deadline set under the UK Financial Services (Banking Reform) Act 2013. For further details refer to the separate section 'Structural reform' on page 16.

Products and services

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

Retail Banking and Wealth Management ('RBWM')

Customers

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

Products and services

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

Business synergies

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

Areas of focus

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

Commercial Banking ('CMB')

Customers

CMB customers range from small enterprises focused primarily on their domestic markets through to corporates operating globally.

Products and services

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

Business synergies

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

Areas of focus

HSBC is focused on creating value from its network. The Group's priority markets cover both sides of 11 of the world's 15 largest trade corridors for goods and services forecast for 2030, and represent at least one side of the other four corridors.

The group is therefore investing heavily in digital and technology aspects of its core Global Liquidity and Cash Management ('GLCM') and Global Trade and Receivables Finance ('GTRF') propositions.

Global Banking and Markets ('GB&M')

Customers

GB&M supports major government, corporate and institutional clients worldwide. Our product specialists continue to deliver a comprehensive range of transaction banking, financing, advisory, capital markets and risk management services.

Products and services

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

Areas of focus

We have made progress on our initiatives to reduce RWAs, including managing our Markets and Capital Financing business and employing a disciplined approach to new client business.

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

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

Global Private Banking ('GPB')

Customers

GPB serves high net worth individuals and families, including those with international banking needs, through 13 booking centres covering the Group's priority markets.

Products and services

Our products and services include: Investment Management, incorporating advisory, discretionary and brokerage services; Private Wealth Solutions, comprising trusts and estate planning, designed to protect wealth and preserve it for future generations; and a full range of Private Banking services.

Business synergies

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

Areas of focus

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

Corporate Centre

Corporate Centre comprises Central Treasury, including Balance Sheet Management ('BSM'), certain legacy assets, interests in our associates and joint ventures, and central stewardship costs that support our businesses.

How we do business

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

Customers

We aim to be the world's leading international bank and strive for excellence when it comes to the quality of service and experiences offered to customers.

Our customers are at the heart of everything we do and we are working to make things simpler, faster and better for them.

Our customer base ranges from individuals to major international corporate clients

Taking responsibility for the experiences we deliver

We have clear policies, frameworks and governance in place to protect customers. These cover the way we behave, design products and services, train and incentivise employees, and interact with customers and each other.

Senior leaders have ultimate responsibility for customer service standards and monitor these through key metrics aligned to performance objectives. These include:

- How customers feel about recommending us, and
- The speed and quality of complaint handling.

The targets for each of these metrics are carefully set and managed to instill the right behaviours among our employees.

What customers are telling us

In 2017, our CMB and RBWM customers told us there were three main issues that we needed to focus on to improve their experience of our products and services:

1. Accessibility

Customers across all of our channels provided feedback on length of queues in branches, call waiting and handling time in our contact centres, the length of appointments with our Relationship Managers and the complexity of logging on to our online and mobile banking services.

We introduced Universal Banker concept from listening and understanding our customers changing needs in branch. It provided a multi-channel expert who can confidently assist customers with a variety of questions while facilitating an increase in digital adoption.

The Multi Channel Appointment Booking system ensures customers can book appointments in the branch they require with a reduced wait time.

2. Complexity

Customers are telling us our processes and procedures are too complicated which impacts the quality and length of time required to service our customers day-to-day.

We have improved our account opening process with a significant reduction in the question set, optimisation of the mobile device application and removing the requirement to return paperwork before account opening.

The mortgage journey improvements include condensing advice to one shortened meeting, instructing valuations at the point of application, increasing the use of automated valuations, reducing the amount of evidential documentation required and sending electronic offer documentation. Customers are now experiencing reduced wait times, a condensed end-to-end journey, shorter mortgage interviews and a significant reduction in the amount of information and documents requested.

3. Fees and charges

Our industry can be complex, and our customers can find it difficult to understand when and why they will be charged for our services.

We refreshed the HSBC mortgage pricing structure by introducing free valuation charges to all customers, reducing the confusion around eligibility and streamlining the journey. This is part of our continuous review and improve process to ensure our journeys are simple and understandable for our customers.

We have continued to simplify our Wealth fee structure, including putting various examples within the fee disclosure document and capping fees.

A digital transformation

Our customers are becoming increasingly digitally oriented in their everyday lives. This means their expectations of us – and their behaviour towards HSBC as a brand – are changing.

Customers are now using branches less often. In the future, we will have fewer – but better – branches, with more empowered front-line employees using a greater range of technology to support all our customers' needs.

The retail transformation programme in the UK has helped to drive digital growth and meet the strategic ambition to digitise our key customer journeys and create new immersive digital experiences for our retail customers, notably being the launch of Connected Money/HSBC Beta, Mobile X and website upgrades in 2017.

We launched Mobile Trade Transaction Tracker which enables corporate clients to monitor deals and trade transactions in real-time via the HSBCnet mobile app for Documentary Credit, Collections and Guarantees. The self-service capability is expected to substantially reduce the number of calls and e-mails on status checks on transactions, leading to massive efficiencies for both our customers and the bank.

Sustainable finance

Supporting sustainable growth

Each and every one of us has a stake in developing a sustainable economic system. It is the combined responsibility of all players in society to respond to climate change, rapid technological change and continuing globalisation to secure a prosperous future.

Since its foundation in 1865, HSBC has adapted to and helped serve the needs of a changing world. It has financed economic growth, fostered international trade and overcome events such as economic crises. We recognise that governments, corporations, the financial system and civil society are all stakeholders in climate change and sustainability challenges.

Now more than ever, there is a need to develop the skills, business innovation and low-carbon solutions needed to secure long-term prosperity for all. For HSBC, these are the key elements of sustainable growth which we can influence. Our network covers the world's largest and fastest growing trade corridors and economic zones. As such, we are uniquely positioned to provide the connections needed to foster sustainable growth across borders and geographies. In 2017, we launched our sustainability strategy focusing on three main areas: sustainable finance; sustainable networks and entrepreneurship; and future skills.

We have a proud record of supporting the communities and environments in which we operate. Thousands of HSBC employees globally are involved every year by volunteering for the Group's community investment programmes. In 2017, employees in Europe volunteered more than 60,900 hours, supporting communities' activities in work time. Charitable giving by our business in Europe in 2017 totalled $19.7m (£15.3m), and in addition the Group community investment spend in Europe was $22.4m (£17.4m). Our HSBC Youth Opportunities and Junior Achievement More than Money programmes are increasing young people's levels of employability and financial capability across Europe. Our flagship environmental partnership, the HSBC Water Programme, continues to invest in projects aimed at protecting

scarce water resources and educating communities about the importance of these resources.

HSBC publishes regular updates to stakeholders about our approach to key environmental, social and governance ('ESG') issues. In November 2017, HSBC published five Sustainable Finance Commitments, which can be found at http://www.hsbc.com/our-approach/sustainability/sustainablefinance.

We recognise its importance and seek to be a leader in managing climate change risk while developing opportunities with – and for – our customers. We welcome the recommendations which assist understanding of climate-related risks and we were a signatory to the June 2017 Taskforce on Climate-related Financial Disclosures ('TCFD') report. HSBC's 2016 Statement on Climate Change may be found on our website at http://www.hsbc.com/our-approach/measuring-our-impact. It gives background in advocacy, our approach to low / high carbon transition, managing our direct impact and partnerships.

Empowering people

Valuing diversity

Diversity

We believe that a diverse and inclusive workforce is critical to running a sustainable and successful business. Our approach aims to increase and leverage diversity of thought to drive greater innovation, better manage risks, enhance collaboration, and improve workforce agility.

Our commitment

We are committed to building an inclusive culture where people are valued, respected and supported. We create business value by actively and empathically seeking out the richness of ideas, backgrounds, styles and perspectives.

Employee networks

Our seven global employee networks play a key role in building community, highlighting opportunities and achieving our diversity and inclusion ambitions. They focus on gender, age, ethnicity, LGBT+, faith, working parents and carers, and ability. Additionally we have common interest groups sharing experiences and engaging with others both internally and externally.

Supporting our employees

We believe that if someone is worth talking to, they are worth listening to. Exchange meetings are our way of doing that: meetings with no agendas and where managers are participants rather than leaders. These meetings bring people together to listen to each other, and allow people to express themselves without interruption or rebuttal. Over 40% of European employees participated in an Exchange meeting in 2017 last quarter. 78% of European employees believe everyone has a chance to say what they think about issues that affect the team they work in.

To further strengthen our culture and promote positive behaviours, we have developed culture change plans that are regularly discussed in regional and local management forums. The plans emphasise enabling a speak-up culture, principles-based judgement and other behaviours that are key to supporting the Group's strategic objectives such as managing financial crime risk.

We include behaviour ratings in employees' performance reviews, and they are factored into variable pay awards.

Whistleblowing

We work hard to create an environment in which people feel able to speak up, but understand that employees may not always feel comfortable raising concerns through their regular escalation channels. There will also be some circumstances which require more discretion. We operate a global whistleblowing standard, HSBC Confidential, which allows individuals to report matters of concern confidentially. We also maintain an external email address for concerns about accounting and internal financial controls or auditing matters (accountingdisclosures@hsbc.com). The Group has a strict policy prohibiting retaliation against those who raise concerns. All allegations of retaliation reported are escalated to senior management.

HSBC Confidential is overseen by our Group Conduct and Values Committee and Group Audit Committee. Investigations are carried out thoroughly and independently, drawing on the expertise of a variety of teams, including Regulatory Compliance, Human Resources, Legal, Financial Crime Risk, Information Security and Internal Audit.

1,585 cases were raised during 2017 (2016: more than 1,100 cases). All cases are subject to investigation.

In 30% of the cases closed in 2017 (2016: 34%), allegations were substantiated in whole or in part, and appropriate remedial action taken.

Tax

Our approach to tax

We apply the spirit as well as the letter of the law in all territories where we operate, and have adopted the UK Code of Practice for the Taxation of Banks. As a consequence, we pay our fair share of tax in the countries in which we operate. We continue to strengthen our processes to help ensure our banking services are not associated with any arrangements known or suspected to facilitate tax evasion.

HSBC continues to apply global initiatives to improve tax transparency such as:

- the US Foreign Account Tax Compliance Act ('FATCA');
- the OECD Standard for Automatic Exchange of Financial Account Information (also known as the Common Reporting Standard);
- the Capital Requirements Directive IV ('CRD IV') Country by Country Reporting; and
- the OECD Base Erosion and Profit Shifting ('BEPS') initiative.

We do not expect the BEPS or similar initiatives adopted by national governments to adversely impact our results.

Key Performance Indicators

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

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

Financial KPIs

	2017	2016
Profit before tax (reported) (£m)	**2,370**	874
Profit before tax (adjusted) (£m)	**3,832**	4,234
Jaws (adjusted) (%)	**(5.8)**	0.4
Cost efficiency ratio (reported) (%)	**78.2**	90.3
Cost efficiency ratio (adjusted) (%)	**67.5**	63.9
Return on average risk-weighted assets (%)	**1.0**	0.4
Adjusted return on average risk-weighted assets (%)	**1.6**	1.7
Common equity tier 1 capital ratio (%)	**11.8**	10.2

Profit before tax (reported/adjusted): Reported profit before tax is the profit as reported under IFRS. Adjusted profit before tax adjusts the reported profit for the effect of significant items as detailed on pages 10 to 13.

Outcome (reported): Reported profit before tax was higher year-on-year principally in GB&M, partly offset by lower reported profit before tax mainly in RBWM and the Corporate Centre. The increase was principally driven by lower expenses in GB&M due to impairment of goodwill in 2016. This was partly offset by lower revenue in 2017 due to the one-off gain on disposal of HSBC's membership interest in Visa Europe which benefited both RBWM and CMB in 2016. The revenue decrease was also due to the transfer of HSBC Bank A.S. out of the group in June 2017. In the Corporate Centre, Balance Sheet Management ('BSM') revenue was lower due to the one off of gain from the discontinuation of a macro cash flow hedge in the prior year.

Outcome (adjusted): Adjusted profit before tax decreased driven by higher operating expenses, primarily due to higher charges from other entities in the Group in both the Corporate Centre and GB&M (partly offset by higher intercompany recoveries in revenue). Excluding this, costs were higher in the Corporate Centre due to higher technology costs and in GB&M due to higher performance costs and severance costs. In addition, operating expenses increased in CMB mainly relating to the ongoing implementation of our Global Standards programme to enhance our financial crime risk controls and capabilities and to meet our external commitments. This was partly offset by an increase in revenue, notably in GB&M in Global Banking with higher revenue in Advisory and Debt Capital Markets, and in Principal Investments due to asset disposals, as well as in Credit, Rates and Equities reflecting higher client flows and improved market share.

Adjusted jaws measures the difference between adjusted revenue and adjusted cost growth rates (excluding the effects of costs-to-achieve and other significant items as detailed on pages 10 to 13). Our target is to grow revenues faster than operating expenses on an adjusted basis. This is referred to as positive jaws.

Outcome: In 2017, we grew revenue by 3% while our operating expenses also went up, but by 9%. Jaws was therefore a negative 5.8%.

Adjusted costs increased due to the unfavourable impact of movements in foreign exchange, and higher charges from other entities in the Group in both the Corporate Centre and GB&M (partly offset by higher intercompany recoveries in revenue). Adjusted revenue was up due to higher income in GB&M in Global Banking with increases in Advisory and Debt Capital Markets, and in Principal Investments due to asset disposals, as well as in Credit, Rates and Equities reflecting higher client flows and improved market share.

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

Outcome (reported): In 2017, reported revenue increased by 1% while reported operating expenses decreased by 15%. The cost efficiency ratio therefore decreased by 12.1%.

Reported operating expenses decreased mainly due to impairment of goodwill in GB&M of £2.2bn in 2016 and lower settlements and provisions in connection with legal and regulatory matters in 2017. Reported revenue was up in 2017 mainly due to a gain on disposal of HSBC's interest in VocaLink Holdings Limited and higher revenue in GB&M.

Outcome (adjusted): The cost efficiency ratio (adjusted) increased from 2016 as costs increased by more than revenue.

Return on risk-weighted assets ratio (reported/adjusted) is measured as pre-tax profit divided by average risk-weighted assets.

Outcome (reported): The return on average risk-weighted assets increased by 0.6% compared with prior year due to the non-recurrence of the GB&M goodwill impairment in 2016.

Outcome (adjusted): The adjusted return on average risk-weighted assets decreased by 0.1% compared with prior year.

Common equity tier 1 ('CET1') capital ratio represents the ratio of common equity tier 1 capital to total risk-weighted assets. CET1 capital is the highest quality form of capital comprising shareholders' equity and related non-controlling interests less regulatory deductions and adjustments. The group seeks to maintain a strong capital base to support the development of its business and meet regulatory capital requirements at all times.

Outcome: The CET1 capital ratio increased during the year due principally to new CET1 capital contributed by HSBC Holdings plc.

Non-financial KPIs

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

For details on customer service and satisfaction please refer below; for the remaining non-financial KPIs refer to the Corporate Governance section on pages 62 to 64.

Customer service and satisfaction

For UK RBWM the principal customer metric is the Customer Recommendation Index ('CRI'), measuring customers' likelihood to recommend HSBC products and services to friends or family. This measure is tracked relative to competitors, aiming for a positive gap to market.

Scores for HSBC UK RBWM have remained broadly consistent with 2016; however improvements across competitors' scores have resulted in the brand ranking consistently in the bottom half of the competitor set. Focus for HSBC continues to be on providing great customer service and ensuring a clear demonstration of understanding our customers and their needs. A customer plan is in place to ensure development against these areas, and the launch of HSBC Beta (a mobile app to help customers track and manage spending across all of their accounts), and the continued development of our new mobile and online banking services will help support this.

First Direct continues to lead the market for customer recommendation and displays a continued high proportion of brand advocates. Excellent customer service remains a key brand strength. Ongoing enhancements to mobile and digital capabilities throughout 2018 will continue to support this, aided further by the Financial Conduct Authority ('FCA') sandbox pilot where first direct will test how it can extend customer service to areas outside of

financial services, for example to help customers save on their energy bills.

M&S Bank CRI scores have remained consistent throughout 2017. For the six month period ending in October, they remain in line with the market average, placing them in joint 3rd position within their competitor set. The launch of M&S Bank mortgages will be a key development for the brand in 2018.

In 2017, France RBWM's CRI score saw the largest increase amongst the competitors. This puts HSBC in joint second place, reaching the target of top 3 within the competitive set, although very close to the followers and CRI remains a highly volatile indicator. HSBC has seen a positive trend through the course of 2017 for digital, with improvements noted for mobile and online banking. There is also an increased proportion of mentions for being flexible and giving relevant advice in the second half of 2017. HSBC continues to focus on making things easier for customers by reducing complexity of processes and improving accessibility.

HSBC UK's Commercial Banking uses Net Promoter Score (NPS) as the principal customer metric, measuring customers' likelihood to recommend their bank to other businesses, which is carried out by an independent third party (Charterhouse). In the UK, small business market (customer turning over less than £2m) we have seen a 7-point improvement when comparing to corresponding period for 2016. This is the biggest uplift across peer group, and reflects the dedicated investments being made across our channels including telephony, online, mobile and Business Specialists, where we aim to bring the best of digital and our people by integrating them through services like video conferencing and Linkscreen.

We continue to support our customers, enabling them to grow their businesses both domestically and internationally. Commercial Banking was ranked number 1 bank in the Charterhouse Survey for supporting international needs by UK businesses.

This position is further endorsed by the Euromoney 2018 Trade Finance survey showing HSBC as the number 1 Trade provider in the UK (for the second year running) as well as number 1 for Service across Europe. Supporting growth extends beyond just our product range, however, exemplified by the launch of our Connections Hub which brings our international network straight to our customers' desktop, allowing them to search, view and connect with other HSBC customers.

Our efforts and investments in improving customer satisfaction has led to us winning several awards from Euromoney magazine including Best Trade Finance Bank in the UK and Best Cash Manager in the UK.

Our priorities for 2018 are around simplifying customer processes across key journeys with strategic programmes underway to develop and launch enhancements to our digital platforms for Business Banking customers.

Economic background and outlook

UK

UK real GDP rose by 0.5% in the fourth quarter of 2017 - a small improvement on 0.4% in the preceding quarter. The annual rate of growth slowed to 1.5% (from 2.0% in the same quarter of 2016). The unemployment rate stood at 4.3% in the three months to November - its lowest level since 1975. Employment as a percentage of the population aged 16-64 was 75.5% in November - a series high. Annual wage growth (excluding bonuses) stood at 2.4% in the three months to November. The annual rate of growth in the Consumer Price Index ('CPI') was 3.0% in December. Activity in the housing market weakened over the year, with price growth moderating but remaining positive. However, the Bank of England raised rates by 25bps to 0.5% in November.

The annual pace of UK real GDP growth is now expected to slow from 1.8% in 2017 to 1.5% in 2018. Though CPI inflation may be at or near its peak, it looks set to continue to outpace wage growth throughout 2018, with employment growth slowing. Together, these factors could weigh on consumption growth. Political uncertainty may also keep investment growth weak, while net trade is not expected to contribute to GDP growth in 2018. Although the rate of growth is lower than it has been in recent years, it is still close to what the Bank of England considers to be the new 'speed limit'. It may therefore raise the Bank Rate again in 2018.

Eurozone

The eurozone continued on a steady growth path in 2017, with GDP increasing at a 0.6% quarterly rate in the fourth quarter of the year, following 0.7% in the previous two quarters. This took full year growth to 2.5% in the eurozone last year, the fastest rate in ten years. So far we only have the data for two of the Big 4 eurozone countries: France and Spain. GDP increased by 0.6% quarter-on-quarter in France, led by strong exports growth and investment, and by 0.7% quarter-on-quarter in Spain, taking the full year growth to 3.1%, the third year in a row in excess of 3%. Domestic consumption is likely to have remained an important driver of growth in the fourth quarter, fuelled by strong job creation, but HSBC Global Research expects it to have eased a little as the recent oil price increase is reducing households' purchasing power. Investment has also been picking up recently, particularly in the business sector, also helped by important fiscal incentives, while net exports are also likely to have contributed positively to growth, thanks to the highly synchronised global cycle, and so far with limited impact from the appreciation of the euro (circa 9% in trade-weighted terms) since last spring.

The latest survey data point to a continuation of the strong growth momentum, although HSBC Global Research expects a marginal slowdown in growth in 2018 (to 2.3%) due to stalling real wage growth putting a lid on domestic consumption, against the background of rising energy prices, while the stronger euro might have a dampening effect on export growth. The European Central Bank ('ECB') Quantitative Easing ('QE') programme has been extended for 9 months from January 2018 albeit at a slightly lower pace (€30bn of asset purchases per month, compared to €60bn previously), which should continue to provide fiscal support to countries, while the ECB forward guidance on rates should help prevent a further appreciation of the euro by pushing expectations for a possible rate hike further into the future. HSBC Global research expects QE to end in October. With nominal wage growth stalling, HSBC Global Research expects inflation to continue to undershoot the ECB's inflation target, at 1.5% both in 2018 and 2019, even if the recent oil price increase has added some pressures to inflation in the short term, only partly offset by the stronger euro. The main political risk is the Italian election on 4 March, with polls pointing to a likely hung parliament. The outcome of the Catalan independence threat remains uncertain, after pro-independence parties re-gained a majority of seats in the Catalan parliament at the regional election on 21 December, while Germany is still without a government after last September's election.

Financial summary

Summary consolidated income statement for the year ended

	2017	2016
	£m	£m
Net interest income	6,181	6,769
Net fee income	2,989	2,945
Net trading income	2,383	4,299
Net income/(expense) from financial instruments designated at fair value	1,122	(1,047)
Gains less losses from financial investments	262	530
Net insurance premium income	1,809	1,567
Other operating income	796	261
Total operating income[1]	15,542	15,324
Net insurance claims, benefits paid and movement in liabilities to policyholders	(2,490)	(2,019)
Net operating income before loan impairment and other credit risk provisions	13,052	13,305
Loan impairment charges and other credit risk provisions	(495)	(416)
Net operating income	12,557	12,889
Total operating expenses[1]	(10,208)	(12,011)
Operating profit	2,349	878
Share of profit/(loss) in associates and joint ventures	21	(4)
Profit before tax	2,370	874
Tax expense	(528)	(1,053)
Profit/(loss) for the year	1,842	(179)
Profit/(loss) attributable to shareholders of the parent company	1,809	(212)
Profit attributable to non-controlling interests	33	33

1 *Total operating income and expenses includes significant items as detailed on pages 10 to 12.*

Reported Performance

Reported profit before tax was £2,370m, £1,496m higher than 2016.

Net interest income ('NII') decreased by £588m or 9%. This decrease was primarily in Corporate Centre, where income was lower mainly in Balance Sheet Management ('BSM') in France due to a one-off gain from a discontinuation of a macro cash flow hedge in the prior year. In RBWM, income decreased due to the transfer of our operations in Turkey to the Middle East and North Africa region ('MENA') in June 2017. NII also decreased due to spread compression on mortgages in France and lower margins on current accounts in both the UK and France. In CMB, income decreased primarily in the UK due to a reduction in the Bank of England base rate in August 2016 and in France due to margin compression on customer deposits.

Net fee income increased by £44m or 1%, primarily due to favourable movements in foreign exchange. Excluding this, net fee income decreased in RBWM mainly due to the transfer of our operations in Turkey to MENA in June 2017. In CMB, net fee income decreased primarily relating to Global Liquidity and Cash Management ('GLCM') reflecting a decline in money transmission fees due to a change in customer behaviour, switching from notes and coins to digital in the UK. This was partly offset by an increase in GB&M in Global Banking due to continued momentum in investment banking products.

Net trading income decreased by £1,916m or 45%, primarily in Corporate Centre in BSM due to adverse foreign exchange movements on assets held as economic hedges of debt designated at fair value (offset in 'Net income from financial instruments designated at fair value'). Excluding this, the decrease was mainly in GB&M in the Foreign Exchange business due to less volatility in 2017, resulting in lower client activity.

Net income from financial instruments designated at fair value increased by £2,169m, mainly in Corporate Centre in BSM due to favourable foreign exchange movements on economically hedged foreign currency debt (offset in 'Net trading income'). Excluding this, income was higher from financial assets and liabilities from investment contracts, primarily driven by improved equity market performance.

Gains less losses from financial investments decreased by £268m or 51%, mainly as 2016 benefitted from a gain on the disposal of our membership interest in Visa Europe of £416m. Excluding this, gains less losses from financial investments increased, mainly due to higher gains on the disposal of available-for-sale bonds in BSM, notably in the UK. In addition, there were gains on the disposal of available-for-sale equity securities.

Net insurance premium income increased by £242m or 15%, primarily due to favourable movements in foreign exchange and increased net insurance premium income in France due to improved commercial performance.

Other operating income increased by £535m, primarily in GB&M due to an increase in the recovery of research and business costs from other entities in the Group (£237m, offset in operating expenses) in 2017. Excluding this, the increase mainly reflected a strong performance in Principal Investments due to asset disposals.

Net insurance claims, benefits paid and movement in liabilities to policyholders increased by £471m or 23%. This was largely due to improved returns on contracts where the policyholder shares the investment risk, and partly offset by a reduction in premium income.

Loan impairment charges and other credit risk provisions ('LICs') increased by £79m or 19%, primarily driven by higher LICs in GB&M in 2017 reflecting charges on two large corporate exposures in the construction and retail sectors in the UK compared with net releases in 2016. This was partly offset by lower LICs in CMB due to net releases of collectively assessed impairments compared with charges in 2016, notably in the UK in the oil and gas sector. In addition, LICs were lower in France and Spain in 2017.

Total operating expenses decreased by £1,803m or 15%, driven by a number of significant items including:

- an impairment of goodwill in GB&M of £2,182m in 2016;
- lower settlements and provisions in connection with legal and regulatory matters, reflecting net provision releases of £540m in 2017 compared with charges in 2016 of £41m; partly offset by an increase of £111m in costs to establish the UK ring-fenced bank compared with 2016;

- an increase of £69m in costs-to-achieve, comprising specific costs relating to the achievement of the strategic actions set out at the Group's investor update; and
- higher UK customer redress provisions of £82m.

Excluding these items, operating expenses increased by £700m notably in GB&M, Corporate Centre and CMB. Higher costs in GB&M were partly offset by increased intercompany recoveries in revenue (£237m) relating to research and business costs charged to other entities in the Group. Costs increased in GB&M due to higher performance related pay, pension and severance costs. In Corporate Centre, the increase reflected higher technology costs. In CMB, operating expenses increased mainly due to the ongoing implementation of our Global Standards programme to enhance our financial crime risk controls and capabilities, and to meet our external commitments.

For further details of significant items affecting revenue and costs, please refer to significant revenue/cost items by business segment on pages 10 and 11.

Tax expense totalled £528m in 2017 compared with £1,053m in 2016. The effective rate for 2017 was 22.3% compared with 120.5% in 2016. Excluding the one-off impact of a goodwill impairment, the effective rate in 2016 would have been 34.5%. The reduction in this rate in 2017 primarily reflected the release of non-taxable regulatory provisions and favourable prior year adjustments.

Adjusted Performance

Use of non-GAAP financial measures

Our reported results are prepared in accordance with IFRSs, as detailed in the Financial Statements starting on page 75. In measuring our performance, the financial measures that we use include those derived from our reported results in order to eliminate factors that distort period-on-period comparisons. These are considered non-GAAP financial measures.

Non-GAAP financial measures are described and reconciled to the closest reported financial measure when used.

The global business segmental results on pages 10 to 15 are presented on an adjusted basis in accordance with IFRS 8 'Operating Segments' as detailed in the 'Basis of preparation'.

Adjusted performance

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

We use 'significant items' to describe collectively the group of individual adjustments excluded from reported results when arriving at adjusted performance. These items, which are detailed below, are ones that management and investors would ordinarily identify and consider separately when assessing performance to understand better the underlying trends in the business. We consider adjusted performance provides useful information for investors by aligning internal and external reporting, identifying and quantifying items management believes to be significant and providing insight into how management assesses year-on-year performance.

Basis of preparation

Global businesses are our reportable segments under IFRS 8.

The global business results are assessed by the chief operating decision maker on the basis of adjusted performance that removes the effects of significant items from reported results. We therefore present these results on an adjusted basis.

Reconciliations of reported and adjusted performance are presented on pages 9 to 15.

Our operations are closely integrated and, accordingly, the presentation of data includes internal allocations of certain items of income and expense. These allocations include the costs of certain support services and global functions to the extent that they can be meaningfully attributed to operational business lines. While such allocations have been made on a systematic and consistent basis, they necessarily involve a degree of subjectivity. Costs which are not allocated to global businesses are included in Corporate Centre.

Where relevant, income and expense amounts presented include the results of inter-segment funding along with inter-company and inter-business line transactions. All such transactions are undertaken on arm's length terms. The intra-group elimination items are presented in the Corporate Centre.

A description of the Global businesses is provided in the Strategic Report, page 4.

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

(Audited)

	RBWM	CMB	GB&M	GPB	Corporate Centre	Total
	£m	£m	£m	£m	£m	£m
31 Dec 2017						
Reported revenue	**4,097**	**3,490**	**4,436**	**321**	**708**	**13,052**
Significant revenue items	**2**	**77**	**166**	**–**	**(65)**	**180**
– UK customer redress programmes	**–**	**73**	**2**	**–**	**–**	**75**
– debit valuation adjustment on derivative contracts	**–**	**–**	**164**	**–**	**–**	**164**
– fair value movement on non-qualifying hedges	**–**	**–**	**–**	**–**	**(4)**	**(4)**
– provisions arising from on-going review of compliance with the CCA in the UK	**2**	**4**	**–**	**–**	**–**	**6**
– gain on disposal of HSBC's interest in VocaLink Holdings Limited	**–**	**–**	**–**	**–**	**(61)**	**(61)**
Adjusted revenue	**4,099**	**3,567**	**4,602**	**321**	**643**	**13,232**
31 Dec 2016						
Reported revenue	4,524	3,702	4,120	327	632	13,305
Significant revenue items	(247)	(164)	(19)	(1)	6	(425)
– change in credit spread on long-term debt	–	–	–	–	4	4
– debit valuation adjustment on derivative contracts	–	–	(33)	–	–	(33)
– fair value movement on non-qualifying hedges	5	–	14	–	2	21
– provisions arising from ongoing review of compliance with the CCA in the UK	–	–	–	(1)	–	(1)
– gain on disposal of HSBC's membership in Visa Europe	(252)	(164)	–	–	–	(416)
Adjusted revenue	4,277	3,538	4,101	326	638	12,880

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

(Audited)

	RBWM	CMB	GB&M	GPB	Corporate Centre	Total
	£m	£m	£m	£m	£m	£m
31 Dec 2017						
Reported operating expenses	**(3,641)**	**(1,571)**	**(2,885)**	**(251)**	**(1,860)**	**(10,208)**
Significant cost items	**569**	**20**	**(396)**	**(1)**	**1,090**	**1,282**
– costs to achieve	**69**	**6**	**147**	**(1)**	**817**	**1,038**
– costs to establish UK ring-fenced bank	**5**	**1**	**—**	**—**	**251**	**257**
– UK customer redress programmes	**495**	**12**	**2**	**—**	**—**	**509**
– settlements and provisions in connection with legal and regulatory matters	**—**	**—**	**(551)**	**—**	**11**	**(540)**
– costs associated with the UK's exit from the EU	**—**	**1**	**6**	**—**	**11**	**18**
Adjusted operating expenses	**(3,072)**	**(1,551)**	**(3,281)**	**(252)**	**(770)**	**(8,926)**
31 Dec 2016						
Reported operating expenses	(3,591)	(1,501)	(5,328)	(227)	(1,364)	(12,011)
Significant cost items	474	52	2,407	2	850	3,785
– impairment of Global Banking & Markets goodwill	—	—	2,182	—	—	2,182
– costs to achieve	93	26	144	2	704	969
– costs to establish UK ring-fenced bank	—	—	—	—	146	146
– UK customer redress programmes	381	26	20	—	—	427
– settlements and provisions in connection with legal and regulatory matters	—	—	41	—	—	41
– Madoff-related litigation costs	—	—	20	—	—	20
– restructuring and other related costs	—	—	—	—	—	—
Adjusted operating expenses	(3,117)	(1,449)	(2,921)	(225)	(514)	(8,226)

Costs to Achieve ('CtA') Definition:

CtA comprise those specific costs relating to the achievement of the strategic actions set out in the Investor Update in June 2015. They comprise costs incurred between 1 July 2015 and 31 December 2017, and do not include ongoing initiatives such as Global Standards. Any costs arising within this category have been incurred as part of a significant transformation programme. CtA are included within significant items and incorporate restructuring costs that were identified as a separate significant item prior to 1 July 2015.

CtA Breakdown:

Costs which are categorised as CtA are those that:

- Relate to initiatives included in the June 2015 Investor Update;
- Are incurred between 1 July 2015 and 31 December 2017 and are not part of ongoing initiatives;
- Arise from significant transformation programmes;
- Reduce Run the Bank spend or Risk Weighted Assets, with reductions being clearly identifiable.

Examples of costs categorised as CtA include:

- Restructuring costs - redundancy costs, write-offs relating to property disposals or where a change in systems results in an impairment of software;
- Consultancy and Third Party costs - for consultants working on specified initiatives only.

Net impact on profit before tax by business segment

(Audited)

	RBWM	CMB	GB&M	GPB	Corporate Centre	Total
	£m	£m	£m	£m	£m	£m
31 Dec 2017						
Reported profit/(loss) before tax	**329**	**1,779**	**1,193**	**60**	**(991)**	**2,370**
Significant revenue items	**2**	**77**	**166**	**—**	**(65)**	**180**
Significant cost items	**569**	**20**	**(396)**	**(1)**	**1,090**	**1,282**
Adjusted profit/(loss) before tax	**900**	**1,876**	**963**	**59**	**34**	**3,832**
Net impact on reported profit and loss	**571**	**97**	**(230)**	**(1)**	**1,025**	**1,462**
31 Dec 2016						
Reported profit/(loss) before tax	746	1,828	(1,156)	105	(649)	874
Significant revenue items	(247)	(164)	(19)	(1)	6	(425)
Significant cost items	474	52	2,407	2	850	3,785
Adjusted profit/(loss) before tax	973	1,716	1,232	106	207	4,234
Net impact on reported profit and loss	227	(112)	2,388	1	856	3,360

By operating segment:

Adjusted profit for the year

(Audited)

	2017					
	RBWM	**CMB**	**GB&M**	**GPB**	**Corporate Centre**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Net interest income	**3,185**	**2,323**	**856**	**175**	**(283)**	**6,256**
Net fee income	**963**	**1,138**	**762**	**117**	**9**	**2,989**
Net trading income	**13**	**40**	**2,368**	**9**	**113**	**2,543**
Other income	**(62)**	**66**	**616**	**20**	**804**	**1,444**
Net operating income before loan impairment charges and other credit risk	**4,099**	**3,567**	**4,602**	**321**	**643**	**13,232**
– external	**3,840**	**3,784**	**5,142**	**242**	**224**	**13,232**
– inter-segment	**259**	**(217)**	**(540)**	**79**	**419**	**—**
Loan impairment charges and other credit risk provisions	**(127)**	**(140)**	**(358)**	**(10)**	**140**	**(495)**
Net operating income	**3,972**	**3,427**	**4,244**	**311**	**783**	**12,737**
Total operating expenses	**(3,072)**	**(1,551)**	**(3,281)**	**(252)**	**(770)**	**(8,926)**
– employee compensation and benefits	**(973)**	**(507)**	**(1,014)**	**(82)**	**(41)**	**(2,617)**
– general and administrative expenses	**(2,084)**	**(1,027)**	**(2,262)**	**(168)**	**(212)**	**(5,753)**
– depreciation and impairment of property, plant and equipment	**(6)**	**(17)**	**(3)**	**(1)**	**(293)**	**(320)**
– amortisation and impairment of intangible assets	**(9)**	**—**	**(2)**	**(1)**	**(224)**	**(236)**
Operating profit	**900**	**1,876**	**963**	**59**	**13**	**3,811**
Share of profit in associates and joint ventures	**—**	**—**	**—**	**—**	**21**	**21**
Adjusted profit before tax	**900**	**1,876**	**963**	**59**	**34**	**3,832**
	%	**%**	**%**	**%**		**%**
Adjusted cost efficiency ratio	**74.9**	**43.5**	**71.3**	**78.5**		**67.5**

	2016					
Net interest income	3,282	2,343	936	196	12	6,769
Net fee income	1,022	1,142	675	110	(4)	2,945
Net trading income	57	10	2,547	7	1,666	4,287
Other income	(84)	43	(57)	13	(1,036)	(1,121)
Net operating income before loan impairment charges and other credit risk	4,277	3,538	4,101	326	638	12,880
– external	3,896	3,652	4,994	267	71	12,880
– inter-segment	381	(114)	(893)	59	567	—
Loan impairment charges and other credit risk provisions	(187)	(373)	52	5	87	(416)
Net operating income	4,090	3,165	4,153	331	725	12,464
Total operating expenses	(3,117)	(1,449)	(2,921)	(225)	(514)	(8,226)
– employee compensation and benefits	(978)	(496)	(1,011)	(86)	(524)	(3,095)
– general and administrative expenses	(2,124)	(939)	(1,905)	(138)	544	(4,562)
– depreciation and impairment of property, plant and equipment	(6)	(14)	(3)	(1)	(305)	(329)
– amortisation and impairment of intangible assets	(9)	—	(2)	—	(229)	(240)
Operating profit	973	1,716	1,232	106	211	4,238
Share of profit in associates and joint ventures	—	—	—	—	(4)	(4)
Adjusted profit before tax	973	1,716	1,232	106	207	4,234
	%	%	%	%		%
Adjusted cost efficiency ratio	72.9	41.0	71.2	69.0		63.9

Adjusted Performance

Our adjusted profit before tax decreased by £402m or 10% compared with 2016. This reflected higher operating expenses and higher LICs, partly offset by higher revenue.

Adjusted revenue increased by £352m or 3%, partly due to favourable movements in foreign exchange. Excluding this, revenue was higher, mainly in GB&M due to an increase in the recovery of research and business costs from other entities in the Group (£237m, offset in operating expenses) in 2017, as well as a strong performance in Global Banking due to continued momentum in investment banking products. Revenue in Principal Investments also increased due to asset disposals. This was partly offset by lower revenue in RBWM, primarily due to the transfer of our operations in Turkey to MENA in June 2017. Revenue also decreased in RBWM due to lower margins on current accounts, mortgages and deposits in France.

Adjusted LICs were £79m or 19% higher than 2016. This primarily reflected higher LICs in GB&M in 2017 due to charges on two large corporate exposures in the construction and retail sector in the UK compared with net releases in 2016. This was partly offset by lower LICs in CMB due to net releases of collectively assessed impairments compared with charges in 2016, notably in the UK in the oil and gas sector. In addition, LICs were lower in France and Spain in 2017.

Adjusted operating expenses increased by £700m or 9%, partly due to unfavourable movements in foreign exchange. Higher costs in GB&M were partly offset by increased intercompany recoveries in revenue (£237m) relating to research and business costs charged to other entities in the Group. Excluding this, operating expenses increased driven by higher performance-related pay, pension and severance costs in GB&M and higher technology costs in Corporate Centre. The increase was also due to the ongoing implementation of our Global Standards programme to enhance our financial crime risk controls and capabilities, and to meet our external commitments.

Retail Banking and Wealth Management

Adjusted profit before tax of £900m was £73m or 8% lower than 2016, primarily due to lower revenue, partly offset by lower LICs and lower operating expenses.

Revenue decreased by £178m or 4%, primarily due to the transfer of our operations in Turkey to MENA in June 2017. Excluding this, the decrease was due to lower margins on mortgages in France reflecting competitive pricing of new business despite increased volumes, and there was margin compression on current accounts in both the UK and France due to lower funding rates.

LICs decreased by £60m or 32%, notably reflecting the transfer of our operations in Turkey to MENA in June 2017. In the UK there were higher individually assessed impairment charges on credit cards, loans and overdrafts in 2017, partly offset by a one-off debt sale in the second half of 2017.

Operating expenses decreased by £45m or 1%, primarily due to the transfer of our operations in Turkey to MENA in June 2017. Excluding this, the decrease was due to lower operations costs, lower risk costs and a lower Financial Services Compensation Scheme ('FSCS') levy. These were partly offset by higher technology costs.

Commercial Banking

Adjusted profit before tax of £1,876m was £160m or 9% higher than 2016, driven by lower loan impairment charges, partly offset by higher operating expenses.

Revenue increased by £29m or 1% due to favourable movements in foreign exchange. Excluding this, revenue decreased compared with 2016. In France, net interest income was lower due to margin compression on customer deposits; resulting from interest rate hedges being renewed at lower rates in the negative interest rate environment of the Eurozone. Net interest income also decreased due to the transfer of our operations in Turkey to MENA in June 2017. These decreases were partly offset by higher revenue in the UK, with higher net interest income despite the Bank of England base rate reduction in August 2016. This was due to balance sheet growth, primarily in term lending and growth in collaboration revenue in the UK.

LICs decreased by £233m or 62%. The reduction in net impairment charges reflected net releases of collectively assessed impairments in 2017 compared with charges in 2016, notably in the UK in the oil and gas sector. There were also individually assessed impairment releases in the UK mainly in the Greek shipping sector. In France, LICs were lower across all sectors. In Spain, lower LICs were mainly driven by higher provisions in the construction and engineering sector in prior year.

Operating expenses increased by £102m or 7%, partly due to unfavourable movements in foreign exchange. Excluding this, operating expenses increased mainly relating to the ongoing implementation of our Global Standards programme to enhance our financial crime risk controls and capabilities, and to meet our external commitments. Costs were also higher due to an increase in staff costs reflecting strategic initiatives in the UK, the non-repeat of a VAT credit in 2016 and a lower pension credit in 2017.

Global Banking and Markets

Adjusted profit before tax of £963m was £269m or 22% lower than 2016, due to higher LICs and higher operating expenses, partly offset by higher revenue.

Revenue increased by £501m or 12%, partly due to favourable movements in foreign exchange and an increase in the recovery of research and business costs from other entities in the Group (£237m, offset in operating expenses). Excluding this, revenue increased reflecting a strong performance in Global Banking due to continued momentum in investment banking products and disposal gains in Principal Investments. Fixed Income, Currencies and Commodities ('FICC') revenue was in line with prior year. This reflected increases in Credit and Rates due to higher client flows, offset by a weaker performance in Foreign Exchange reflecting market volatility and reduced client activity. Equities revenue also increased due to market share gains in Prime Finance products.

LICs increased by £410m reflecting charges on two large corporate exposures in the construction and retail sectors in 2017 compared with net releases in 2016.

Operating expenses were £360m or 12% higher than 2016, partly offset by increased intercompany recoveries in revenue (£237m) relating to research and business costs charged from other entities in the Group. Excluding this, costs were higher reflecting performance-related pay, pension and severance costs.

Global Private Banking

Adjusted profit before tax of £59m was £47m or 44% lower than 2016, due to higher operating expenses, higher LICs and lower revenue.

Revenue decreased by £5m or 1%, despite favourable movements in foreign exchange. The decrease reflected lower average balances (down £550m or 10%) in 2017 following the exit from a Commercial Real Estate book in the UK.

LICs increased by £15m, notably reflecting net individually assessed impairment charges related to a single client in the UK in 2017 compared with net releases in prior year.

Operating expenses increased by £27m, partly due to unfavourable movements in foreign exchange. Excluding this, operating expenses increased driven by higher financial crime management costs and global operations costs.

Corporate Centre

Adjusted profit before tax of £34m was £173m or 84% lower than 2016. This reflected higher operating expenses and lower revenue, partly offset by lower LICs.

Revenue was broadly in line with 2016.

LICs decreased by £53m or 61%, mainly driven by significant impairment provision releases in Legacy Credit in 2017 reflecting portfolio disposals.

Operating expenses increased by £256m or 50%, partly offset by higher intercompany recoveries (£142m) in revenue relating to technology costs charged from other entities in the Group. Excluding this, the increase reflected higher technology costs including cyber-security investment.

Dividends

The consolidated reported profit for the year attributable to the shareholders of the bank was £1,809m.

Interim dividends of £415m, in lieu of a final dividend in respect of the previous financial year, and £186m in respect of 2017 were paid on the ordinary share capital during the year. A second interim dividend, in lieu of a final dividend, of £583m was declared after 31 December 2017, payable at the end of February 2018.

Further information about the results is given in the consolidated income statement on page 76.

Review of business position

Summary consolidated balance sheet as at 31 Dec

	2017 £m	2016 £m
Total assets	**818,868**	816,829
– cash and balances at central banks	**97,601**	54,278
– trading assets	**145,725**	125,069
– financial assets designated at fair value	**9,266**	8,345
– derivative assets	**143,335**	199,419
– loans and advances to banks	**14,149**	21,363
– loans and advances to customers	**280,402**	272,760
– reverse repurchase agreements – non-trading	**45,808**	31,660
– financial investments	**58,000**	83,135
– other	**24,582**	20,800
Total liabilities	**774,819**	776,204
– deposits by banks	**29,349**	23,682
– customer accounts	**381,546**	375,252
– repurchase agreements – non-trading	**37,775**	19,709
– trading liabilities	**106,496**	93,934
– financial liabilities designated at fair value	**18,249**	18,486
– derivative liabilities	**140,070**	190,092
– debt securities in issue	**13,286**	16,140
– liabilities under insurance contracts issued	**21,033**	19,724
– other	**27,015**	19,185
Total equity	**44,049**	40,625
– total shareholders' equity	**43,462**	39,930
– non-controlling interests	**587**	695

By operating segment:

Balance sheet information by global business

(Audited)

	RBWM £m	CMB £m	GB&M £m	GPB £m	Corporate Centre £m	Total £m
Year ended 31 Dec 2017						
Loans and advances to customers	**117,933**	**84,947**	**63,379**	**7,372**	**6,771**	**280,402**
Customer accounts	**151,985**	**100,831**	**94,069**	**12,774**	**21,887**	**381,546**
Year ended 31 Dec 2016						
Loans and advances to customers	111,692	80,969	67,416	7,050	5,633	272,760
Customer accounts	148,469	97,630	89,115	14,279	25,759	375,252

There are no reconciling items between the adjusted and reported view of the balance sheet for 2017 and 2016.

The group maintained a strong and liquid balance sheet with the ratio of customer advances to customer accounts remaining broadly constant at 73.5% compared to 72.7% at 31 December 2016.

Assets

Cash and balances at central banks increased by 80% as a result of deploying surplus deposits from customers and reflecting a partial move of the liquid asset portfolio from bonds into cash.

Trading assets increased by 17% primarily due to an increase in market activity.

Derivative assets decreased by 28% largely due to shifts in major yield curves and movements in foreign exchange rates with a commensurate decrease within derivative liabilities.

Loans and advances to customers increased by 3%. The increase was due to higher levels of corporate and retail mortgage lending as well as increased overdraft balances resulting from lower levels of IFRS netting.

Reverse repurchase agreements – non-trading increased by 45% primarily due to an increase in market activity offset by higher levels of netting.

Financial investments decreased by 30% primarily due to a sale of assets within the available-for-sale portfolio.

Liabilities

Customer accounts increased by 2% due to growth in corporate and retail balances compounded by lower levels of IFRS netting and foreign exchange movements. This increase was partially offset by debt issued for future Minimum Requirements for own funds and Eligible Liabilities ('MREL') compliance being repaid to HSBC Holdings plc and replaced with subordinated debt, hence recognised as Subordinated Liabilities.

Repurchase agreements - non-trading increased by 92% due to increased market activity.

Trading liabilities increased by 13% broadly in line with trading assets.

Financial liabilities designated at fair value and debt securities in issue reduced by 1% and 18% respectively. The reduction is due to maturing issuances being replaced by term funding from HSBC Holdings plc in relation to the group's MREL plans.

Derivative liabilities decreased by 26% and this is in line with derivative assets as the underlying risk is broadly matched.

Equity

Total shareholders' equity increased by 9%. The increase was due to retained earnings from profit generated for the period as well as adjustments to actuarial assumptions.

Reported performance by country

Profit before tax – by country

	RBWM	CMB	GB&M	GPB	Corporate Centre	Total
	£m	£m	£m	£m	£m	£m
31 Dec 2017						
United Kingdom	**320**	**1,491**	**704**	**50**	**(950)**	**1,615**
France	**(8)**	**158**	**181**	**4**	**(121)**	**214**
Germany	**16**	**48**	**111**	**7**	**30**	**212**
Turkey[2]	**(9)**	**8**	**19**	**—**	**2**	**20**
Other	**10**	**74**	**178**	**(1)**	**48**	**309**
Profit before tax	**329**	**1,779**	**1,193**	**60**	**(991)**	**2,370**
31 Dec 2016						
United Kingdom	710	1,632	514	94	(681)	2,269
France	114	144	218	6	(31)	451
Germany	17	50	105	5	10	187
Turkey	(106)	(20)	40	—	10	(76)
Other[1]	11	22	(2,033)	—	43	(1,957)
Profit before tax	746	1,828	(1,156)	105	(649)	874

1 *GB&M includes goodwill impairment of £2,182m.*
2 *On 29 June 2017, the Turkish operations transferred to HSBC Middle East Holdings B.V. and HSBC Bank Middle East Limited.*

Net interest margin

Net interest margin is calculated by dividing net interest income as reported in the income statement by the average balance of interest-earning assets. Average balances are based on daily averages of the group's activities with monthly or less frequent averages used elsewhere.

Net interest margin of 1.36% was 20 basis points ('bps') lower than in 2016, including the effects of significant items and foreign currency translation. Excluding these factors, net interest margin decreased due to pressure on customer asset yields, including mortgages, overdrafts and term lending.

Net interest income

	2017	2016
	£m	£m
Interest income	**9,043**	9,322
Interest expense	**(2,862)**	(2,553)
Net interest income	**6,181**	6,769
Average interest-earning assets	**453,182**	434,686
	%	%
Gross interest yield	**1.84**	2.04
Less: cost of funds	**(0.53)**	(0.53)
Net interest spread	**1.31**	1.51
Net interest margin[1]	**1.36**	1.56

1 *Net interest margin is net interest income expressed as an annualised percentage of average interest-earning assets.*

Summary of interest income by asset type

	2017			2016		
	Average balance	Interest income	Yield[1]	Average balance	Interest income	Yield[1]
	£m	£m	%	£m	£m	%
Short-term funds and loans and advances to banks	**78,133**	**53**	**0.07**	60,655	116	0.19
Loans and advances to customers	**266,491**	**7,136**	**2.68**	250,087	7,687	3.07
Reverse repurchase agreements	**44,739**	**186**	**0.42**	45,233	90	0.20
Financial investments	**63,462**	**943**	**1.49**	78,391	975	1.24
Other interest-earning assets	**357**	**18**	**5.04**	320	9	2.81
Total interest-earning assets	**453,182**	**8,336**	**1.84**	434,686	8,877	2.04
Trading assets[2] and financial assets designated at fair value	**82,765**	**1,685**	**2.04**	82,609	1,401	1.70
Impairment allowances	**(2,328)**	**—**	**—**	(2,744)	—	—
Non-interest-earning assets	**300,521**	**—**	**—**	333,169	—	—
Total assets	**834,140**	**10,021**	**1.20**	847,720	10,278	1.21

1 *Yield calculations include negative interest on assets recognised as interest expense in the income statement.*
2 *Interest income arising from trading assets is included within 'Net trading income' in the income statement.*

Summary of interest expense by type of liability and equity

	2017			2016		
	Average balance	**Interest expense[1]**	**Cost**	Average balance	Interest expense[1]	Cost
	£m	**£m**	**%**	£m	£m	%
Deposits by banks	**17,293**	**54**	**0.31**	18,054	98	0.54
Financial liabilities designated at fair value – own debt issued	**17,307**	**218**	**1.26**	18,681	176	0.94
Customer accounts	**308,944**	**1,279**	**0.41**	297,913	1,456	0.49
Repurchase agreements	**39,239**	**152**	**0.39**	34,955	62	0.18
Debt securities in issue	**21,846**	**377**	**1.73**	28,822	250	0.87
Other interest–bearing liabilities	**1,114**	**75**	**6.73**	1,106	56	5.06
Total interest–bearing liabilities	**405,743**	**2,155**	**0.53**	399,531	2,098	0.53
Trading liabilities[2] and financial liabilities designated at fair value (excluding own debt)	**91,830**	**1,167**	**1.27**	78,230	912	1.17
Non-interest bearing current accounts	**49,527**	**—**	**—**	39,754	—	—
Total equity and other non-interest bearing liabilities	**287,040**	**—**	**—**	330,205	—	—
Total equity and liabilities	**834,140**	**3,322**	**0.40**	847,720	3,010	0.36

1 *Cost of funding calculations include negative interest on liabilities recognised as interest income in the income statement.*
2 *Interest expense arising from trading liabilities is included within 'Net trading income' in the income statement.*

Structural reform

Policy background

The UK Financial Services (Banking Reform) Act 2013 and associated secondary legislation and regulatory rules require UK deposit-taking banks with more than £25bn of 'core deposits' (broadly from individuals and small to medium-sized businesses) to separate their UK retail banking activities from their other wholesale and investment banking activities by 1 January 2019. The resulting UK ring-fenced bank entities need to be legally distinct, operationally separate and economically independent from the non ring-fenced bank entities.

Ring-fencing rules have been published by the Prudential Regulation Authority ('PRA') determining how ring-fenced banks will be permitted to operate. Further rules published by the FCA set out the disclosures that non ring-fenced banks are required to make to prospective customers who are individuals.

Ring-fencing implementation

HSBC's ring-fenced bank ('RFB'), named HSBC UK Bank plc ('HSBC UK'), was set up to hold the qualifying components of HSBC Bank plc's UK RBWM, CMB and GPB businesses. The UK GB&M business and current overseas subsidiaries and branches will remain in HSBC Bank plc, which will become HSBC's non ring-fenced bank ('NRFB'). The two banking entities will operate alongside each other, together with HSBC Global Services (UK) Limited ('UK ServCo'). The impact of any restructuring required as a result of the UK withdrawal from the European Union has not been included in the following disclosure and pro forma financial information.

In order to achieve this target-state, HSBC Bank plc will need to undertake a number of legal transfers. These include the transfer of customer and non-customer assets, liabilities and contractual arrangements. The majority of these transfers will be made via a court-approved ring-fencing transfer scheme ('RFTS') as provided for in Part VII, section 106 of the Financial Services and Markets Act 2000 (as amended) ('FSMA'). In addition to these transfers, certain items will be transferred via alternative arrangements.

HSBC's Structural Reform timeline, including progress to date and indicative future milestones, is as follows:

2015

- HSBC UK, the legal entity which will become the RFB, was incorporated in December 2015.

2016

- The Group presented the final ring-fencing project plan to the PRA and FCA.
- An RFB banking licence application was submitted to the regulators.
- A skilled person as defined by the FSMA, responsible for preparing the RFTS report was appointed.

2017

- In January 2017, HSBC UK Holdings Limited was incorporated and in March 2017 HSBC UK was transferred from HSBC Holdings plc to this new intermediate holding company.
- In March 2017, HSBC Bank plc's share premium totalling £20.7bn was converted to distributable reserves through a court-approved process in preparation for the transfer of businesses and related capital to HSBC UK.
- In July 2017, HSBC UK was granted a restricted banking licence from its regulators prior to the satisfaction of the PRA/FCA's Threshold Conditions, and HSBC is currently working on an agreed mobilisation plan to receive an unrestricted licence in 2018.
- In August 2017, HSBC UK was converted from a private company to a public limited company.
- A number of legal entities connected with the future NRFB business started to be transferred to, or divisionalised into, HSBC Bank plc.

2018

- In January 2018, the RFTS court process was initiated with the submission of an application to the High Court, followed by the first hearing to consider and approve the communications programme.
- The final court hearing to sanction the RFTS is planned to take place in May 2018.
- We plan to execute simultaneously the following three transfers on 1 July 2018 under an agreement between HSBC Holdings plc, HSBC Bank plc, HSBC UK and HSBC UK Holdings Limited:
  - HSBC Bank plc's UK RBWM and the qualifying components of CMB businesses and related items will be transferred to HSBC UK through the RFTS;
  - HSBC Bank plc's qualifying subsidiaries, notably Marks and Spencer Financial Services plc, HSBC Private Bank (UK) Limited and a number of asset finance entities, will be transferred to HSBC UK as part of the RFTS; and
  - HSBC Bank plc's excess reserves will be transferred to HSBC UK through a capital contribution.
- HSBC Bank plc will be transferred to HSBC UK Holdings Limited in the second half of 2018.

During 2017 and early 2018 there were also a number of other significant milestones including the establishment of HSBC UK's IT infrastructure and the successful migration of around 209,000 customer sterling accounts and 203,000 foreign currency accounts to new HSBC UK sort codes.

On 1 October 2017, 21,571 employees were transferred from HSBC Bank plc to HSBC UK. At the same time, an intra-group service agreement between these two entities, effective until 30 June 2018, enabled the deployment of these employees back to HSBC Bank plc.

We plan to officially open HSBC UK's headquarters in Birmingham on 16 May 2018. More than 90% of the roles that need to move from London to Birmingham have now been filled, and we are on track to have a fully functioning team in place by 1 July 2018.

The cost to HSBC Bank plc of ring-fencing in 2017 was £0.3bn (2016: £0.1bn). The total cost is expected to be £0.6bn over the lifetime of the restructuring.

HSBC UK Bank plc 2017 pro forma balance sheet

The purpose of this disclosure is to provide an estimate of the likely financial position of the RFB following legal separation, based on assets and liabilities held in HSBC Bank plc as at 31 December 2017. This pro forma information is being furnished solely for informational purposes. The unaudited pro forma financial information is based on available information and assumptions that management believes were reasonable at the date of preparation.

The disclosure below sets out pro forma consolidated financial information in respect of HSBC UK. HSBC Bank plc (excluding HSBC UK) is not presented in the disclosure due to various transfers and re-organisation activities which have not yet occurred and that will take place in the months leading to legal separation (including capital contributions). This will ensure that HSBC Bank plc and HSBC UK can operate as separate legal entities from 1 July 2018.

Consolidated balance sheet

	Footnotes	Pro forma HSBC UK Bank plc balance sheet 2017 £bn
Assets		
Liquid assets	1	**59.1**
Derivatives	2	**0.1**
Loans and advances to customers		**162.0**
Pension asset		**6.1**
Prepayments, accrued income and other assets		**2.1**
Goodwill and intangible assets		**3.6**
Total assets at 31 Dec		**233.0**
Liabilities and equity		
Liabilities		
Customer accounts		**203.5**
Items in the course of transmission to other banks		**0.4**
Financial liabilities designated at fair value		**1.0**
Derivatives	2	**0.2**
Accruals, deferred income and other liabilities		**1.6**
Provisions		**1.1**
Deferred tax liabilities		**1.2**
Subordinated liabilities		**3.9**
Total liabilities at 31 Dec		**212.9**
Total shareholder's equity at 31 Dec	3	**20.1**
Total liabilities and equity at 31 Dec		**233.0**

1 *Liquid assets include cash and balances at central banks, items in the course of collection from other banks and financial investments.*
2 *HSBC UK derivative assets and liabilities relate solely to customer driven derivative transactions and hedging instruments used to manage HSBC UK's own risk.*
3 *Total shareholders' equity includes share capital, share premium, additional Tier 1 instruments and reserves. Reserves include accounting reserves of c.£7.6bn relating to the recognition of goodwill and the pension asset net of deferred tax which do not form part of regulatory capital. Shareholders' equity is based on information available and assumptions made at the date of preparation; as such, subsequent amounts reported may differ.*

Risk Weighted Assets (RWAs) by global business[1]

	At 31 Dec 2017					
	RBWM £bn	CMB £bn	GB&M £bn	GPB £bn	Corporate Centre £bn	Total RWAs £bn
Pro forma HSBC UK Bank plc						
Credit Risk	**15.1**	**54.1**	**—**	**1.8**	**1.0**	**72.0**
Market Risk	**—**	**—**	**—**	**—**	**0.1**	**0.1**
Operational Risk	**5.4**	**4.5**	**—**	**0.3**	**0.1**	**10.3**
Total RWAs at 31 Dec 2017	**20.5**	**58.6**	**—**	**2.1**	**1.2**	**82.4**

1 *Includes only third-party RWAs.*

Basis of preparation

The establishment of HSBC UK will be accounted for as a group restructuring. HSBC's accounting policy for such transactions requires that assets and liabilities are recognised by HSBC UK at their existing carrying amounts in the financial statements of HSBC Bank plc. Equity reserves relating to items such as cash flow hedging and available-for-sale fair values will not be recycled by HSBC Bank plc but will be transferred across to continue the existing accounting basis in HSBC UK, as if the RFB had always been in place.

The pro forma financial information set out above is prepared in accordance with HSBC's accounting policy on group restructuring and on the basis that the business operations are transferred to HSBC UK on 31 December 2017.

As the systems and processes to support the generation of HSBC UK's financial reporting have not yet been fully implemented, certain estimates and assumptions are necessary to generate the pro forma balances. As a result, subsequent financial information reported by HSBC UK may differ from that presented in the pro forma disclosures.

International Financial Reporting Standard 9 ('IFRS 9') 'Financial Instruments'

IFRS 9 will replace International Accounting Standard ('IAS 39') 'Financial Instruments: Recognition and Measurement' from 1 January 2018. The new standard includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting. The pro forma Balance Sheet has been prepared on the basis of IAS 39, however it is not fully compliant with IFRSs.

Goodwill

While goodwill is an accounting concept and therefore will not form part of the legal transfer of assets and liabilities, consistent with the accounting approach for other assets and liabilities, it is necessary to take a relative proportion of the goodwill accounting value previously recognised by HSBC Bank plc. Goodwill has therefore been allocated to HSBC UK based on estimated Risk Weighted Assets.

Following an acquisition goodwill loses its original identity and is managed and monitored by cash generating units, which for HSBC Bank plc are the global businesses that have benefited from those historical acquisitions. Given that a significant percentage of the global businesses that supported the goodwill have been transferred to HSBC UK, it therefore follows that a significant portion of the goodwill is also transferred with those businesses.

Provisions

Provisions have been allocated to HSBC UK based on the underlying business line that generated an obligating event.

Pension asset

The surplus on the UK principal defined benefit plan has been recognised entirely in the pro forma balance sheet of HSBC UK.

Taxation

No current tax has been recognised on the pro forma balance sheet of HSBC UK. Deferred tax has been recognised in respect of the temporary differences arising on the underlying assets and liabilities transferred.

Risk overview

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

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

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

The exposure to our risks and risk management of these are explained in more detail in the Risk section of the Report of the Directors on pages 20 to 36.

During 2017, a number of changes to our top and emerging risks have been made, to reflect the revised assessment of their effect on the group.

Risk		Mitigants
Externally driven		
UK exit from EU	▲	The UK is due to leave the EU in March 2019 and negotiations are ongoing. We will continue to work with regulators, governments and our customers to manage the risks of the UK's exit from the EU (and the current period of uncertainty) as they arise, particularly across those sectors most impacted.
Geopolitical risk	▲	We continually assess the impact of geopolitical events on our businesses and exposures across Europe and take steps to mitigate, where required, to ensure we remain within risk appetite. We have also strengthened physical security at our premises where the risk of terrorism is heightened.
Turning of the credit cycle	▶	We continue to undertake detailed reviews of our portfolios and are also proactively accessing other customers and sectors likely to come under stress as a result of geopolitical or macroeconomic events, reducing limits where appropriate.
Cyber threat and unauthorised access to systems	▲	We continue to strengthen our cyber control framework and implement initiatives to improve our resilience and cybersecurity capabilities, including threat detection and analysis, access control, payment system controls, data protection and backup and recovery.
Increasing regulatory expectations	▶	We proactively engage with regulators and policy makers wherever possible to help ensure that new regulatory requirements are considered fully and can be implemented in an effective manner.
Regulatory focus on conduct of business	▶	We continue to enhance our management of conduct in a number of areas, including the treatment of potentially vulnerable customers, market surveillance, employee training and performance.
Financial Crime Compliance	▶	We continue to develop and enhance our Financial Crime Risk function, strengthen our governance processes and augment our risk management capabilities to further improve our financial crime detection and compliance capabilities.
Market illiquidity and volatility	▶	We monitor risks closely and report regularly on illiquidity and concentration risks to the PRA.
Internally driven		
People risk	▶	We continue to increase our focus on resource planning and employee retention and to equip line managers with the skills to both manage change and support their employees.
IT systems infrastructure and resilience	▶	We continue to monitor and improve service resilience across our technology infrastructure, enhancing our problem diagnosis/resolution and change execution capabilities, reducing service disruption to our customers.
Execution risk	▶	We continue to strengthen our prioritisation and governance processes for significant strategic, regulatory and compliance projects.
Model risk	▶	We continue to enhance our model risk governance framework by establishing an independent Second Line of Defence Model Risk Management function, and we continue to enhance our existing policy and standards in order to address evolving regulatory, external and internal requirements.
Data management	▲	We continue to improve our insights, consistency of data aggregation, reporting and decisions through ongoing enhancement of our data governance, data quality and architecture framework.

▲ Risk has heightened during 2017

▶ Risk remains at the same level as 2016

On behalf of the Board

A P S Simoes, *Director*

20 February 2018

Registered number 14259

Risk

	Page
Our conservative risk appetite	**20**
Top and emerging risks	**20**
Externally driven	**20**
Internally driven	**22**
Areas of special interest	**23**
Risk management	**23**
Our risk management framework	**23**
Our material banking and insurance risks	**25**
Credit risk management	**26**
Liquidity and funding risk management	**29**
Market risk management	**29**
Operational risk management	**32**
Legal risk	**32**
Regulatory compliance risk management	**33**
Financial crime risk management	**33**
Insurance manufacturing operations risk management	**34**
Other material risks	**35**
Reputational risk management	**35**
Pension risk management	**35**
Key developments and risk profile in 2017	**36**
Key developments	**36**
Credit risk profile	**36**
Management of liquidity and funding risk profile	**48**
Market risk profile	**50**
Operational risk profile	**52**
Insurance manufacturing operations risk profile	**52**

Our conservative risk appetite

Throughout its history, HSBC has maintained an evolving conservative risk profile. It is central to our business and strategy. The following principles express the group's overarching risk appetite and fundamentally drive how the business and risks are managed:

Enterprise-wide application

- Our risk appetite encapsulates consideration of financial and non-financial risks and is expressed in both quantitative and qualitative terms.
- It is applied at the global business level, at the country level and to material European entities.

Financial position

- Strong capital position, defined by regulatory and internal ratios.
- Liquidity and funding management for each entity on a stand-alone basis.

Operating model

- Returns generated in line with risk taken.
- Sustainable and diversified earnings mix, delivering consistent returns for shareholders.

Business practice

- Zero tolerance for knowingly engaging in any business, activity or association where foreseeable reputational risk or damage has not been considered and/or mitigated.
- No appetite for deliberately or knowingly causing detriment to consumers arising from our products and services or incurring a breach of the letter or spirit of regulatory requirements.
- No appetite for inappropriate market conduct by a member of staff or by any group business.

Top and emerging risks

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

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

Externally driven

Process of UK withdrawal from the European Union

Uncertainty regarding the terms of the UK's exit agreement and its future relationship (including trading) with both the EU and the rest of the world is expected to continue for the next few years at least. Market volatility will therefore persist as the UK continues its negotiations with the EU and its potential future trading partners around the world. Throughout this period, we will continually update our assessment of potential consequences for our customers, products and banking model and re-evaluate our mitigating actions accordingly.

The scale and nature of the impact on HSBC will depend on the precise terms on which HSBC and its customers will be able to conduct cross-border business following the UK's departure from the EU. Changes to the UK's current trade relationships could require changes to HSBC's banking model to ensure we continue to comply with law and regulation in meeting the needs of our customers and conducting our business. Such changes could, among other things, increase our operating costs and require us to relocate staff and businesses to other jurisdictions. In addition, any negative impact on the economy, demand for borrowing and capital flows as a result of the aforementioned uncertainty, volatility or result of UK negotiations could have a consequential negative impact on HSBC.

Mitigating actions

- We have undertaken a comprehensive impact assessment to understand the range of potential implications for our customers, our products and our business. We have identified options to ensure we can continue to serve our customers across the UK and Europe, and we will continue to update these options as the negotiations with the EU develop.
- We actively monitor our portfolio to identify areas of stress, supported by stress testing analyses. Vulnerable sectors will be subject to management review to determine if any adjustments to risk policy or appetite are required.
- We will continue to work with regulators, governments and our clients in an effort to manage risks as they arise, particularly across the most impacted sectors.

Geopolitical risk

Our operations and portfolios are exposed to risks associated with political instability, civil unrest and military conflict which could lead to disruption to our operations, physical risk to our staff and/or physical damage to our assets. In addition rising protectionism and the increased trend of using trade and investment policies as diplomatic tools may also adversely affect global trade flows. Geopolitical risk remain heightened throughout 2017.

In the Middle East, the Islamic State's ('IS') loss of territory in both Iraq and Syria in 2017 have reduced their power and influence in the region, but attacks further afield by IS terrorists, particularly in Europe, remain likely.

In Europe, there remains an uncertain economic and political outlook. Italy, Hungary and Sweden all have elections in 2018 and the political situation in Spain remains tense following the Spanish Government's decision to take direct control of Catalonia following the independence referendum. The EU's future relationship with the UK is still yet to be determined, with negotiations on the terms of the UK's exit from the EU ongoing.

Mitigating actions

- We continually monitor the geopolitical outlook, in particular in countries where we have material exposures and/or a physical presence.
- We use internal stress tests and scenario analysis as well as regulatory stress test programmes, to adjust limits and exposures to reflect our risk appetite and mitigate risks as appropriate.
- We have taken steps to enhance physical security in those countries deemed to be at high risk from terrorism.

Turning of the credit cycle

While Geopolitical events in 2017 have not materially impacted our loss rates, they have created a climate of uncertainty with regards to trade and investment.

In the UK, rising inflation led to the MPC increasing the base rate by 0.25%, the first rise since July 2007, with expectations of a further increase in the first half of 2018. Combined with negative wage growth, the income squeeze that continues to be experienced within UK households has impacted consumer spending with a consequential negative effect on the retail sector.

Continental Europe enjoyed more buoyant trading conditions than seen in 2016, albeit particular areas of financial weakness (e.g. Greece and the Italian banking sector) and political vulnerability (e.g. Spain) remain.

While impairment charges increased in the second half of 2017 from historic lows, they remained well within our risk appetite for the full year and overall the wholesale portfolio remained stable.

Mitigating actions

- We closely monitor economic developments in key markets and sectors and undertake scenario analysis. This enables us to take portfolio actions where necessary, including enhanced monitoring, amending our risk appetite and/or reducing limits and exposures. We continue to monitor certain high risk portfolios such as oil and gas which has been more stable in 2017.
- We stress test portfolios of particular concern to identify sensitivity to loss under a range of scenarios, with management actions being taken to rebalance exposures and manage risk appetite where necessary.
- Reviews of key portfolios are undertaken regularly to ensure that individual customer or portfolio risks are understood and our ability to manage the level of facilities offered through any downturn are appropriate. In 2017 we have undertaken specific reviews of portfolios showing vulnerability such as construction and retail.

Cyber threat and unauthorised access to systems

HSBC and other public and private organisations continue to be the targets of increasingly sophisticated cyber attacks. Ransomware and distributed denial of service attacks appear to be an increasingly dominant threat to the financial industry, which may result in disruption to our operations and customer-facing websites or loss of customer data.

Mitigating actions

- We continue to strengthen and significantly invest in our ability to prevent, detect and respond to the ever-increasing and sophisticated threat of cyber attacks. Specifically, we continue to enhance our capabilities to protect against increasingly sophisticated malware, denial of service attacks and data leakage prevention, as well as enhancing our security event detection and incident response processes.
- Cyber risk is a top priority of the Operations and Technology Committee ('OPTEC') of the Board and is regularly reported to ensure appropriate visibility, governance and executive support for our ongoing cybersecurity programme.
- We participate in intelligence sharing with both law enforcement and industry schemes to help improve our understanding of, and ability to respond to, the evolving threats faced by us and our peers.

Increasing regulatory expectations

Financial service providers continue to face stringent regulatory and supervisory requirements, particularly in the areas of capital and liquidity management, conduct of business, financial crime, internal control frameworks, the use of models and the integrity of financial services delivery. Regulatory changes including any resulting from the UK's exit from the EU may affect the activities, of the group as a whole or of some or all of its principal subsidiaries.

Mitigating actions

- We are fully engaged with governments and regulators in the countries in which we operate, to help ensure that new requirements are considered properly by regulatory authorities and the financial sector and can be implemented in an effective manner.
- We hold regular meetings with UK authorities to discuss strategic contingency plans covering a wide range of scenarios relating to the UK's exit from the EU.

Regulatory focus on conduct of business

Financial institutions remain under considerable scrutiny regarding conduct of business, particularly in relation to fair outcomes for customers and orderly and transparent operations in financial markets. Regulators, prosecutors, the media and the public all have heightened expectations as to the behaviour and conduct of financial institutions, and any shortcomings or failure to demonstrate adequate controls are in place to mitigate such risks could result in regulatory sanctions, fines or an increase in civil litigation.

In September 2017, HBSC Holdings and HSBC North America Holdings Inc. ('HNAH') consented to a civil money penalty order with the US Federal Reserve Board ('FRB') in connection with its investigation into HSBC's historic foreign exchange activities. Under the terms of the order, HSBC Holdings and HNAH agreed to undertake certain remedial steps and to pay a civil money penalty to the FRB. In January 2018, HSBC Holdings entered into a three-year deferred prosecution agreement with the Criminal Division of the US Department of Justice ('DoJ') relating to HSBC's historical foreign exchange sales and trading activities. Under the terms of the deferred prosecution agreement, HSBC agreed to undertake certain remedial steps; to provide annual reports to the DoJ and to pay a financial penalty and restitution. For further detail, see Note 30 of the Financial Statements.

Mitigating actions

- We have continued to enhance our management of conduct in areas including the treatment of potentially vulnerable customers, market surveillance, employee training and performance management (see 'Regulatory compliance risk management' on page 33).

Financial crime compliance

Financial institutions remain under considerable regulatory scrutiny regarding their ability to prevent and detect financial crime. Financial crime threats continue to evolve, often in tandem with geopolitical developments. The financial crime risks related to the use of innovative fintech are not yet fully understood, while the changing sanctions regulatory landscape presents execution challenges.

Recent terrorist attacks in Europe and the US may increase law enforcement and/or regulatory focus on bank controls to combat terrorist financing and timely reporting to authorities. This focus may also lead to conflicts between data demands from law enforcement and the data protections which HSBC is required to enforce.

An independent compliance monitor ('the Monitor') was appointed in 2013 under the 2012 agreements entered into with the DoJ and the UK FCA to produce annual assessments of the effectiveness of our Anti-Money Laundering ('AML') and sanctions compliance

programme. Additionally, the Monitor is serving as HSBC's independent consultant under the consent order of the FRB. In December 2017, the US Deferred Prosecution Agreement ('AML DPA') expired as HSBC lived up to all of its commitments. The Monitor is to continue working as an independent consultant for a period of time at the discretion of the FCA and FRB.

Mitigating actions

- We continued to enhance our Financial Crime Risk function which brings together all areas of financial crime risk management at HSBC.
- We are working to develop enhanced risk management capabilities through the better use of sophisticated analytical techniques.
- We are working to ensure that the reforms we have put in place are both effective and sustainable over the long term. Work in this area will continue to be consistent with the strategic objective of implementing the most effective standards to combat financial crime across our operations.

Market illiquidity and volatility

Market liquidity, as defined by the ability to trade the desired volume of a financial security in a timely manner, continues to be sporadic. Liquidity remains challenging due to multiple factors: regulatory demands such as increased capital requirements constraining the overall balance sheet size of financial institutions, the implementation of the Volcker rule, which prohibits certain trading activities, and the impact of revised collateral requirements.

This is a market-wide issue, where HSBC may suffer further losses or incur lower revenue due to higher volatility.

Mitigating actions

- We continually monitor our illiquid positions and concentration risks, adjusting our market risk limits where appropriate.

Internally driven

People risk

Increasingly complex and conflicting demands continue to be placed on our workforce, where the expertise is often in short supply and globally mobile. These demands arise from our regulatory reform and remediation programmes, together with those related to the delivery of our strategy.

The Senior Managers and Certification regimes and the related Rules of Conduct sets clear expectations of the accountabilities and behaviour of both senior and more junior employees.

Organisational changes to support the group's strategy, including the relocation of the HSBC UK head office to Birmingham and the implementation of regulatory reform programmes, have the potential to lead to increased staff turnover.

Following the referendum on the UK's membership of the EU and vote to leave, there are increased people risks for the UK to be assessed.

Mitigating actions

- We continue to increase the level of specialist resources in key areas and to engage with our regulators as they finalise new regulations.
- Risks related to organisational change are subject to close management oversight, especially in those countries where staff turnover is particularly high.
- Plans to support the move of the HSBC UK head office to Birmingham are being implemented. The potential impacts resulting from the UK exit from the EU are being reviewed and action plans created.

IT systems infrastructure and resilience

HSBC continues to invest in the reliability and resilience of the group's IT systems and crucial services, which could result in reputational and regulatory damage.

Mitigating actions

- Strategic initiatives are transforming how technology is developed, delivered and maintained, with a particular focus on providing high quality, stable and secure services. As part of this, we are concentrating on materially improving system resilience and service continuity testing. In addition we have enhanced the security of our development lifecycle and improved our testing processes and tools.
- During 2017, we continued to monitor and upgrade our IT systems, simplifying our service provision and replacing older IT infrastructure and applications.

Execution risk

In order to deliver our strategic objectives and meet mandatory regulatory requirements, it is important for HSBC to maintain a strong focus on execution risk. This requires robust management of significant resource intensive and time sensitive programmes. Risks arising from the magnitude and complexity of change may include regulatory censure, reputational damage or financial losses. Current major initiatives include the implementation of the Ring Fenced Bank and managing the operational implications of updating our business model following the UK's vote to leave the EU.

Mitigating actions

- Our prioritisation and governance processes for significant projects are monitored by the group's Executive Committee. Within HSBC Bank plc, the Board's Operations and Technology sub-committee ('OPTEC') has visibility of, and provides input to, regional priorities.
- In 2017, we continued to manage execution risks through closely monitoring the punctual delivery of critical initiatives, internal and external dependencies, and key risks, to allow better portfolio management across the group.

Model risk

We use models for a range of purposes in managing our business, including regulatory capital calculations, stress testing, credit approvals, financial crime risk management and financial reporting. Evolving regulatory requirements have had a significant impact on our approach to model risk management, which poses execution challenges. The adoption of more sophisticated modelling approaches and technology across the industry could also lead to increased model risk.

We could incur losses, be required to hold additional capital, fail to meet regulatory standards or incur higher operating expenses due to the use of inappropriate models or poor model risk management.

Mitigating actions

- We have created centralised global analytical functions and continue to enhance the capability and expertise of our modelling and independent model review teams.
- We are continuing to enhance our model risk governance framework by establishing a Second Line of Defence Model Risk Management function independent from our Global Risk Analytics teams.
- As we adopt new modelling technologies, we are updating our model risk management framework and governance standards to help address any new risks arising.

Data management

The group currently uses a large number of systems and applications to support key business processes and operations. As a result, we often need to reconcile multiple data sources, including customer data sources, to reduce the risk of error. HSBC, along with other organisations, also needs to meet external/internal/regulatory obligations e.g. the General Data Protection Regulation ('GDPR') which requires implementation of data privacy and protection capabilities across our customer data systems by May 2018.

Mitigating actions

- We continue to improve the data quality across a large number of group systems. Our data management and aggregation continues to strengthen and enhance the effectiveness of internal systems and processes.
- We continue to make progress on improving data quality by proactively monitoring customer and transaction data and resolving any data issues. We have also implemented data controls and enhanced reconciliation in order to improve the reliability of data used by our customers and staff.

Areas of special interest

Process of UK withdrawal from the European Union

The UK is due to formally leave the EU in March 2019. Before this can happen the UK and the EU have to finalise the Article 50 Withdrawal Agreement, which will then need to be approved by their respective Parliaments. Concluding negotiations on a comprehensive trade deal within this time frame could be challenging. A period of transition is therefore possible but the scope and length of any such arrangement would need to be agreed between the UK and the EU. Uncertainty therefore continues and with it the risk of significant market volatility. Our objective in all scenarios is to continue to meet customers' needs and minimise disruption. This is likely to require adjustments to our cross-border banking model, with impacted business transferring from the UK to our existing subsidiary in France or other European subsidiaries, as appropriate.

Given the tight time frame and the complexity of the negotiations, we have put in place a robust contingency plan. It is based on a scenario whereby the UK exits the EU in March 2019, without access to the single market or customs union, and without a transitional arrangement. When negotiation positions and timelines become clearer, we will update our contingency plan.

Risks are monitored continually, with vulnerable industry sectors reviewed by management to determine if adjustments to our risk policy or appetite are required.

Construction, contracting and outsourcing sector

The construction, contracting and outsourcing sector, primarily in the UK, remained a challenging operating environment throughout the second half of 2017 and into early 2018. The medium to long term environment remains uncertain with the full impacts of the UK's vote to leave the EU yet to be quantified. HSBC's overall portfolio directly attributable to the construction-contracting sector had agreed risk exposures of $7.3bn with $3bn of drawn risk exposures. In terms of credit quality, 45% was rated 'strong/good' and 38% 'satisfactory'. Throughout the Europe region, our appetite, since the second half of 2016, is classified as Restricted. The sector remains under enhanced monitoring and heightened risk management focus.

Risk management

As a provider of banking and financial services, the group actively manages risk as a core part of its day-to-day activities. It continues to maintain a strong liquidity position and is well positioned for the evolving regulatory landscape. The group also maintained its conservative risk profile in 2017.

Our risk management framework

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

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

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

Three lines of defence

To create a robust control environment to manage risks, we use an activity-based three lines of defence model. This model delineates management accountabilities and responsibilities for risk management and the control environment.

The model underpins our approach to risk management by clarifying responsibility, encouraging collaboration and enabling efficient coordination of risk and control activities. The three lines are summarised below:

- The first line of defence owns the risks and is responsible for identifying, recording, reporting and managing them, and ensuring that the right controls and assessments are in place to mitigate them.
- The second line of defence sets the policy and guidelines for managing specific risk areas, provides advice and guidance in relation to the risk, and challenges the first line of defence on effective risk management.
- The third line of defence is our Internal Audit function, which provides independent and objective assurance of the adequacy of the design and operational effectiveness of the group's risk management framework and control governance process.

Our risk culture

Risk culture refers to HSBC's norms, attitudes and behaviours related to risk awareness, risk taking and risk management.

HSBC has long recognised the importance of a strong risk culture, the fostering of which is a key responsibility of senior executives. Our risk culture is reinforced by the HSBC Values and our Global Standards programme. It is instrumental in aligning the behaviours of individuals with our attitude to assuming and managing risk, which helps to ensure that our risk profile remains in line with our risk appetite.

We use clear and consistent employee communication on risk to convey strategic messages and set the tone from senior management and the Board. We also deploy mandatory training on risk and compliance topics to embed skills and understanding in order to strengthen our risk culture and reinforce the attitude to risk in the behaviour expected of employees, as described in our risk policies.

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

Whistleblowing

We operate a global whistleblowing standard, HSBC Confidential, allowing staff to report matters of concern confidentially. We also maintain an external email address for concerns about accounting and internal financial controls or auditing matters (accountingdisclosures@hsbc.com).

For further details, see page 5 of the How we do Business section.

Risk appetite

The group's Risk Appetite Statement describes the types and levels of risk that the group is prepared to accept in executing its strategy. Quantitative and qualitative metrics are assigned to 15 key categories, including: earnings, capital and leverage, liquidity

and funding, interest rate risk in the banking book, credit risk, traded risk, operational risk, financial crime compliance and regulatory compliance.

Measurement against the metrics:

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

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

Stress testing

Stress testing is an important tool for banks and regulators to assess vulnerabilities in individual banks and/or the financial banking sector under hypothetical adverse scenarios. The results of stress testing are used to assess banks' resilience to a range of adverse shocks and to assess their capital adequacy.

HSBC Bank plc is subject to regulatory stress testing in several jurisdictions. These requirements are increasing in frequency and granularity. They include the programmes of the Bank of England ('BoE'), Prudential Regulation Authority ('PRA') and the European Banking Authority ('EBA'). Assessment by regulators is on both a quantitative and qualitative basis, the latter focusing on our portfolio quality, data provision, stress testing capability and capital planning processes.

A number of internal macroeconomic and event-driven scenarios specific to the European region were considered and reported to senior management during the course of the year. The group also conducts Reverse Stress Testing. This exercise requires a firm to assess scenarios and circumstances that would render its business model unviable, thereby identifying potential business vulnerabilities.

In 2017, the group participated in the successful completion of the annual BoE concurrent stress testing exercise. The Annual Cyclical Scenario incorporates a synchronised global downturn affecting Asia and the UK in particular. Financial markets come under severe stress with a reduction in global risk appetite and reductions in market liquidity. The UK experiences a slowdown driven by the downturn in its trading partners, fall in confidence, and a sharp sterling depreciation leading to inflationary pressure on imports. In response monetary policy tightening leads to a steep rise in market and lending interest rates in the UK while global yield curves remain flat.

In addition to the Annual Cyclical Scenario, there was an additional Exploratory Scenario, intended to assess banks' strategic response to a structurally more challenging operating environment. This scenario incorporates a slowdown in productivity growth, which is driven by weak trade and a continuing fall in cross-border banking. Interest rates remain very low and competitive pressure intensifies globally.

The BoE published the results of the 2017 Concurrent Stress Test in November 2017, confirming that these tests did not reveal any capital inadequacies for the HSBC Group.

At the European level, the EBA did not undertake a stress testing exercise in 2017.

Our material banking and insurance risks

The material risk types associated with our banking and insurance manufacturing operations are described in the following tables.

Description of risks – banking operations

Risks	Arising from	Measurement, monitoring and management of risk
Credit risk (see page 26)		
The risk of financial loss if a customer or counterparty fails to meet an obligation under a contract.	Credit risk arises principally from direct lending, trade finance and leasing business, but also from certain other products such as guarantees and derivatives.	Credit risk is: • measured as the amount that could be lost if a customer or counterparty fails to make repayments; • monitored within limits approved by individuals within a framework of delegated authorities; and • managed through a robust risk control framework that outlines clear and consistent policies, principles and guidance for risk managers.
Liquidity and funding risk (see page 29)		
The risk that we do not have sufficient financial resources to meet our obligations as they fall due or that we can only do so at an excessive cost. Funding Risk is the risk that funding considered to be sustainable, and therefore used to fund assets, is not sustainable over time.	Liquidity risk arises from mismatches in the timing of cash flows. Funding risk arises when illiquid asset positions cannot be funded at the expected terms and when required.	Liquidity and funding risk is: • measured using a range of different metrics including the liquidity coverage ratio and net stable funding ratio; • monitored against the group's liquidity and funding risk framework; and • managed on a stand-alone basis with no reliance on any group entity (unless pre-committed) or central bank unless this represents routine established business-as-usual market practice.
Market risk (see page 29)		
The risk that movements in market factors such as foreign exchange rates, interest rates, credit spreads,equity prices and commodity prices will reduce our income or the value of our portfolios.	Exposure to market risk is separated into two portfolios: • trading portfolios; and • non-trading portfolios. Market risk exposures arising from our insurance operations are discussed on page 54.	Market risk is: • measured using sensitivities, value at risk ('VaR') and stress testing, giving a detailed picture of potential gains and losses for a range of market movements and scenarios, as well as tail risks over specified time horizons; • monitored using VaR, stress testing and other measures, including the sensitivity of net interest income and the sensitivity of structural foreign exchange; and • managed using risk limits approved by the risk management meeting ('RMM') and the RMM in various global businesses.
Operational risk (see page 32)		
The risk to achieving our strategy or objectives as a result of inadequate or failed internal processes, people and systems or from external events.	Operational risk arises from day-to-day operations or external events, and is relevant to every aspect of our business. Regulatory compliance risk and financial crime compliance risk are discussed below.	Operational risk is: • measured using the risk and control assessment process, which assesses the level of risk and effectiveness of controls; • monitored using key indicators and other internal control activities; and • managed primarily by global business and functional managers that identify and assess risks, implement controls to manage them and monitor the effectiveness of these controls utilising the operational risk management framework.
Regulatory compliance risk (see page 33)		
The risk that we fail to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice, and incur fines and penalties and suffer damage to our business as a consequence.	Regulatory compliance risk is part of operational risk, and arises from the risks associated with breaching our duty to customers and other counterparties, inappropriate market conduct and breaching other regulatory standards.	Regulatory compliance risk is: • measured by reference to identified metrics, incident assessments, regulatory feedback and the judgement and assessment of our Regulatory Compliance teams; • monitored against our regulatory compliance risk assessments and metrics, the results of the monitoring and control activities of the second line of defence functions, and the results of internal and external audits and regulatory inspections; and • managed by establishing and communicating appropriate policies and procedures, training employees in them, and monitoring activity to assure their observance. Proactive risk control and/or remediation work is undertaken where required.
Financial crime compliance risk (see page 33)		
The risk that we knowingly or unknowingly help parties to commit or to further potentially illegal activity through the group.	Financial crime compliance risk is part of operational risk and arises from day-to-day banking operations.	Financial crime compliance risk is: • measured by reference to identified metrics, incident assessments, regulatory feedback and the judgement and assessment of our Financial Crime Compliance teams; • monitored against our financial crime compliance risk appetite statement and metrics, the results of the monitoring and control activities of the second line of defence functions, and the results of internal and external audits and regulatory inspections; and • managed by establishing and communicating appropriate policies and procedures, training employees in them, and monitoring activity to ensure their observance. Proactive risk control and/or remediation work is undertaken where required.

Other material risks

Risks	Arising from	Measurement, monitoring and management of risk
Reputational risk (see page 35)		
The risk of failure to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by the group itself, our employees or those with whom we are associated, that might cause stakeholders to form a negative view of the group.	Primary reputational risks arise directly from an action or inaction by HSBC, its employees or associated parties that are not the consequence of another type of risk. Secondary reputational risks are those arising indirectly and are a result of a failure to control any other risks.	Reputational risk is: • measured by reference to our reputation as indicated by our dealings with all relevant stakeholders, including media, regulators, customers and employees; • monitored through a reputational risk management framework that is integrated into the group's broader risk management framework; and • managed by every member of staff, and covered by a number of policies and guidelines. There is a clear structure of committees and individuals charged with mitigating reputational risk.
Pension risk (see page 35)		
The risk of increased costs to the group from offering post-employment benefit plans to its employees.	Pension risk arises from investments delivering an inadequate return, adverse changes in interest rates or inflation, or members living longer than expected. Pension risk also includes the operational and reputational risk of sponsoring pension plans.	Pension risk is: • measured in terms of the schemes' ability to generate sufficient funds to meet the cost of their accrued benefits; • monitored through the specific risk appetite that has been developed at both Group and regional levels; and • managed locally through the group Pensions Oversight Forum and ultimately through the group's RMM.

Our insurance manufacturing subsidiaries are regulated separately from our banking operations. Risks in our insurance entities are managed using methodologies and processes that are subject to Group oversight. Our insurance operations are also subject to some of the same risks as our banking operations, which are covered by the group's risk management processes.

Description of risks – insurance manufacturing operations

Risks	Arising from	Measurement, monitoring and management of risk
Financial risk (see page 52)		
Our ability to effectively match liabilities arising under insurance contracts with the asset portfolios that back them is contingent on the management of financial risks and the extent to which these are borne by policyholders.	Exposure to financial risks arises from: • market risk affecting the fair values of financial assets or their future cash flows; • credit risk; and • liquidity risk of entities not being able to make payments to policyholders as they fall due.	Financial risk is: • measured (i) for credit risk, in terms of economic capital and the amount that could be lost if a counterparty fails to make repayments; (ii) for market risk, in terms of economic capital, internal metrics and fluctuations in key financial variables; and (iii) for liquidity, in terms of internal metrics, including stressed operational cash flow projections; • monitored through a framework of approved limits and delegated authorities; and • managed through a robust risk control framework that outlines clear and consistent policies, principles and guidance. This includes using product design and asset liability matching and bonus rates.
Insurance risk (see page 55)		
The risk that, over time, the cost of the contract, including claims and benefits may exceed the total amount of premiums and investment income received.	The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, as well as lapse and surrender rates.	Insurance risk is: • measured in terms of life insurance liabilities and economic capital allocated to insurance underwriting risk; • monitored though a framework of approved limits and delegated authorities; and • managed through a robust risk control framework that outlines clear and consistent policies, principles and guidance. This includes using product design, underwriting, reinsurance and claims-handling procedures.

Credit risk management

(Audited)

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

The principal objectives of our credit risk management are:

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

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

- to formulate credit policy. Compliance, subject to approved dispensations, is mandatory for all operating companies which must develop local credit policies consistent with group policies that very closely reflect Group policy;
- to guide operating companies on the group's appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain higher-risk sectors;
- to undertake an independent review and objective assessment of risk. Credit risk assesses all credit facilities and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken;
- to monitor the performance and management of portfolios across the group;
- to control exposure to sovereign entities, banks and other financial institutions, as well as debt securities which are not held solely for the purpose of trading;

- to set policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to the group's capital base, and remain within internal and regulatory limits;
- to maintain and develop the group's risk rating framework and systems through the Regional Model Oversight Committee ('RMOC'), for the wholesale businesses and the group's and HSBC UK's RBWM Model Oversight Committee ('RBWM MOC') for the retail businesses, both of which oversee risk rating system governance;
- to report on retail portfolio performance, high risk portfolios, risk concentrations, large impaired accounts, impairment allowances and stress testing results and recommendations to the group's RMM, the group's Risk Committee and the Board; and
- to act on behalf of the group as the primary interface, for credit-related issues, with the BoE, the PRA, local regulators, rating agencies, analysts and counterparts in major banks and non-bank financial institutions.

Concentration of credit risk exposure

(Audited)

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

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

- general wrong-way risk occurs when the probability of counterparty default is positively correlated with general risk factors such as where the counterparty is resident and/or incorporated in a higher-risk country and seeks to sell a non-domestic currency in exchange for its home currency; and
- specific wrong-way risk occurs in self-referencing transactions. These are transactions in which exposure is driven by capital or financing instruments issued by the counterparty and occurs where exposure from HSBC's perspective materially increases as the value of the counterparty's capital or financing instruments referenced in the contract decreases. It is HSBC policy that specific wrong-way risk transactions are approved on a case-by-case basis.

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

Credit quality of financial instruments

(Audited)

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

Our risk rating system facilitates the internal ratings-based approach under the Basel framework adopted by the Group to support calculation of the minimum credit regulatory capital requirement.

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

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

Risk rating scales

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

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

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

For the purpose of the following disclosure, retail loans which are past due up to 89 days and are not otherwise classified as EL 9 or EL 10, are not disclosed within the EL grade to which they relate, but are separately classified as past due but not impaired. The following tables set out the group's distribution of financial instruments by measures of credit quality.

The five credit quality classifications defined each encompasses a range of granular internal credit rating grades assigned to wholesale and retail lending businesses and the external ratings attributed by external agencies to debt securities.

For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications based upon the mapping of related CRR to external credit ratings. The mapping is reviewed on a regular basis and the most recent review resulted in sovereign BBB+ and BBB exposures previously mapped to Credit Quality band 'Good' being mapped to Credit Quality band 'Strong'. Sovereign BB+ and BB exposures previously mapped to Credit Quality band 'Satisfactory' were mapped to Credit Quality band 'Good'. This represents a change in disclosure mapping unrelated to changes in counterparty creditworthiness.

Credit quality classification

	Sovereign debt securities and bills	Other debt securities and bills	Wholesale lending and derivatives		Retail lending	
	External credit rating	External credit rating	Internal credit rating	12-month probability of default %	Internal credit rating	Expected loss %
Quality classification						
Strong	**BBB and above**	**A- and above**	**CRR1 to CRR2[1]**	**0 – 0.169**	**EL1 to EL2[2]**	**0 – 0.999**
Good	**BB to BBB-**	**BBB+ to BBB-**	**CRR3**	**0.170 – 0.740**	**EL3**	**1.000 – 4.999**
Satisfactory	**BB- to B and unrated**	**BB+ to B and unrated**	**CRR4 to CRR5**	**0.741 – 4.914**	**EL4 to EL5**	**5.000 – 19.999**
Sub–standard	**B- to C**	**B- to C**	**CRR6 to CRR8**	**4.915 – 99.999**	**EL6 to EL8**	**20.000 – 99.999**
Impaired	**Default**	**Default**	**CRR9 to CRR10**	**100**	**EL9 to EL10**	**100+ or defaulted[3]**

1 *Customer risk rating ('CRR').*
2 *Expected loss ('EL').*
3 *The EL percentage is derived through a combination of Probability of Default ('PD') and Loss Given Default ('LGD') and may exceed 100% in circumstances where the LGD is above 100% reflecting the cost of recoveries.*

Quality classification definitions

- 'Strong': Exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss. Retail accounts operate within product parameters and only exceptionally show any period of delinquency.
- 'Good': Exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.
- 'Satisfactory': Exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minor following the adoption of recovery processes.
- 'Sub-standard': Exposures require varying degrees of special attention and default risk is of greater concern. Retail portfolio segments show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes.
- 'Impaired': Exposures have been assessed, individually or collectively, as impaired.

Renegotiated loans and forbearance

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

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

Refinance risk

Personal lending

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

Wholesale lending

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

Impairment assessment

(Audited)

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

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

When impairment losses occur, we reduce the carrying amount of loans and advances through the use of an allowance account. When impairment of available-for-sale financial assets and held-to-maturity financial investments occurs, the carrying amount of the asset is reduced directly. For further details on the accounting policy for impairment of available-for-sale debt and equity securities, see Note 1.2(e) on the Financial Statements.

Write-off of loans and advances

(Audited)

For details of our accounting policy on the write-off of loans and advances, see Note 1.2(d) on the Financial Statements.

Personal lending

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

Unsecured personal facilities, including credit cards, are generally written off at between 150 and 210 days past due, the standard period being the end of the month in which the account becomes 180 days contractually delinquent.

In exceptional circumstances write-off periods may be extended to 360 days past due. In countries where local regulations or legislation constrain earlier write-off, or in instances where the realisation of collateral in secured lending takes longer, the period may extend beyond 360 days past due.

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

Wholesale lending

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

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

Liquidity and funding risk management

Details of HSBC's Liquidity and Funding Risk Management Framework ('LFRF') can be found in the group's Pillar 3 document.

Liquidity and funding risk management framework

HSBC has an internal liquidity and funding risk management framework ('LFRF') which aims to allow it to withstand very severe liquidity stresses. It is designed to be adaptable to changing business models, markets and regulations. The Group Treasurer, who reports to the Group CFO, has responsibility for the oversight of the LFRF. Asset, Liability and Capital Management ('ALCM') teams are responsible for the application of the LFRF at a local operating entity level. This comprises of the following elements:

- stand-alone management of liquidity and funding by operating entity;
- operating entity classification by inherent liquidity risk ('ILR') categorisation;
- minimum LCR requirement depending on ILR categorisation;
- minimum NSFR requirement depending on ILR categorisation;
- legal entity depositor concentration limit;
- three-month and 12-month cumulative rolling term contractual maturity limits covering deposits from banks, deposits from non-bank financial institutions and securities issued;
- annual individual liquidity adequacy assessment by principal operating entity;
- minimum LCR requirement by currency;
- intra-day liquidity;
- liquidity funds transfer pricing; and
- forward-looking funding assessments.

Risk governance and oversight

The elements of the LFRF are underpinned by a robust governance framework, the two major elements of which are:

- Group, regional and entity level asset and liability management committees ('ALCOs'); and
- Annual individual liquidity adequacy assessment process ('ILAAP') used to validate risk tolerance and set risk appetite

The Group's operating entities are predominantly defined on a country basis to reflect the local management of liquidity and funding. However, where appropriate, this definition may be expanded to cover a consolidated group of legal entities or narrowed to a principal office (branch) of a wider legal entity to reflect the management under internal or regulatory definitions.

The RMM reviews and agrees annually the list of entities it directly oversees and the composition of these entities.

There were no material changes to the policies and practices for the management of liquidity and funding risk in 2017.

Market risk management

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

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

Market risk governance

(Audited)

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

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

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

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

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

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

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

offices with appropriate levels of product expertise and robust control systems.

Market risk measures

Monitoring and limiting market risk exposures

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

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

Sensitivity analysis

Sensitivity analysis measures the impact of individual market factor movements on specific instruments or portfolios, including interest rates, foreign exchange rates, credit spreads and equity prices, such as the effect of a one basis point change in yield. We use sensitivity measures to monitor the market risk positions within each risk type. Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

Value at risk

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

In addition, the group calculates VaR for non-trading portfolios in order to have a complete picture of risk. The models are predominantly based on historical simulation. VaR is calculated at a 99% confidence level for a one-day holding period. Where we do not calculate VaR explicitly, we use alternative tools as summarised in the Market Risk Stress testing section.

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

The historical simulation models used incorporate the following features:

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

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

VaR model limitations

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

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

Risk not in VaR framework

Other basis risks which are not completely covered in VaR, such as the Libor tenor basis, are complemented by our risk not in VaR ('RNIV') calculations, and are integrated into our capital framework.

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

Stress-type RNIVs include a gap risk exposure measure to capture risk on non-recourse margin loans and a de-peg risk measure to capture risk to pegged and heavily managed currencies.

Stress testing

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

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

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

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

Trading portfolios

Back-testing

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

We would expect on average to see two or three profits in excess of the VaR at 1% confidence level and two or three losses in excess of VaR at the 99% confidence level over a one-year period. The actual number of profits or losses in excess of VaR over this period can therefore be used to gauge how well the models are performing.

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

Non-trading portfolios

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

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

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

Structural foreign exchange exposure

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

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

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

Interest rate risk in the banking book

Overview

Interest Rate Risk in the Banking Book ('IRRBB') is the risk of an adverse impact to earnings or capital due to changes in market interest rates. IRRBB is generated by our non-traded assets and liabilities. The Asset, Liability and Capital Management ('ALCM') function is responsible for measuring and controlling IRRBB under the supervision of the RMM who approve risk limits used in the management of interest rate risk. IRRBB is transferred to and managed by BSM, who are overseen by Wholesale Market Risk and Product Control functions.

Key risk drivers

The bank's IRRBB can be segregated into the following drivers:

- Managed rate risk – the risk that the pricing of products, which are dependent upon business line decisions, do not correlate to movements in market interest rates.
- Re-investment risk – risk arising due to change in rates when behaviouralised balances are reinvested as per the transfer pricing policy.
- Basis Risk – the risk arising from assets and liabilities that are priced referencing different market indices creating a repricing mismatch.
- Prepayment risk – the risk that the actual customer prepayment in different interest rate scenarios does not match the profile used to hedge the interest rate risk.
- Duration risk – the risk that there are changes in the maturities of assets and liabilities due to changes in interest rate, which create or exacerbate a mismatch.

Governance and structure

ALCM monitor and control non-traded interest rate risk as well as reviewing and challenging the business prior to the release of new products and proposed behavioural assumptions used for hedging activities. ALCM are also responsible for maintaining and updating the transfer pricing framework, informing ALCO of the group's overall banking book interest rate risk exposure and managing the balance sheet in conjunction with BSM.

The internal transfer pricing framework is constructed to ensure that structural interest rate risk, arising due to differences in the re-pricing timing of assets and liabilities, is transferred to BSM and business lines are correctly allocated income and expense based on the products they write, inclusive of activities to mitigate this risk. Contractual principal repayments, payment schedules, expected prepayments, contractual rate indices used for re-pricing and interest rate reset dates are examples of elements transferred for risk management by BSM.

The internal transfer pricing framework is governed by ALCO whose responsibility it is to define each operating entity's transfer pricing curve and review and approve the transfer pricing policy, including behaviouralisation assumptions used for products where there is either no defined maturity or customer optionality exists. ALCO is responsible for monitoring and reviewing overall structural interest rate risk position. Interest rate behaviouralisation policies have to be formulated in line with the Group's behaviouralisation policies and approved at least annually by local ALCOs.

Non-traded assets and liabilities are transferred to BSM based on their re-pricing and maturity characteristics. For assets and liabilities with no defined maturity or repricing characteristics behaviouralisation is used to assess the interest rate risk profile; the maximum average duration to which a portfolio of non-maturity defined customer balances or equity can be behaviouralised is five years. The maximum percentage of any portfolio that can be behaviouralised is 90% with the residual treated as contractual, meaning overnight.

BSM manages the banking book interest rate positions transferred to it within the Markets Risk limits approved by RMM. Effective governance across BSM is supported by the dual reporting lines it has to the Chief Executive Officer of GB&M and to the Group Treasurer. BSM will only receive non-trading assets and liabilities as long as they can economically hedge the risk they receive. Hedging is generally managed through vanilla interest rate derivatives or fixed rate government bonds. Any interest rate risk which BSM cannot economically hedge is not transferred and will remain within the business line where the risk is originated.

Measurement of interest rate risk in the banking book

The following measures are used by ALCM to monitor and control interest rate risk in the banking book including:

- Non-traded VaR;
- Net Interest Income ('NII') sensitivity; and
- Economic value of equity ('EVE').

Non-traded VaR uses the same models as those used in the trading book but for banking book balances. It will exclude the elements of risk which are not transferred to BSM as well as HSBC Holdings.

NII sensitivity reflects the group's sensitivity of earnings to changes in market interest rates. Entities forecast both one year and five year NII sensitivities across a range of interest rate scenarios based on a static balance sheet assumption. Sites include business line rate pass-on assumptions, re-investment of maturing assets and liabilities at market rates per shock scenario and prepayment risk. BSM is modelled based on no management actions i.e. the risk profile at the month end is assumed to remain constant throughout the forecast horizon.

Net interest income sensitivity

A principal part of our management of non-traded interest rate risk is to monitor the sensitivity of expected NII under varying interest rate scenarios (simulation modelling), where all other economic variables are held constant. This monitoring is undertaken by ALCO.

The group applies a combination of scenarios and assumptions relevant to the businesses as well as applying standard scenarios that are required throughout HSBC.

Projected NII sensitivity figures represent the effect of the pro forma movements in projected yield curves based on a static balance sheet size and structure assumption, other than instances where the size of the balances or repricing is deemed interest rate sensitive (non-interest bearing current account migration and fixed rate loan early prepayment) and where non-traded VaR is assumed to contractually run off. This effect, however, does not incorporate actions which would be taken by BSM or in the business units to mitigate the effect of interest rate risk. The NII sensitivity calculations assume that interest rates of all maturities move by the same amount in the 'up-shock' scenario. Rates are not assumed to become negative in the 'down-shock' scenario unless the central bank rate is already negative and then not assumed to go further negative, which may effectively result in non-parallel shock. In addition, the net interest income sensitivity calculations take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates over which the entity has discretion in terms of the timing and extent of rate changes.

Economic value of equity

EVE represents the present value of the future banking book cash flows that could be distributed to equity providers under a managed run-off scenario, i.e. the current book value of equity plus the present value of future net interest income in this scenario. This can be used to assess the economic capital required to support IRRBB. An EVE sensitivity is the extent to which the EVE value will change due to a pre-specified movements in interest rates, where all other economic variables are held constant. Operating entities are required to monitor EVE sensitivity as a percentage of capital resources.

Defined benefit pension scheme

Market risk also arises within the group's defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows. Refer to Pension risk section on page 35 for additional information.

Operational risk management

Details of our operational risk profile in 2017 can be found on page 52, in 'Operational risk exposures in 2017'.

Overview

The objective of our operational risk management is to manage and control operational risk in a cost-effective manner within targeted levels of operational risk consistent with our risk appetite, as defined by the GMB.

Key developments in 2017

During 2017 we implemented a new operational risk management framework ('ORMF') and Group-wide risk management system. The new ORMF provides an end-to-end view of non-financial risks, enhancing focus on the risks that matter the most and associated controls. It provides a platform to drive forward-looking risk awareness and assist management focus. It also helps the organisation understand the level of risk it is willing to accept.

We also maintained activity to continually strengthen our risk culture. In particular, we focused on the use of the three lines of defence model to reinforce individual accountability. It sets our roles and responsibilities for managing operational risk on a daily basis.

Further information on the three lines of defence model can be found in the 'Our risk management framework' section on page 23.

Governance and structure

The ORMF defines minimum standards and processes, and the governance structure for the management of operational risk and internal control in our geographical regions, global businesses and global functions. The ORMF has been codified in a high-level standards manual, supplemented with detailed policies, which describes our approach to identifying, assessing, monitoring and controlling operational risk and gives guidance on mitigating action to be taken when weaknesses are identified.

We have a dedicated Global Operational Risk sub-function within our Global Risk function. It is responsible for leading the embedding of the ORMF, and assuring adherence to associated policies and processes across the first and second lines of defence. It supports the Group Chief Risk Officer and the Global Operational Risk Committee, which meets at least quarterly to discuss key risk issues and review implementation of the ORMF. The sub-function is also responsible for preparation of operational risk reporting at the group level, including reports for consideration by the RMM and the group Risk Committee.

Key risk management processes

Business managers throughout the Group are responsible for maintaining an acceptable level of internal control commensurate with the scale and nature of operations, and for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The ORMF helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

A Group-wide risk management system is used to record the results of the operational risk management process. Operational risk and control self-assessments, along with issues and action plans, are entered and maintained by business units. Business and functional management monitor the progress of documented action plans to address shortcomings. To help ensure that operational risk losses are consistently reported and monitored at Group level, all Group companies are required to report individual losses when the net loss is expected to exceed $10,000, and to aggregate all other operational risk losses under $10,000. Losses are entered into the Group-wide risk management system and reported to governance on a monthly basis.

For further details, see the Pillar 3 Disclosures 2017 report.

Legal risk

Global businesses and functions must establish procedures required by the Global legal function and conforming to Group standards, including procedures to manage Legal Risk. Legal Risk falls within the definition of Operational Risk and includes:

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

The group has a legal function, headed by the General Counsel for Global Businesses and Regions, which is responsible for providing and managing legal services to members of the group, thereby facilitating its business and protecting the group from Legal Risk. The function provides legal advice, including support in managing

claims against the group's companies, as well as in respect of non-routine debt recoveries or other litigation against third parties.

The Group's operating companies must notify the relevant legal department immediately of all actual or threatened litigation, all significant contentious regulatory matters and all criminal proceedings against a Group entity, Group executive or employee. Local legal departments must provide appropriate notifications, monthly reports and semi-annual returns to their regional legal departments in relation to actual or threatened litigation, significant contentious regulatory matters and criminal proceedings. Regional legal departments are in turn required to provide appropriate notifications, monthly reports and semi-annual returns to the Group legal function in relation to actual or threatened litigation, significant contentious regulatory matters and criminal proceedings.

These notifications, monthly reports and semi-annual returns are used for reporting to various committees within the Group.

Group security risk

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

Regulatory compliance risk management

Overview

The Regulatory Compliance sub-function ('RC') provides independent, objective oversight and challenge and promotes a compliance-orientated culture, supporting the business in delivering fair outcomes for customers and maintaining the integrity of financial markets and achieving HSBC's strategic objectives.

Key developments in 2017

In 2017 RC restructured our operating model under eleven service areas to align more closely to policy obligations, the Enterprise Risk Management Framework and the Operational Risk Management Framework. The RC Operating Model sets out the key activities, operational controls and management oversight controls performed by each team across RC.

Governance and structure

The European Head of RC reports to the Global Head of RC. To align with our business line coverage matrix structure and help ensure coverage of local regulatory requirements, RC Europe is structured with country RC teams, who support and advise businesses and functions in their respective countries.

Key risk management processes

We regularly review our policies and procedures. Global policies and procedures require the prompt identification and escalation of any actual or potential regulatory breach to RC.

Reportable events of group significance are escalated to the bank's RMM. Matters relating to regulatory conduct of business are reported to the Conduct & Values Committee.

Conduct of business

In 2017, we continued to take steps to raise our standards relating to conduct, which included:

- designing further global mandatory conduct training for delivery to all employees in 2017;
- incorporating the assessment of expected values and behaviours as key determinants in recruitment, performance appraisal and remuneration processes;
- improving our markets surveillance capability;
- introducing policies and procedures to strengthen support for potentially vulnerable customers;
- enhancing the quality and depth of conduct management information and how it is used across the group;
- implementing an assessment process to check the effectiveness of our conduct initiatives across the group; and
- assessing conduct standards and practices within our key third-party suppliers and distributors.

Throughout 2017, Management maintained oversight of conduct matters through the Conduct & Values Committee.

Further information on our conduct is provided in the Strategic Report on page 5 and www.hsbc.com/conduct, and for conduct-related costs relating to significant items, see page 11.

Financial crime risk management

Overview

HSBC continued its progress towards implementing an effective financial crime risk management capability across the Group. We completed the rollout of major compliance systems and shifted our focus towards embedding a sustainable approach to financial crime risk management everywhere we operate. This was underpinned by the implementation of a target operating model for the Financial Crime Risk function and by the completion of a country-by-country assessment against our financial crime risk framework.

Key developments in 2017

During 2017, HSBC continued to step up its efforts to keep financial crime out of the financial system. We completed the rollout of compliance systems to support our anti-money laundering and sanctions policies, having invested $1bn in new and upgraded IT systems since 2015. We also worked with, or invested in, a number of financial technology (fintech) firms to help us continue to innovate.

To ensure we have a clear view of our progress, we completed an assessment of each country in which we operate against the capabilities set out in our financial crime risk framework.

We implemented a new target operating model for the Financial Crime Risk function which puts in place a sustainable structure at a global, regional and country level, and across all lines of business, and continued to build the function's leadership at the most senior levels.

An engaged and well-trained workforce is crucial and in 2017 we continued to invest significantly in this area. We re-launched and refreshed our global mandatory training for all employees and introduced targeted training for relationship managers and other key roles.

Working in partnership is vital to managing financial crime risk. HSBC is a strong proponent of public-private partnerships and information-sharing initiatives. During 2017 we joined three new partnerships – in Australia, Singapore and Hong Kong – and co-sponsored a major public report into the future of financial intelligence sharing.

Key risk management processes

During 2017, HSBC introduced a strengthened financial crime risk management governance framework, mandating Financial Crime Risk Management Committees with a standardised agenda at country, region and global business line levels.

At a Group level, the Financial System Vulnerabilities Committee ('FSVC') continues to report to the Board on matters relating to financial crime, and we introduced new members with significant external expertise in this area. Throughout the year the committee, which is attended by the Group Head of Financial Crime Risk, received regular reports on actions being taken to address issues and vulnerabilities.

We strengthened our approach to affiliate risk management, implementing an effective Group-level process to assess and remediate affiliate risk, and established a strong investigations and analytical capability to enable us to proactively identify emergent risk issues.

The Monitor

Under the agreements entered into with the US Department of Justice ('DoJ') and the UK Financial Conduct Authority ('FCA') in 2012, including the five-year deferred prosecution agreement ('AML DPA') and a Direction issued by the FCA, the Monitor (who is, for FCA purposes, a 'skilled person' under section 166 of the Financial Services and Markets Act) was appointed in July 2013 for an expected five-year period to produce annual assessments of the effectiveness of the Group's AML and sanctions compliance programme. Additionally, under the Cease and Desist Order issued by the US Federal Reserve Board ('FRB') in 2012, the Monitor also serves as an independent consultant to conduct annual assessments.

In December 2017, the AML DPA expired and the charges deferred by the AML DPA were dismissed. The Monitor will continue working in his capacity as a skilled person and independent consultant for a period of time at the FCA's and FRB's discretion.

In February 2018, the Monitor delivered his fourth annual follow-up review report based on various thematic and country reviews he had conducted during 2017. In his report, the Monitor concluded that, in 2017, HSBC made significant progress in developing a reasonably effective and sustainable AML and sanctions compliance programme and expressed confidence that HSBC can achieve its target end state within the next eighteen months if it is able to maintain the concerted effort and focus it has demonstrated in remediating and enhancing its programme over the last five years. Nonetheless, the Monitor identified various challenges that HSBC faces in achieving this objective, noted deficiencies in HSBC's financial crime compliance controls and areas of HSBC's programme that require further work, and highlighted potential instances of financial crime and certain areas in which he believes that HSBC is not yet adequately managing financial crime risk. As described on page 133 in Note 30, the Monitor identified potential anti-money laundering and sanctions compliance issues that HSBC is reviewing further with the DoJ, FRB and/or FCA.

Throughout 2017, the Financial System Vulnerabilities Committee ('FSVC') received regular reports on HSBC's relationship with the Monitor and its compliance with the AML DPA. The FSVC received regular updates on the Monitor's review activity as part of the fourth annual review, and has received the Monitor's fourth annual review report.

Insurance manufacturing operations risk management

Details of changes in our insurance manufacturing operations risk profile in 2017 can be found on page 52 in 'Insurance manufacturing operations risk in 2017'.

There were no material changes to our policies and practices for the management of risks arising in our insurance manufacturing operations in 2017.

Governance

(Audited)

Insurance risks are managed to a defined risk appetite, which is aligned to the bank's risk appetite and risk management framework, including the three lines of defence model. For details on the governance framework, see page 23. The Group Insurance Risk Management Meeting oversees the control framework globally and is accountable to the RBWM Risk Management Meeting on risk matters relating to the insurance business.

The monitoring of the risks within the insurance operations is carried out by insurance risk teams. Specific risk functions, including Wholesale Credit & Market Risk, Operational Risk, Information Security Risk and Financial Crime Risk, support Insurance Risk teams in their respective areas of expertise.

Stress and scenario testing

(Audited)

Stress testing forms a key part of the risk management framework for the insurance business. We participate in local and group-wide regulatory stress tests, including the Bank of England stress test of the banking system, the European Insurance and Occupational Pensions Authority stress test, and individual country insurance regulatory stress tests.

These have highlighted that a key risk scenario for the insurance business is a prolonged low interest rate environment. In order to mitigate the impact of this scenario, the insurance operations are taking a number of actions including repricing some products to reflect lower interest rates, launching less capital intensive products, investing in more capital efficient assets and developing investment strategies to optimise the expected returns against the cost of economic capital.

Management and mitigation of key risk types

Market risk

All our insurance manufacturing subsidiaries have market risk mandates which specify the investment instruments in which they are permitted to invest and the maximum quantum of market risk which they may retain. They manage market risk by using, among others, some or all of the techniques listed below, depending on the nature of the contracts written:

- For products with discretionary participating features ('DPF'), adjusting bonus rates to manage the liabilities to policyholders. The effect is that a significant portion of the market risk is borne by the policyholder.
- Asset and liability matching where asset portfolios are structured to meet projected liability cash flows. The group manages its assets using an approach that considers asset quality, diversification, cash flows matching, liquidity, volatility and target investment return. It is not always possible to match asset and liability durations due to uncertainty over the receipt of all future premiums and the timing of claims, and also because the forecast payment dates of liabilities may exceed the duration of the longest-dated investments available. We use models to assess the effect of a range of future scenarios on the values of assets and associated liabilities, and local ALCOs employ the outcomes in determining how to best structure asset holdings to support liabilities.
- Using derivatives to protect against adverse market movements or better match liability cash flows.
- For new products with investment guarantees, considering the cost when determining the level of premiums or the price structure.
- Periodically reviewing products identified as higher risk, which contain investment guarantees and embedded optionality features linked to savings and investment products, for active management.
- Designing new products to mitigate market risk, such as changing the investment return sharing between policyholders and the shareholder.
- Exiting, to the extent possible, investment portfolios whose risk is considered unacceptable.
- Repricing premiums charged to policyholders.

Credit risk

Our insurance manufacturing subsidiaries are responsible for the credit risk, quality and performance of their investment portfolios. Our assessment of the creditworthiness of issuers and counterparties is based primarily upon internationally recognised credit ratings and other publicly available information.

Investment credit exposures are monitored against limits by our insurance manufacturing subsidiaries, and are aggregated and reported to the Group Insurance Credit Risk and Group Credit Risk functions. Stress testing is performed on the investment credit exposures using credit spread sensitivities and default probabilities.

We use a number of tools to manage and monitor credit risk. These include a credit report which contains a watch-list of investments with current credit concerns, primarily investments that may be at risk of future impairment or where high

concentrations to counterparties are present in the investment portfolio. The report is circulated monthly to senior management in Group Insurance and the individual country chief risk officers to identify investments which may be at risk of future impairment.

Liquidity risk

Risk is managed by cash flow matching and maintaining sufficient cash resources, investing in high credit-quality investments with deep and liquid markets, monitoring investment concentrations and restricting them where appropriate, and establishing committed contingency borrowing facilities.

Insurance manufacturing subsidiaries are required to complete quarterly liquidity risk reports for the Group Insurance Risk function and an annual review of the liquidity risks to which it is exposed.

Insurance risk

The bank primarily uses the following techniques to manage and mitigate insurance risk:

- product design, pricing and overall proposition management (for example, management of lapses by introducing surrender charges);
- underwriting policy;
- claims management processes; and
- reinsurance which cedes risks above our acceptable thresholds to an external reinsurer thereby limiting our exposure.

Other material risks

Reputational risk management

There were no material changes to our policies and practices for the management of reputational risk in 2017.

Overview

Reputational risk relates to stakeholders' perceptions, whether fact-based or otherwise. Stakeholders' expectations change constantly and so reputational risk is dynamic and varies between geographical regions, groups and individuals. We have an unwavering commitment to operating at the high standards we set for ourselves in every jurisdiction. Any lapse in standards of integrity, compliance, customer service or operating efficiency represents a potential reputational risk.

Governance and structure

The development of policies, management and mitigation of reputational risk are coordinated through our Reputational Risk Policy Committee. This committee keeps the RMM apprised of areas and activities presenting significant reputational risk and, where appropriate, make recommendations to the RMM to mitigate such risks. Significant issues posing reputational risk are also reported to the Board where appropriate.

Key risk management processes

Our External Affairs function maintains policies and gives policy advice for the issues that might affect HSBC's reputation and standing with customers, employees, opinion formers and the public. It oversees the identification, management and control of reputational risk for all group entities in the areas of media relations and engagement with non-governmental organisations and other external stakeholders.

Our Reputational Risk and Client Selection ('RRCS') teams help ensure that issues are directed to the appropriate forums, that decisions are made and implemented effectively, and that management information is generated to aid senior management in the businesses and regions in understanding where reputational risk exists. Each global business has established a governance process that empowers our Reputational Risk Policy Committee to address reputational risk issues at the right level, escalating decisions where appropriate. The global functions manage and escalate reputational risks within established operational risk frameworks.

Our policies set out our risk appetite and operational procedures for all areas of reputational risk, including financial crime prevention, regulatory compliance, conduct-related concerns, environmental impacts, human rights matters and employee relations.

We have taken, and are taking, measures to address the requirements of the US DPA and enhance our AML, sanctions and other regulatory compliance frameworks. These measures should also enhance our reputational risk management in the future. For further details, see 'Financial crime risk management' on page 33.

Further details can be found on www.hsbc.com.

Pension risk management

There were no material changes to our policies and practices for the management of pension risk in 2017.

Governance and structure

A global pension risk framework and accompanying global policies on the management of risks related to defined benefit and defined contribution plans are in place. Pension risk is managed by a network of local and regional pension risk forums. The group's Pension Oversight Forum is responsible for the governance and oversight of pension plans sponsored by HSBC within its European operations.

Key risk management processes

In the UK, all future pension benefits are provided on a defined contribution basis. There remain future defined benefit pensions provided elsewhere in the region.

In defined contribution pension plans, the contributions that HSBC is required to make are known, while the ultimate pension benefit will vary, typically with investment returns achieved by investment choices made by the employee. While the market risk to HSBC of defined contribution plans is low, the bank is still exposed to operational and reputational risk.

In defined benefit pension plans, the level of pension benefit is known. Therefore, the level of contributions required by HSBC will vary due to a number of risks, including:

- investments delivering a return below that required to provide the projected plan benefits;
- the prevailing economic environment leading to corporate failures, thus triggering write-downs in asset values (both equity and debt);
- a change in either interest rates or inflation, causing an increase in the value of the plan liabilities; and
- plan members living longer than expected (known as longevity risk).

Pension risk is assessed using an economic capital model that takes into account potential variations in these factors. The impact of these variations on both pension assets and pension liabilities is assessed using a one-in-200 year stress test. Scenario analysis and other stress tests are also used to support pension risk management.

To fund the benefits associated with defined benefit plans, sponsoring Group companies, and in some instances employees, make regular contributions in accordance with advice from actuaries and in consultation with the plan's trustees where relevant. These contributions are normally set to ensure that there are sufficient funds to meet the cost of the accruing benefits for the future service of active members. However, higher contributions are required when plan assets are considered insufficient to cover the existing pension liabilities. Contribution rates are typically revised annually or once every three years, depending on the plan.

The defined benefit plans invest contributions in a range of investments designed to limit the risk of assets failing to meet a plan's liabilities. Any changes in expected returns from the investments may also change future contribution requirements. In pursuit of these long-term objectives, an overall target allocation

of the defined benefit plan assets between asset classes is established. In addition, each permitted asset class has its own benchmarks, such as stock market or property valuation indices. The benchmarks are reviewed at least once every three to five years and more frequently if required by local legislation or circumstances. The process generally involves an extensive asset and liability review.

Key developments and risk profile

Key developments in 2017

In 2017, the group undertook a number of initiatives to enhance our approach to the management of risk. These included:

- Implementing a new operational risk management framework ('ORMF') and system of record, as described on page 32 of the 'Operational risk management' section.
- Completing the roll-out of major compliance systems, designed to support our anti-money laundering and sanctions policies. We shifted our focus towards achieving financial crime risk ('FCR') management programme sustainability through the continued implementation of the FCR function operating model, as described on page 33 of the 'Financial crime risk management' section. HSBC met its obligations under the DPA and with the Department of Justice's agreement, the DPA expired.
- We continued to take steps to enhance our regulatory compliance risk management and controls, implementing a number of initiatives to raise our standards in relation to the conduct of our business, as described on page 33 of the 'Regulatory compliance risk management' section.

Credit risk in 2017

A summary of our current policies and practices regarding credit risk is set out on page 26.

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

There were no material changes to our policies and practices for the management of credit risk in 2017.

Maximum exposure to credit risk

(Audited)

'Maximum exposure to credit risk' table
The following table presents our maximum exposure before taking account of any collateral held or other credit enhancements (unless such enhancements meet accounting offsetting requirements). The table excludes financial instruments whose carrying amount best represents the net exposure to credit risk; and it excludes equity securities as they are not subject to credit risk. For the financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees and similar contracts granted, it is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments, it is generally the full amount of the committed facilities.The offset in the table relates to amounts where there is a legally enforceable right of offset in the event of counterparty default and where, as a result, there is a net exposure for credit risk purposes. However, as there is no intention to settle these balances on a net basis under normal circumstances, they do not qualify for net presentation for accounting purposes. No offset has been applied to off-balance sheet collateral. In the case of derivatives the offset column also includes collateral received in cash and other financial assets.

Maximum exposure to credit risk

(Audited)

	2017			2016		
	Maximum exposure	**Offset**	**Exposure to credit risk (net)**	Maximum exposure	Offset	Exposure to credit risk (net)
The group	**£m**	**£m**	**£m**	£m	£m	£m
Trading assets: loans and advances to banks	**20,590**	**(97)**	**20,493**	19,652	(113)	19,539
Trading assets: loans and advances to customers	**22,520**	**(222)**	**22,298**	21,803	(272)	21,531
Derivatives	**143,335**	**(139,174)**	**4,161**	199,419	(189,349)	10,070
Loans and advances to banks	**14,149**	**(202)**	**13,947**	21,363	(202)	21,161
Loans and advances to customers	**280,402**	**(19,074)**	**261,328**	272,760	(19,746)	253,014
Reverse repurchase agreements – non-trading	**45,808**	**(2,748)**	**43,060**	31,660	(3,866)	27,794
Total balance sheet exposure to credit risk	**728,568**	**(161,517)**	**567,051**	750,507	(213,548)	536,959
Total off-balance sheet	**155,594**	**–**	**155,594**	163,406	–	163,406
– financial guarantees	**13,316**	**–**	**13,316**	12,895	–	12,895
– loan commitments and other credit-related commitments	**142,278**	**–**	**142,278**	150,511	–	150,511
At 31 Dec	**884,162**	**(161,517)**	**722,645**	913,913	(213,548)	700,365

Maximum exposure to credit risk

	2017			2016		
	Maximum exposure	**Offset**	**Exposure to credit risk (net)**	Maximum exposure	Offset	Exposure to credit risk (net)
The bank	**£m**	**£m**	**£m**	£m	£m	£m
Trading assets: loans and advances to banks	**17,744**	**(97)**	**17,647**	16,902	(113)	16,789
Trading assets: loans and advances to customers	**22,254**	**(222)**	**22,032**	19,743	(272)	19,471
Derivatives	**135,236**	**(121,736)**	**13,500**	185,779	(165,490)	20,289
Loans and advances to banks	**15,160**	**–**	**15,160**	16,713	–	16,713
Loans and advances to customers	**220,450**	**(19,024)**	**201,426**	215,084	(19,051)	196,033
Reverse repurchase agreements – non-trading	**36,627**	**(342)**	**36,285**	23,351	(1,931)	21,420
Total balance sheet exposure to credit risk	**588,080**	**(141,421)**	**446,659**	603,782	(186,857)	416,925
Total off-balance sheet	**109,033**	**–**	**109,033**	116,674	–	116,674
– financial guarantees	**9,219**	**–**	**9,219**	9,089	–	9,089
– loan commitments and other credit-related commitments	**99,814**	**–**	**99,814**	107,585	–	107,585
At 31 Dec	**697,113**	**(141,421)**	**555,692**	720,456	(186,857)	533,599

Concentration of exposures

The geographical diversification of our lending portfolio and our broad range of global businesses and products ensured that we did not overly depend on a few markets to generate growth in 2017. This diversification also supported our strategy for growth in faster-growing markets and those with international connectivity.

Financial investments

Our holdings of available-for-sale government and government agency debt securities, corporate debt securities, asset-backed securities ('ABSs') and other securities were spread across a wide range of issuers in 2017 with 60% (2016: 61%) invested in government or government agency debt securities.

Trading assets

Trading securities remained the largest concentration within trading assets of the group at 70% (2016: 67%).

Derivatives

Derivative assets were £143bn at 31 December 2017 (2016: £199bn).

Items in the course of collection from other banks

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

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

Loans and advances

The table below analyses loans and advances by industry sector to show any concentration of credit risk exposures (please also see below).

Gross loans and advances to customers by industry sector

	2017		2016	
	Gross loans and advances to customers	**Gross loans by industry sector as a % of total gross loans to customers**	Gross loans and advances to customers	Gross loans by industry sector as a % of total gross loans to customers
The group	**£m**	**%**	£m	%
Personal	**120,289**	**42.56**	114,314	41.52
Corporate and commercial	**134,513**	**47.59**	132,556	48.15
Financial	**27,842**	**9.85**	28,447	10.33
Total gross loans and advances to customers at 31 Dec	**282,644**	**100.00**	275,317	100.00
The bank				
Personal	**97,248**	**43.80**	90,103	41.59
Corporate and commercial	**89,549**	**40.34**	90,055	41.57
Financial	**35,214**	**15.86**	36,475	16.84
Total gross loans and advances to customers at 31 Dec	**222,011**	**100.00**	216,633	100.00

Distribution of financial instruments by credit quality

(Audited)

	2017								
	Neither past due nor impaired								
	Strong	Good	Satisfactory	Sub-standard	Past due not impaired	Impaired	Total gross amount	Impairment allowances	Total
The group	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	97,601	–	–	–	–	–	97,601	–	97,601
Items in the course of collection from other banks	2,023	–	–	–	–	–	2,023	–	2,023
Trading assets	57,965	11,279	12,132	1,218	–	–	82,594	–	82,594
– treasury and other eligible bills	775	252	139	782	–	–	1,948	–	1,948
– debt securities	29,038	3,577	4,744	177	–	–	37,536	–	37,536
– loans and advances to banks	12,980	4,207	3,385	18	–	–	20,590	–	20,590
– loans and advances to customers	15,172	3,243	3,864	241	–	–	22,520	–	22,520
Financial assets designated at fair value	898	118	24	0	–	–	1,040	–	1,040
Derivatives	122,547	17,143	3,113	532	–	–	143,335	–	143,335
Loans and advances to customers held at amortised cost	157,147	56,744	57,092	4,871	973	5,817	282,644	(2,242)	280,402
– personal	109,224	5,687	2,860	453	607	1,458	120,289	(437)	119,852
– corporate and commercial	30,262	45,954	49,458	4,266	355	4,218	134,513	(1,671)	132,842
– non-bank financial institutions	17,661	5,103	4,774	152	11	141	27,842	(134)	27,708
Loans and advances to banks held at amortised cost	11,509	1,651	982	7	–	–	14,149	–	14,149
Reverse repurchase agreements – non-trading	36,667	4,563	4,274	304	–	–	45,808	–	45,808
Financial investments	51,478	3,271	1,132	920	–	537	57,338	–	57,338
Other assets	2,118	609	1,358	185	4	4	4,278	–	4,278
At 31 Dec	539,953	95,378	80,107	8,037	977	6,358	730,810	(2,242)	728,568
	%	%	%	%	%	%	%		
Percentage of total gross amount	73.8	13.1	11.0	1.1	0.1	0.9	100.0		

	2016								
Cash and balances at central banks	54,278	–	–	–	–	–	54,278	–	54,278
Items in the course of collection from other banks	1,363	–	–	–	–	–	1,363	–	1,363
Trading assets	59,974	12,288	8,711	521	–	–	81,494	–	81,494
– treasury and other eligible bills	554	280	14	–	–	–	848	–	848
– debt securities	31,268	4,596	3,234	93	–	–	39,191	–	39,191
– loans and advances to banks	12,844	4,161	2,615	32	–	–	19,652	–	19,652
– loans and advances to customers	15,308	3,251	2,848	396	–	–	21,803	–	21,803
Financial assets designated at fair value	870	159	257	17	–	–	1,303	–	1,303
Derivatives	168,840	26,042	4,056	481	–	–	199,419	–	199,419
Loans and advances to customers held at amortised cost	153,861	50,743	57,024	5,702	1,177	6,810	275,317	(2,557)	272,760
– personal	102,472	6,089	2,743	473	798	1,739	114,314	(658)	113,656
– corporate and commercial	32,304	39,411	50,480	5,150	368	4,843	132,556	(1,724)	130,832
– non-bank financial institutions	19,085	5,243	3,801	79	11	228	28,447	(175)	28,272
Loans and advances to banks held at amortised cost	17,330	2,613	1,410	10	–	–	21,363	–	21,363
Reverse repurchase agreements – non-trading	24,993	3,404	2,665	598	–	–	31,660	–	31,660
Financial investments	75,834	3,116	1,581	1,012	–	831	82,374	–	82,374
Other assets	2,362	551	1,370	197	4	9	4,493	–	4,493
At 31 Dec	559,705	98,916	77,074	8,538	1,181	7,650	753,064	(2,557)	750,507
	%	%	%	%	%	%	%		
Percentage of total gross amount	74.4	13.1	10.2	1.1	0.2	1.0	100.0		

Distribution of financial instruments by credit quality

	2017								
	Neither past due nor impaired								
	Strong	Good	Satisfactory	Sub-standard	Past due not impaired	Impaired	Total gross amount	Impairment allowances	Total
The bank	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	81,358	–	–	–	–	–	81,358	–	81,358
Items in the course of collection from other banks	1,407	–	–	–	–	–	1,407	–	1,407
Trading assets	43,271	9,643	9,578	1,218	–	–	63,710	–	63,710
– treasury and other eligible bills	458	–	139	782	–	–	1,379	–	1,379
– debt securities	15,251	3,313	3,592	177	–	–	22,333	–	22,333
– loans and advances to banks	12,493	3,208	2,025	18	–	–	17,744	–	17,744
– loans and advances to customers	15,069	3,122	3,822	241	–	–	22,254	–	22,254
Derivatives	116,791	15,017	2,915	513	–	–	135,236	–	135,236
Loans and advances to customers held at amortised cost	133,341	38,408	41,835	3,735	488	4,204	222,011	(1,561)	220,450
– personal	91,589	2,688	1,175	390	451	955	97,248	(307)	96,941
– corporate and commercial	15,126	31,551	36,528	3,199	37	3,108	89,549	(1,100)	88,449
– non-bank financial institutions	26,626	4,169	4,132	146	–	141	35,214	(154)	35,060
Loans and advances to banks held at amortised cost	13,273	1,204	682	1	–	–	15,160	–	15,160
Reverse repurchase agreements – non-trading	30,807	2,914	2,605	301	–	–	36,627	–	36,627
Financial investments	29,607	1,034	42	291	–	1	30,975	–	30,975
Other assets	2,146	581	426	4	–	–	3,157	–	3,157
At 31 Dec	**452,001**	**68,801**	**58,083**	**6,063**	**488**	**4,205**	**589,641**	**(1,561)**	**588,080**
	%	%	%	%	%	%	%		
Percentage of total gross amount	76.6	11.7	9.9	1.0	0.1	0.7	100.0		
	2016								
Cash and balances at central banks	49,252	–	–	–	–	–	49,252	–	49,252
Items in the course of collection from other banks	780	–	–	–	–	–	780	–	780
Trading assets	44,775	8,278	6,897	506	–	–	60,456	–	60,456
– treasury and other eligible bills	501	–	12	–	–	–	513	–	513
– debt securities	17,866	2,500	2,839	93	–	–	23,298	–	23,298
– loans and advances to banks	12,861	2,574	1,450	17	–	–	16,902	–	16,902
– loans and advances to customers	13,547	3,204	2,596	396	–	–	19,743	–	19,743
Derivatives	159,390	22,557	3,373	459	–	–	185,779	–	185,779
Loans and advances to customers held at amortised cost	133,279	32,446	41,727	4,072	448	4,661	216,633	(1,549)	215,084
– personal	85,726	2,194	411	404	407	961	90,103	(281)	89,822
– corporate and commercial	18,910	25,987	38,017	3,609	41	3,491	90,055	(1,090)	88,965
– non-bank financial institutions	28,643	4,265	3,299	59	–	209	36,475	(178)	36,297
Loans and advances to banks held at amortised cost	13,653	1,931	1,128	1	–	–	16,713	–	16,713
Reverse repurchase agreements – non-trading	20,187	1,760	816	588	–	–	23,351	–	23,351
Financial investments	48,799	18	44	238	–	1	49,100	–	49,100
Other assets	2,255	521	466	20	–	5	3,267	–	3,267
At 31 Dec	472,370	67,511	54,451	5,884	448	4,667	605,331	(1,549)	603,782
	%	%	%	%	%	%	%		
Percentage of total gross amount	78.0	11.1	9.0	1.0	0.1	0.8	100.0		

Past due but not impaired gross financial instruments

(Audited)

Past due but not impaired are those loans where, although customers have failed to make payments in accordance with the contractual terms of their facilities, they have not met the impaired loan criteria described below.

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

(Audited)

The group	Up to 29 days £m	30-59 days £m	60-89 days £m	90-179 days £m	Over 180 days £m	Total £m
Loans and advances held at amortised cost	**726**	**161**	**86**	**—**	**—**	**973**
– personal	**426**	**116**	**65**	**—**	**—**	**607**
– corporate and commercial	**291**	**43**	**21**	**—**	**—**	**355**
– financial	**9**	**2**	**—**	**—**	**—**	**11**
Other assets	**4**	**—**	**—**	**—**	**—**	**4**
At 31 Dec 2017	**730**	**161**	**86**	**—**	**—**	**977**
Loans and advances held at amortised cost	841	225	111	—	—	1,177
– personal	547	165	86	—	—	798
– corporate and commercial	283	60	25	—	—	368
– financial	11	—	—	—	—	11
Other assets	3	1	—	—	—	4
At 31 Dec 2016	844	226	111	—	—	1,181
The bank						
Loans and advances held at amortised cost	**340**	**93**	**55**	**—**	**—**	**488**
– personal	**312**	**87**	**52**	**—**	**—**	**451**
– corporate and commercial	**28**	**6**	**3**	**—**	**—**	**37**
– financial	**—**	**—**	**—**	**—**	**—**	**—**
Other assets	**—**	**—**	**—**	**—**	**—**	**—**
At 31 Dec 2017	**340**	**93**	**55**	**—**	**—**	**488**
Loans and advances held at amortised cost	310	85	53	—	—	448
– personal	278	79	50	—	—	407
– corporate and commercial	32	6	3	—	—	41
– financial	—	—	—	—	—	—
Other assets	—	—	—	—	—	—
At 31 Dec 2016	310	85	53	—	—	448

Impaired loans

(Audited)

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

- Wholesale loans and advances classified as CRR 9 or CRR 10. These grades are assigned when the bank considers that either the customer is unlikely to pay its credit obligations in full, without recourse to security, or when the customer is more than 90 days past due on any material credit obligation to HSBC.
- Retail loans and advances classified as EL 9 or EL 10. These grades are assigned to retail loans and advances greater than 90 days past due unless they have been assessed as not individually impaired. Renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet the contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

Impairment and credit risk mitigation

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

Impaired loans and advances to customers and banks by industry sector

(Audited)

	2017			2016		
	Individually assessed	**Collectively assessed**	**Total**	Individually assessed	Collectively assessed	Total
	£m	**£m**	**£m**	£m	£m	£m
Banks	**—**	**—**	**—**	—	—	—
Customers	**5,365**	**452**	**5,817**	6,198	612	6,810
– personal	**1,061**	**397**	**1,458**	1,199	540	1,739
– corporate and commercial	**4,163**	**55**	**4,218**	4,771	72	4,843
– financial	**141**	**—**	**141**	228	—	228
At 31 Dec	**5,365**	**452**	**5,817**	6,198	612	6,810

Renegotiated loans and forbearance

Where a loan is modified due to significant concerns about the borrower's ability to meet contractual payments when due, a range of forbearance strategies are employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default, foreclosure or repossession.

Identifying renegotiated loans

Loans are identified as renegotiated loans when we modify the contractual payment terms due to significant credit distress of the borrower. 'Forbearance' describes concessions made on the contractual terms of a loan in response to an obligor's financial difficulties. We classify and report loans on which concessions have been granted under conditions of credit distress as 'renegotiated loans' when their contractual payment terms have been modified because we have significant concerns about the borrowers' ability to meet contractual payments when due. When considering modification terms, the borrower's continued ability to repay is assessed and where they are unrelated to payment arrangements, while potential indicators of impairment, these loans are not considered as renegotiated loans.

Credit quality classification of renegotiated loans

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

A renegotiated loan is presented as impaired when:

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

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

The renegotiated loan will continue to be disclosed as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment. For loans that were assessed for impairment on a collective basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

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

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

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

Derecognition of renegotiated loans

(Audited)

Loans that have been identified as renegotiated retain this designation until maturity or derecognition. When determining whether a loan that is restructured should be derecognised and a new loan recognised, we consider the extent to which the changes to the original contractual terms result in the renegotiated loan, considered as a whole, being a substantially different financial instrument. Any new loans that arise following derecognition events will continue to be disclosed as renegotiated loans.

The following are examples of circumstances that individually are likely to result in this test being met and derecognition accounting being applied:

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

Renegotiated loans and recognition of impairment allowances

(Audited)

For retail lending, renegotiated loans are segregated from other parts of the loan portfolio for collective impairment assessment to reflect the higher rates of losses often encountered in these segments.

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

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

Renegotiated loans and advances to customers by industry sector

	2017					2016				
	Residential mortgages	**Other personal lending**	**Corporate and commercial**	**Non-bank financial institutions**	**Total**	Residential mortgages	Other personal lending	Corporate and commercial	Non-bank financial institutions	Total
	£m	**£m**	**£m**	**£m**	**£m**	£m	£m	£m	£m	£m
Neither past due nor impaired	**252**	**57**	**1203**	**6**	**1518**	328	73	1203	1	1605
Past due not impaired	**33**	**6**	**42**	**—**	**81**	105	44	74	—	223
Impaired	**211**	**71**	**2165**	**136**	**2583**	451	97	2435	155	3138
Renegotiated loans at 31 Dec	**496**	**134**	**3410**	**142**	**4182**	884	214	3712	156	4966
Impairment allowance on renegotiated loans					**(684)**					(843)

Impairment of loans and advances

(Audited)

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

Loan impairment charge to the income statement by industry sector

	2017	2016
	£m	£m
Personal	**120**	189
– residential mortgages	**7**	(4)
– other personal	**113**	193
Corporate and commercial	**454**	266
– manufacturing and international trade and services	**227**	52
– commercial real estate and other property-related	**149**	(12)
– other commercial	**78**	226
Financial	**50**	24
Total loan impairment charge for the year ended 31 Dec	**624**	479
Individually assessed impairment allowances	**529**	306
– new allowances	**919**	708
– release of allowances no longer required	**(366)**	(383)
– recoveries of amounts previously written off	**(24)**	(19)
Collectively assessed impairment allowances	**95**	173
– new allowances net of allowance releases	**327**	351
– recoveries of amounts previously written off	**(232)**	(178)
Total loan impairment charge for the year ended 31 Dec	**624**	479

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

(Audited)

	2017				2016			
	Banks	**Customers**			Banks	Customers		
	Individually assessed	**Individually assessed**	**Collectively assessed**	**Total**	Individually assessed	Individually assessed	Collectively assessed	Total
The group	**£m**	**£m**	**£m**	**£m**	£m	£m	£m	£m
At 1 Jan	**—**	**1,729**	**828**	**2,557**	—	1,788	815	2,603
Amounts written off	**—**	**(553)**	**(358)**	**(911)**	—	(550)	(359)	(909)
Recoveries of loans and advances	**—**	**24**	**232**	**256**	—	19	178	197
Loan impairment charge	**—**	**529**	**95**	**624**	—	306	173	479
Exchange and other movements	**—**	**(52)**	**(232)**	**(284)**	—	166	21	187
At 31 Dec	**—**	**1,677**	**565**	**2,242**	—	1,729	828	2,557
as a percentage of gross loans and advances[1]	**—**	**0.59%**	**0.20%**	**0.76%**	—	0.63%	0.30%	0.86%

Movement in impairment allowances on loans and advances to customers and banks (continued)

The bank	2017 Banks Individually assessed £m	2017 Customers Individually assessed £m	2017 Customers Collectively assessed £m	2017 Total £m	2016 Banks Individually assessed £m	2016 Customers Individually assessed £m	2016 Customers Collectively assessed £m	2016 Total £m
At 1 Jan	**—**	**1,074**	**475**	**1,549**	—	1,178	497	1,675
Amounts written off	**—**	**(345)**	**(308)**	**(653)**	—	(374)	(264)	(638)
Recoveries of loans and advances written off in previous years	**—**	**20**	**201**	**221**	—	15	147	162
Loan impairment charge	**—**	**347**	**84**	**431**	—	158	83	241
Exchange and other movements	**—**	**1**	**12**	**13**	—	97	12	109
At 31 Dec	**—**	**1,097**	**464**	**1,561**	—	1,074	475	1,549
as a percentage of gross loans and advances[1]	**—**	**0.49%**	**0.21%**	**0.66%**	—	0.50%	0.22%	0.66%

1 *Net of reverse repo transactions, settlement accounts and stock borrowings.*

Personal lending

Total personal lending

We provide a broad range of secured and unsecured personal lending products to meet customer needs. Personal lending includes advances to customers for asset purchases such as residential property where the loans are secured by the assets being acquired. We also offer loans secured on existing assets, such as first charges on residential property, and unsecured lending products such as overdrafts, credit cards and payroll loans. The following table shows the levels of personal lending products in the various portfolios in the UK and the rest of Europe.

Total personal lending

	UK £m	Continental Europe £m	Total £m	As a % of total gross loans
First lien residential mortgages	**88,653**	**4,171**	**92,824**	**31.28**
– *of which:*				
interest-only (including endowment) mortgages	***24,773***	***14***	***24,787***	***8.35***
affordability mortgages, including adjustable rate mortgages	***—***	***303***	***303***	***0.10***
Other personal lending	**14,648**	**12,817**	**27,465**	**9.25**
– personal loans and overdrafts	**7,430**	**12,386**	**19,816**	**6.68**
– credit cards	**7,218**	**358**	**7,576**	**2.55**
– second lien residential mortgages	**—**	**73**	**73**	**0.02**
– motor vehicle finance	**—**	**—**	**—**	**—**
Total gross loans at 31 Dec 2017	**103,301**	**16,988**	**120,289**	**40.53**
Impairment allowances on personal lending				
First lien residential mortgages	**(108)**	**(86)**	**(194)**	
Other personal lending	**(192)**	**(51)**	**(243)**	
– personal loans and overdrafts	**(110)**	**(51)**	**(161)**	
– credit cards	**(82)**	**—**	**(82)**	
– second lien residential mortgages	**—**	**—**	**—**	
– motor vehicle finance	**—**	**—**	**—**	
Total impairment allowances at 31 Dec 2017	**(300)**	**(137)**	**(437)**	
First lien residential mortgages	82,614	4,326	86,940	29.30
– *of which:*				
interest-only (including endowment) mortgages	*25,878*	*18*	*25,896*	*8.73*
affordability mortgages, including adjustable rate mortgages	*—*	*241*	*241*	*0.08*
Other personal lending	14,460	12,914	27,374	9.23
– personal loans and overdrafts	7,457	11,651	19,108	6.44
– credit cards	7,003	1,182	8,185	2.76
– second lien residential mortgages	—	79	79	0.03
– motor vehicle finance	—	2	2	—
Total gross loans at 31 Dec 2016	97,074	17,240	114,314	38.53
Impairment allowances on personal lending				
First lien residential mortgages	(99)	(86)	(185)	
Other personal lending	(187)	(286)	(473)	
– personal loans and overdrafts	(126)	(134)	(260)	
– credit cards	(61)	(151)	(212)	
– second lien residential mortgages	—	—	—	
– motor vehicle finance	—	(1)	(1)	
Total impairment allowances at 31 Dec 2016	(286)	(372)	(658)	

Mortgage lending

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

Exposure to UK interest-only mortgage loans

Interest-only mortgage products made up £24.8bn of total UK mortgage lending.

The following information is presented for the bank's HSBC branded UK interest-only mortgage loans with balances of £11.7bn; this excludes £9bn of offset mortgages in First Direct, £3bn of Private Bank mortgages, £0.8bn of endowment mortgages and £0.3bn of other products. During 2017, £123m of interest-only mortgages matured; of these, 1290 loans with balances of £42m were repaid in full, 153 loans with balances of £8m had agreed future repayment plans and 438 loans with balances of £73m were subject to ongoing individual assessments. At the end of 2017, the average LTV ratio in the portfolio was 41%, and 98% of mortgages had an LTV ratio of 75% or less.

The profile of maturing UK interest-only loans is as follows:

UK interest-only mortgage loans

	£m
Matured interest-only mortgage loans[1]	**160**
Interest-only mortgage loans by maturity	
– 2018	**344**
– 2019	**385**
– 2020	**394**
– 2021	**482**
– 2022–2026	**2,358**
– post 2026	**7,561**
At 31 Dec 2017	**11,684**

1 *Includes interest-only mortgages which have reached their contractual maturity date, but were unsettled at the end of 2017.*

Other personal lending

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

Collateral and other credit enhancements held

(Audited)

The tables below show residential mortgage lending including off-balance sheet loan commitments by level of collateral. They provide a quantification of the value of fixed charges we hold over borrowers' specific assets where we have a history of enforcing, and are able to enforce, collateral in satisfying a debt in the event of the borrower failing to meet its contractual obligations, and where the collateral is cash or can be realised by sale in an established market. The LTV ratio is calculated as the gross on-balance sheet carrying amount of the loan and any off-balance sheet loan commitment at the balance sheet date divided by the value of collateral. The value of collateral is determined using professional valuations and house price indices. The collateral valuation excludes any adjustments for obtaining and selling the collateral and, in particular, loans shown as not collateralised or partly collateralised may also benefit from other forms of credit mitigants. Valuations must be updated on a regular basis and, as a minimum, at intervals of every three years. More frequent revaluations are conducted where market conditions or portfolio performance are subject to significant change or where a loan is identified and assessed as impaired.

Residential mortgage loans including loan commitments by level of collateral

(Audited)

	The group		The bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Non-impaired loans and advances				
Fully collateralised	**96,173**	89,997	**90,421**	83,885
LTV ratio:				
– Less than 50%	**52,940**	51,100	**51,015**	48,876
– 51% to 60%	**15,989**	15,333	**14,954**	14,179
– 61% to 70%	**12,083**	11,501	**10,818**	10,150
– 71% to 80%	**9,517**	7,353	**8,585**	6,589
– 81% to 90%	**4,698**	4,036	**4,218**	3,587
– 91% to 100%	**946**	674	**831**	504
Partially collateralised:				
greater than 100% LTV (A)	**228**	352	**91**	107
– 101% to 110%	**92**	122	**27**	29
– 111% to 120%	**34**	53	**15**	11
– greater than 120%	**102**	177	**49**	67
Collateral value on A	**190**	280	**59**	67
Impaired loans and advances				
Fully collateralised	**917**	993	**725**	810
LTV ratio:				
– Less than 50%	**470**	475	**396**	401
– 51% to 60%	**175**	182	**136**	155
– 61% to 70%	**115**	148	**91**	112
– 71% to 80%	**86**	99	**56**	76
– 81% to 90%	**40**	54	**28**	40
– 91% to 100%	**31**	35	**18**	26
Partially collateralised:				
greater than 100% LTV (B)	**64**	66	**19**	19
– 101% to 110%	**28**	30	**8**	6
– 111% to 120%	**10**	10	**6**	7
– greater than 120%	**26**	26	**5**	6
Collateral value on B	**49**	54	**18**	18
At 31 Dec	**97,382**	91,408	**91,256**	84,821

Wholesale lending

Total wholesale lending

	2017		2016	
	£m	**As a % of total gross loans**	£m	As a % of total gross loans
Corporate and commercial	**134,513**	**45.32**	132,556	44.68
– manufacturing	**21,494**	**7.24**	22,785	7.68
– international trade and services	**47,837**	**16.12**	45,222	15.24
– commercial real estate	**18,849**	**6.35**	17,343	5.85
– other property-related	**5,908**	**1.99**	5,797	1.95
– government	**2,583**	**0.87**	2,347	0.79
– other commercial	**37,842**	**12.75**	39,062	13.17
Financial	**41,991**	**14.15**	49,810	16.79
– non-bank financial institutions	**27,842**	**9.38**	28,447	9.59
– banks	**14,149**	**4.77**	21,363	7.20
Gross loans at 31 Dec	**176,504**	**59.47**	182,366	61.47
Impairment allowances on wholesale lending				
Corporate and commercial	**(1,671)**		(1,723)	
– manufacturing	**(226)**		(383)	
– international trade and services	**(497)**		(392)	
– commercial real estate	**(268)**		(326)	
– other property-related	**(256)**		(137)	
– government	**(2)**		(1)	
– other commercial	**(422)**		(484)	
Financial	**(134)**		(175)	
– non-bank financial institutions	**(134)**		(175)	
– banks	**—**		—	
Impairment allowances at 31 Dec	**(1,805)**		(1,898)	
Impairment allowances % of impaired loans	**41.41%**		37.43%	

Commercial real estate lending

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

Commercial real estate lending

	2017	2016
	£m	£m
Neither past due nor impaired	**18,010**	16,326
Past due but not impaired	**41**	34
Impaired loans	**798**	983
Total gross loans and advances at 31 Dec	**18,849**	17,343
– *of which: renegotiated loans*	***823***	*906*
Impairment allowances	**(268)**	(326)

Refinance risk in commercial real estate

Commercial real estate lending tends to require the repayment of a significant proportion of the principal at maturity. Typically, a customer will arrange repayment through the acquisition of a new loan to settle the existing debt. Refinance risk is the risk that a customer, being unable to repay their debt on maturity, is unable to refinance the debt at commercial rates. We monitor our commercial real estate portfolio closely, assessing those factors that may indicate potential issues with refinancing. The principal factor is the vintage of the loan, when origination reflected previous market norms which no longer apply in the current market. Examples might be higher LTV ratios and/or lower interest cover ratios. The range of refinancing sources in the local market is also an important consideration, with risk increasing when lenders are restricted to banks and when bank liquidity is limited. In addition, underlying fundamentals such as the reliability of tenants, the ability to let and the condition of the property are important, as they influence property values.

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

Collateral and other credit enhancement held

(Audited)

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

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

Collateral on loans and advances

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

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

Other types of collateral which are commonly taken for corporate and commercial lending such as unsupported guarantees and floating charges over the assets of a customer's business are not measured in the tables below. While such mitigants have value, often providing rights in insolvency, their assignable value is not sufficiently certain and they are therefore assigned no value for disclosure purposes.

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

Commercial real estate loans and advances including loan commitments by level of collateral

(Audited)

	2017	2016
	£m	£m
Rated CRR[1] 1 to 7		
Not collateralised	**4,526**	3,158
Fully collateralised	**18,850**	17,625
Partially collateralised	**1,208**	1,104
– *collateral value*	***940***	*829*
Total	**24,584**	21,887
Rated CRR[1] 8 to 10		
Not collateralised	**44**	60
Fully collateralised	**439**	774
LTV Ratio:		
– less than 50%	**112**	107
– 51% to 75%	**147**	526
– 76% to 90%	**111**	87
– 90% to 100%	**69**	54
Partially collateralised	**371**	386
– *collateral value*	***214***	*177*
Total	**854**	1,220
Total at 31 Dec	**25,438**	23,107

1 *Customer risk rating ('CRR'). See page 27 for further information.*

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

(Audited)

Other corporate, commercial and financial (non-bank) lending is detailed below, reflecting the difference in collateral held on the portfolios. For financing activities in corporate and commercial lending that are not predominantly commercial real estate-oriented, collateral value is not strongly correlated to principal repayment performance. Collateral values are generally refreshed when an obligor's general credit performance deteriorates and we have to assess the likely performance of secondary sources of repayment should it prove necessary to rely on them.

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

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

(Audited)

	2017	2016
	£m	£m
Not collateralised	**2,546**	2,669
Fully collateralised	**1,343**	1,346
LTV Ratio:		
– less than 50%	**526**	548
– 51% to 75%	**372**	379
– 76% to 90%	**202**	169
– 90% to 100%	**243**	250
Partially collateralised	**403**	569
– *collateral value*	***226***	*291*
Total at 31 Dec	**4,292**	4,584

Other credit risk exposures

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

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

Derivatives

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

Transactions vary in value by reference to a market factor such as interest rate, exchange rate or asset price. The counterparty risk from derivative transactions is taken into account when reporting the fair value of derivative positions. The adjustment to the fair value is known as the credit value adjustment ('CVA').

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

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

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

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

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

Securitisation exposures and other structured products

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

Also included within this section is information on the GB&M legacy credit activities in respect of Solitaire and the securities investment conduits ('SICs'). For further information on structured entities please refer to Note 17.

Carrying amount of consolidated holdings of ABS

	Trading	Available for sale	Loans and receivables	Total[1]	Of which held through consolidated SEs
	£m	£m	£m	£m	£m
Mortgage-related assets:					
– Sub-prime residential	**4**	**679**	**24**	**707**	**358**
– US Alt-A residential	**—**	**778**	**—**	**778**	**771**
– Other residential	**603**	**134**	**816**	**1,553**	**56**
– Commercial property	**444**	**198**	**41**	**683**	**167**
Leveraged finance-related assets	**38**	**276**	**—**	**314**	**209**
Student loan-related assets	**29**	**1,627**	**—**	**1,656**	**1,597**
Other assets	**573**	**455**	**1**	**1,029**	**317**
At 31 Dec 2017	**1,691**	**4,147**	**882**	**6,720**	**3,475**
Mortgage-related assets:					
– Sub-prime residential	9	1,253	84	1,346	501
– US Alt-A residential	—	1,129	—	1,129	1,121
– Other residential	537	290	44	871	123
– Commercial property	282	927	115	1,324	574
Leveraged finance-related assets	40	1,042	16	1,098	596
Student loan-related assets	41	2,323	9	2,373	2,123
Other assets	815	491	39	1,345	328
At 31 Dec 2016	1,724	7,455	307	9,486	5,366

1 *The asset-backed securities are primarily US dollar ('USD') denominated. Principal and carrying amounts are converted into sterling ('GBP') at the prevailing exchange rates at 31 December (2017: 1GBP: USD 1.351; 2016: 1GBP: USD 1.2325).*

Included in the above table are securities with a carrying amount of £884m (2016: £1,587m) held through the SICs, excluding Solitaire, that are consolidated by the group. Although the group includes these assets in full on its balance sheet, significant first loss risks are borne by the third-party capital notes investors. The carrying amount of the capital notes liability at the year ended 31 December 2017 was £182m (2016: £175m).

The available-for-sale reserve movement in relation to these ABSs for the year was an increase of £25m (2016: increase of £45m). The impairment write-back attributed to the group for the year was £40m (2016: write-back of £16m).

Management of liquidity and funding risk in 2017

Liquidity coverage ratio

The Liquidity Coverage Ratio ('LCR') aims to ensure that a bank has sufficient unencumbered high-quality liquid assets ('HQLA') to meet its liquidity needs in a 30-calendar-day liquidity stress scenario. HQLA consist of cash or assets that can be converted into cash at little or no loss of value in markets.

At 31 December 2017, all the group's principal operating entities were within the LCR risk tolerance level established by the Board and applicable under the LFRF.

The following table displays the individual LCR levels for our principal operating entities on an EC LCR Delegated Regulation basis.

Operating entities' LCRs

	At	
	31 Dec 2017	31 Dec 2016
	%	%
HSBC UK liquidity group[1]	**139**	123
HSBC France	**149**	122
HSBC Trinkaus & Burkhardt AG	**114**	133

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

Net stable funding ratio

The Net Stable Funding Ratio ('NSFR') requires institutions to maintain sufficient stable funding relative to required stable funding, and reflects a bank's long-term funding profile (funding with a term of more than a year). It is designed to complement the LCR.

At 31 December 2017, all the group's principal operating entities were within the NSFR risk tolerance level established by the Board and applicable under the LFRF.

The table below displays the NSFR levels for the principal operating entities on a BCBS 295 basis.

Operating entities' NSFRs

	At	
	31 Dec 2017	31 Dec 2016
	%	%
HSBC UK liquidity group	**108**	116
HSBC France	**116**	120
HSBC Trinkaus & Burkhardt AG	**117**	120

Depositor concentration and term funding maturity concentration

The LCR and NSFR metrics assume a stressed outflow based on a portfolio of depositors within each deposit segment. The validity of these assumptions is undermined if the underlying depositors do not represent a large enough portfolio so that a depositor concentration exists.

In addition to this, operating entities are exposed to term re-financing concentration risk if the current maturity profile results in future maturities being overly concentrated in any defined period.

At 31 December 2017, all principal operating entities were within the risk tolerance levels set for depositor concentration and term funding maturity concentration which were established by the Board and are applicable under the LFRF.

Liquid assets of the group's principal operating entities

The table below shows the unweighted liquidity value of assets categorised as liquid, which is used for the purposes of calculating the LCR metric. This reflects the stock of unencumbered liquid assets at the reporting date, using the regulatory definition of liquid assets.

Operating entities' liquid assets

	Estimated liquidity value at 31 Dec 2017	At Estimated liquidity value 31 Dec 2016
	£m	£m
HSBC UK liquidity group		
Level 1	**119,198**	116,742
Level 2a	**2,157**	1,691
Level 2b	**13,899**	6,217
HSBC France		
Level 1	**16,441**	16,860
Level 2a	**741**	650
Level 2b	**2**	12
HSBC Trinkaus & Burkhardt AG		
Level 1	**6,237**	4,969
Level 2a	**50**	4
Level 2b	**590**	1,057

Sources of funding

Our primary sources of funding are customer current accounts and customer savings deposits payable on demand or at short notice. We issue wholesale securities (secured and unsecured) to supplement our customer deposits and change the currency mix, maturity profile or location of our liabilities.

The following 'Funding sources and uses' table provides a consolidated view of how our balance sheet is funded, and should be read in light of the LFRF, which requires operating entities to manage liquidity and funding risk on a stand-alone basis.

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

In 2017, the level of customer accounts continued to exceed the level of loans and advances to customers. The positive funding gap was predominantly deployed in liquid assets, cash and balances with central banks and financial investments, as required by the LFRF.

Funding sources and uses for the group

	2017	2016
	£m	£m
Sources		
Customer accounts	**381,546**	375,252
Deposits by banks	**29,349**	23,682
Repurchase agreements – non-trading	**37,775**	19,709
Debt securities issued	**13,286**	16,140
Liabilities of disposal groups held for sale	**454**	—
Subordinated liabilities	**16,494**	8,421
Financial liabilities designated at fair value	**18,249**	18,486
Liabilities under insurance contracts	**21,033**	19,724
Trading liabilities	**106,496**	93,934
– repos	**1,182**	562
– stock lending	**21,156**	14,836
– settlement accounts	**2,959**	2,624
– other trading liabilities	**81,199**	75,912
Total equity	**44,049**	40,625
At 31 Dec	**668,731**	615,973

	2017	2016
	£m	£m
Uses		
Loans and advances to customers	**280,402**	272,760
Loans and advances to banks	**14,149**	21,363
Reverse repurchase agreements – non-trading	**45,808**	31,660
Assets held for sale[1]	**461**	94
Trading assets	**145,725**	125,069
– reverse repos	**5,987**	2,583
– stock borrowing	**5,189**	4,588
– settlement accounts	**4,947**	4,031
– other trading assets	**129,602**	113,867
Financial investments	**58,000**	83,135
Cash and balances with central banks	**97,601**	54,278
Net deployment in other balance sheet assets and liabilities[1]	**26,585**	27,614
At 31 Dec	**668,731**	615,973

1 *Net deployment in other balance sheet assets and liabilities in 2016 was £27,708m, which included a £94m of assets held for sale.*

Contingent liquidity risk arising from committed lending facilities

The group provides customers with committed facilities such as standby facilities to corporate customers and committed backstop lines to conduit vehicles sponsored by the group. All of the undrawn commitments provided to conduits or external customers are accounted for in the LCR and NSFR in line with the applicable regulations. This ensures that under a stress scenario any additional outflow generated by increased utilisation of these committed facilities by either customers or the groups's sponsored conduits will not give rise to liquidity risk for the group.

At 31 December 2017, the CP issued by Solitaire and Mazarin was entirely held by HSBC UK liquidity group.

Since the group controls the size of the portfolio of securities held by these conduits, no contingent liquidity risk exposure arises as a result of these undrawn committed lending facilities. In relation to commitments to customers, the table below shows the level of undrawn commitments outstanding in terms of the five largest single facilities and the largest market sector.

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

	2017	2016
	£bn	£bn
Commitments to conduits		
Consolidated multi-seller conduits[1]		
– total lines	**6.8**	6.2
– largest individual lines	**0.6**	0.3
Consolidated securities investment conduits – total lines	**3.4**	3.8
Commitments to customers		
– five largest[2]	**2.5**	3.6
– largest market sector[3]	**19.0**	14.8

1 *These exposures relate to the Regency multi-seller conduit. This vehicle provides funding to group customers by issuing debt secured by a diversified pool of customer-originated assets.*
2 *These figures represent the undrawn balance for the five largest committed liquidity facilities provided to customers, other than those facilities to conduits.*
3 *These figures represent the undrawn balance for the total of all committed liquidity facilities provided to the largest market sector, other than those facilities to conduits.*

Asset encumbrance and collateral management

An asset is defined as encumbered if it has been pledged as collateral against an existing liability and, as a result, is no longer available to the group to secure funding, satisfy collateral needs or be sold to reduce the funding requirement. Collateral is managed on an operating entity basis consistent with the approach to managing liquidity and funding. Available collateral held in an operating entity is managed as a single consistent collateral pool from which each operating entity will seek to optimise the use of the available collateral. The objective of this disclosure is to facilitate an understanding of available and unrestricted assets that could be used to support potential future funding and collateral needs. The disclosure is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

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

	2017	2016
	£m	£m
Total on-balance sheet assets at 31 Dec	**818,868**	816,829
Less:		
– reverse repo/stock borrowing receivables and derivative assets	**(200,319)**	(238,250)
– other assets that cannot be pledged as collateral	**(79,306)**	(76,431)
Total on-balance sheet assets that can support funding and collateral needs at 31 Dec	**539,243**	502,148
Add: off-balance sheet assets		
– fair value of collateral received in relation to reverse repo/stock borrowing/derivatives that is available to sell or repledge	**173,386**	112,322
Total assets that can support future funding and collateral needs	**712,629**	614,470
Less:		
– on-balance sheet assets pledged	**(88,768)**	(65,084)
– re-pledging of off-balance sheet collateral received in relation to reverse repo/stock borrowing/derivatives	**(130,430)**	(81,156)
Assets available to support funding and collateral needs at 31 Dec	**493,431**	468,230

Market risk in 2017

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

There were no material changes to our policies and practices for the management of market risk in 2017.

Exposure to market risk is separated into two portfolios.

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

Trading portfolios

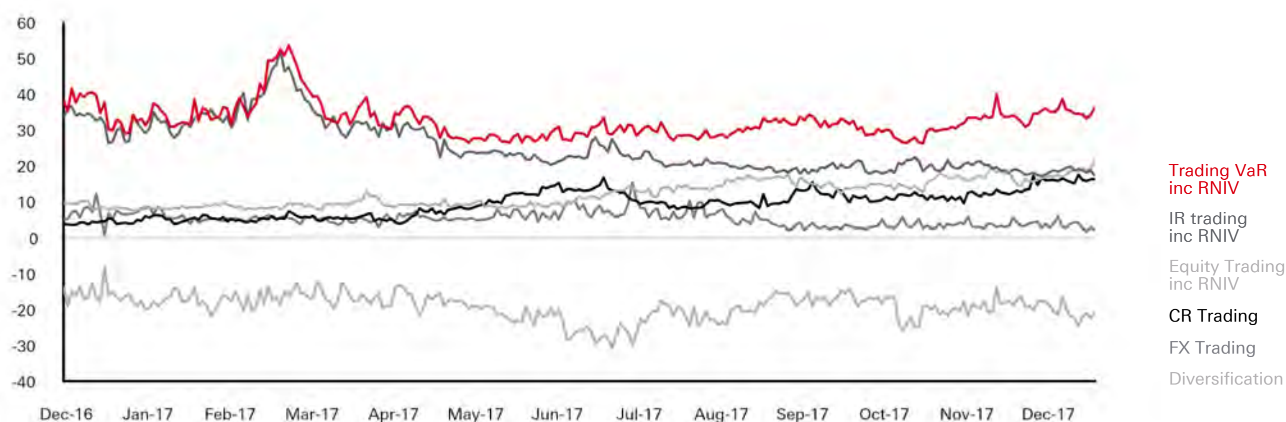
Value at risk of the trading portfolios

(Audited)

Trading VaR predominantly resides within Global Markets. The total VaR for trading activity showed some variation in the first quarter of the year, mostly due a low rates environment, as work was ongoing on the implementation of a compressed return model. As this was implemented around the beginning of the second quarter the VaR stabilised. The overall trading positions were constrained and VaR reached a low around mid-year. Towards the end of the year, activity picked up again, and the VaR increase can be ascribed to increased Equity risk (mainly coming from correlation and dividend Risk-Not-In-Var ('RNIV'), as well as Credit.

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

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



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

Trading VaR, 99% 1 day

(Audited)

	Foreign exchange (FX) and commodity	Interest rate (IR)	Equity (EQ)	Credit Spread (CS)	Portfolio Diversification[1]	Total[2]
	£m	£m	£m	£m	£m	£m
Balance at 31 Dec 2017	**2.1**	**17.1**	**21.4**	**16.2**	**(20.5)**	**36.3**
Average	**5.2**	**25.3**	**12.0**	**9.2**	**(19.1)**	**32.6**
Maximum	**15.3**	**52.3**	**21.4**	**17.4**		**53.4**
Minimum	**0.9**	**17.1**	**7.5**	**3.4**		**26.2**
Balance at 31 Dec 2016	5.2	33.2	9.6	3.9	(13.6)	38.3
Average	5.9	30.3	14.5	7.8	(19.1)	39.4
Maximum	12.0	44.8	20.3	16.9		55.4
Minimum	2.3	21.5	9.6	3.6		29.7

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

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

Back-testing

In 2017, the group experienced one back-testing exception against both hypothetical and actual loss driven by a margin loan.

There was no evidence of model failure or control error. The back-testing results exclude exemptions due from changes in fair value adjustments.

Value at Risk of the non-trading portfolios

(Audited)

Non-trading VaR of the group includes contributions from all global businesses. The gradual reduction is Interest Rate VaR is driven by a decision to de-risk the banking book in 2017. The decrease in non-trading credit spread risk is attributed to the continuous decrease of legacy ABS exposures.

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

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

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

Non-trading VaR, 99% 1 day

(Audited)

	Interest rate	Credit spread	Portfolio diversification	Total
	£m	£m	£m	£m
Balance at 31 Dec 2017	**45.8**	**22.1**	**(17.8)**	**50.1**
Average	**64.1**	**29.3**	**(23.6)**	**69.8**
Maximum	**92.0**	**53.4**		**91.2**
Minimum	**44.8**	**9.3**		**47.7**
Balance at 31 Dec 2016	91.5	29.5	(39.6)	81.4
Average	79.9	27.9	(29.6)	78.2
Maximum	94.5	48.3		92.5
Minimum	67.0	17.4		66.1

Fixed-rate securities

The principal non-trading risk which is not included in the VaR arises out of Fixed Rate Subordinated Notes. The VaR related to these instruments was £35.5m at 31 December 2017 (2016: £29.2m); while the average and maximum during the year was £31.0m and £35.6m respectively (2016: £30.1m and £36.6m).

Equity securities held as available-for-sale

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

Market risk arises on equity securities held as available-for-sale. The fair value of these securities at 31 December 2017 was £662m (2016: £761m).

The fair value of the constituents of equity securities held as available-for-sale can fluctuate considerably. For details of the impairment incurred on available-for-sale equity securities see the accounting policies in Note 1.2(e).

Structural foreign exchange exposures

The group's structural foreign currency exposure is represented by the net asset value of its foreign currency equity and subordinated debt investments in subsidiary undertakings, branches, joint ventures and associates.

For our policies and procedures for managing structural foreign exchange exposures, see page 31 of the 'Risk management' section.

Net structural foreign currency exposures

	2017	2016
	£m	£m
Currency of structural exposure		
Euro	**11,132**	11,718
US dollars	**515**	907
Turkish lira[1]	**–**	596
South African rand	**326**	279
Russian rouble	**225**	214
Others, each less than £100m	**378**	366
At 31 Dec	**12,576**	14,080

1 *On 29 June 2017, HSBC Bank plc transferred its shareholding in HSBC Bank A.S. to HSBC Middle East Holdings B.V. and HSBC Bank Middle East Limited. Please see page 3.*

Operational risk in 2017

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

Responsibility for minimising operational risk lies with HSBC's employees. They are required to manage the operational risks of the business and operational activities for which they are responsible.

A summary of our current policies and practices regarding the management of operational risk is set out on page 32.

Operational risk exposures in 2017

In 2017 we continued our ongoing work to strengthen those controls that manage our most material risks. Among other measures, we:

- further developed controls to help ensure that we know our customers, ask the right questions, monitor transactions and escalate concerns to detect, prevent and deter financial crime risk;
- implemented a number of initiatives to raise our standards in relation to the conduct of our business and other regulatory compliance-related initiatives, as described on page 33 of the 'Regulatory compliance risk management' section;
- increased monitoring and enhanced detective controls to manage those fraud risks which arise from new technologies and new ways of banking;
- strengthened internal security controls to prevent cyber-attacks;
- improved controls and security to protect customers when using digital channels; and
- enhanced our third-party risk management capability to enable the consistent risk assessment of any third-party service.

Further information on the nature of these risks is provided in 'Top and emerging risks' on page 20 and in 'Risk management' from pages 23 to 35.

Operational risk losses in 2017

Operational risk losses in 2017 are lower than in 2016, reflecting a reduction in losses incurred relating to large legacy conduct-related events. Provisions related to the civil money penalty order associated with the FRB agreed in September 2017 and the DPA with the US DoJ in January 2018, in connection with investigations into HSBC's historic foreign exchange activities, were recognised in prior periods. For further details, see Note 30 on the Financial Statements and on conduct-related costs included in significant items on page 11.

Insurance manufacturing operations risk in 2017

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

A summary of our current policies and practices regarding the management of insurance risk is set out on page 34.

The group's bancassurance model

We operate an integrated bancassurance model that provides insurance products principally for customers with whom we have a banking relationship.

The insurance contracts we sell relate to the underlying needs of our banking customers, which we can identify from our point-of-sale contacts and customer knowledge. The majority of sales are of savings and investment products and term and credit life contracts.

By focusing largely on personal and SME lines of business, we are able to optimise volumes and diversify individual insurance risks.

We choose to manufacture these insurance products in HSBC subsidiaries based on an assessment of operational scale and risk appetite. Manufacturing insurance allows us to retain the risks and rewards associated with writing insurance contracts by keeping part of the underwriting profit and investment income within the bank.

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

Insurance products are sold through all global businesses, but predominantly by RBWM, GPB and CMB through our branches and direct channels.

Measurement

(Audited)

The risk profile of our insurance manufacturing businesses is measured using an economic capital approach. Assets and liabilities are measured on a market value basis, and a capital requirement is defined to ensure that there is a less than one-in-200 chance of insolvency over a one-year time horizon, given the risks to which the businesses are exposed. The methodology for the economic capital calculation is largely aligned to the pan-European Solvency II insurance capital regulations. The economic capital coverage ratio (economic net asset value divided by the economic capital requirement) is a key risk appetite measure. The business has a current appetite to remain above 140% with a tolerance of 110%. In addition to economic capital, the regulatory solvency ratio is also a metric used to manage risk appetite on an entity basis.

The following table shows the composition of assets and liabilities by contract type. A portfolio of business in our Maltese insurance operations was reported as held for sale at 31 December 2017.

Balance sheet of insurance manufacturing subsidiaries by type of contract

(Audited)

	With DPF	Unit-linked	Other contracts[1]	Shareholder assets and liabilities	Total
	£m	£m	£m	£m	£m
Financial assets	**18,749**	**1,530**	**190**	**1,906**	**22,375**
– financial assets designated at fair value	**7,020**	**1,466**	**85**	**630**	**9,201**
– derivatives	**95**	**—**	**—**	**30**	**125**
– financial investments – AFS[2]	**9,918**	**—**	**104**	**1,188**	**11,210**
– other financial assets[3]	**1,716**	**64**	**1**	**58**	**1,839**
Reinsurance assets	**—**	**188**	**159**	**—**	**347**
PVIF[4]	**—**	**—**	**—**	**572**	**572**
Other assets and investment properties	**784**	**1**	**1**	**449**	**1,235**
Total assets at 31 Dec 2017	**19,533**	**1,719**	**350**	**2,927**	**24,529**
Liabilities under investment contracts designated at fair value	**—**	**548**	**—**	**—**	**548**
Liabilities under insurance contracts	**19,533**	**1,166**	**334**	**—**	**21,033**
Deferred tax[5]	**—**	**5**	**—**	**156**	**161**
Other liabilities	**—**	**—**	**—**	**1,561**	**1,561**
Total liabilities at 31 Dec 2017	**19,533**	**1,719**	**334**	**1,717**	**23,303**
Total equity at 31 Dec 2017	**—**	**—**	**—**	**1,226**	**1,226**
Total liabilities and equity at 31 Dec 2017	**19,533**	**1,719**	**334**	**2,943**	**24,529**
Financial assets	17,663	1,997	208	1,450	21,318
– financial assets designated at fair value	5,822	1,882	106	442	8,252
– derivatives	114	—	—	38	152
– financial investments – AFS[2]	10,204	—	99	902	11,205
– other financial assets[3]	1,523	115	3	68	1,709
Reinsurance assets	—	124	169	—	293
PVIF[4]	—	—	—	577	577
Other assets and investment properties	692	5	2	5	704
Total assets at 31 Dec 2016	18,355	2,126	379	2,032	22,892
Liabilities under investment contracts designated at fair value	—	1,072	—	—	1,072
Liabilities under insurance contracts	18,355	1,030	339	—	19,724
Deferred tax[5]	—	2	—	189	191
Other liabilities	—	—	30	733	763
Total liabilities at 31 Dec 2016	18,355	2,104	369	922	21,750
Total equity at 31 Dec 2016	—	—	—	1,142	1,142
Total liabilities and equity at 31 Dec 2016	18,355	2,104	369	2,064	22,892

1 *'Other contracts' includes term assurance and credit life insurance.*
2 *Financial investments available-for-sale ('AFS').*
3 *Comprise mainly loans and advances to banks, cash and intercompany balances with other non-insurance legal entities.*
4 *Present value of in-force long-term insurance business.*
5 *'Deferred tax' includes the deferred tax liabilities arising on recognition of PVIF.*

Key risk types

The key risks for the insurance operations are market risks (in particular interest rate and equity) and credit risks, followed by insurance underwriting risks and operational risks. Liquidity risk, whilst significant for the bank, is minor for our insurance operations.

Market risk

(Audited)

Description and exposure

Market risk is the risk of changes in market factors affecting the bank's capital or profit. Market factors include interest rates, equity and growth assets and foreign exchange rates.

Our exposure varies depending on the type of contract issued. Our most significant life insurance products are investment contracts with discretionary participating features ('DPF') issued in France. These products typically include some form of capital guarantee or guaranteed return on the sums invested by the policyholders, to which discretionary bonuses are added if allowed by the overall performance of the funds. These funds are primarily invested in bonds with a proportion allocated to other asset classes, to provide customers with the potential for enhanced returns.

DPF products expose the bank to the risk of variation in asset returns, which will impact our participation in the investment performance. In addition, in some scenarios the asset returns can become insufficient to cover the policyholders' financial guarantees, in which case the shortfall has to be met by the bank. Reserves are held against the cost of such guarantees, calculated by stochastic modelling.

Where local rules require, these reserves are held as part of liabilities under insurance contracts. Any remainder is accounted for as a deduction from the present value of in-force 'PVIF' long-term insurance contracts and on the relevant product. The table below shows the total reserve held for the cost of guarantees, the range of investment returns on assets supporting these products and the implied investment return that would enable the business to meet the guarantees.

The financial guarantees offered on some portfolios exceeded the current yield on the assets that back them. The cost of guarantees on portfolios in France increased, driven principally by the impact of modelling changes.

For unit-linked contracts, market risk is substantially borne by the policyholder, but some market risk exposure typically remains as fees earned are related to the market value of the linked assets.

Financial return guarantees

(Audited)

	2017			2016		
	Investment returns implied by guarantee	**Long-term investment returns on relevant portfolios**	**Cost of guarantees**	Investment returns implied by guarantee	Long-term investment returns on relevant portfolios	Cost of guarantees
	%	**%**	**£m**	%	%	£m
Capital	**0.0**	**3.2**	**67**	0.0	3.0	25
Nominal annual return[1]	**2.6**	**3.2**	**80**	2.6	3.0	76
Nominal annual return	**4.5**	**3.2**	**44**	4.5	3.0	52
At 31 Dec			**191**			153

1 *A block of contracts in France with guaranteed nominal annual returns in the range 1.25%-3.72% are reported in line with the average guaranteed return of 2.6% (2016: 2.6%) offered to policyholders on these contracts.*

Sensitivities

The following table illustrates the effects of selected interest rate and equity price scenarios on our profit for the year and the total equity of our insurance manufacturing subsidiaries.

Where appropriate, the effects of the sensitivity tests on profit after tax and equity incorporate the impact of the stress on the PVIF. The relationship between the profit and total equity and the risk factors is non-linear; therefore, the results disclosed should not be extrapolated to measure sensitivities to different levels of stress. For the same reason, the impact of the stress is not symmetrical on the upside and downside. The sensitivities are stated before allowance for management actions which may mitigate the effect of changes in the market environment. The sensitivities presented allow for adverse changes in policyholder behaviour that may arise in response to changes in market rates.

Changes in sensitivity compared to 2016 were primarily driven by the impact of increasing yields in France on the projected cost of options and guarantees.

Sensitivity of the group's insurance manufacturing subsidiaries to market risk factors

(Audited)

	2017		2016	
	Effect on profit after tax	**Effect on total equity**	Effect on profit after tax	Effect on total equity
	£m	**£m**	£m	£m
+100 basis points parallel shift in yield curves	**24**	**9**	58	44
–100 basis points parallel shift in yield curves[1]	**(44)**	**(28)**	(110)	(95)
10% increase in equity prices	**20**	**20**	13	13
10% decrease in equity prices	**(19)**	**(19)**	(13)	(13)

1 *For 2016, where a -100 basis point parallel shift in the yield curve would result in a negative interest rate, the effect on profit after tax and total equity has been calculated using a minimum rate of 0%.*

Credit risk

(Audited)

Description and exposure

Credit risk arises in two main areas for our insurance manufacturers:

- risk associated with credit spread volatility and default by debt security counterparties after investing premiums to generate a return for policyholders and shareholders; and
- risk of default by reinsurance counterparties and non-reimbursement for claims made after ceding insurance risk.

The amounts outstanding at the balance sheet date in respect of these items are shown in the table on page 53.

The credit quality of the reinsurers' share of liabilities under insurance contracts is assessed as 'satisfactory' or higher (as defined on page 27), with 100% of the exposure being neither past due nor impaired.

Credit risk on assets supporting unit-linked liabilities is predominantly borne by the policyholder; therefore our exposure is primarily related to liabilities under non-linked insurance and investment contracts and shareholders' funds. The credit quality of these financial assets is included in the table on page 38.

Liquidity risk

(Audited)

Description and exposure

Liquidity risk is the risk that an insurance operation, though solvent, either does not have sufficient financial resources available to meet its obligations when they fall due, or can secure them only at excessive cost.

The following table shows the expected undiscounted cash flows for insurance contract liabilities at 31 December 2017. The liquidity risk exposure is wholly borne by the policyholder in the case of unit-linked business and is shared with the policyholder for non-linked insurance.

The profile of the expected maturity of insurance contracts at 31 December 2017 remained comparable with 2016.

The remaining contractual maturity of investment contract liabilities is included in Note 25.

Expected maturity of insurance contract liabilities

(Audited)

	Expected cash flows (undiscounted)				
	Within 1 year	**1-5 years**	**5-15 years**	**Over 15 years**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
Unit-linked	**289**	**323**	**436**	**440**	**1,488**
With DPF and other contracts	**1,460**	**6,665**	**6,625**	**5,212**	**19,962**
At 31 Dec 2017	**1,749**	**6,988**	**7,061**	**5,652**	**21,450**
Unit-linked	195	277	418	370	1,260
With DPF and other contracts	1,377	6,074	5,912	5,372	18,735
At 31 Dec 2016	1,572	6,351	6,330	5,742	19,995

Insurance risk

Description and exposure

Insurance risk is the risk of loss through adverse experience, in either timing or amount, of insurance underwriting parameters (non-economic assumptions). These parameters include mortality, morbidity, longevity, lapses and unit costs.

The principal risk we face is that, over time, the cost of the contract, including claims and benefits, may exceed the total amount of premiums and investment income received.

The table on page 53 analyses our life insurance risk exposures by type of contract.

The insurance risk profile and related exposures remain largely consistent with those observed at 31 December 2016.

Sensitivities

The table below shows the sensitivity of profit and total equity to reasonably possible changes in non-economic assumptions across all our insurance manufacturing subsidiaries.

Mortality and morbidity risk is typically associated with life insurance contracts. The effect on profit of an increase in mortality or morbidity depends on the type of business being written. Our largest exposure to mortality and morbidity risk exists in the UK.

Sensitivity to lapse rates depends on the type of contracts being written. For a portfolio of term assurance, an increase in lapse rates typically has a negative effect on profit due to the loss of future income on the lapsed policies. However, some contract lapses have a positive effect on profit due to the existence of policy surrender charges. We are most sensitive to a change in lapse rates in France.

Expense rate risk is the exposure to a change in the cost of administering insurance contracts. To the extent that increased expenses cannot be passed on to policyholders, an increase in expense rates will have a negative effect on our profits.

Sensitivity analysis

(Audited)

	2017	2016
	£m	£m
Effect on profit after tax and total equity at 31 Dec		
10% increase in mortality and/or morbidity rates	**(18)**	(13)
10% decrease in mortality and/or morbidity rates	**18**	12
10% increase in lapse rates	**(22)**	(18)
10% decrease in lapse rates	**25**	22
10% increase in expense rates	**(31)**	(32)
10% decrease in expense rates	**31**	31

Capital

Capital management

Approach and policy

(Audited)

Our objective in managing the group's capital is to maintain appropriate levels of capital to support our business strategy and meet regulatory and stress testing related requirements.

We manage group capital to ensure that we exceed current and expected future requirements, and that we respect the payment priority of our capital providers. Throughout 2017, we complied with the Prudential Regulation Authority's ('PRA') regulatory capital adequacy requirements, including those relating to stress testing.

Capital measurement

The PRA is the supervisor of the bank and lead supervisor of the group. The PRA sets capital requirements and receives information on the capital adequacy of the bank and the group.

Individual banking subsidiaries are directly regulated by their local banking supervisors, who set and monitor their capital adequacy requirements. Since 1 January 2014, our capital at group level is calculated under CRD IV and the PRA Rulebook.

Our policy and practice in capital measurement and allocation at the group level is underpinned by the CRD IV rules. In most jurisdictions, non-bank financial subsidiaries are also subject to the supervision and capital requirements of local regulatory authorities.

The Basel III framework, like Basel II, is structured around three 'pillars': minimum capital requirements, supervisory review process and market discipline. Basel III also introduces a number of capital buffers, including the Capital Conservation Buffer ('CCB'), Countercyclical Capital Buffer ('CCyB'), and other systemic buffers such as the Globally/Other Systemically Important Institutions ('G-SII'/'O-SII') buffer. CRD IV legislation implemented Basel III in the EU, and in the UK, the 'PRA Rulebook' for CRR Firms transposed the various national discretions under the CRD IV legislation into UK requirements.

Regulatory capital

Our capital base is divided into three main categories, namely common equity tier 1, additional tier 1 and tier 2, depending on their characteristics.

- Common equity tier 1 ('CET 1') capital is the highest quality form of capital, comprising shareholders' equity and related non-controlling interests (subject to limits). Under CRD IV various capital deductions and regulatory adjustments are made against these items; these include deductions for goodwill and intangible assets, deferred tax assets that rely on future profitability, negative amounts resulting from the calculation of expected loss amounts under internal ratings based ('IRB') approach and surplus defined benefit pension fund assets.
- Additional tier 1 capital comprises eligible non-common equity capital instruments and any related share premium; it also includes other qualifying instruments issued by subsidiaries subject to certain limits. Holdings of additional tier 1 instruments of financial sector entities are deducted from our additional tier 1 capital.
- Tier 2 capital comprises eligible capital instruments and any related share premium and other qualifying tier 2 capital instruments issued by subsidiaries, subject to limits. Holdings of tier 2 capital instruments of financial sector entities are deducted from our tier 2 capital.

Pillar 3 disclosure requirements

Pillar 3 of the Basel regulatory framework is related to market discipline and aims to increase market transparency by requiring firms to publish, at least annually, wide-ranging information on their risks and capital, and how these are managed. Our Pillar 3 Disclosures 2017 are published on HSBC's website, www.hsbc.com, under 'Investor Relations'.

Capital overview

Key capital numbers

		At 31 Dec	
	Footnotes	**2017**	2016
Available capital (£m)	*1*		
Common equity tier 1 capital		**27,409**	25,098
Tier 1 capital		**32,243**	30,218
Total regulatory capital		**39,288**	38,522
Risk-weighted assets (£m)			
Credit risk		**164,767**	168,936
Counterparty credit risk		**24,018**	28,593
Market risk		**20,978**	24,975
Operational risk		**23,310**	22,733
Total risk-weighted assets		**233,073**	245,237
Capital ratios (%)			
Common equity tier 1		**11.8**	10.2
Total tier 1		**13.8**	12.3
Total capital		**16.9**	15.7
Leverage ratio			
Tier 1 capital (£m)		**31,165**	28,853
Total leverage ratio exposure measure (£m)		**787,220**	733,415
Leverage ratio (%)	*2*	**4.0**	3.9

1 *Capital figures are reported on a transitional basis.*
2 *Leverage ratio is calculated on a fully phased-in basis.*

Capital structure at 31 December

(Audited)

Own funds disclosure

Ref		Footnotes	At 31 Dec 2017 £m	31 Dec 2016 £m
	Common equity tier 1 ('CET1') capital: instruments and reserves			
1	Capital instruments and the related share premium accounts		**797**	21,099
	– ordinary shares		**797**	21,099
2	Retained earnings	1	**32,601**	12,638
3	Accumulated other comprehensive income (and other reserves)	1	**4,341**	1,758
5	Minority interests (amount allowed in consolidated CET1)		**337**	349
5a	Independently reviewed interim net profits net of any foreseeable charge or dividend	1	**217**	(820)
6	**Common equity tier 1 capital before regulatory adjustments**		**38,293**	35,024
	Common equity tier 1 capital: regulatory adjustments			
7	Additional value adjustments		**(587)**	(756)
8	Intangible assets (net of related deferred tax liability)		**(5,337)**	(5,145)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)		**(39)**	(30)
11	Fair value reserves related to gains or losses on cash flow hedges		**41**	(84)
12	Negative amounts resulting from the calculation of expected loss amounts		**(864)**	(1,128)
14	Gains or losses on liabilities at fair value resulting from changes in own credit standing		**452**	(141)
15	Defined-benefit pension fund assets		**(4,550)**	(2,642)
28	**Total regulatory adjustments to common equity tier 1**		**(10,884)**	(9,926)
29	**Common equity tier 1 capital**		**27,409**	25,098
	Additional tier 1 ('AT1') capital: instruments			
30	Capital instruments and the related share premium accounts		**3,781**	3,781
31	– classified as equity under IFRSs		**3,781**	3,781
33	Amount of qualifying items and the related share premium accounts subject to phase out from AT1		**1,083**	1,389
34	Qualifying tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issued by subsidiaries and held by third parties		**44**	56
36	**Additional tier 1 capital before regulatory adjustments**		**4,908**	5,226
	Additional tier 1 capital: regulatory adjustments			
37	Direct and indirect holdings of own AT1 instruments		**(45)**	(49)
41b	Residual amounts deducted from AT1 capital with regard to deduction from tier 2 ('T2') capital during the		**(29)**	(57)
	– direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities		**(29)**	(57)
43	**Total regulatory adjustments to additional tier 1 capital**		**(74)**	(106)
44	**Additional tier 1 capital**		**4,834**	5,120
45	**Tier 1 capital (T1 = CET1 + AT1)**		**32,243**	30,218
	Tier 2 capital: instruments and provisions			
46	Capital instruments and the related share premium accounts		**5,977**	7,058
47	Amount of qualifying items and the related share premium accounts subject to phase out from T2		**1,194**	1,310
48	Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in CET1 or AT1) issued by subsidiaries and held by third parties		**169**	196
49	*– of which: instruments issued by subsidiaries subject to phase out*		***146***	*182*
51	**Tier 2 capital before regulatory adjustments**		**7,340**	8,564
	Tier 2 capital: regulatory adjustments			
52	Direct and indirect holdings of own T2 instruments		**(30)**	(32)
55	Direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions)		**(265)**	(228)
57	**Total regulatory adjustments to tier 2 capital**		**(295)**	(260)
58	**Tier 2 capital**		**7,045**	8,304
59	**Total capital (TC = T1 + T2)**		**39,288**	38,522

* *The references identify the lines prescribed in the EBA template, which are applicable and where there is a value.*
1 *In the comparative period, dividend paid has been reallocated from row 2 and 3 to row 5a.*

CET1 capital increased during the year by £2.3bn, due to:

- £1.2bn of capital generation through profits, net of dividends;
- £1.2bn of capital contribution from HSBC Holdings plc; and
- favourable foreign currency translation differences of £0.4bn.

These increases were partly offset by a reduction of £0.5bn as a result of the transfer of HSBC Bank A.S. to HSBC Middle East Holdings B.V.

Risk-Weighted Assets ('RWAs')

RWA movement by business by key driver

	Credit risk, counterparty credit risk and operational risk						
	RBWM	CMB	GB&M	GPB	Corporate Centre	Market risk	Total RWAs
	£m	£m	£m	£m	£m	£m	£m
RWAs at 1 Jan 2017	25,849	81,958	81,504	3,509	27,442	24,975	245,237
RWA initiatives	(10)	(3,930)	(9,746)	(135)	(5,927)	(1,783)	(21,531)
Foreign exchange movement	91	606	(2,289)	22	(1,203)	(2,024)	(4,797)
Acquisitions and disposals	(791)	(1,611)	(631)	–	(585)	(462)	(4,080)
Book size	368	3,799	4,327	120	216	(294)	8,536
Book quality	298	587	86	150	442	–	1,563
Model updates	661	3,666	252	(90)	–	–	4,489
Methodology and policy	210	373	3,287	(36)	(744)	566	3,656
– internal updates	210	373	2,525	(36)	(744)	566	2,894
– external updates – regulatory	–	–	762	–	–	–	762
Total RWA movement	827	3,490	(4,714)	31	(7,801)	(3,997)	(12,164)
RWAs at 31 Dec 2017	26,676	85,448	76,790	3,540	19,641	20,978	233,073

RWAs decreased by £12.2bn during the year, including a decrease of £4.8bn due to foreign currency translation differences. The remaining decrease of £7.4bn (excluding foreign currency translation differences) was due to RWA initiatives of £21.5bn and acquisitions and disposals of £4.1bn, less increases from book size growth of £8.5bn, model updates of £4.5bn, and methodology and policy movements of £3.7bn.

The following comments describe the principal RWA movements in 2017, excluding foreign currency translation differences.

RWA Initiatives

Continued reduction in legacy credit reduced RWAs by £5.6bn. Further savings mainly came from refined calculations of £3.1bn, exposure reductions of £2.9bn, trade actions of £2.7bn and process improvements of £3.1bn.

Acquisitions and disposals

The transfer of HSBC Bank A.S. to HSBC Middle East Holdings B.V. decreased the group's RWAs by £4.1bn.

Book size

Book size movements of £8.5bn principally represent lending growth, mainly in GB&M and CMB.

Leverage ratio

Our fully phased-in CRD IV leverage ratio was 4.0% at 31 December 2017, up from 3.9% at 31 December 2016. Growth in tier 1 capital was partly offset by a rise in the leverage exposure measure, primarily due to a growth in on balance sheet exposures.

Corporate Governance Report

The statement of corporate governance practices set out on pages 59 to 64 and information incorporated by reference constitutes the Corporate Governance Report of HSBC Bank plc.

The Directors serving as at 31 December 2017 are set out below.

Directors

Jonathan Symonds, CBE

Chairman and independent non-executive Director

Chairman of the Chairman's Nominations and Remuneration Committee

Appointed to the Board: 2014

Jonathan is a former Chief Financial Officer of Novartis AG and AstraZeneca plc. He was also a partner and Managing Director of Goldman Sachs, a partner of KPMG, and a non-executive director and chair of the Audit Committee of Diageo plc. He is a fellow of the Institute of Chartered Accountants in England and Wales.

His current appointments include being Senior Independent Director, Chairman of the Group Audit Committee and member of the Nomination Committee and the Conduct & Values Committee of HSBC Holdings plc. Jonathan is also Chairman of Proteus Digital Health Inc, and a non-executive director of Genomics England Limited.

John Trueman

Deputy Chairman and independent non-executive Director

Member of the Audit Committee, the Risk Committee, the Risk Sub-Committee for Global Banking and Markets Risk Oversight and the Chairman's Nominations and Remuneration Committee

Appointed to the Board: 2004. Deputy Chairman since December 2013

John is Chairman of HSBC Private Bank (UK) Limited and HSBC Global Asset Management Limited. Former appointments include: Deputy Chairman of S.G. Warburg & Co Ltd.

Antonio Simoes

Chief Executive

Chairman of the Executive Committee

Appointed to the Board: 2012. Chief Executive since September 2015

Antonio joined HSBC in 2007 and became a Group Managing Director of HSBC Holdings plc on 1 February 2016. He is Chief Executive of Europe and a director of HSBC France. Former appointments include: Chief Executive of HSBC UK; Head of Retail Banking and Wealth Management, Europe; Chief of Staff to the Group Chief Executive; and Group Head of Strategy and Planning. Antonio was formerly the Chairman of the Practitioner Panel of the FCA, Partner of McKinsey & Company and an Associate at Goldman Sachs.

James Coyle

Independent non-executive Director

Chairman of the Risk Committee and member of the Audit Committee, the Risk Sub-Committee for Global Banking and Markets Risk Oversight and the Chairman's Nominations and Remuneration Committee

Appointed to the Board: 2015

James is Chairman of HSBC Trust Company (UK) Limited and Marks & Spencer Unit Trust Management Limited and a non-executive director of Marks and Spencer Financial Services plc and Marks and Spencer Savings and Investments Limited. He is a non-executive director and chairman of the Audit and Risk Committee of Scottish Water, a non-executive director and chairman of the Audit and Risk Committee of Honeycomb Investment Trust plc, director and chairman of the Audit and Risk Committee of Worldfirst and a member of the Financial Reporting Council's Monitoring Committee. Former appointments include: Group Financial Controller for Lloyds Banking Group; Group Chief Accountant of Bank of Scotland; member of the Audit Committee of the British Bankers Association; non-executive director of the Scottish Building Society; and a non-executive director and chairman of the Audit Committee of Vocalink plc.

Dame Denise Holt

Independent non-executive Director

Member of the Risk Committee

Appointed to the Board: 2011

Denise is Chairman of Marks and Spencer Financial Services plc and Marks and Spencer Savings and Investments Limited. She is a non-executive director of Iberdrola SA and and a member of the Board of Governors at Nuffield Health. Former appointments include: a senior British Ambassador with 40 years' experience of working in government including postings in Ireland, Mexico, Brazil and Spain.

David Lister

Independent non-executive Director

Chairman of the Operations and Technology Committee and a member of the Chairman's Nominations and Remuneration Committee

Appointed to the Board: 2015

David is a non-executive director of FDM Group (Holdings) plc and CIS General Insurance Limited; and a member of the Board of Governors at Nuffield Health. Former appointments include: Group Chief Information Officer at each of National Grid, Royal Bank of Scotland, Reuters, Boots and GlaxoSmithKline plc and a non-executive director at the Department for Work and Pensions.

Dame Mary Marsh

Independent non-executive Director

Member of the Operations and Technology Committee

Appointed to the Board: 2009

Mary is non-executive Chair of Trustees of the Royal College of Paediatrics and Child Health, director of the London Symphony Orchestra,a member of the Governing Body at the London Business School and Trustee of Teach First. Former appointments include: founding director of the Clore Social Leadership Programme, a co-opted non-director member of the Corporate Sustainability Committee of HSBC Holdings plc and Chief Executive of the National Society for the Prevention of Cruelty to Children (NSPCC).

Thierry Moulonguet

Independent non-executive Director

Chairman of the Audit Committee and a member of the Risk Committee, the Operations and Technology Committee and the Chairman's Nominations and Remuneration Committee

Appointed to the Board: 2012

Thierry is a director of HSBC France, Chairman of its Audit Committee and a member of its Risk Committee. He is a director of Fimalac; Groupe Lucien Barrière; Valéo; and the Prodways Group. Former appointments include: Executive Vice-President, and Chief Financial Officer of Renault Group.

Dr Eric Strutz

Independent non-executive Director

Member of the Risk Committee, the Chairman's Nominations and Remuneration Committee and Chairman of the Risk Sub-Committee for Global Banking and Markets Risk Oversight

Appointed to the Board: 2016

Eric is a member of the Supervisory Board and Chairman of the Risk and Audit Committees of HSBC Trinkaus & Burkhardt AG, Germany. He is a member of the Board of Directors and Chairman of the Risk and Audit Committee of Partners Group Holding AG,

Switzerland. Former appointments include: Chief Financial Officer of Commerzbank AG.

Company Secretary

Nicola Black held the position of Company Secretary until 31 December 2017. Loren Wulfsohn, who joined HSBC in 2015 as Head of Shareholder Services, was appointed Company Secretary with effect from 1 January 2018.

Board of Directors

The objectives of the management structures within the bank, headed by the Board of Directors and led by the Chairman, are to deliver sustainable value to shareholders and to internal and external stakeholders. Implementation of the strategy set by the Board is delegated to the bank's Executive Committee.

The Board meets regularly and Directors receive information between meetings about the activities of committees and developments in the bank's business. All Directors have full and timely access to all relevant information and may take independent professional advice if necessary.

The names of Directors serving at the date of this report and brief biographical particulars for each of them are set out on pages 59 and 60.

All Directors, including those appointed by the Board to fill a casual vacancy, are subject to annual re-election at the bank's Annual General Meeting. Non-executive Directors have no service contracts.

Simon Leathes retired as a non-executive Director on 21 April 2017.

Directors' emoluments

Details of the emoluments of the Directors of the bank for 2017, disclosed in accordance with the Companies Act, are shown in Note 4 'Employee compensation and benefits'.

Board committees

The Board has established a number of committees, the membership of which comprises certain Directors and, where appropriate, senior executives. The Chairman of each non-executive Board committee reports to each meeting of the Board on the activities of the Committee since the previous Board meeting.

All of the members of the Audit Committee, Risk Committee, Chairman's Nominations and Remuneration Committee and Operations and Technology Committee are independent non-executive Directors.

As at the date of this report, the following are the principal committees:

Audit Committee

The Audit Committee is accountable to the Board and has non-executive responsibility for oversight of and advice to the Board on financial reporting related matters and internal controls over financial reporting.

The Committee meets regularly with the bank's senior financial and internal audit management and the external auditor to consider, among other matters, the bank's financial reporting, the nature and scope of audit reviews, the effectiveness of the systems of internal control relating to financial reporting, the review of the financial underpinnings of structural reform projects and the monitoring of the finance function transformation program.

The current members are: Thierry Moulonguet (Chairman); James Coyle and John Trueman.

Significant accounting judgements and related matters considered by the Audit Committee during 2017 included:

Key area	Action taken
Appropriateness of provisioning for legal proceedings and regulatory matters	The HSBC Bank plc Audit Committee ('AC') received reports from management on the recognition and amounts of provisions, as well as the existence of contingent liabilities for legal proceedings and regulatory matters. Specific matters included accounting judgements in relation to provisions and contingent liabilities arising out of investigations by regulators and competition and law enforcement authorities around the world into trading on the foreign exchange market.
Half-year and annual reporting	The AC considered key judgements in relation to half-year and annual reporting.
Loan impairment, allowances and charges	The AC considered loan impairment allowances for personal and wholesale lending. Specific attention was applied to credit risk in the UK and the implication of economic uncertainty from a credit perspective.
Valuation of financial instruments	The AC considered the key valuation metrics and judgements involved in the determination of the fair value of financial instruments.
Going Concern	In making their going concern assessment, the Directors have considered a wide range of detailed information relating to present and potential conditions, including projections for profitability, cash flows, capital requirements and capital resources.
UK customer remediation	The AC considered the provisions for redress for mis-selling of payment protection insurance ('PPI') policies in the UK and the associated redress on PPI commissions earned under certain criteria, including management's judgements regarding the effect of the time-bar for claims ending August 2019. In addition, the GAC monitored progress on the remediation of operational processes for foreign currency overdrafts, and associated customer redress.
Goodwill impairment testing	The AC noted that no impairment was identified as a result of the annual goodwill impairment test and subsequent review for any impairment indicators. Following the full impairment of GB&M goodwill in 2016, the 1 July 2017 test indicated that none of the cash-generating units are considered sensitive to reasonably possible changes to key assumptions.
Controls	The AC considered control matters including IT access controls, model governance and hedge accounting.
Expected impact of IFRS 9	The AC considered the progress of the project to implement IFRS 9 and the key judgements related to its implementation, including the expected impacts disclosed.
Restatement of the 2016 results	The AC considered the need to restate the 2016 numbers in the 2017 Interim Report for the identification of a macro cash flow hedge not having met the hedge accounting criteria of IAS 39 during the half-year to 30 June 2016. Profit before tax was restated to reflect a gain of £134m that should have been transferred from the cash flow hedge reserve to the income statement during the half-year to 30 June 2016.
Ring-Fenced Bank ('RFB')	The AC considered the accounting in relation to the creation of the RFB and the associated judgements.

Risk Committee

The Risk Committee is accountable to the Board and has non-executive responsibility for oversight of and advice to the Board on high-level risk related matters and risk governance.

The Committee meets regularly with the bank's senior financial, risk, internal audit and compliance management and the external auditor to consider, among other matters, risk reports and internal audit reports and the effectiveness of compliance.

The current members are: James Coyle (Chairman); Denise Holt; Thierry Moulonguet; Dr Eric Strutz; and John Trueman.

In addition to the Risk Committee there is the Risk Sub-Committee for Global Banking and Markets ('GB&M)' Risk Oversight.

The objective of the Risk Sub-Committee is to provide non-executive oversight and review of material European and United Kingdom risk matters relating to GB&M and to advise the Risk Committee as appropriate. The Sub-Committee will not act as a substitute for oversight by the Risk Committee but will supplement efforts.

Operations and Technology Committee

The Operations and Technology Committee has responsibility for independent oversight of systems, IT-oriented projects, operations and processes and information security and for reviewing the risks associated with the bank's IT infrastructure, its performance, appropriateness, resilience, recovery and resolution plans, plus the capability of the organisation and its management, and the material risks arising therefrom.

The Committee meets regularly with the bank's senior risk, operations, security and fraud risk and technology audit management to consider, among other matters, internal audit reports and reports on the risks associated with the bank's IT infrastructure and transformation projects, cybersecurity and data management.

The current members are: David Lister (Chairman); Mary Marsh; and Thierry Moulonguet.

Chairman's Nominations and Remuneration Committee

The Chairman's Nominations and Remuneration Committee has responsibility for: (i) leading the process for Board appointments and for identifying and nominating, for the approval of the Board, candidates for appointment to the Board; (ii) the endorsement of the appointment of the chairman and any director to the Board of certain subsidiaries of the bank; and (iii) reviewing the implementation and appropriateness of the Group's remuneration policy and the remuneration of the bank's senior executives.

The current members are: Jonathan Symonds (Chairman); James Coyle; David Lister; Thierry Moulonguet; John Trueman; and Eric Strutz.

Executive Committee

The Executive Committee meets regularly and operates as a general management committee under the direct authority of the Board, exercising all of the powers, authorities and discretions of the Board in so far as they concern the management and day-to-day running of the bank, in accordance with such policies and directions as the Board may from time to time determine. The bank's Chief Executive Officer, Antonio Simoes, chairs the Committee.

Regular Risk Management Meetings of the Executive Committee, chaired by the Chief Risk Officer, Europe, are held to establish, maintain and periodically review the policy and guidelines for the management of risk within the bank.

The following committees are sub-committees of the Executive Committee:

- International Executive Committee;
- International Risk Management Meeting;
- HSBC UK Executive Committee; and
- HSBC UK Risk Management Meeting.

The International Executive Committee is responsible for monitoring and, where appropriate, implementing and driving execution of the group's strategy as it pertains to the portion of the group's operations designated as International.

The International Risk Management Committee is responsible for the oversight and management of all risks impacting the group's operations designated as International.

The HSBC UK Executive Committee is responsible for the oversight of HSBC's UK operations.

The HSBC UK Risk Management Meeting is responsible for the oversight and management of all risks impacting HSBC's UK operations.

The oversight provided by the UK Executive Committee and the UK Risk Management Meeting acts as a proxy for the Ring Fenced Bank activities. The Board of the Ring Fenced Bank will formally constitute an Executive Committee and a Risk Management Meeting in the first half of 2018, which will assume the activities of these two group sub committees.

Dividends

Information about dividends is provided on page 13 of the Strategic Report.

Internal control

The Board is responsible for maintaining and reviewing the effectiveness of risk management and internal control systems and for determining the aggregate level and types of risks the bank is willing to take in achieving its strategic objectives.

The bank has procedures in place designed to safeguard assets against unauthorised use or disposal, maintain proper accounting records and ensure the reliability and usefulness of financial information whether used within the business or for publication.

These procedures can only provide reasonable assurance against material mis-statement, errors, losses or fraud. They are designed to provide effective internal control within the bank. The procedures have been in place throughout the year and up to 20 February 2018, the date of approval of the *Annual Report and Accounts 2017.*

In the case of companies acquired during the year, the risk management and internal controls in place are being reviewed against HSBC's benchmarks and integrated into HSBC's processes.

Key risk management and internal control procedures include the following:

- The Group's Global Standards Manual ('GSM'). The GSM outlines the core principles within which all member of the Group must operate wherever business is conducted. The GSM overlays all other policies and procedures throughout the Group. The requirements of the GSM are mandatory, apply to and must be observed by all businesses within the Group, regardless of the nature or location of their activities.
- Delegation of authority within limits set by the Board. Authority to manage the day to day running of the bank is delegated within limits set by the Board to the Chief Executive who has responsibility for overseeing the establishment and maintenance of systems of control appropriate to the business and who has the authority to delegate such duties and responsibilities as he sees fit. Appointments to the most senior positions within the group require the approval of the Board of Directors of HSBC Holdings plc.
- Risk identification and monitoring. Systems and procedures are in place to identify, control and report on the material risk types facing the group.
- Changes in market conditions/practices. Processes are in place to identify new risks arising from changes in market conditions/

practices or customer behaviours, which could expose the group to heightened risk of loss or reputational damage. The group employs a top and emerging risks framework at all levels of the organisation, which enables it to identify current and forward-looking risks and to take action which either prevents them materialising or limits their impact.

- Responsibility for risk management. All employees are responsible for identifying and managing risk within the scope of their role as part of the three lines of defence model, which is an activity-based model to delineate management accountabilities and responsibilities for risk management and the control environment. The second line of defence sets the policy and guidelines for managing specific areas, provides advice and guidance in relation to the risk, and challenges the first line of defence (the risk owners) on effective risk management.
- Strategic plans. Strategic plans are prepared for global businesses, global functions and geographical regions within the framework of the Group's overall strategy. The bank also prepares and adopts an Annual Operating Plan, which is informed by detailed analysis of risk appetite, describing the types and quantum of risk that the bank is prepared to take in executing its strategy and sets out the key business initiatives and the likely financial effects of those initiatives.
- IT operations. Centralised control is exercised over all IT developments and operations. Common systems are employed for similar business processes wherever practicable.

The key risk management and internal control procedures over financial reporting include the following:

- Disclosure Committee. The Disclosure Committee reviews financial reporting disclosures made by the bank for any material errors, misstatements or omissions. The integrity of disclosures is underpinned by structures and processes within the group's Finance and Risk functions that support rigorous analytical review of financial reporting and the maintenance of proper accounting records.
- Financial reporting. The bank's financial reporting process for preparing the consolidated *Annual Report and Accounts 2017* is controlled using documented accounting policies and reporting formats, supported by detailed instructions and guidance on reporting requirements, issued by Global Finance to the bank and all reporting entities within the group in advance of each reporting period end. The submission of financial information from each reporting entity is subject to certification by the responsible financial officer, and analytical review procedures at reporting entity and group levels.
- Subsidiary certifications. Half yearly confirmations are provided to the Audit Committee and the Risk Committee from audit and risk committees of principal subsidiary companies regarding whether the financial statements have been prepared in accordance with Group policies, present fairly the state of affairs of the relevant principal subsidiary and are prepared on a going concern basis.

During the year, the Risk Committee and the Audit Committee have kept under review the effectiveness of this system of internal control and have reported regularly to the Board. In carrying out their reviews, the Audit Committee and Risk Committee receive regular business and operational risk assessments; regular reports from the heads of key risk functions, which cover all internal controls, both financial and non-financial; internal audit reports; external audit reports; prudential reviews; and regulatory reports.

The Risk Committee monitors the status of principal risks and considers whether the mitigating actions put in place are appropriate. In addition, when unexpected losses have arisen or when incidents have occurred which indicate gaps in the control framework or in adherence to Group policies, the Risk Committee and the Audit Committee review special reports, prepared at the instigation of management, which analyse the cause of the issue, the lessons learned and the actions proposed by management to address the issue.

Employees

Health and safety

The Group is committed to providing a healthy and safe working environment for our employees, contractors, customers and visitors on HSBC premises and where impacted by our operations. We aim to be compliant with all applicable health and safety legal requirements, and to ensure that best practice health and safety management standards are implemented and maintained across the HSBC Group.

Everyone at HSBC has a responsibility for helping to create a healthy and safe working environment. Employees are expected to take ownership of their safety and are encouraged and empowered to report any concerns.

Chief Operating Officers have overall responsibility for ensuring that the correct policies, procedures and safeguards are put into practice. This includes making sure that everyone in HSBC has access to appropriate information, instruction, training and supervision.

Putting our commitment into practice, in 2017 the Group delivered a health and safety education and information training programme to every one of our employees, and the Group implemented a range of programmes to help us understand the risks we face and improve the buildings in which we operate:

- We completed fire risk assessments in over 2,000 properties worldwide, and addressed areas of concern.
- We completed a health and safety inspection and remediation programme in 97% of our premises across the globe.
- The application of our health and safety policies and procedures continue to be integrated throughout our supply chain, particularly in developing markets, with audit and inspection programmes demonstrating continued improvements in health and safety performance.
- We developed and implemented an improved risk assurance and oversight function to ensure our health and safety management system was performing appropriately, including conducting full reviews of health and safety management in 12 countries.

Employee health and safety

	Footnotes	2017	2016	2015
Number of workplace fatalities	1	2	1	0
Number of major injuries to employees	2	31	44	n/a
All injury rate per 100,000 employees		205	246	n/a

1 *Customer death on branch premises; contractor involved in road traffic accident on bank business.*
2 *Fractures, dislocation, concussion.*
n/a *Comparable data not available at global level for 2015 following change in reporting procedure for 2016.*

Diversity and inclusion

HSBC is committed to a thriving organisational culture where individuals are valued, respected and supported; where different ideas, backgrounds, styles and perspectives are actively sought out to create business value; and where career advancement is based on objective criteria. We are focusing on the diversity profile of our workforce to make it more reflective of the communities in which we operate and the customers we serve.

Building a more inclusive workplace is part of everyone's role at HSBC. Our Global Diversity and Inclusion Policy is clear that all employees and workers are responsible for treating colleagues with dignity and respect, and for creating an inclusive environment free from discrimination, bullying, harassment or victimisation, irrespective of their age, colour, disability, ethnic or national origin, gender, gender expression, gender identity, marital status, pregnancy, race, religion or belief, or sexual orientation. Our employees are expected to demonstrate openness by listening and valuing different backgrounds, perspectives and cultures, and their performance in this respect is reviewed in our year-end review process.

Diversity and inclusion is governed by our Group People Committee and carries the highest level of executive support at HSBC, and oversight of our diversity agenda and related activities resides with the Global Diversity and Inclusion sub-function.

Key achievements:

- HSBC awarded Company of the Year at the European Diversity Awards.
- HSBC listed as a top employer in the Times Top 50 Employers for Women, which acknowledges our UK focus on improving gender balance in senior leadership.
- HSBC named in the UK Top 100 Stonewall Workplace Equality Index.
- HSBC named by Business in the Community ('BITC') as one of the UK's Best Employers for Race.

In 2017, France has established its own Diversity Committee to keep driving its actions regarding diversity and inclusion. Aiming at helping women to get access to more senior roles, France continued to raise managers' awareness of diversity and unconscious bias via dedicated workshops and to support womens' development using mentoring and individual and collective coaching focusing on acquiring the tools to manage their career and progress to senior roles.

France has also taken actions to create a more inclusive environment for disabled people, for example HOST are ensuring disabilities are accommodated through assisted technologies.

2017 was also marked by the creation of Pride in Malta, providing support to the Lesbian, Gay, Bisexual and Transgender population and their allies; the purpose of this employee resource group is to raise awareness of the challenges they face in the workplace and promote our culture of inclusion.

Germany successfully launched the women network 'HSBC.Frauen.Dialog'. The network aims to help women broaden their network within the bank and share professional insights. Typical activities include speeches by senior women, Blind date lunches, Quarterly Newsletter as well as Senior Events. Germany also continued to run Career Panels for women in HSS & GB&M to encourage exchange with senior managers and seizing career advancing opportunities. Additionally, a local Mentoring programme was launched by co-creation of HR and representatives from the Business. To date 145 senior leaders offered their guidance for junior colleagues

Diverse representation in Europe

Internally, our focus on improving gender balance in senior leadership across Europe is on going.

Female representation by management level:

- All grades: 54%
- Clerical grades: 71%
- Junior management: 58%
- Management: 40%
- Senior management: 25%
- Executive management: 13%

Improving youth employment

HSBC apprenticeship programmes provide access to opportunity for a wide range of new starters and existing employees.HSBC was the first major bank to launch an apprenticeship programme in 2011; since then more than 2500 employees have enrolled in the UK Of our current participants 59% are female, and this year a high-performer has progressed from the apprenticeship programme to the graduate programme.This type of progression is now being actively encouraged and facilitated by a new, more connected Emerging Talent strategy.

For 14 to 19-year-old individuals, the bank offered just over 300 work experience programmes in 2017 in the UK. We also had 239 school leaver apprentices on programme, with 50 new joiners starting on Apprenticeship Levy standards to date. The opportunities are spread across our branch network, contact centres, First Direct and M&S Bank. We made 80 internship placements available to university students and 123 graduates joined the graduate programmes in our Commercial and RBWM business areas.The global graduate intake of over 500 came together for the Global Graduate Discovery induction in London.

HSBC has continued to run its successful traineeship programme with The Prince's Trust, providing training and employment opportunities for young people not in education, employment or training. This is the flagship programme representing our commitment to Movement To Work, a nationwide programme to encourage the country's largest employers to provide training or work opportunities to young people. A further 170 participants benefited from our programme this year.

Our Emerging Talent programmes received external recognition in 2017, with Global Graduate Induction receiving an award from the Institute of Student Employers and *The Times* naming HSBC as the Graduate Employer of Choice in the Finance sector.

Employment of people with a disability

We believe in providing equal opportunities for all employees. The employment of people with a disability is included in this commitment and recruitment, training, and career development are based on the aptitudes and abilities of the individual. Should employees become disabled during their employment with us, efforts are made to continue their employment and to provide workplace adjustments.

A number of countries have dedicated teams to ensure that barriers to work are removed for colleagues. In the UK we are a Disability Confident employer and our disability work is led by our Business Disability Steering Group and sponsored at an executive level by the COO. The group is formed of relevant business areas including recruitment, IT, corporate real estate and the employee voice is represented by the chairs of Ability, our employee resource group for disability, carers and mental health.

Learning and talent development

The development of our people is essential to the future strength of our business. We continue to develop and implement practices that build employee capability and identify, develop and deploy talented employees to ensure an appropriate supply of high calibre individuals with the right values, skills and experience for current and future senior management positions. In 2017 classroom and virtual classroom training has been delivered to over 86,000 people within the group.

In 2017, we launched HSBC University providing employees world class world class leadership and professional programmes, excellent learner experiences and an opportunity for leaders and people managers to connect and learn together and from each other. The introduction of new University Flagship programmes focus on developing management and leadership skills, complemented by tailored business learning to help employees excel in their role. New Flagship programmes launched in 2017 include Team Management Essentials, which helps employees build a high-functioning team by encouraging specific behaviours critical to effective team management; Leadership Essentials, enabling participants to better understand their own leadership strengths and then build the critical capabilities required to effectively lead; and Innovation in the Digital Age designed to help HSBC leaders hone their awareness, skills and ways of working needed to lead in the Digital Age. Over 2,700 employees across Europe attended a Flagship programme in 2017 and all courses continue to receive positive feedback.

HSBC is embracing the Apprenticeship Levy as a means of developing and up-skilling employees at all employment levels. The first learners are already enrolled and benefiting from this exciting new initiative.

Employee relations

We consult with and, where appropriate, negotiate with employee representative bodies. It is our policy to maintain well developed communications and consultation programmes with all employee

representative bodies and there have been no material disruptions to our operations from labour disputes during the past five years.

Auditor

PricewaterhouseCoopers LLP ('PwC') is external auditor to the bank. PwC has expressed its willingness to continue in office and the Board recommends that PwC be re-appointed as the bank's auditor. A resolution proposing the re-appointment of PwC as the bank's auditor and giving authority to the Audit Committee to determine its remuneration will be submitted to the forthcoming AGM.

Conflicts of interest and indemnification of Directors

The bank's Articles of Association give the Board authority to approve Directors' conflicts and potential conflicts of interest. The Board has adopted a policy and procedures for the approval of Directors' conflicts or potential conflicts of interest. The Board's powers to authorise conflicts are operating effectively and the procedures are being followed. A review of situational conflicts which have been authorised, including the terms of authorisation, is undertaken by the Board annually.

The Articles of Association provide that Directors are entitled to be indemnified out of the assets of the company against claims from third parties in respect of certain liabilities arising in connection with the performance of their functions, in accordance with the provisions of the UK Companies Act 2006. Such indemnity provisions have been in place during the financial year but have not been utilised by the Directors. All Directors have the benefit of directors' and officers' liability insurance.

Statement on going concern

The Directors consider it appropriate to prepare the financial statements on the going concern basis. In making their going concern assessment, the Directors have considered a wide range of detailed information relating to present and potential conditions, including profitability, cash flows, capital requirements and capital resources.

Further information relevant to the assessment is provided in the Strategic Report and the Report of the Directors, in particular:

- A description of the group's strategic direction;
- A summary of the group's financial performance and a review of performance by business;
- The group's approach to capital management and its capital position; and
- The top and emerging risks facing the group, as appraised by the Directors, along with details of the group's approach to mitigating those risks and it's approach to risk management in general.

In addition, the objectives, policies and processes for managing credit, liquidity and market risk are set out in the 'Report of the Directors: Risk'.

Disclosure of Information to the Auditor and Statement of Directors' Responsibilities

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the bank's auditors are unaware; and each Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

The Directors are responsible for preparing the *Annual Report and Accounts 2017*, comprising the consolidated financial statements of HSBC Bank plc and its subsidiaries (the 'group') and parent company financial statements for HSBC Bank plc (the 'bank') in accordance with applicable laws and regulations.

Company law requires the Directors to prepare a Strategic Report, a Report of the Directors and group and parent company ('Company') financial statements for each financial year. The Directors are required to prepare the group financial statements in accordance with IFRSs as adopted by the European Union and have elected to prepare the bank's financial statements on the same basis.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and Company and of their profit or loss for that period. In preparing each of these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the European Union; and
- prepare the financial statements on a going concern basis unless it is not appropriate. Since the Directors are satisfied that the group has the resources to continue in business for the foreseeable future, the financial statements continue to be prepared on a going concern basis.

The Directors have responsibility for ensuring that sufficient accounting records are kept that disclose with reasonable accuracy at any time the financial position of the bank and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for safeguarding the assets of the Company and the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors have responsibility for the maintenance and integrity of the *Annual Report and Accounts 2017* as they appear on the bank's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors, the names of whom are set out in the 'Report of Directors: Governance' section on pages 59 and 60 of the *Annual Report and Accounts 2017*, confirm to the best of their knowledge:

- in accordance with rule 4.1.12(3)(a) of the Disclosure Rules and Transparency Rules, the consolidated financial statements, which have been prepared in accordance with IFRSs as issued by the IASB and as endorsed by the European Union, have been prepared in accordance with the applicable set of accounting standards and give a true and fair view of the assets, liabilities, financial position and profit or loss of the bank and the undertakings included in the consolidation taken as a whole; and
- the management report represented by the Strategic Report and the Report of the Directors has been prepared in accordance with rule 4.1.12(3)(b) of the Disclosure Rules and Transparency Rules, and includes a fair review of the development and performance of the business and the position of the bank and the undertakings included in the consolidation as a whole, together with a description of the principal risks and uncertainties that the group faces.

On behalf of the Board

Loren Wulfsohn

Company Secretary

20 February 2018

Registered number 14259

Independent auditors' report to the member of HSBC Bank plc

Report on the audit of the financial statements

Opinion

In our opinion, HSBC Bank plc's group financial statements and parent company financial statements (the 'financial statements'):

- give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2017 and of the group's profit and the group's and the parent company's cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report and Accounts (the 'Annual Report'), which comprise:

- the consolidated and HSBC Bank plc balance sheets as at 31 December 2017;
- the consolidated income statement and consolidated statement of comprehensive income;
- the consolidated and HSBC Bank plc statements of cash flows;
- the consolidated and HSBC Bank plc statements of changes in equity for the year then ended; and
- the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)') and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company.

Other than those disclosed in Note 5 to the financial statements, we have provided no non-audit services to the group or the parent company in the period from 1 January 2017 to 31 December 2017.

Our audit approach

Overview

- Overall group materiality: £183 million (2016: £159 million), based on 5% of adjusted profit before tax.
- Overall parent company materiality: £183 million (2016: £159 million), group materiality was applied.
- HSBC Bank plc is a member of the HSBC Group, the ultimate parent company of which is HSBC Holdings plc. HSBC Bank plc operates in 18 countries.
- We performed audits of the complete financial information of the UK Operations of the Bank and HSBC France components.
- For five further reporting units, specific audit procedures were performed over selected significant account balances.

The following areas were identified as key audit matters. These are discussed in further detail in the Appendix:

- IT access management
- Impairment of loans and advances
- Application of hedge accounting
- Litigation and regulatory enforcement actions
- Valuation of financial instruments
- Customer redress - Payment Protection Insurance ('PPI')
- IFRS 9 Expected Credit Loss – IAS 8 disclosure

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We gained an understanding of the legal and regulatory framework applicable to the group and the industry in which it operates, and considered the risk of acts by the group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at group level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

We focused on laws and regulations that could give rise to a material misstatement in the financial statements, including but not limited to the Companies Act 2006, the Financial Conduct Authority's regulations, the Prudential Regulation Authority's regulations, UK Listing Rules, the UK tax legislation and equivalent local laws and regulations applicable to significant component teams. Our tests included

review of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the regulators, review of correspondence with legal advisors, enquiries of management, enquiries of legal counsel, review of significant component auditors' work and review of internal audit reports in so far as they related to the financial statements.

There are inherent limitations in the audit procedures described above and the further removed non-compliance is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

As in all of our audits, we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit. The key audit matters are discussed further in the Appendix.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the group and the parent company, the accounting processes and controls, and the industry in which they operate.

HSBC Bank plc is structured into four divisions being Retail Banking and Wealth Management, Commercial Banking, Global Banking & Markets and Global Private Banking. The divisions operate across a number of operations, subsidiary entities and branches throughout Europe. Within the group's main consolidation and financial reporting system, the consolidated financial statements are an aggregation of the operations, subsidiary entities and branches ('reporting units'). Each reporting unit submits their financial information to the group in the form of a consolidation pack.

In establishing the overall approach to the group and parent company audit, we scoped using the balances included in the consolidation pack. We determined the type of work that needed to be performed over the reporting units by us, as the group engagement team, or auditors within PwC UK and from other PwC network firms operating under our instruction ('component auditors').

As a result of our scoping, for the parent company we determined that an audit of the complete financial information of the UK Operations of the Bank was necessary, owing to its financial significance. For group purposes, we additionally performed an audit of the complete financial information of HSBC France. We instructed component auditors, PwC UK and PwC France, to perform the audits of these components. Our interactions with component auditors included regular communication throughout the audit, including visits to France, the issuance of instructions, a review of working papers relating to the key audit matters and formal clearance meetings. The group audit engagement partner was also the partner on the audit of the UK Operations significant component.

We then considered the significance of other reporting units in relation to primary statement account balances. In doing this we also considered the presence of any significant audit risks and other qualitative factors (including history of misstatements through fraud or error). For five further reporting units, specific audit procedures were performed over selected significant account balances. For the remainder, the risk of material misstatement was mitigated through group audit procedures including testing of entity level controls and group and parent company level analytical review procedures.

Certain group-level account balances (including goodwill) were audited by the group engagement team.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent company financial statements
Overall materiality	£183 million (2016: £159 million).	£183 million (2016: £159 million).
How we determined it	5% of adjusted profit before tax.	We applied the group materiality
Rationale for benchmark applied	Adjusted profit before tax excluding the debit valuation adjustment and non-qualifying hedges is used as a benchmark as this reflects the group's underlying performance. The debit valuation adjustment and non-qualifying hedges have been excluded as they are recurring items that form part of ongoing business performance.	Materiality was determined as the lower of group materiality or the parent company's profit before tax adjusted on the same basis as for the group financial statements. The group materiality was lower.

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was £58m to £155m. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £9 million (group audit and parent company audit) (2016: £10 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the group's and parent company's ability to continue to adopt the going concern basis of accounting for a period of at least 12 months from the date when the financial statements are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's and parent company's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Report of the Directors, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic Report and Report of the Directors

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Report of the Directors for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the group and parent company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Report of the Directors.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on page 65, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the parent company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the parent company financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the directors on 31 March 2015 to audit the financial statements for the year ended 31 December 2015 and subsequent financial periods. The period of total uninterrupted engagement is three years, covering the years ended 31 December 2015 to 31 December 2017.

Simon Hunt *(Senior Statutory Auditor)*

for and on behalf of **PricewaterhouseCoopers LLP**

Chartered Accountants and Statutory Auditors

London

20 February 2018

Appendix: Key audit matters discussed with the Audit Committee ('AC')

The key audit matters are discussed below together with an explanation of how the audit was tailored to address these specific areas. All key audit matters are applicable to both the group and parent company.

IT Access Management

Nature of key audit matter	Matters discussed with the Audit Committee
All banks are highly dependent on technology due to the significant number of transactions that are processed daily. The audit approach relies extensively on automated controls and therefore on the effectiveness of controls over IT systems. It was identified that the entity's controls over individuals' access rights to operating systems, applications, and data used in the financial reporting process required improvement. Access rights are important as they ensure that changes to applications and data are authorised and made in an appropriate manner. Ensuring staff only have appropriate access, and that the access is monitored, are key controls to mitigate the potential for fraud or error as a result of a change to an application or underlying data. The results of our work show an improvement of controls over infrastructure privileged access for systems relevant to our audit. By the end of the audit period, a number of controls had been implemented and operated effectively in the latter part of the year to address the critical operating system and database related matters previously reported. Management continue to progress the remaining issues including several relating to the management of business application access.	The status on remediation of access controls was discussed at several Audit Committee meetings during the year. Controls were enhanced and implemented over FY17 to respond to our audit findings and to reduce the risks over privileged access to IT infrastructure such as databases and operating systems. However, given the scale and complexity of the remediation, there were still actions to be taken during the year to ensure that controls are fully embedded and operate effectively. By the end of the audit period, management had successfully operated controls to address the critical operating system and database related matters previously reported. Management continue to progress remediation relating to the management of business application access.

Procedures performed to support our discussions and conclusions

Access rights were tested over applications, operating systems and databases relied upon for financial reporting. Specifically, the audit tested that:

- new access requests for joiners were properly reviewed and authorised;
- user access rights were removed on a timely basis when an individual left or moved role;
- access rights to applications, operating systems and databases were periodically monitored for appropriateness; and
- highly privileged access is restricted to appropriate personnel.

Other areas that were independently assessed included password policies, security configurations, controls over changes to applications and databases and that business users, developers and production support did not have access to change applications, the operating system or databases in the production environment.

As a consequence of deficiencies identified, a range of other procedures were performed:

- where inappropriate access was identified, we understood the nature of the access and obtained additional evidence on the appropriateness of the activities performed;
- additional substantive testing was performed on specific year-end reconciliations (i.e. custodian, bank account and suspense account reconciliations) and confirmations with external counterparties;
- testing was performed on other compensating controls such as business performance reviews;
- testing was performed over toxic combination controls; and
- a list of users' access permissions was obtained and manually compared to other access lists where segregation of duties was deemed to be of higher risk.

Relevant references in the Annual Report and Accounts 2017

AC Report, page 60.
Effectiveness of internal controls, page 61.

Impairment of loans and advances

Nature of key audit matter	Matters discussed with the Audit Committee
Impairment allowances represent management's best estimate of the losses incurred within the loan portfolios at the balance sheet date. They are calculated on a collective basis for portfolios of loans of a similar nature and on an individual basis for significant loans. The calculation of both collective and specific impairment allowances is inherently judgemental for any bank. Collective impairment allowances are calculated using models which approximate the impact of current economic and credit conditions on large portfolios of loans. The inputs to these models are based on historical loss experience with judgement applied to determine the assumptions used to calculate impairment. Model overlays are applied where data driven parameters or calculations are not considered representative of current risks or conditions of the loan portfolios. For specific impairments, judgement is required to determine when an impairment event has occurred and then to estimate the expected future cash flows related to that loan. The audit was focused on impairment due to the materiality of the loan balances and associated impairment allowances and the subjective nature of the impairment calculation.	Discussions with the Audit Committee and Risk Committee focussed on the risks that changed or emerged during the year together with the key judgements on the collective allowance models and individually significant loan impairments. A number of specific risks were discussed including: • the changing macroeconomic environment in the UK, as negotiations between the UK and European Union over the UK's withdrawal from the EU continued; • concerns about personal indebtedness particularly in the UK; and • specific sector and industry matters. In each of the cases above, the performance of the existing credit exposure and the potential need for changes to the modelling approach were discussed. Significant changes made to the inputs or models impacting the collective impairment allowance were discussed, noting the results of our controls and substantive testing and the impact on the audit approach. A focus was also on significant post model adjustments and the suitability of changes made to relevant models in the period. Key judgements around significant changes to specific impairments including over the assessment of the the likelihood and timing of the cash flows expected to be received and the valuation of collateral supporting the loan were discussed.

Procedures performed to support our discussions and conclusions

The controls management has established to support their collective and specific impairment calculations were tested.

- For collective impairment, this included controls over the appropriateness of models used to calculate the charge, the process of determining key assumptions and the identification of loans to be included within the calculation.
- For specific impairment charges on individual loans, this included controls over the monitoring of the credit watch list, credit file review processes, approval of external collateral valuation vendors and controls over the approval of significant individual impairments.

Substantive testing procedures were also performed over the loan impairments.

- For collective allowances, the appropriateness of the modelling policy and methodology used for material portfolios was independently assessed by reference to the accounting standards and market practices. Model calculations were tested through reperformance and code review. Specifically with respect to the collective impairment models for the retail portfolios, we examined the enhancements made to the models and methodology to ensure they were appropriate.
- The appropriateness of management's judgements was also independently considered in respect of calculation methodologies, segmentation, economic factors and judgemental overlays, the period of historical loss rates used, loss emergence periods, cure rates for impaired loans, and the valuation of recovery assets and collateral.
- For specific allowances, the appropriateness of provisioning methodologies and policies was independently assessed for a sample of loans across the portfolio selected on the basis of risk. An independent view was formed on the levels of provisions booked based on the detailed loan and counterparty information in the credit file. Calculations within a sample of discounted cash flow models were re-performed.

Relevant references in the Annual Report and Accounts 2017

Impaired loans, page 40-43.
Areas of special interest, page 23.
AC Report, page 60.
Note 1.2 (d): Impairment of loans and advances, page 87.

Application of hedge accounting

Nature of key audit matter	Matters discussed with the Audit Committee
To qualify for hedge accounting, certain criteria must be met including documenting the nature and purpose of the hedge and performing regular testing over its effectiveness. Due to the complex nature of the hedge accounting rules this is often an area of significant risk for banks. In December 2016, management in France identified an issue with an established hedging relationship which resulted in a partial disqualification of the hedge. Due to the errors identified, the HSBC Bank plc 2017 Interim Report was restated. In light of the complexity of the area and the prior year matter noted above, we determined this to be an area of significant audit risk.	We discussed with the Audit Committee the partial disqualification that arose in France in the prior year and the testing performed over remediated controls. We discussed the results of our controls and substantive testing, which found no further hedges that required disqualification and no further significant control findings.

Procedures performed to support our discussions and conclusions

- For significant macro cash flow hedges, documentation was examined and the relationships assessed to determine if the hedges had been appropriately designated. This included consideration of the hedge objectives and specific compliance with IFRS.
- A sample of new hedging relationships was examined and the relationships assessed to determine if they had been appropriately designated. This included consideration of the hedge objectives and specific compliance with IFRS.
- Management's hedge effectiveness reviews, and the measurement and recording of hedge ineffectiveness, were tested for a sample of hedge relationships.
- We gained an understanding of and tested controls over the documentation and review of the hedge relationships and their initial and ongoing effectiveness. This included testing the relevant remediated or newly implemented controls identified in France.

Relevant references in the Annual Report and Accounts 2017

AC Report, page 60.
Note 12: Derivatives, page 114.

Litigation and regulatory enforcement actions

Nature of key audit matter	Matters discussed with the Audit Committee
HSBC, like other global banking institutions, is exposed to a significant number of open legal cases and regulatory investigations in a number of its markets. Given the business is geographically dispersed, the same matter could be subject to investigation in multiple jurisdictions. Provisions have been established to account for probable legal liabilities and regulatory fines. The most significant provisions related to foreign exchange market manipulation albeit these were largely used or released in the year. There are also a number of legal and regulatory matters for which no provision has been established, as discussed on page 132. There is an inherent risk that legal exposures are not identified and considered for financial reporting purposes on a timely basis. Importantly, the decision to recognise a provision and the basis of measurement are judgemental.	Group Legal provided to each Audit Committee meeting an update on the status of significant legal cases. These updates considered whether all related litigation or investigations about a specific matter had been identified. Material matters were discussed during each meeting and the need for changes to provisions considered. We participated in these discussions, including consideration of whether any constructive obligation had arisen in individual cases.

Procedures performed to support our discussions and conclusions

- Controls designed to ensure the completeness and adequacy of current legal and regulatory provisions were tested. Regulatory correspondence from material markets was also read, and a sample of legal expenses were assessed.
- Open legal cases were discussed with Group Legal and in certain instances we obtained and read the relevant regulatory and litigation documents in order to assess the facts and circumstances.
- The range of reasonably possible outcomes was considered for material provisions to independently assess the appropriateness of the judgement made by HSBC.
- The disclosures of legal exposures and provisions were assessed for completeness and accuracy.

Relevant references in the Annual Report and Accounts 2017

AC Report, page 60.
Note 23: Provisions, page 124.
Note 30: Legal proceedings and regulatory matters, page 132.

Valuation of financial instruments

Nature of key audit matter	Matters discussed with the Audit Committee
The financial instruments held by HSBC range from those that are traded daily on active markets with quoted prices, to more complex and bespoke positions. The valuation of these complex financial instruments can require the use of prices or inputs which are not readily observable in the market. Financial instruments classified as Level 3 ('L3'), per the IFRS 13 fair value hierarchy, are valued using some unobservable inputs. There is a risk that certain L3 portfolios are not valued appropriately due to the complexity of the trades and/or unobservability of some inputs. Valuation of the following L3 portfolios was therefore classified as a significant risk for the audit: certain asset backed securities, equity linked structured notes, securitisation swaptions and certain long-dated interest rate derivatives.	We discussed with the Audit Committee the results of our controls testing. This included observations on how controls may be improved, particularly with respect to model governance. We also discussed the results of our substantive testing which included independent revaluation of a range of financial instruments, including a sample of Level 3 positions.

Procedures performed to support our discussions and conclusions

- We evaluated the design and tested the operating effectiveness of the key controls supporting the identification, measurement and oversight of the valuation of financial instruments. We examined the key controls, including the independent price verification process and governance and reporting controls. This included review of the year end IPV results by the HSBC Bank plc Valuation Committee.
- Methodology and underlying assumptions of key valuation adjustments, including the Credit Valuation Adjustment, Debt Valuation Adjustment and Funding Fair Value Adjustment, were assessed, and compared with our knowledge of current industry practice. Controls over the calculation of these adjustments were also tested.
- We utilised internal valuation specialists to perform independent valuations to determine if management's valuations fell within a reasonable range. The revaluation covered a range of product classes and was performed across level 1, 2 & 3 of the Group's IFRS 13 fair value hierarchy. This testing specifically included a sample of Level 3 positions as at the balance sheet date. Where revaluation was not possible, alternative testing procedures were performed.

Relevant references in the Annual Report and Accounts 2017

AC Report, page 60.
Note 9: Fair values of financial instruments carried at fair value, page 104.

Customer Redress – Payment Protection Insurance ('PPI')

Nature of key audit matter	Matters discussed with the Audit Committee
In March 2017 the FCA issued Policy Statement 17/3 (PS17/3) concluding its PPI complaint consultation process. PS17/3 set out a number of key requirements and determinations; • Finalisation of the time bar being 29 August 2019; and • Details and timings on an FCA-led consumer communications campaign designed to inform consumers of the time bar The provision for customer redress in respect of PPI incorporates assumptions regarding expected complaint volumes. The statements made in the policy statement will impact complaint volumes and therefore the provision set aside for customer redress. The assumptions made with respect to the expected volume of future customer complaints are highly judgemental.	We discussed with the Audit Committee the impact that the release of the policy statement, and specifically the announcements of the time bar and FCA media campaigns, could have on claim volumes and therefore the provision held. The impact of the first media campaign was then discussed including changes to key modelling assumptions given the actual data observed during this campaign. We discussed the results of our controls and substantive testing. We also discussed the key assumptions made, including their sensitivity to reasonably possible alternative assumptions.

Procedures performed to support our discussions and conclusions

- We evaluated the design and tested the operating effectiveness of key controls over the process of capturing key data used in the PPI provision calculation model. We examined the modelling process around the PPI provision calculation. We tested the nature and history of claim volumes and settlement amounts and assessed whether the assumptions underpinning the provision calculations, including future claim volumes and settlement amounts, were appropriate.
- We tested the appropriateness of the provisioning model and underlying assumptions used, in particular how management updated their provisioning model to reflect updated assumptions related to complaint volumes and the updated timebar following the issuance of PS 17/3 and the completion of the first media campaign.
- We considered the sensitivity of the provision to possible variations in those assumptions. This could result in different amounts for some provisions to those calculated, but in our view these differences were within a reasonable range of outcomes in the context of the degree of uncertainty.
- We evaluated whether the disclosures within the financial statements appropriately address the significant uncertainties that exist around determining the provisions and the sensitivity of the provisions to changes in the underlying assumptions and found these to be appropriate.

Relevant references in the Annual Report and Accounts 2017

AC Report, page 60.

IFRS 9 Expected Credit Loss – IAS 8 disclosure

Nature of key audit matter	Matters discussed with the Audit Committee
There is a requirement to disclose the expected impact of adopting IFRS 9. This is a new and complex accounting standard which has required considerable judgement and interpretation in its implementation. These judgements have been key in the development of the new models which have been built and implemented to measure the expected credit losses on loans measured at amortised cost. There is a large increase in the data inputs required by these models. The data is from a number of systems that have not been used previously for the preparation of the accounting records. This increases the risk of completeness and accuracy of the data that has been used to create assumptions and is used to operate the model. In some cases, data is unavailable and reasonable alternatives have been sought to allow calculations to be performed.	Status updates were provided during the year due to the complexity and size of the implementation programme. An assessment and conclusion on the more judgemental interpretations made by management was shared with the Audit Committee. These included the determination of what constitutes a significant increase in credit risk for retail portfolios, the life of retail and wholesale revolving products and the judgements made in applying forward economic guidance to the expected credit loss calculation. We highlighted significant post model adjustments that had been recorded to address challenges in data quality or areas of model weakness. Perspectives were shared on the control environment and quality of data being used for the disclosure of the IAS 8 impact of adopting IFRS 9.

Procedures performed to support our discussions and conclusions

Controls and substantive testing procedures were performed to assess the reasonableness of the disclosed estimated impact of adopting IFRS 9.

- Controls over the selection and approval of the accounting policy were tested. This included our assessment of the technical papers prepared by management with the IFRS 9 requirements.
- Controls over governance and model development were tested. We used our modelling specialists to test the modelling methodology for material portfolios.
- Risk based testing of models, including independent re-build of certain assumptions, was performed.
- Testing was performed of the review controls executed by management to assess the reasonableness of the disclosed impact of adopting IFRS 9.

Relevant references in the Annual Report and Accounts 2017

AC Report, page 60.

Financial Statements

	Page
Consolidated income statement	**76**
Consolidated statement of comprehensive income	**77**
Consolidated balance sheet	**78**
Consolidated statement of cash flows	**79**
Consolidated statement of changes in equity	**80**
HSBC Bank plc balance sheet	**81**
HSBC Bank plc statement of cash flows	**82**
HSBC Bank plc statement of changes in equity	**83**

Notes on the Financial Statements

1	Basis of preparation and significant accounting policies	**84**
2	Insurance business	**93**
3	Operating profit	**94**
4	Employee compensation and benefits	**94**
5	Auditors' remuneration	**100**
6	Tax	**101**
7	Dividends	**103**
8	Trading assets	**103**
9	Fair values of financial instruments carried at fair value	**104**
10	Fair values of financial instruments not carried at fair value	**112**
11	Financial assets designated at fair value	**113**
12	Derivatives	**114**
13	Financial investments	**116**
14	Assets pledged, collateral received and assets transferred	**116**
15	Interests in associates and joint ventures	**117**
16	Investments in subsidiaries	**118**
17	Structured entities	**119**
18	Goodwill and intangible assets	**121**
19	Prepayments, accrued income and other assets	**123**
20	Trading liabilities	**123**
21	Financial liabilities designated at fair value	**123**
22	Accruals, deferred income and other liabilities	**124**
23	Provisions	**124**
24	Subordinated liabilities	**125**
25	Maturity analysis of assets, liabilities and off-balance sheet commitments	**127**
26	Offsetting of financial assets and financial liabilities	**129**
27	Called up share capital and other equity instruments	**130**
28	Contingent liabilities, contractual commitments and guarantees	**131**
29	Lease commitments	**132**
30	Legal proceedings and regulatory matters	**132**
31	Related party transactions	**137**
32	Events after the balance sheet date	**140**
33	HSBC Bank plc's subsidiaries, joint ventures, joint operations and associates	**140**

Consolidated income statement

for the year ended 31 December

	Notes	2017 £m	2016 £m
Net interest income		**6,181**	6,769
– interest income		**9,043**	9,322
– interest expense		**(2,862)**	(2,553)
Net fee income		**2,989**	2,945
– fee income		**4,345**	4,062
– fee expense		**(1,356)**	(1,117)
Net trading income		**2,383**	4,299
– trading income excluding net interest income		**1,951**	3,887
– net interest income on trading activities		**432**	412
Net income/(expense) from financial instruments designated at fair value		**1,122**	(1,047)
Gains less losses from financial investments		**262**	530
Dividend income		**10**	8
Net earned insurance premiums	2	**1,809**	1,567
Other operating income		**786**	253
Total operating income		**15,542**	15,324
Net insurance claims incurred and movement in liabilities to policyholders	2	**(2,490)**	(2,019)
Net operating income before loan impairment charges and other credit risk provisions		**13,052**	13,305
Loan impairment charges and other credit risk provisions	3	**(495)**	(416)
Net operating income		**12,557**	12,889
Total operating expenses		**(10,208)**	(12,011)
– employee compensation and benefits	4	**(3,129)**	(3,711)
– general and administrative expenses		**(6,523)**	(5,549)
– depreciation and impairment of property, plant and equipment		**(320)**	(329)
– amortisation and impairment of intangible assets	18	**(236)**	(2,422)
Operating profit	3	**2,349**	878
Share of profit/(loss) in associates and joint ventures	15	**21**	(4)
Profit before tax		**2,370**	874
Tax expense	6	**(528)**	(1,053)
Profit/(loss) for the year		**1,842**	(179)
Profit/(loss) attributable to shareholders of the parent company		**1,809**	(212)
Profit attributable to non-controlling interests		**33**	33

Consolidated statement of comprehensive income

for the year ended 31 December

	2017	2016
	£m	£m
Profit/(loss) for the year	**1,842**	(179)
Other comprehensive income/(expense)		
Items that will be reclassified subsequently to profit or loss when specific conditions are met:		
Available-for-sale investments	**84**	27
– fair value gains	**414**	540
– fair value gains reclassified to the income statement	**(354)**	(526)
– amounts reclassified to the income statement in respect of impairment losses	**26**	20
– income taxes	**(2)**	(7)
Cash flow hedges	**(125)**	46
– fair value losses	**(133)**	(166)
– fair value (gains)/losses reclassified to the income statement	**(26)**	214
– income taxes	**34**	(2)
Exchange differences and other	**380**	2,156
Items that will not be reclassified subsequently to profit or loss:		
Actuarial gains/(losses) on defined benefit plans	**1,797**	(184)
– before income taxes	**2,393**	(247)
– income taxes	**(596)**	63
Changes in fair value of financial liabilities designated at fair value due to movement in own credit risk	**(164)**	–
– before income taxes	**(185)**	–
– income taxes	**21**	–
Other comprehensive income for the year, net of tax	**1,972**	2,045
Total comprehensive income for the year	**3,814**	1,866
Attributable to:		
– shareholders of the parent company	**3,772**	1,755
– non-controlling interests	**42**	111
Total comprehensive income for the year	**3,814**	1,866

Consolidated balance sheet

at 31 December

	Notes	2017 £m	2016 £m
Assets			
Cash and balances at central banks		**97,601**	54,278
Items in the course of collection from other banks		**2,023**	1,363
Trading assets	*8*	**145,725**	125,069
Financial assets designated at fair value	*11*	**9,266**	8,345
Derivatives	*12*	**143,335**	199,419
Loans and advances to banks		**14,149**	21,363
Loans and advances to customers		**280,402**	272,760
Reverse repurchase agreements – non-trading		**45,808**	31,660
Financial investments	*13*	**58,000**	83,135
Prepayments, accrued income and other assets	*19*	**16,026**	13,215
Current tax assets		**140**	114
Interests in associates and joint ventures	*15*	**327**	266
Goodwill and intangible assets	*18*	**5,936**	5,735
Deferred tax assets	*6*	**130**	107
Total assets at 31 Dec		**818,868**	816,829
Liabilities and equity			
Liabilities			
Deposits by banks		**29,349**	23,682
Customer accounts		**381,546**	375,252
Repurchase agreements – non-trading		**37,775**	19,709
Items in the course of transmission to other banks		**1,089**	657
Trading liabilities	*20*	**106,496**	93,934
Financial liabilities designated at fair value	*21*	**18,249**	18,486
Derivatives	*12*	**140,070**	190,092
Debt securities in issue		**13,286**	16,140
Accruals, deferred income and other liabilities	*22*	**6,615**	6,792
Current tax liabilities		**88**	400
Liabilities under insurance contracts	*2*	**21,033**	19,724
Provisions	*23*	**1,796**	2,431
Deferred tax liabilities	*6*	**933**	484
Subordinated liabilities	*24*	**16,494**	8,421
Total liabilities at 31 Dec		**774,819**	776,204
Equity			
Total shareholders' equity		**43,462**	39,930
– called up share capital	*27*	**797**	797
– share premium account		**—**	20,733
– other equity instruments	*27*	**3,781**	3,781
– other reserves		**2,744**	1,882
– retained earnings		**36,140**	12,737
Non-controlling interests		**587**	695
Total equity at 31 Dec		**44,049**	40,625
Total liabilities and equity at 31 Dec		**818,868**	816,829

The accompanying notes on pages 84 to 143 and the audited sections of the 'Strategic Report: Financial summary' on pages 9 to 16 and the 'Report of the Directors' on pages 20 to 64 form an integral part of these financial statements.

The financial statements on pages 76 to 83 were approved by the Board of Directors on 20 February 2018 and signed on its behalf by:

A P S Simoes
Director

Consolidated statement of cash flows

for the year ended 31 December

	2017	2016
	£m	£m
Profit before tax	**2,370**	874
Adjustments for non-cash items		
Depreciation, amortisation and impairment	**556**	2,751
Net gain from investing activities	**(314)**	(534)
Share of profits in associates and joint ventures	**(21)**	4
(Gain) on disposal of subsidiaries, businesses, associates and joint ventures	**(61)**	—
Loan impairment losses gross of recoveries and other credit risk provisions	**877**	676
Provisions including pensions	**170**	717
Share-based payment expense	**114**	124
Other non-cash items included in profit before tax	**(130)**	(77)
Elimination of exchange differences[1]	**67**	(12,524)
Changes in operating assets and liabilities	**11,458**	24,859
- change in net trading securities and derivatives	**(1,828)**	6,402
- change in loans and advances to banks and customers	**(5,605)**	(14,240)
- change in reverse repurchase agreements – non-trading	**(9,792)**	(1,435)
- change in financial assets designated at fair value	**(921)**	(1,516)
- change in other assets	**(415)**	(980)
- change in deposits by banks and customer accounts	**15,381**	41,902
- change in repurchase agreements – non-trading	**18,065**	2,709
- change in debt securities in issue	**(2,854)**	(9,929)
- change in financial liabilities designated at fair value	**(400)**	(515)
- change in other liabilities	**968**	3,448
- contributions paid to defined benefit plans	**(233)**	(233)
- tax paid	**(908)**	(754)
Net cash from operating activities	**15,086**	16,870
Net cash from investing activities	**22,694**	(2,357)
- purchase of financial investments	**(16,573)**	(32,942)
- proceeds from the sale and maturity of financial investments	**39,990**	31,312
- net cash flows from the purchase and sale of property, plant and equipment	**(304)**	(425)
- net investment in intangible assets	**(357)**	(264)
- net cash outflow from acquisition of businesses and subsidiaries	**(43)**	(44)
- net cash flow on disposal of subsidiaries, business, associates and joint ventures	**(19)**	6
Net cash from financing activities	**9,027**	(764)
- issue of ordinary share capital and other equity instruments	**—**	197
- subordinated loan capital issued[2]	**10,092**	1,055
- subordinated loan capital repaid[2]	**(1,251)**	(2,461)
- dividends paid to shareholders of the parent company	**(873)**	(804)
- funds received from the shareholder of the parent company	**1,081**	1,229
- net cash inflow from change in stake of subsidiaries	**—**	40
- dividends paid to non-controlling interests	**(22)**	(20)
Net increase in cash and cash equivalents	**46,807**	13,749
Cash and cash equivalents at 1 Jan	**82,037**	62,995
Exchange difference in respect of cash and cash equivalents	**893**	5,293
Cash and cash equivalents at 31 Dec	**129,737**	82,037
Cash and cash equivalents comprise of:[3]		
- cash and balances at central banks	**97,601**	54,278
- items in the course of collection from other banks	**2,023**	1,363
- loans and advances to banks of one month or less	**5,381**	18,105
- reverse repurchase agreement with banks of one month or less	**11,528**	6,933
- treasury bills, other bills and certificates of deposit less than three months	**14,293**	2,015
- less: items in the course of transmission to other banks	**(1,089)**	(657)
	129,737	82,037

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.*
2 *Subordinated liabilities changes during the year are attributable to cash flows from issuance (£10,092m, (2016: £1,055m)) and repayment (£(1,251)m (2016: £(2,461)m)) of securities as presented in the Consolidated statement of cash flows. Non-cash changes during the year included foreign exchanges losses ((£463)m (2016: £1,342m)) and fair value gains (£94m (2016: £(54)m loss)).*
3 *At 31 December 2017, £4,159m (2016: £2,471m) was not available for use by the group, of which £1,585m (2016: £1,673m) related to mandatory deposits at central banks.*

Interest received was £10,172m (2016: £10,002m), interest paid was £2,650m (2016: £2,843m) and dividends received were £1,332m (2016: £85m).

Consolidated statement of changes in equity

for the year ended 31 December

	Called up share capital	Share premium	Other equity instruments	Retained earnings	Available-for-sale fair value reserve	Cash flow hedging reserve	Foreign exchange reserve	Total share-holders' equity	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 Jan 2017	**797**	**20,733**	**3,781**	**12,737**	**1,007**	**89**	**786**	**39,930**	**695**	**40,625**
Profit for the year	**—**	**—**	**—**	**1,809**	**—**	**—**	**—**	**1,809**	**33**	**1,842**
Other comprehensive income (net of tax)	**—**	**—**	**—**	**1,632**	**92**	**(125)**	**364**	**1,963**	**9**	**1,972**
– available-for-sale investments	**—**	**—**	**—**	**—**	**92**	**—**	**—**	**92**	**(8)**	**84**
– cash flow hedges	**—**	**—**	**—**	**—**	**—**	**(125)**	**—**	**(125)**	**—**	**(125)**
– remeasurement of defined benefit asset/liability	**—**	**—**	**—**	**1,796**	**—**	**—**	**—**	**1,796**	**1**	**1,797**
– changes in fair value of financial liabilities designated at fair value due to movement in own credit risk[1]	**—**	**—**	**—**	**(164)**	**—**	**—**	**—**	**(164)**	**—**	**(164)**
– exchange differences and other	**—**	**—**	**—**	**—**	**—**	**—**	**364**	**364**	**16**	**380**
Total comprehensive income for the year	**—**	**—**	**—**	**3,441**	**92**	**(125)**	**364**	**3,772**	**42**	**3,814**
Dividends to shareholders	**—**	**—**	**—**	**(872)**	**—**	**—**	**—**	**(872)**	**(22)**	**(894)**
Distribution in-specie of HSBC Bank A.S.[2]	**—**	**—**	**—**	**(1,174)**	**—**	**(2)**	**533**	**(643)**	**—**	**(643)**
Net impact of equity-settled share-based payments	**—**	**—**	**—**	**(21)**	**—**	**—**	**—**	**(21)**	**—**	**(21)**
Transfer of share premium to retained earnings[3]	**—**	**(20,733)**	**—**	**20,733**	**—**	**—**	**—**	**—**	**—**	**—**
Change in business combinations and other movements[4]	**—**	**—**	**—**	**1,241**	**—**	**—**	**—**	**1,241**	**(128)**	**1,113**
Tax on items taken directly to equity	**—**	**—**	**—**	**55**	**—**	**—**	**—**	**55**	**—**	**55**
At 31 Dec 2017	**797**	**—**	**3,781**	**36,140**	**1,099**	**(38)**	**1,683**	**43,462**	**587**	**44,049**
At 1 Jan 2016	797	20,733	3,584	12,599	979	43	(1,238)	37,497	628	38,125
Profit for the year	—	—	—	(212)	—	—	—	(212)	33	(179)
Other comprehensive income (net of tax)	—	—	—	(183)	30	46	2,074	1,967	78	2,045
– available-for-sale investments	—	—	—	—	30	—	—	30	(3)	27
– cash flow hedges	—	—	—	—	—	46	—	46	—	46
– remeasurement of defined benefit asset/liability	—	—	—	(183)	—	—	—	(183)	(1)	(184)
– exchange differences and other	—	—	—	—	—	—	2,074	2,074	82	2,156
Total comprehensive income for the year	—	—	—	(395)	30	46	2,074	1,755	111	1,866
Capital securities issued[5]	—	—	197	—	—	—	—	197	—	197
Dividends to shareholders	—	—	—	(804)	—	—	—	(804)	(20)	(824)
Net impact of equity settled share based payments	—	—	—	25	—	—	—	25	—	25
Capital contribution[6]	—	—	—	1,229	—	—	—	1,229	—	1,229
Change in business combinations and other movements	—	—	—	(4)	(2)	—	(50)	(56)	(24)	(80)
Tax on items taken directly to equity	—	—	—	87	—	—	—	87	—	87
At 31 Dec 2016	797	20,733	3,781	12,737	1,007	89	786	39,930	695	40,625

1 *At 1 January 2017, the cumulative changes in fair value attributable to changes in own credit risk of financial liabilities designated at fair value was a loss of £127m.*
2 *The distribution in-specie of HSBC Bank A.S. comprises the distribution of retained profits of £643m and cash flow reserve of £(2)m, and the transfer of £533m from the foreign exchange reserve to retained earnings. The net assets distributed include an allocation of goodwill of £77m.*
3 *On 15 March 2017 the High Court confirmed the conversion of the share premium in full to distributable reserves by means of a capital reduction.*
4 *HSBC Holdings plc provided £1,081m to HSBC Bank plc in exchange for HSBC Bank plc repaying its existing $1.45bn Tier 2 subordinated loan and conversion into CET1. HSBC Bank plc received £150m from HSBC Holdings plc in exchange for HSBC Bank plc purchasing £150m non-cumulative redeemable preference shares in Midcorp held previously by HSBC Holdings plc.*
5 *All new capital subscribed during the year was issued to HSBC Holdings plc. See Note 27 for further details.*
6 *HSBC Holdings plc injected £1,229m of CET1 capital into HSBC Bank plc. There was no new issuance of share capital.*

HSBC Bank plc balance sheet

at 31 December

	Notes	2017 £m	2016 £m
Assets			
Cash and balances at central banks		**81,358**	49,252
Items in the course of collection from other banks		**1,407**	780
Trading assets	*8*	**124,094**	102,407
Derivatives	*12*	**135,236**	185,779
Loans and advances to banks		**15,160**	16,713
Loans and advances to customers		**220,450**	215,084
Reverse repurchase agreements – non-trading		**36,627**	23,351
Financial investments	*13*	**31,382**	49,472
Prepayments, accrued income and other assets	*19*	**12,858**	10,543
Current tax assets		**195**	71
Interests in associates and joint ventures	*15*	**5**	5
Investments in subsidiary undertakings	*16*	**8,476**	8,838
Goodwill and intangible assets	*18*	**1,048**	920
Deferred tax assets	*6*	**5**	6
Total assets at 31 Dec		**668,301**	663,221
Liabilities and equity			
Liabilities			
Deposits by banks		**24,626**	26,184
Customer accounts		**320,026**	303,571
Repurchase agreements – non-trading		**35,220**	15,420
Items in the course of transmission to other banks		**600**	243
Trading liabilities	*20*	**77,303**	72,139
Financial liabilities designated at fair value	*21*	**11,006**	10,175
Derivatives	*12*	**133,035**	179,481
Debt securities in issue		**6,108**	6,866
Accruals, deferred income and other liabilities	*22*	**3,367**	4,489
Current tax liabilities		**54**	192
Provisions	*23*	**1,394**	1,885
Deferred tax liabilities	*6*	**932**	468
Subordinated liabilities	*24*	**15,930**	7,362
Total liabilities at 31 Dec		**629,601**	628,475
Equity			
Called up share capital	*27*	**797**	797
Share premium account		**—**	20,733
Other equity instruments	*27*	**3,781**	3,781
Other reserves		**277**	428
Retained earnings		**33,845**	9,007
Total equity at 31 Dec		**38,700**	34,746
Total liabilities and equity at 31 Dec		**668,301**	663,221

Profit after tax for the year was £2,565m (2016: £480m).

The accompanying notes on pages 84 to 143 and the audited sections of the 'Report of the Directors' on pages 20 to 64 form an integral part of these financial statements.

The financial statements on pages 76 to 83 were approved by the Board of Directors on 20 February 2018 and signed on its behalf by:

A P S Simoes

Director

HSBC Bank plc statement of cash flows

for the year ended 31 December

	2017	2016
	£m	£m
Profit before tax	**2,898**	1,250
Adjustments for non-cash items		
Depreciation, amortisation and impairment	**460**	2,611
Net gain from investing activities	**(208)**	(399)
(Gain) on disposal of subsidiaries, businesses, associates and joint ventures	**(61)**	—
Loan impairment losses gross of recoveries and other credit risk provisions	**548**	403
Provisions including pensions	**37**	398
Share-based payment expense	**85**	95
Other non-cash items included in profit before tax	**17**	22
Elimination of exchange differences[1]	**826**	(7,465)
Changes in operating assets and liabilities	**5,619**	18,630
- change in net trading securities and derivatives	**(12,326)**	3,433
- change in loans and advances to banks and customers	**(3,695)**	(10,578)
- change in reverse repurchase agreements – non-trading	**(10,416)**	847
- change in other assets	**80**	(685)
- change in deposits by banks and customer accounts	**14,773**	29,156
- change in repurchase agreements – non-trading	**19,801**	4,145
- change in debt securities in issue	**(758)**	(5,490)
- change in financial liabilities designated at fair value	**692**	(1,638)
- change in other liabilities	**(1,685)**	269
- contributions paid to defined benefit plans	**(233)**	(233)
- tax paid	**(614)**	(596)
Net cash from operating activities	**10,221**	15,545
Net cash from investing activities	**16,364**	(4,933)
- purchase of financial investments	**(12,624)**	(23,554)
- proceeds from the sale and maturity of financial investments	**28,834**	18,921
- net cash flows from the purchase and sale of property, plant and equipment	**(168)**	(348)
- net investment in intangible assets	**(276)**	(197)
- net cash outflow from acquisition of businesses and subsidiaries	**(1)**	(197)
- net cash flow on disposal of subsidiaries, business, associates and joint ventures	**599**	442
net cash from financing activities	**8,695**	(641)
- issue of ordinary share capital and other equity instruments	**—**	197
- subordinated loan capital issued[2]	**10,067**	1,055
- subordinated loan capital repaid[2]	**(1,085)**	(2,322)
- funds received from the shareholder of the parent company	**1,081**	1,229
- dividends paid to shareholders of the parent company	**(1,368)**	(800)
Net increase in cash and cash equivalents	**35,280**	9,971
Cash and cash equivalents at 1 Jan	**70,344**	56,090
Exchange difference in respect of cash and cash equivalents	**443**	4,283
Cash and cash equivalents at 31 Dec	**106,067**	70,344
Cash and cash equivalents comprise of:		
- cash and balances at central banks	**81,358**	49,252
- items in the course of collection from other banks	**1,407**	780
- loans and advances to banks of one month or less	**4,264**	14,965
- reverse repurchase agreement with banks of one month or less	**6,995**	4,135
- treasury bills, other bills and certificates of deposit less than three months	**12,643**	1,455
- less: items in the course of transmission to other banks	**(600)**	(243)
	106,067	70,344

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.*

2 *Subordinated liabilities changes during the year are attributable to cash flows from issuance (£10,067m (2016: £1,055m)) and repayment (£(1,085)m (2016: £(2,322)m)) of securities as presented in the bank's statement of cash flows. Non-cash changes during the year included foreign exchanges losses (£(110)m (2016: £1,173m)) and fair value gains (£94m (2016: £(54)m loss)).*

Interest received was £7,498m (2016: £7,147m), interest paid was £1,634m (2016: £1,932m) and dividends received was £1,294m (2016: £51m).

HSBC Bank plc statement of changes in equity

for the year ended 31 December

					Other reserves			
	Called up share capital	Share premium	Other equity instruments	Retained earnings	Available-for-sale fair value reserve	Cash flow hedging reserve	Foreign exchange reserve	Total shareholders' equity
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 Jan 2017	**797**	**20,733**	**3,781**	**9,007**	**218**	**137**	**73**	**34,746**
Profit for the year	**–**	**–**	**–**	**2,565**	**–**	**–**	**–**	**2,565**
Other comprehensive income (net of tax)	**–**	**–**	**–**	**1,641**	**(28)**	**(155)**	**32**	**1,490**
– available-for-sale investments	**–**	**–**	**–**	**–**	**(28)**	**–**	**–**	**(28)**
– cash flow hedges	**–**	**–**	**–**	**–**	**–**	**(155)**	**–**	**(155)**
– remeasurement of defined benefit asset/liability	**–**	**–**	**–**	**1,790**	**–**	**–**	**–**	**1,790**
– changes in fair value of financial liabilities designated at fair value due to movement in own credit risk[1]	**–**	**–**	**–**	**(149)**	**–**	**–**	**–**	**(149)**
– exchange differences and other	**–**	**–**	**–**	**–**	**–**	**–**	**32**	**32**
Total comprehensive income for the year	**–**	**–**	**–**	**4,206**	**(28)**	**(155)**	**32**	**4,055**
Dividends to shareholders	**–**	**–**	**–**	**(872)**	**–**	**–**	**–**	**(872)**
Distribution in specie of HSBC Bank A.S.[2]	**–**	**–**	**–**	**(496)**	**–**	**–**	**–**	**(496)**
Net impact of equity-settled share-based payments	**–**	**–**	**–**	**(20)**	**–**	**–**	**–**	**(20)**
Transfer of share premium to retained earnings[3]	**–**	**(20,733)**	**–**	**20,733**	**–**	**–**	**–**	**–**
Change in business combinations and other movements[4]	**–**	**–**	**–**	**1,232**	**–**	**–**	**–**	**1,232**
Tax on items taken directly to equity	**–**	**–**	**–**	**55**	**–**	**–**	**–**	**55**
At 31 Dec 2017	**797**	**–**	**3,781**	**33,845**	**190**	**(18)**	**105**	**38,700**
At 1 Jan 2016	797	20,733	3,584	8,179	290	33	(84)	33,532
Profit for the year	–	–	–	480	–	–	–	480
Other comprehensive income (net of tax)	–	–	–	(174)	(72)	104	157	15
– available-for-sale investments	–	–	–	–	(72)	–	–	(72)
– cash flow hedges	–	–	–	–	–	104	–	104
– remeasurement of defined benefit asset/liability	–	–	–	(174)	–	–	–	(174)
– exchange differences and other	–	–	–	–	–	–	157	157
Total comprehensive income for the year	–	–	–	306	(72)	104	157	495
Capital securities issued[5]	–	–	197	–	–	–	–	197
Dividends to shareholders	–	–	–	(800)	–	–	–	(800)
Net impact of equity-settled share-based payments	–	–	–	24	–	–	–	24
Capital contribution[6]	–	–	–	1,229	–	–	–	1,229
Change in business combinations and other movements	–	–	–	(18)	–	–	–	(18)
Tax on items taken directly to equity	–	–	–	87	–	–		87
At 31 Dec 2016	797	20,733	3,781	9,007	218	137	73	34,746

1 *At 1 January 2017, the cumulative changes in fair value attributable to changes in own credit risk of financial liabilities designated at fair value was a loss of £43m.*
2 *The distribution in-specie of HSBC Bank A.S. comprises of the return of cost of investment in HSBC Bank A.S.*
3 *On 15 March 2017 the High Court confirmed the conversion of the share premium in full to distributable reserves by means of a capital reduction.*
4 *HSBC Holdings plc provided £1,081m to HSBC Bank plc in exchange for HSBC Bank plc repaying its existing $1.45bn Tier 2 subordinated loan and conversion into CET1. HSBC Bank plc received £150m from HSBC Holdings plc in exchange for HSBC Bank plc purchasing £150m non-cumulative redeemable preference shares in Midcorp held previously by HSBC Holdings plc.*
5 *All new capital subscribed during the year was issued to HSBC Holdings plc. See Note 27 for further details.*
6 *HSBC Holdings plc injected £1,229m of CET1 capital into HSBC bank plc. There was no new issuance of share capital*

1 Basis of preparation and significant accounting policies

1.1 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The consolidated financial statements of the group and the separate financial statements of HSBC Bank plc have been prepared in accordance with IFRSs as issued by the IASB, including interpretations issued by the IFRS Interpretations Committee, and as endorsed by the European Union ('EU'). At 31 December 2017, there were no unendorsed standards effective for the year ended 31 December 2017 affecting these consolidated and separate financial statements, and the group's application of IFRSs results in no differences between IFRSs as issued by the IASB and IFRSs as endorsed by the EU.

Standards adopted during the year ended 31 December 2017

The group has adopted the requirements of IFRS 9 'Financial Instruments' relating to the presentation of gains and losses on financial liabilities designated at fair value from 1 January 2017 in the consolidated and separate financial statements. As a result, the effects of changes in those liabilities' credit risk is presented in other comprehensive income with the remaining effect presented in profit or loss. As permitted by the transitional requirements of IFRS 9, comparatives have not been restated. Adoption increased profit after tax of group by £164m and of bank by £149m with the opposite effect on other comprehensive income and no effect on net assets.

There were no other new standards applied in 2017. However, during 2017, the group adopted a number of interpretations and amendments to standards which had an insignificant effect on the consolidated financial statements of the group and the separate financial statements of HSBC Bank plc.

(b) Future accounting developments

Minor amendments to IFRSs

The IASB has published a number of minor amendments to IFRSs which are effective from 1 January 2018 and 2019, some of which have been endorsed for use in the EU. HSBC expects they will have an insignificant effect, when adopted, on the consolidated financial statements of HSBC and the separate financial statements of HSBC Bank plc. HSBC has not early adopted any of the amendments effective after 31 December 2017, except the requirements of IFRS 9 'Financial Instruments' relating to the presentation of gains and losses on financial liabilities designated at fair value which was adopted from 1 January 2017.

Major new IFRSs

The IASB has published IFRS 9 'Financial Instruments', IFRS 15 'Revenue from Contracts with Customers', IFRS 16 'Leases' and IFRS 17 'Insurance contracts'. IFRS 9, IFRS 15 and IFRS 16 have been endorsed for use in the EU and IFRS 17 has not yet been endorsed.

IFRS 9 'Financial Instruments'

In July 2014, the IASB issued IFRS 9 'Financial Instruments', which is the comprehensive standard to replace IAS 39 'Financial Instruments: Recognition and Measurement', and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

Classification and measurement

The classification and measurement of financial assets will depend on how these are managed (the entity's business model) and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income ('FVOCI') or fair value through profit or loss ('FVPL'). The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of financial assets measured at amortised cost or fair value compared with IAS 39. In addition, on transition to IFRS 9 entities are required to revoke previous designations of financial assets and financial liabilities measured at fair value through profit or loss where the accounting mismatch no longer exists and are permitted to revoke such designations where accounting mismatches continue to exist.

Impairment

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, lease receivables, and certain loan commitments and financial guarantee contracts. At initial recognition, an impairment allowance (or provision in the case of commitments and guarantees) is required for expected credit losses ('ECL') resulting from default events that are possible within the next 12 months ('12-month ECL'). In the event of a significant increase in credit risk, an allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are in 'stage 1'; financial assets that are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in 'stage 3'.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted, and should incorporate all available information relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under IAS 39, and the resulting impairment charge may be more volatile. IFRS 9 may also result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks. However, they do not explicitly address macro hedge accounting strategies, which are particularly important for banks. As a result, IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting.

Transitional impact

With the exception of the provisions relating to the presentation of gains and losses on financial liabilities designated at fair value, which were adopted from 1 January 2017, the requirements of IFRS 9 'Financial Instruments' will be adopted from 1 January 2018. IFRS 9 includes an accounting policy choice to continue IAS 39 hedge accounting, which HSBC has exercised, although it will implement the revised hedge accounting disclosures required by the related amendments to IFRS 7 'Financial Instruments: Disclosures'. The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The group does not intend to restate comparatives.

Adoption is expected to reduce net assets of the group at 1 January 2018 by £532m, with the classification and measurement changes increasing net assets by £58m and impairment reducing net assets by £764m, offset by deferred tax of £174m. There is no significant impact expected on the common equity tier 1 capital of the group, both when applying regulatory transitional arrangements and on a fully loaded basis. Net assets of the bank are expected to reduce by £455m, with the classification and measurement changes increasing net assets by £52m and impairment reducing net assets by £653m, offset by deferred tax of £146m.

IFRS 15 'Revenue from Contracts with Customers'

In May 2014, the IASB issued IFRS 15 'Revenue from Contracts with Customers' and it is effective for annual periods beginning on or after 1 January 2018. IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for performance obligations as they are satisfied. HSBC will adopt the standard on its mandatory effective date, and the standard will be applied on a retrospective basis, recognising the cumulative effect, if any, of initially applying the standard as an adjustment to the opening balance of retained earnings. The group has assessed the impact of IFRS 15 and expects that the standard will have no significant effect, when applied, on the consolidated financial statements of the group and the separate financial statements of HSBC Bank plc.

IFRS 16 'Leases'

In January 2016, the IASB issued IFRS 16 'Leases' with an effective date for annual periods beginning on or after 1 January 2019. IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under IAS 17 'Leases'. Lessees will recognise a 'right of use' asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease, and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as under IAS 17. The group is currently assessing the impact of IFRS 16, and it is not practicable to quantify the effect at the date of the publication of these financial statements. Existing operating lease commitments are set out in Note 29.

IFRS 17 'Insurance contracts'

IFRS 17 'Insurance contracts' was issued in May 2017, and sets out the requirements that an entity should apply in accounting for insurance contracts it issues and reinsurance contracts it holds. IFRS 17 is effective from 1 January 2021, and the group is considering its impact.

(c) Foreign currencies

The functional currency of the bank is sterling, which is also the presentational currency of the consolidated financial statements of the group.

Transactions in foreign currencies are recorded at the rate of exchange on the date of the transaction. Assets and liabilities denominated in foreign currencies are translated at the rate of exchange at the balance sheet date except non-monetary assets and liabilities measured at historical cost which are translated using the rate of exchange at the initial transaction date. Exchange differences are included in other comprehensive income or in the income statement depending on where the gain or loss on the underlying item is recognised.

In the consolidated financial statements, the assets, liabilities and results of foreign operations whose functional currency is not sterling are translated into the group's presentation currency at the reporting date. Exchange differences arising are recognised in other comprehensive income. On disposal of a foreign operation, exchange differences previously recognised in other comprehensive income are reclassified to the income statement.

(d) Presentation of information

Certain disclosures required by IFRSs have been included in the audited sections of this *Annual Report and Accounts 2017* as follows:

- segmental disclosures are included in the 'Report of the Directors: Financial Review' on pages 9 to 16;
- disclosures concerning the nature and extent of risks relating to financial instruments and insurance contracts are included in the 'Report of the Directors: Risk' on pages 20 to 55;
- capital disclosures are included in the 'Report of the Directors: Capital' on pages 56 to 58; and
- disclosures relating to HSBC's securitisation activities and structured products are included in the 'Report of the Directors: Risk' on pages 47 and 48. In publishing the parent company financial statements together with the group financial statements, the bank has taken advantage of the exemption in Section 408(3) of the Companies Act 2006 not to present its individual income statement and related notes.

(e) Critical accounting estimates and judgements

The preparation of financial information requires the use of estimates and judgements about future conditions. In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of items highlighted as the critical accounting estimates and judgements in section 1.2 below, it is possible that the outcomes in the next financial year could differ from those on which management's estimates are based. This could result in materially different estimates and judgements from those reached by management for the purposes of the these Financial Statements. Management's selection of the group's accounting policies which contain critical estimates and judgements reflects the materiality of the items to which the policies are applied and the high degree of judgement and estimation uncertainty involved.

(f) Segmental analysis

HSBC Bank plc's chief operating decision-maker is the group Chief Executive, supported by the group Executive Committee, and operating segments are reported in a manner consistent with the internal reporting provided to the group Chief Executive and the group Executive Committee.

Measurement of segmental assets, liabilities, income and expenses is in accordance with the bank's accounting policies. Segmental income and expenses include transfers between segments and these transfers are conducted at arm's length. Shared costs are included in segments on the basis of the actual recharges made.

The types of products and services from which each reportable segment derives its revenue are discussed in the 'Strategic Report – Products and services'.

(g) Going concern

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

1.2 Summary of significant accounting policies

(a) Consolidation and related policies

Investments in subsidiaries

Where an entity is governed by voting rights, the group consolidates when it holds, directly or indirectly, the necessary voting rights to pass resolutions by the governing body. In all other cases, the assessment of control is more complex and requires judgement of other factors, including having exposure to variability of returns, power to direct relevant activities and whether power is held as agent or principal.

Business combinations are accounted for using the acquisition method. The amount of non-controlling interest is measured either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets.

The banks' investments in subsidiaries are stated at cost less impairment losses.

Critical accounting estimates and judgements

Investments in subsidiaries are tested for impairment when there is an indication that the investment may be impaired. Impairment testing involves significant judgement in determining the value in use ('VIU'), and in particular estimating the present values of cash flows expected to arise from continuing to hold the investment and the rates used to discount these cash flows.

Goodwill

Goodwill is allocated to cash-generating units ('CGUs') for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. The group's CGUs are based on global businesses. Impairment testing is performed once a year, or whenever there is an indication of impairment, by comparing the recoverable amount of a CGU with its carrying amount.

Goodwill is included in a disposal group if the disposal group is a CGU to which goodwill has been allocated or it is an operation within such a CGU. The amount of goodwill included in a disposal group is measured on the basis of the relative values of the operation disposed of and the portion of the CGU retained.

Critical accounting estimates and judgements

The review of goodwill for impairment reflects management's best estimate of the future cash flows of the CGUs and the rates used to discount these cash flows, both of which are subject to uncertain factors as follows:

- The future cash flows of the CGUs are sensitive to the cash flows projected for the periods for which detailed forecasts are available and to assumptions regarding the long-term pattern of sustainable cash flows thereafter. Forecasts are compared with actual performance and verifiable economic data, but they reflect management's view of future business prospects at the time of the assessment;
- The rates used to discount future expected cash flows can have a significant effect on their valuation and are based on the costs of capital assigned to individual CGUs. The cost of capital percentage is generally derived from a capital asset pricing model, which incorporates inputs reflecting a number of financial and economic variables, including the risk-free interest rate in the country concerned and a premium for the risk of the business being evaluated. These variables are subject to fluctuations in external market rates and economic conditions beyond management's control. They are therefore subject to uncertainty and require the exercise of significant judgement.

The accuracy of forecast cash flows is subject to a high degree of uncertainty in volatile market conditions. In such circumstances, management retests goodwill for impairment more frequently than once a year when indicators of impairment exist. This ensures that the assumptions on which the cash flow forecasts are based continue to reflect current market conditions and management's best estimate of future business prospects.

Group sponsored structured entities

The group is considered to sponsor another entity if, in addition to ongoing involvement with the entity, it had a key role in establishing that entity or in bringing together relevant counterparties so the transaction that is the purpose of the entity could occur. The group is generally not considered a sponsor if the only involvement with the entity is merely administrative.

Interests in associates and joint arrangements

Joint arrangements are investments in which the group, together with one or more parties, has joint control. Depending on the group's rights and obligations, the joint arrangement is classified as either a joint operation or a joint venture. The group classifies investments in entities over which it has significant influence, and that are neither subsidiaries nor joint arrangements, as associates.

The group recognises its share of the assets, liabilities and results in a joint operation. Investments in associates and interests in joint ventures are recognised using the equity method. The attributable share of the results and reserves of joint ventures and associates are included in the consolidated financial statements of the group based on either financial statements made up to 31 December or pro-rated amounts adjusted for any material transactions or events occurring between the date the financial statements are available and 31 December.

Investments in associates and joint ventures are assessed at each reporting date and tested for impairment when there is an indication that the investment may be impaired. Goodwill on acquisition of interests in joint ventures and associates is not tested separately for impairment, but is assessed as part of the carrying amount of the investment.

(b) Income and expense

Operating income

Interest income and expense

Interest income and expense for all financial instruments, excluding those classified as held for trading or designated at fair value are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method. However, as an exception to this, interest on debt securities issued by the group that are designated under the fair value option and derivatives managed in conjunction with those debt securities is included in interest expense.

Interest on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Non-interest income and expense

Fee income is earned from a diverse range of services provided by the group to its customers. Fee income is accounted for as follows:

- Income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating a transaction, such as the acquisition of shares, for a third party).
- Income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management services).

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with the related interest income, expense and dividends.

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders approve the dividend for unlisted equity securities.

Net income from financial instruments designated at fair value includes all gains and losses from changes in the fair value of financial assets and liabilities designated at fair value through profit or loss, including derivatives that are managed in conjunction with those financial assets and liabilities, and liabilities under investment contracts. Interest income, interest expense and dividend income in respect of those financial instruments are also included, except for interest arising from debt securities issued by the group and derivatives managed in conjunction with those debt securities, which is recognised in 'Interest expense'.

The accounting policies for insurance premium income are disclosed in Note 1.2(f).

(c) Valuation of financial instruments

All financial instruments are initially recognised at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, if there is a difference between the transaction price and the fair value of financial instruments whose fair value is based on a quoted price in an active market or a valuation technique that uses only data from observable markets, the group recognises the difference as a trading gain or loss at inception (a 'day 1 gain or loss'). In all other cases, the entire day 1 gain or loss is deferred and recognised in the income statement over the life of the transaction either until the transaction matures or is closed out or the valuation inputs become observable.

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

Critical accounting estimates and judgements

The majority of valuation techniques employ only observable market data. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them the measurement of fair value is more judgemental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's inception profit or greater than 5% of the instrument's valuation is driven by unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

(d) Financial instruments measured at amortised cost

Loans and advances to banks and customers, held-to-maturity investments and most financial liabilities are measured at amortised cost. The carrying value of these financial instruments at initial recognition includes any directly attributable transactions costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some leveraged finance and syndicated lending activities, the difference is deferred and recognised over the life of the loan (as described in sub-section (c) above) through the recognition of interest income, unless the loan becomes impaired.

The group may commit to underwriting loans on fixed contractual terms for specified periods of time. When the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative. When the group intends to hold the loan, a provision on the loan commitment is only recorded where it is probable that the group will incur a loss.

Impairment of loans and advances

Losses for impaired loans are recognised when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Losses which may arise from future events are not recognised.

Individually assessed loans and advances

The factors considered in determining whether a loan is individually significant for the purposes of assessing impairment include the size of the loan, the number of loans in the portfolio, the importance of the individual loan relationship and how this is managed. Loans that are determined to be individually significant will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective methodology.

Loans considered as individually significant are typically to corporate and commercial customers, are for larger amounts and are managed on an individual basis. For these loans, the group considers on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired.

The determination of the realisable value of security is based on the most recently updated market value at the time the impairment assessment is performed. The value is not adjusted for expected future changes in market prices, though adjustments are made to reflect local conditions such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which include expected future receipts of contractual interest, at the loan's original effective interest rate or an approximation thereof, and comparing the resultant present value with the loan's current carrying amount.

Collectively assessed loans and advances

Impairment is assessed collectively to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment or for homogeneous groups of loans that are not considered individually significant, which are generally retail lending portfolios.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for a collective impairment assessment. This assessment captures impairment losses that the group has incurred as a result of events occurring before the balance sheet date that the group is not able to identify on an individual loan basis, and that can be reliably estimated. When information becomes available that identifies losses on individual loans within a group, those loans are removed from the group and assessed individually.

Homogeneous groups of loans and advances

Statistical methods are used to determine collective impairment losses for homogeneous groups of loans not considered individually significant. The methods used to calculate collective allowances are set out below:

- When appropriate empirical information is available, the group utilises roll-rate methodology, which employs statistical analyses of historical data and experience of delinquency and default to reliably estimate the amount of the loans that will eventually be written off as a result of events occurring before the balance sheet date. Individual loans are grouped using ranges of past due days and statistical estimates are made of the likelihood that loans in each range will progress through the various stages of delinquency and become irrecoverable. Additionally, individual loans are segmented based on their credit characteristics, such as industry sector, loan grade or product. In applying this methodology, adjustments are made to estimate the periods of time between a loss event occurring, for example because of a missed payment, and its confirmation through write-off (known as the loss identification period). Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss. In certain highly-developed markets, models also take into account behavioural and account management trends as revealed in, for example, bankruptcy and rescheduling statistics.
- When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, the group adopts a basic formulaic approach based on historical loss rate experience, or a discounted cash flow model. Where a basic formulaic approach is undertaken, the period between a loss event occurring and its identification is estimated by local management, and is typically between six and 12 months.

Write-off of loans and advances

Loans and the related impairment allowance accounts are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write-off may be earlier.

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognised in the income statement.

Assets acquired in exchange for loans

When non-financial assets acquired in exchange for loans as part of an orderly realisation are held for sale, these assets are recorded as 'Assets held for sale' and reported in 'Other assets'.

Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as up-to-date loans for measurement purposes once a minimum number of required payments has been received. Where collectively assessed loan portfolios include significant levels of renegotiated loans, these loans are segregated from other parts of the loan portfolio for the purposes of collective impairment assessment to reflect their risk profile. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired. The carrying amounts of loans that have been classified as renegotiated retain this classification until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified such that the renegotiated loan is substantially a different financial instrument. Any new loans that arise following derecognition events will continue to be disclosed as renegotiated loans and are assessed for impairment as above.

Critical accounting estimates and judgements

Loan impairment allowances represent management's best estimate of losses incurred in the loan portfolios at the balance sheet date. Management is required to exercise judgement in making assumptions and estimates when calculating loan impairment allowances on both individually and collectively assessed loans and advances.

Collective impairment allowances are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan basis due to the large number of individually insignificant loans in the portfolio. The estimation methods include the use of statistical analyses of historical information, supplemented with significant management judgement, to assess whether current economic and credit conditions are such that the actual level of incurred losses is likely to be greater or less than historical experience. Where changes in economic, regulatory or behavioural conditions result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models, risk factors are taken into account by adjusting the impairment allowances derived solely from historical loss experience.

- Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographical concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other influences on customer payment patterns. Different factors are applied in different regions and countries to reflect local economic conditions, laws and regulations. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. For example, roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.
- For individually assessed loans, judgement is required in determining whether there is objective evidence that a loss event has occurred and, if so, the measurement of the impairment allowance. In determining whether there is objective evidence that a loss event has occurred, judgement is exercised in evaluating all relevant information on indicators of impairment, including the consideration of whether payments are contractually past due and the consideration of other factors indicating deterioration in the financial condition and outlook of borrowers affecting their ability to pay.

A higher level of judgement is required for loans to borrowers showing signs of financial difficulty in market sectors experiencing economic stress, particularly where the likelihood of repayment is affected by the prospects for refinancing or the sale of a specified asset. For those loans where objective evidence of impairment exists, management determines the size of the allowance required based on a range of factors such as the realisable value of security, the likely dividend available on liquidation or bankruptcy, the viability of the customer's business model and the capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations.

The group might provide loan forbearance to borrowers experiencing financial difficulties by agreeing to modify the contractual payment terms of loans in order to improve the management of customer relationships, maximise collection opportunities or avoid default or repossession. Where forbearance activities are significant, higher levels of judgement and estimation uncertainty are involved in determining their effects on loan impairment allowances. Judgements are involved in differentiating the credit risk characteristics of forbearance cases, including those which return to performing status following renegotiation. Where collectively assessed loan portfolios include significant levels of loan forbearance, portfolios are segmented to reflect the different credit risk characteristics of forbearance cases, and estimates are made of the incurred losses inherent within each forbearance portfolio segment.

The exercise of judgement requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas. Many of the factors have a high degree of interdependency and there is no single factor to which our loan impairment allowances as a whole are sensitive.

Non-trading reverse repurchase, repurchase and similar agreements

When debt securities are sold subject to a commitment to repurchase them at a predetermined price ('repos'), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to resell ('reverse repos') are not recognised on the balance sheet and an asset is recorded in respect of the initial consideration paid. Non-trading repos and reverse repos are measured at amortised cost. The difference between the sale and repurchase price or between the purchase and resale price is treated as interest and recognised in net interest income over the life of the agreement.

Contracts that are economically equivalent to reverse repurchase or repurchase agreements (such as sales or purchases of debt securities entered into together with total return swaps with the same counterparty) are accounted for similarly to, and presented together with, reverse repurchase or repurchase agreements.

(e) Financial instruments measured at fair value

Available-for-sale financial assets

Available-for-sale financial assets are recognised on the trade date when the group enters into contractual arrangements to purchase them, and are normally derecognised when they are either sold or redeemed. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income until the assets are either sold or become impaired. Upon disposal, the cumulative gains or losses in other comprehensive income are recognised in the income statement as 'Gains less losses from financial investments'.

Impairment of available-for-sale financial assets

Available-for-sale financial assets are assessed at each balance sheet date for objective evidence of impairment. Impairment losses are recognised in the income statement within 'Loan impairment charges and other credit risk provisions' for debt instruments and within 'Gains less losses from financial investments' for equities.

Available-for-sale debt securities

In assessing objective evidence of impairment at the reporting date, the group considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in the recovery of future cash flows. A subsequent decline in the fair value of the instrument is recognised in the income statement when there is objective evidence of impairment as a result of decreases in the estimated future cash flows. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, or the instrument is no longer impaired, the impairment loss is reversed through the income statement.

Available-for-sale equity securities

A significant or prolonged decline in the fair value of the equity below its cost is objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the continuous period in which the fair value of the asset has been below its original cost at initial recognition.

All subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised in other comprehensive income. Subsequent decreases in the fair value of the available-for-sale equity security are recognised in the income statement to the extent that further cumulative impairment losses have been incurred. Impairment losses recognised on the equity security are not reversed through the income statement.

Financial instruments designated at fair value

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated irrevocably at inception:

- the use of the designation removes or significantly reduces an accounting mismatch;
- when a group of financial assets, liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; and
- where financial instruments contain one or more non-closely related embedded derivatives.

Designated financial assets are recognised when the group enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when the rights to the cash flows expire or are transferred. Designated financial liabilities are recognised when the group enters into contracts with counterparties, which is generally on settlement date, and are normally derecognised when extinguished. Subsequent changes in fair values are recognised in the income statement in 'Net income from financial instruments designated at fair value'.

Under this criterion, the main classes of financial instruments designated by the group are:

Long-term debt issues

The interest and/or foreign exchange exposure on certain fixed rate debt securities issued has been matched with the interest and/or foreign exchange exposure on certain swaps as part of a documented risk management strategy.

Financial assets and financial liabilities under unit-linked and non-linked investment contracts

A contract under which the group does not accept significant insurance risk from another party is not classified as an insurance contract, other than investment contracts with discretionary participation features ('DPF'), but is accounted for as a financial liability. See Note 1.2(f) for investment contracts with DPF and contracts where the group accepts significant insurance risk. Customer liabilities under linked and certain non-linked investment contracts issued by insurance subsidiaries and the corresponding financial assets are designated at fair value. Liabilities are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices. Premiums receivable and amounts withdrawn are accounted for as increases or decreases in the liability recorded in respect of investment contracts. The incremental costs directly related to the acquisition of new investment contracts or renewing existing investment contracts are deferred and amortised over the period during which the investment management services are provided.

Derivatives

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, interest rates or other indices. Derivatives are recognised initially and are subsequently measured at fair value, with changes in fair value generally recorded in the income statement. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative; this includes embedded derivatives which are bifurcated from the host contract when they meet the definition of a derivative on a stand-alone basis and are required by IFRSs to be accounted for separately from the host contract.

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

Hedge accounting

When derivatives are not part of fair value designated relationships, if held for risk management purposes they are designated in hedge accounting relationships where the required criteria for documentation and hedge effectiveness are met. The group uses these derivatives or, where allowed, other non-derivative hedging instruments in fair value hedges, cash flow hedges or hedges of net investments in foreign operations as appropriate to the risk being hedged.

Fair value hedge

Fair value hedge accounting does not change the recording of gains and losses on derivatives and other hedging instruments but results in recognising changes in the fair value of the hedged assets or liabilities attributable to the hedged risk that would not otherwise be recognised in the income statement. If a hedge relationship no longer meets the criteria for hedge accounting, hedge accounting is discontinued; the cumulative adjustment to the carrying amount of the hedged item is amortised to the income statement on a recalculated effective interest rate, unless the hedged item has been derecognised, in which case it is recognised in the income statement immediately.

Cash flow hedge

The effective portion of gains and losses on hedging instruments is recognised in other comprehensive income; the ineffective portion of the change in fair value of derivative hedging instruments that are part of a cash flow hedge relationship is recognised immediately in the income statement within 'Net trading income'. The accumulated gains and losses recognised in other comprehensive income are reclassified to the income statement in the same periods in which the hedged item affects profit or loss. In hedges of forecast transactions that result in recognition of a non-financial asset or liability, previous gains and losses recognised in other comprehensive income are included in the initial measurement of the asset or liability. When a hedge relationship is discontinued, or partially discontinued, any cumulative gain or loss recognised in other comprehensive income remains in equity until the forecast transaction is recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss previously recognised in other comprehensive income is immediately reclassified to the income statement.

Net investment hedge

Hedges of net investments in foreign operations are accounted for in a similar way to cash flow hedges. The effective portion of gains and losses on the hedging instrument is recognised in other comprehensive income; other gains and losses are recognised immediately in the income statement. Gains and losses previously recognised in other comprehensive income are reclassified to the income statement on the disposal, or part disposal, of the foreign operation.

Derivatives that do not qualify for hedge accounting

Non-qualifying hedges are derivatives entered into as economic hedges of assets and liabilities for which hedge accounting was not applied.

(f) Insurance contracts

A contract is classified as an insurance contract where the group accepts significant insurance risk from another party by agreeing to compensate that party on the occurrence of a specified uncertain future event. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant. In addition, the group issues investment contracts with DPF which are also accounted for as insurance contracts as required by IFRS 4 'Insurance Contracts'.

Net insurance premium income

Premiums for life insurance contracts are accounted for when receivable, except in unit-linked insurance contracts where premiums are accounted for when liabilities are established.

Reinsurance premiums are accounted for in the same accounting period as the premiums for the direct insurance contracts to which they relate.

Net insurance claims and benefits paid and movements in liabilities to policyholders

Gross insurance claims for life insurance contracts reflect the total cost of claims arising during the year, including claim handling costs and any policyholder bonuses allocated in anticipation of a bonus declaration.

Maturity claims are recognised when due for payment. Surrenders are recognised when paid or at an earlier date on which, following notification, the policy ceases to be included within the calculation of the related insurance liabilities. Death claims are recognised when notified.

Reinsurance recoveries are accounted for in the same period as the related claim.

Liabilities under insurance contracts

Liabilities under non-linked life insurance contracts are calculated by each life insurance operation based on local actuarial principles. Liabilities under unit-linked life insurance contracts are at least equivalent to the surrender or transfer value, which is calculated by reference to the value of the relevant underlying funds or indices.

Future profit participation on insurance contracts with DPF

Where contracts provide discretionary profit participation benefits to policyholders, liabilities for these contracts include provisions for the future discretionary benefits to policyholders. These provisions reflect the actual performance of the investment portfolio to date and management's expectation of the future performance of the assets backing the contracts, as well as other experience factors such as mortality, lapses and operational efficiency, where appropriate. The benefits to policyholders may be determined by the contractual terms, regulation or past distribution policy.

Investment contracts with DPF

While investment contracts with DPF are financial instruments, they continue to be treated as insurance contracts as required by IFRS 4. The Group therefore recognises the premiums for these contracts as revenue and recognises as an expense the resulting increase in the carrying amount of the liability.

In the case of net unrealised investment gains on these contracts, whose discretionary benefits principally reflect the actual performance of the investment portfolio, the corresponding increase in the liabilities is recognised in either the income statement or other comprehensive income, following the treatment of the unrealised gains on the relevant assets. In the case of net unrealised losses, a deferred participating asset is recognised only to the extent that its recoverability is highly probable. Movements in the liabilities arising from realised gains and losses on relevant assets are recognised in the income statement.

Present value of in-force long-term insurance business

The group recognises the value placed on insurance contracts, and investment contracts with DPF, that are classified as long-term and in-force at the balance sheet date, 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 ('PVIF') is determined by discounting those expected future profits 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.

(g) Employee compensation and benefits

Share-based payments

The group enters into both equity-settled and cash-settled share-based payment arrangements with its employees as compensation for services provided by employees.

The vesting period for these schemes may commence before the grant date if the employees have started to render services in respect of the award before the grant date. Expenses are recognised when the employee starts to render service to which the award relates.

Cancellations result from the failure to meet a non-vesting condition during the vesting period, and are treated as an acceleration of vesting recognised immediately in the income statement. Failure to meet a vesting condition by the employee is not treated as a cancellation, and the amount of expense recognised for the award is adjusted to reflect the number of awards expected to vest.

Post-employment benefit plans

The group operates a number of pension schemes (including defined benefit and defined contribution) and post-employment benefit schemes.

Payments to defined contribution schemes are charged as an expense as the employees render service.

Defined benefit pension obligations are calculated using the projected unit credit method. The net charge to the income statement mainly comprises the service cost and the net interest on the net defined benefit asset or liability, and is presented in operating expenses.

Remeasurements of the net defined benefit asset or liability, which comprise actuarial gains and losses, return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognised immediately in other comprehensive income. The net defined benefit asset or liability represents the present value of defined benefit obligations reduced by the fair value of plan assets, after applying the asset ceiling test, where the net defined benefit surplus is limited to the present value of available refunds and reductions in future contributions to the plan.

The cost of obligations arising from other post-employment plans are accounted for on the same basis as defined benefit pension plans.

(h) Tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case the tax is recognised in the same statement in which the related item appears.

Current tax is the tax expected to be payable on the taxable profit for the year and on any adjustment to tax payable in respect of previous years. The group provides for potential current tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet, and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax is calculated using the tax rates expected to apply in the periods as the assets will be realised or the liabilities settled.

Current and deferred tax are calculated based on tax rates and laws enacted, or substantively enacted, by the balance sheet date.

(i) Provisions, contingent liabilities and guarantees

Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation that has arisen as a result of past events and for which a reliable estimate can be made.

Critical accounting estimates and judgements

Judgement is involved in determining whether a present obligation exists and in estimating the probability, timing and amount of any outflows. Professional expert advice is taken on the assessment of litigation, property (including onerous contracts) and similar obligations. Provisions for legal proceedings and regulatory matters typically require a higher degree of judgement than other types of provisions. When matters are at an early stage, accounting judgements can be difficult because of the high degree of uncertainty associated with determining whether a present obligation exists, and estimating the probability and amount of any outflows that may arise. As matters progress, management and legal advisers evaluate on an ongoing basis whether provisions should be recognised, revising previous judgements and estimates as appropriate. At more advanced stages, it is typically easier to make judgements and estimates around a better defined set of possible outcomes. However, the amount provisioned can remain very sensitive to the assumptions used. There could be a wide range of possible outcomes for any pending legal proceedings, investigations or inquiries. As a result, it is often not practicable to quantify a range of possible outcomes for individual matters. It is also not practicable to meaningfully quantify ranges of potential outcomes in aggregate for these types of provisions because of the diverse nature and circumstances of such matters and the wide range of uncertainties involved. Provisions for customer remediation also require significant levels of estimation and judgement. The amounts of provisions recognised depend on a number of different assumptions, such as, the volume of inbound complaints, the projected period of inbound complaint volumes, the decay rate of complaint volumes, the population identified as systemically mis-sold and the number of policies per customer complaint.

Contingent liabilities, contractual commitments and guarantees

Contingent liabilities

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, and contingent liabilities related to legal proceedings or regulatory matters, are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

Financial guarantee contracts

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received or present value of the fee receivable.

The bank has issued financial guarantees and similar contracts to other group entities. The group elects to account for certain guarantees as insurance contracts in the bank's financial statements, in which case they are measured and recognised as insurance liabilities. This election is made on a contract by contract basis, and is irrevocable.

2 Insurance business

Net insurance premium income

	Non-linked insurance	Linked life insurance	Investment contracts with DPF[1]	Total
	£m	£m	£m	£m
Gross insurance premium income	**219**	**106**	**1,575**	**1,900**
Reinsurers' share of gross insurance premium income	**(88)**	**(3)**	**–**	**(91)**
Year ended 31 Dec 2017	**131**	**103**	**1,575**	**1,809**
Gross insurance premium income	209	75	1,378	1,662
Reinsurers' share of gross insurance premium income	(92)	(3)	–	(95)
Year ended 31 Dec 2016	117	72	1,378	1,567

1 *Discretionary participation features.*

Net insurance claims and benefits paid and movement in liabilities to policyholders

	Non-linked insurance	Linked life insurance	Investment contracts with DPF[1]	Total
	£m	£m	£m	£m
Gross claims and benefits paid and movement in liabilities	**132**	**217**	**2,257**	**2,606**
– claims, benefits and surrenders paid	**145**	**90**	**1,556**	**1,791**
– movement in liabilities	**(13)**	**127**	**701**	**815**
Reinsurers' share of claims and benefits paid and movement in liabilities	**(49)**	**(67)**	**–**	**(116)**
– claims, benefits and surrenders paid	**(61)**	**(3)**	**–**	**(64)**
– movement in liabilities	**12**	**(64)**	**–**	**(52)**
Year ended 31 Dec 2017	**83**	**150**	**2,257**	**2,490**
Gross claims and benefits paid and movement in liabilities	162	206	1,802	2,170
– claims, benefits and surrenders paid	114	96	1,491	1,701
– movement in liabilities	48	110	311	469
Reinsurers' share of claims and benefits paid and movement in liabilities	(80)	(71)	–	(151)
– claims, benefits and surrenders paid	(55)	(3)	–	(58)
– movement in liabilities	(25)	(68)	–	(93)
Year ended 31 Dec 2016	82	135	1,802	2,019

1 *Discretionary participation features.*

Liabilities under insurance contracts

	Non-linked insurance	Linked life insurance	Investment contracts with DPF[1]	Total
	£m	£m	£m	£m
Gross liabilities under insurance contracts at 1 Jan 2017	**616**	**1,030**	**18,078**	**19,724**
Claims and benefits paid	**(145)**	**(90)**	**(1,556)**	**(1,791)**
Increase in liabilities to policyholders	**132**	**217**	**2,257**	**2,606**
Exchange differences and other movements[2]	**14**	**9**	**471**	**494**
Gross liabilities under insurance contracts at 31 Dec 2017	**617**	**1,166**	**19,250**	**21,033**
Reinsurers' share of liabilities under insurance contracts	**(148)**	**(188)**	**–**	**(336)**
Net liabilities under insurance contracts at 31 Dec 2017	**469**	**978**	**19,250**	**20,697**
Gross liabilities under insurance contracts at 1 Jan 2016	506	904	15,254	16,664
Claims and benefits paid	(114)	(96)	(1,491)	(1,701)
Increase in liabilities to policyholders	162	206	1,802	2,170
Exchange differences and other movements[2]	62	16	2,513	2,591
Gross liabilities under insurance contracts at 31 Dec 2016	616	1,030	18,078	19,724
Reinsurers' share of liabilities under insurance contracts	(159)	(124)	–	(283)
Net liabilities under insurance contracts at 31 Dec 2016	457	906	18,078	19,441

1 *Discretionary participation features.*
2 *'Exchange differences and other movements' includes movements in liabilities arising from net unrealised investment gains recognised in other comprehensive income.*

The key factors contributing to the movement in liabilities to policyholders included death claims, surrenders, lapses, liabilities to policyholders created at the initial inception of the policies, the declaration of bonuses and other amounts attributable to policyholders.

3 Operating profit

Operating profit is stated after the following items:

	2017	2016
	£m	£m
Income		
Interest recognised on impaired financial assets	**39**	53
Fees earned on financial assets that are not at fair value through profit or loss (other than amounts included in determining the effective interest rate)	**2,780**	2,630
Fees earned on trust and other fiduciary activities	**626**	585
Expense		
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated at fair value	**(2,216)**	(2,098)
Fees payable on financial liabilities that are not at fair value through profit or loss (other than amounts included in determining the effective interest rate)	**(471)**	(390)
Fees payable relating to trust and other fiduciary activities	**(1)**	(1)
Payments under lease and sublease agreements	**(174)**	(175)
– minimum lease payments	**(171)**	(172)
– contingent rents and sublease payments	**(3)**	(3)
Gains/(losses)		
Impairment of available-for-sale equity securities	**(26)**	(4)
Gains recognised on assets held for sale	**65**	2
Loan impairment charges and other credit risk provisions	**(495)**	(416)
– net impairment charge on loans and advances	**(624)**	(479)
– release of impairment on available-for-sale debt securities	**145**	83
– other credit risk provisions	**(16)**	(20)

External net operating income is attributed to countries on the basis of the location of the branch responsible for reporting the results or advancing the funds:

	2017	2016
	£m	£m
External net operating income by country	**13,052**	13,305
– United Kingdom	**9,693**	9,907
– France	**1,708**	1,906
– Germany	**653**	598
– Turkey	**133**	406
– Other countries	**865**	488

4 Employee compensation and benefits

	2017	2016
	£m	£m
Wages and salaries	**2,550**	3,157
Social security costs	**475**	405
Post-employment benefits	**104**	149
Year ended 31 Dec	**3,129**	3,711

Average number of persons employed by the group during the year[1]

	2017	2016
Retail Banking and Wealth Management	**24,793**	26,678
Commercial Banking	**6,659**	7,025
Global Banking and Markets	**5,295**	6,355
Global Private Banking	**677**	729
Corporate Centre	**7,918**	14,559
Year ended 31 Dec	**45,342**	55,346

1 *Figures include staff seconded from HSBC UK back to the group*

The 15,447 employees in Corporate Centre transferred to the UK ServCo are excluded from the tables above from 1 July 2016 onward, the date from which the UK ServCo took over a number of operational, reporting and management tasks for payroll costs. During the year the UK ServCo has recharged £1,682m (2016: £722m) to the bank in relation to the remuneration and other costs associated with these employees. The recharge is included under 'General and administrative expenses'.

Share-based payments

The share-based payment income statement charge is recognised in wages and salaries as follows:

	2017	2016
	£m	£m
Restricted share awards	**104**	111
Savings-related and other share award option plans	**10**	13
Year ended 31 Dec	**114**	124

HSBC share awards

Award	Policy
Restricted share awards (including annual incentive awards delivered in shares) and GPSP	• An assessment of performance over the relevant period ending on 31 December is used to determine the amount of the award to be granted. • Deferred awards generally require employees to remain in employment over the vesting period and are not subject to performance conditions after the grant date. • Deferred share awards generally vest over a period of three years and GPSP awards vest after five years. • Vested shares may be subject to a retention requirement post-vesting. GPSP awards are retained until cessation of employment. • Awards granted from 2010 onwards are subject to a malus provision prior to vesting.
International Employee Share Purchase Plan ('ShareMatch')	• The plan was first introduced in Hong Kong in 2013 and now includes employees based in 25 jurisdictions. • Shares are purchased in the market each quarter up to a maximum value of £750, or the equivalent in local currency. • Matching awards are added at a ratio of one free share for every three purchased. • Matching awards vest subject to continued employment and the retention of the purchased shares for a maximum period of two years and nine months.

Movement on HSBC share awards

	2017	2016
	Number	Number
	(000s)	(000s)
Restricted share awards outstanding at 1 Jan	**30,513**	34,273
Additions during the year[1]	**17,287**	31,770
Released in the year[1]	**(21,858)**	(34,886)
Forfeited in the year	**(574)**	(644)
Restricted share awards outstanding at 31 Dec	**25,368**	30,513
Weighted average fair value of awards granted (£)	**5.00**	4.82

1 *Includes a number of share option plans transferred from or to other subsidiaries of HSBC Holdings plc.*

HSBC share option plans

Main plans	Policy
Savings-related share option plans ('Sharesave')	• Two plans: the UK Plan and the International Plan. The last grant of options under the International Plan was in 2012. • From 2014, eligible employees can save up to £500 per month with the option to use the savings to acquire shares. • Exercisable within six months following either the third or fifth anniversary of the commencement of a three-year or five-year contract, respectively. • The exercise price is set at a 20% (2016: 20%) discount to the market value immediately preceding the date of invitation.
HSBC Holdings Group share option plan	• Plan ceased in May 2005. • Exercisable between the third and tenth anniversaries of the date of grant.

Calculation of fair values

The fair values of share options are calculated using a Black-Scholes model. The fair value of a share award is based on the share price at the date of the grant.

Movement on HSBC share option plans

	Savings-related share option plans	
	Number	WAEP[1]
	(000s)	£
Outstanding at 1 Jan 2017	**34,365**	**4.32**
Granted during the year[2]	**5,510**	**5.13**
Exercised during the year[2]	**(4,438)**	**4.61**
Expired during the year	**(2,870)**	**4.41**
Outstanding at 31 Dec 2017	**32,567**	**4.51**
Weighted average remaining contractual life (years)	**2.39**	
Outstanding at 1 Jan 2016	63,261	4.35
Granted during the year[2]	8,099	4.35
Exercised during the year[2]	(26,112)	4.62
Expired during the year	(10,883)	4.46
Outstanding at 31 Dec 2016	34,365	4.32
Weighted average remaining contractual life (years)	2.87	

1 *Weighted average exercise price.*
2 *Includes a number of share option plans transferred from or to other subsidiaries of HSBC Holdings plc.*

Post-employment benefit plans

We operate a number of pension plans throughout Europe for our employees. Some are defined benefit plans, of which the largest is the HSBC Bank (UK) Pension Scheme ('the principal plan'). The Pension Risk section on page 35 contains details about the policies and practices associated with the principal plan.

The principal plan

The principal plan has a defined benefit section and a defined contribution section. The defined benefit section was closed to future benefit accrual in 2015, with defined benefits earned by employees at that date continuing to be linked to their salary while they remain employed by HSBC Bank. The plan is overseen by an independent corporate trustee, who has a fiduciary responsibility for the operation of the plan. Its assets are held separately from the assets of the Group.

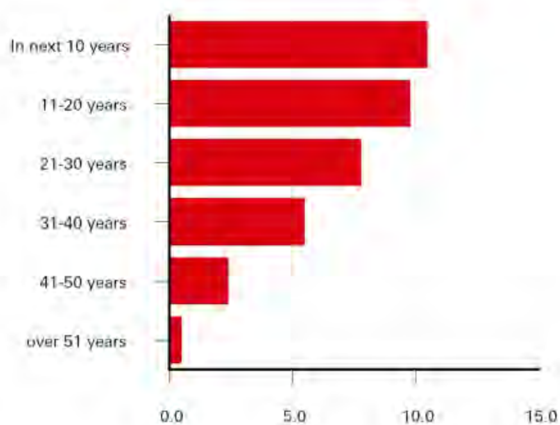
The investment strategy of the plan is to hold the majority of assets in bonds, with the remainder in a diverse range of investments. It also includes some interest rate swaps to reduce interest rate risk and inflation swaps to reduce inflation risk.

The latest funding valuation of the plan at 31 December 2014 was carried out by Colin G Singer, at Willis Towers Watson Limited, who is a Fellow of the UK Institute and Faculty of Actuaries, using the projected unit credit method. At that date, the market value of the plan's assets was £24.6bn and this exceeded the value placed on its liabilities on an ongoing basis by £520m, giving a funding level of 102%. The main differences between the assumptions used for assessing the liabilities for this funding valuation and those used for IAS 19 are more prudent assumptions for discount rate, inflation rate and life expectancy assumptions. Although the plan was in surplus at the valuation date, HSBC agreed to make further contributions to the plan to support a lower-risk investment strategy over the longer term. The remaining contributions are £64m in each of 2018 and 2019, and £160m in each of 2020 and 2021.

To meet the requirements of the Banking Reform Act, it is currently planned that from 1 July 2018, the main employer of the plan will change from HSBC Bank plc to HSBC UK Bank plc, with additional support from HSBC Holdings plc. At the same time, non-ring fenced entities including HSBC Bank plc will exit the section of the plan for ring-fenced entities and join a newly created section for the future defined benefit and defined contribution pension benefits of their employees (approximately 0.2% of the total plan). These changes are not expected to materially affect the funding position of the plan.

The chart below shows the expected profile of future benefits payable from the plan.

Future benefit payments (£bn)



The actuary also assessed the value of the liabilities if the plan were to be stopped and an insurance company asked to secure all future pension payments. This is generally larger than the amount needed on the ongoing basis described above because an insurance company would use more prudent assumptions and include an explicit allowance for the future administrative expenses of the plan. Under this approach, the amount of assets needed was estimated to be £31bn at 31 December 2014.

Income statement charge

	2017	2016
	£m	£m
Defined benefit pension plans	(40)	(73)
Defined contribution pension plans	140	214
Pension plans	**100**	141
Defined benefit and contribution healthcare plans	4	8
Year ended 31 Dec	**104**	149

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

Cumulative actuarial gains/(losses) recognised in other comprehensive income

	2017	2016
	£m	£m
At 1 Jan	**105**	352
Actuarial gains/(losses) recognised in other comprehensive income for the year	2,393	(247)
At 31 Dec	**2,498**	105

Net assets/(liabilities) recognised on the balance sheet in respect of defined benefit plans

	Fair value of plan assets	Present value of defined benefit obligations	Total
	£m	£m	£m
Defined benefit pension plans	28,309	(22,481)	5,828
Defined benefit healthcare plans	—	(100)	(100)
At 31 Dec 2017	**28,309**	**(22,581)**	**5,728**
Total employee benefit liabilities (within 'Accruals, deferred income and other liabilities')			(338)
Total employee benefit assets (within 'Prepayments, accrued income and other assets')			6,066
Defined benefit pension plans	27,321	(24,092)	3,229
Defined benefit healthcare plans	—	(113)	(113)
At 31 Dec 2016	27,321	(24,205)	3,116
Total employee benefit liabilities (within 'Accruals, deferred income and other liabilities')			(364)
Total employee benefit assets (within 'Prepayments, accrued income and other assets')			3,480

Defined benefit pension plans

Net asset/(liability) under defined benefit pension plans

	Fair value of plan assets		Present value of defined benefit obligations		Net defined benefit asset/ (liability)	
	Principal plan	Other plans	Principal plan	Other plans	Principal plan	Other plans
	£m	£m	£m	£m	£m	£m
At 1 Jan 2017	**26,891**	**430**	**(23,413)**	**(679)**	**3,478**	**(249)**
Service cost	**—**	**—**	**(90)**	**(20)**	**(90)**	**(20)**
– current service cost	**—**	**—**	**(10)**	**(20)**	**(10)**	**(20)**
– past service cost and gains/(losses) from settlements	**—**	**—**	**(80)**	**—**	**(80)**	**—**
Net interest income/(cost) on the net defined benefit asset/(liability)	**665**	**5**	**(576)**	**(9)**	**89**	**(4)**
Remeasurement effects recognised in other comprehensive income	**1,076**	**6**	**1,299**	**2**	**2,375**	**8**
– return on plan assets (excluding interest income)	**1,076**	**6**	**—**	**—**	**1,076**	**6**
– actuarial gains/(losses)	**—**	**—**	**1,299**	**2**	**1,299**	**2**
– other changes	**—**	**—**	**—**	**—**	**—**	**—**
Exchange differences	**—**	**(44)**	**—**	**48**	**—**	**4**
Transfer to another HSBC scheme[1]	**—**	**—**	**—**	**—**	**—**	**—**
Contributions by the group	**229**	**4**	**—**	**—**	**229**	**4**
– normal	**168**	**4**	**—**	**—**	**168**	**4**
– special	**61**	**—**	**—**	**—**	**61**	**—**
Contributions by employees	**—**	**—**	**—**	**—**	**—**	**—**
Benefits paid	**(888)**	**(32)**	**888**	**51**	**—**	**19**
Administrative costs and taxes paid by plan	**(33)**	**—**	**18**	**—**	**(15)**	**—**
At 31 Dec 2017	**27,940**	**369**	**(21,874)**	**(607)**	**6,066**	**(238)**
Present value of defined benefit obligation relating to:						
– actives			**(4,052)**	**(422)**		
– deferreds			**(6,468)**	**(42)**		
– pensioners			**(11,354)**	**(143)**		
At 1 Jan 2016	21,876	366	(18,506)	(559)	3,370	(193)
Service cost	—	—	(25)	(25)	(25)	(25)
– current service cost	—	—	(25)	(21)	(25)	(21)
– past service cost and gains/(losses) from settlements	—	—	—	(4)	—	(4)
Net interest income/(cost) on the net defined benefit asset/(liability)	798	10	(672)	(13)	126	(3)
Remeasurement effects recognised in other comprehensive income	4,763	12	(4,988)	(22)	(225)	(10)
– return on plan assets (excluding interest income)	4,763	12	—	—	4,763	12
– actuarial gains/(losses)	—	—	(4,988)	(22)	(4,988)	(22)
– other changes	—	—	—	—	—	—
Exchange differences	—	44	—	(86)	—	(42)
Transfer to another HSBC scheme[1]	(39)	—	39	—	—	—
Contributions by the group	233	—	—	—	233	—
– normal	151	—	—	—	151	—
– special	82	—	—	—	82	—
Contributions by employees	—	—	—	1	—	1
Benefits paid	(740)	(2)	739	25	(1)	23
Administrative costs and taxes paid by plan	—	—	—	—	—	—
At 31 Dec 2016	26,891	430	(23,413)	(679)	3,478	(249)
Present value of defined benefit obligation relating to:						
– actives			(5,390)	(461)		
– deferreds			(7,480)	(68)		
– pensioners			(10,543)	(150)		

1 *A transfer was made to the UK ServCo section in respect of the pension benefit arising from future salary increase above CPI for employees transferred to the UK ServCo during the prior year.*

Benefits expected to be paid from the HSBC UK Pension Scheme to retirees over each of the next five years, and in aggregate for the five years thereafter, are as follows:

Benefits expected to be paid from plans

	2018	2019	2020	2021	2022	2023-2027
	£m	£m	£m	£m	£m	£m
HSBC Bank (UK) Pension Scheme	**916**	944	974	1,004	1,035	5,677

Fair value of plan assets by asset classes

	31 Dec 2017				31 Dec 2016			
	Value	**Quoted market price in active market**	**No quoted market price in active market**	**Thereof HSBC[1]**	Value	Quoted market price in active market	No quoted market price in active market	Thereof HSBC[1]
	£m	**£m**	**£m**	**£m**	£m	£m	£m	£m
The principal plan								
Fair value of plan assets	**27,940**				26,891			
– equities	**4,161**	**3,696**	**465**	**—**	4,129	3,590	539	—
– bonds	**19,682**	**19,682**	**—**	**—**	19,007	19,007	—	—
– derivatives	**1,775**	**—**	**1,775**	**745**	1,709	—	1,709	712
– other	**2,322**	**1,127**	**1,195**	**—**	2,046	997	1,049	—

1 *The fair value of plan assets includes derivatives entered into by HSBC Bank plc detailed in Note 31.*

Post-employment defined benefit plans' principal actuarial financial assumptions

The group determines the discount rates to be applied to its obligations in consultation with the plans' local actuaries, on the basis of current average yields of high quality (AA-rated or equivalent) debt instruments with maturities consistent with those of the defined benefit obligations.

Key actuarial assumptions for the principal plan

	Discount rate[1]	**Inflation rate**	**Rate of increase for pensions**	**Rate of pay increase**
	%	**%**	**%**	**%**
UK				
At 31 Dec 2017	**2.60**	**3.40**	**3.10**	**3.90**
At 31 Dec 2016	2.50	3.50	3.20	4.00

1 *The discount rate applied is arrived at through looking at a reference pool of AA corporate bonds. During the year, the reference pool of bonds was amended to remove certain bonds that are UK government backed by nature. As a result, an actuarial gain of £0.8bn was recognised in the year. The discount rate on the same basis as in the prior year would have been 2.4%.*

Mortality tables and average life expectancy at age 65 for the principal plan

	Footnote	**Mortality table**	**Life expectancy at age 65 for a male member currently:**		**Life expectancy at age 65 for a female member currently:**	
			Aged 65	**Aged 45**	**Aged 65**	**Aged 45**
UK						
At 31 Dec 2017		SAPS S1[1]	**22.2**	**23.6**	**24.4**	**25.9**
At 31 Dec 2016		SAPS S1[1]	22.3	24.0	24.7	26.6

1 *Self-administered Pension Scheme ('SAPS') with Continuous Mortality Investigation 2016 improvements (2016: 2016 improvements) and a 1.25% long-term annual improvement. Heavy table with 0.98 rating for male pensioners and 0.976 rating for female pensioners.*

The effect of changes in key assumptions on the principal plan

	Impact on HSBC Bank (UK) Pension Scheme Obligation			
	Financial impact of increase		**Financial impact of decrease**	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Discount rate – increase/decrease of 0.25%	**(908)**	(1,053)	**971**	1,129
Inflation rate – increase/decrease of 0.25%	**623**	584	**(613)**	(835)
Pension payments and deferred pensions – increase/decrease of 0.25%	**958**	1,089	**(901)**	(1,021)
Pay – increase/decrease of 0.25%	**26**	65	**(26)**	(64)
Change in mortality – increase of 1 year	**967**	1,060	**n/a**	n/a

Directors' emoluments

The aggregate emoluments of the Directors of the bank, computed in accordance with the Companies Act 2006 as amended by statutory instrument 2008 No.410, were:

	2017	2016
	£000	£000
Fees[1]	1,830	1,637
Salaries and other emoluments[2]	1,581	2,161
Annual incentives[3]	810	763
Long-term incentives[4]	1,396	1,608
Year ended 31 Dec	**5,617**	6,169

1 *Fees paid to non-executive Directors.*
2 *Salaries and other emoluments include Fixed Pay Allowances.*
3 *Discretionary annual incentives for executive Directors are based on a combination of individual and corporate performance and are determined by the Remuneration Committee of the bank's parent company, HSBC Holdings plc. Incentive awards made to executive directors are delivered in the form of cash and HSBC Holdings plc shares. The total amount shown is comprised of £404,880 (2016: £381,558) in cash and £404,880 (2016: £381,558) in Restricted Shares, which is the upfront portion of the annual incentive granted in respect of performance year 2017.*
4 *The amount shown is comprised of £441,103 (2016: £410,918) in deferred cash, £700,709 (2016: £567,376) in deferred Restricted Shares, and £253,806 (2016: £630,100) in shares under the Group Performance Share Plan ('GPSP'). These amounts relate to the portion of the awards that will vest following the substantial completion of the vesting condition attached to these awards in 2017. The total vesting period of deferred cash and share awards is no less than three years, with 33% of the award vesting on each of the first and second anniversaries of the date of the award and the balance vesting on the third anniversary of the date of the award. The deferred share awards are subject to a six-month retention period upon vesting. GPSP awards are subject to a five-year vesting period and a retention requirement until cessation of employment upon vesting. Details of the Plans are contained within the Directors' Remuneration Report of HSBC Holdings plc. The cost of any awards subject to service conditions under the HSBC Share Plan 2011 are recognised through an annual charge based on the fair value of the awards, apportioned over the period of service to which the award relates.*

No Director exercised share options over HSBC Holdings plc ordinary shares during the year.

Awards were made to one Director under long-term incentive plans in respect of qualifying services rendered in 2017 (2016: two Directors). During 2017, one Director received shares in respect of awards under long-term incentive plans that vested during the year (2016: two Directors).

Retirement benefits are accruing to one Director under money purchase schemes in respect of Directors' qualifying services (2016: one Director). Contributions of £10,000 were made during the year to money purchase arrangements in respect of Directors' qualifying services (2016: £14,441).

In addition, there were payments under retirement benefit agreements with former Directors of £791,152 (2016: £836,079), including payments in respect of unfunded pension obligations to former Directors of £666,214 (2016: £713,591). The provision as at 31 December 2017 in respect of unfunded pension obligations to former Directors amounted to £11,695,477 (2016: £12,230,422).

Of these aggregate figures, the following amounts are attributable to the highest paid Director:

	2017	2016
	£000	£000
Salaries and other emoluments	1,581	1,703
Annual incentives[1]	810	594
Long-term incentives[2]	1,396	1,043
Year ended 31 Dec	**3,787**	3,340

1 *Awards made to the highest paid Director are delivered in the form of cash and HSBC Holdings plc shares. The amount shown is comprised of £404,880 (2016: £297,192) in cash and £404,880 (2016: £297,192) in Restricted Shares.*
2 *The amount shown is comprised of £441,103 (2016: £318,051) in deferred cash, £700,709 (2016: £441,673) in deferred Restricted Shares and £253,806 (2016: £283,347) in shares under the GPSP. These amounts relate to a portion of the awards that will vest following the substantial completion of the vesting condition attached to these awards in2017. The total vesting period of deferred cash and share awards is no less than three years, with 33% of the award vesting on each of the first and second anniversaries of the date of the award and the balance vesting on the third anniversary of the date of the award. The share awards are subject to a six-month retention period upon vesting. GPSP awards are subject to a five-year vesting period and a retention requirement until cessation of employment upon vesting.*

The highest paid Director received shares in respect of qualifying services under a long-term incentive scheme.

Pension contributions of £10,000 were made by the bank in respect of services by the highest paid Director during the year (2016: £12,950).

5 Auditors' remuneration

	2017	2016
	£m	£m
Audit fees payable to PwC	14.1	10.0
Audit fees payable by other HSBC group companies[1]	–	0.7
Other audit fees payable	0.5	0.5
Year ended 31 Dec	**14.6**	11.2

Fees payable by the group to PwC

	2017	2016
	£m	£m
Audit fees for HSBC Bank plc's statutory audit[2]: current year	7.7	6.4
Fees for other services provided to the group	13.3	8.5
– audit of the group's subsidiaries[3]	6.4	3.6
– audit-related assurance services[4]	5.5	3.7
– taxation compliance services	—	0.1
– taxation advisory services	—	0.1
– other assurance services	0.1	—
– other non-audit services[5]	1.3	1.0
Year ended 31 Dec	21.0	14.9

1 *Audit fees in 2016 included an allocation of amounts paid by other HSBC Group companies for which the audit work undertaken benefits to the group.*
2 *Fees payable to PwC for the statutory audit of the consolidated financial statements of the group and the separate financial statements of HSBC Bank plc. They exclude amounts payable for the statutory audit of the bank's subsidiaries which have been included in 'Fees for other services provided to the group'.*
3 *Including fees payable to PwC for the statutory audit of the bank's subsidiaries.*
4 *Including services for assurance and other services that relate to statutory and regulatory filings, including comfort letters and interim reviews.*
5 *Including other permitted services relating to advisory, corporate finance transactions, etc.*

Fees payable for non-audit services for HSBC Bank plc are not disclosed separately because such fees are disclosed on a consolidated basis for the group.

6 Tax

Tax expense

	2017	2016
	£m	£m
Current tax	599	969
– for this year	642	957
– adjustments in respect of prior years	(43)	12
Deferred tax	(71)	84
– origination and reversal of temporary differences	(18)	97
– effect of changes in tax rates	(15)	(27)
– adjustments in respect of prior years	(38)	14
Year ended 31 Dec	528	1,053

The group's profits are taxed at different rates depending on the country in which the profits arise. The key applicable corporate tax rates in 2017 include the UK and France. The UK tax rate applying to HSBC Bank plc and its banking subsidiaries was 27.25% (2016: 28%), comprising 19.25% corporation tax plus 8% surcharge on UK banking profits. The decrease from 2016 is due to the reduction in the corporation tax rate to 19% from 1 April 2017. The 19% rate of corporation tax in the UK will be reduced to 17% on 1 April 2020. The applicable tax rate in France was 44% (2016: 34%) and will be reduced to 26% from 1 January 2022. The increase from 2016 is due to an exceptional tax contribution which applies for 2017 only. Other overseas subsidiaries and overseas branches provided for taxation at the appropriate rates in the countries in which they operate.

Tax reconciliation

The tax charged to the income statement differs from the tax expense that would apply if all profits had been taxed at the UK corporation tax rate as follows:

	2017		2016	
	£m	%	£m	%
Profit before tax	2,370		874	
Tax expense				
UK corporation tax at 19.25% (2016: 20.00%)	456	19.25	175	20.0
Non-deductible customer compensation expense	129	5.4	165	18.9
8% surcharge on UK banking profits	108	4.6	160	18.3
Impact of taxing overseas profits at different rates	106	4.5	74	8.5
Permanent disallowables	99	4.2	22	2.5
Local taxes and overseas withholding taxes	31	1.3	47	5.4
Impairment of goodwill	9	0.3	436	50.0
Non-deductible regulatory settlements	(153)	(6.5)	9	1.0
Non-taxable income and gains subject to tax at a lower rate	(129)	(5.4)	(53)	(6.1)
Adjustment in respect of prior years	(81)	(3.4)	26	3.0
Movements in unrecognised deferred tax	(25)	(1.1)	9	1.0
Change in tax rates	(15)	(0.6)	(27)	(3.1)
Other	(7)	(0.3)	10	1.1
Year ended 31 Dec	528	22.3	1,053	120.5

The effective tax rate for the year of 22.3% (2016: 120.5%). This was lower than 2016 due to the reversal of non-taxable regulatory provisions in 2017 and a large non-deductible goodwill impairment charge in 2016.

Accounting for taxes involves some estimation because the tax law is uncertain and the application requires a degree of judgement, which authorities may dispute. Liabilities are recognised based on best estimates of the probable outcome, taking into account external advice where appropriate. We do not expect significant liabilities to arise in excess of the amounts provided. The current tax asset includes an estimate of tax recoverable from HMRC with regards to past dividends received from EU resident companies. The ultimate resolution of this matter involves litigation for which the outcome is uncertain and is unlikely to be resolved in the short-term.

Movement of deferred tax assets and liabilities

The group	Retirement benefits £m	Loan impairment allowances £m	Property, plant and equipment £m	Available-for-sale investments £m	Goodwill and intangibles £m	Other[1] £m	Total £m
At 1 Jan 2017	**(765)**	**67**	**290**	**(100)**	**147**	**(16)**	**(377)**
– assets[2]	**75**	**78**	**297**	**—**	**156**	**428**	**1,034**
– liabilities[2]	**(840)**	**(11)**	**(7)**	**(100)**	**(9)**	**(444)**	**(1,411)**
Income statement	**(61)**	**(22)**	**73**	**(4)**	**36**	**49**	**71**
Other comprehensive income	**(596)**	**—**	**—**	**27**	**—**	**67**	**(502)**
Equity	**—**	**—**	**—**	**—**	**—**	**11**	**11**
Foreign exchange and other adjustments	**1**	**(15)**	**(14)**	**(3)**	**2**	**23**	**(6)**
At 31 Dec 2017	**(1,421)**	**30**	**349**	**(80)**	**185**	**134**	**(803)**
– assets[2]	**34**	**35**	**349**	**—**	**185**	**134**	**737**
– liabilities[2]	**(1,455)**	**(5)**	**—**	**(80)**	**—**	**—**	**(1,540)**
At 1 Jan 2016	(781)	60	316	(85)	117	(23)	(396)
– assets[2]	—	68	316	—	121	178	683
– liabilities[2]	(781)	(8)	—	(85)	(4)	(201)	(1,079)
Income statement	(53)	(6)	(8)	(1)	31	(47)	(84)
Other comprehensive income	54	—	—	7	—	(2)	59
Equity	—	—	—	—	—	11	11
Foreign exchange and other adjustments	15	13	(18)	(21)	(1)	45	33
At 31 Dec 2016	(765)	67	290	(100)	147	(16)	(377)
– assets[2]	75	78	297	—	156	428	1,034
– liabilities[2]	(840)	(11)	(7)	(100)	(9)	(444)	(1,411)

1 *Other deferred tax assets and liabilities relate to unused tax losses, share-based payments and cash flow hedges.*
2 *After netting off balances within countries, the balances as disclosed in the accounts are as follows: deferred tax assets £130m (2016: £107m); and deferred tax liabilities £933m (2016: £484m).*

Movement of deferred tax assets and liabilities

The bank	Retirement benefits £m	Property, plant and equipment £m	Goodwill and intangibles £m	Other[1] £m	Total £m
At 1 Jan 2017	**(838)**	**217**	**156**	**1**	**(464)**
– assets[2]	**—**	**217**	**156**	**94**	**467**
– liabilities[2]	**(838)**	**—**	**—**	**(93)**	**(931)**
Income statement	**(57)**	**72**	**35**	**79**	**129**
Other comprehensive income	**(594)**	**—**	**—**	**—**	**(594)**
Equity	**—**	**—**	**—**	**—**	**—**
Foreign exchange and other adjustments	**—**	**—**	**1**	**1**	**2**
At 31 Dec 2017	**(1,489)**	**289**	**192**	**81**	**(927)**
– assets[2]	**—**	**289**	**192**	**81**	**562**
– liabilities[2]	**(1,489)**	**—**	**—**	**—**	**(1,489)**
At 1 Jan 2016	(848)	223	128	11	(486)
– assets[2]	—	223	128	64	415
– liabilities[2]	(848)	—	—	(53)	(901)
Income statement	(55)	(6)	28	(7)	(40)
Other comprehensive income	60	—	—	(14)	46
Equity	—	—	—	11	11
Foreign exchange and other adjustments	5	—	—	—	5
At 31 Dec 2016	(838)	217	156	1	(464)
– assets[2]	—	217	156	94	467
– liabilities[2]	(838)	—	—	(93)	(931)

1 *Other deferred tax assets and liabilities relate to loan impairment allowances, unused tax losses, share-based payments and cash flow hedges.*
2 *After netting off balances within countries, the balances as disclosed in the accounts are as follows: deferred tax assets £5m (2016: £6m) and deferred tax liabilities £932m (2016: £468m).*

Unrecognised deferred tax

The group

The amount of temporary differences, unused tax losses and tax credits for which no deferred tax asset is recognised in the balance sheet was £765m (2016: £655m). These amounts include unused tax losses and tax credits arising in the US branch of £513m (2016: £519m) and unused temporary differences and tax losses in Europe of £251m (2016: £58m), of which £208m (2016: £nil) arises as a result of the bank's election to exempt its overseas branches from UK taxation. The majority of the unrecognised losses in group expire after 10 years.

The bank

The amount of temporary differences, unused tax losses and tax credits for which no deferred tax asset is recognised in the balance sheet was £707m (2016: £521m). These amounts include unused tax losses and tax credits arising in the US branch of £513m (2016: £519m) and unused temporary differences and tax losses in Europe of £251m (2016: £58m), of which £208m (2016: £nil) arises as a result of the bank's election to exempt its overseas branches from UK taxation. The unrecognised losses in bank expire after 10 years.

There are no unrecognised deferred tax liabilities arising from the group's investments in subsidiaries and branches.

7 Dividends

Dividends to shareholders of the parent company

	2017		2016	
	£ per share	£m	£ per share	£m
Dividends paid on ordinary shares				
Second interim dividend in respect of the previous year	**0.52**	**415**	0.34	272
First interim dividend in respect of the current year	**0.23**	**186**	0.32	255
Total	**0.75**	**601**	0.66	527
Dividends on preference shares classified as equity				
Dividend on HSBC Bank plc non-cumulative third dollar preference shares	**1.43**	**50**	1.54	54
Total	**1.43**	**50**	1.54	54

A second interim dividend for 2017 of £583m to shareholders of the parent company was declared by the Directors after 31 December 2017 (Note 32). The total dividend declared on ordinary shares in respect of 2017 was £769m (2016: £670m).

Distribution in-specie of HSBC Bank A.S.

An interim dividend in-specie of the bank's shareholding in HSBC Bank A.S. was declared by the board on 4 May 2017 and distributed on 29 June 2017 to the parent company, representing the bank's 100% holding of the 0.01 Turkish Lira common shares.

Total coupons on capital securities classified as equity

		2017	2016
	First call date	£m	£m
Undated Subordinated additional Tier 1 instruments			
– £1,096m	Dec 2019	**59**	61
– £1,100m	Dec 2024	**61**	63
– €1,900m	Dec 2020	**100**	95
– €235m	Jan 2022	**1**	–
		221	219

8 Trading assets

	The group		The bank	
	2017	2016	2017	2016
	£m	£m	£m	£m
Treasury and other eligible bills	**1,948**	848	**1,379**	513
Debt securities[1, 2]	**37,536**	39,191	**22,333**	23,298
Equity securities	**63,131**	43,575	**60,384**	41,951
Trading securities	**102,615**	83,614	**84,096**	65,762
Loans and advances to banks[3]	**20,590**	19,652	**17,744**	16,902
Loans and advances to customers[3]	**22,520**	21,803	**22,254**	19,743
At 31 Dec	**145,725**	125,069	**124,094**	102,407

1 *Included within the above figures for the group are debt securities issued by banks and other financial institutions of £8,659m (2016: £8,202m), of which £551m (2016: £571m) are guaranteed by various governments.*
2 *Included within the above figures for the bank are debt securities issued by banks and other financial institutions of £6,272m (2016: £6,521m), of which nil (2016: nil) are guaranteed by governments.*
3 *Loans and advances to banks and customers include settlement accounts, stock borrowing, reverse repos and other amounts.*

9 Fair values of financial instruments carried at fair value

Control framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk taker.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, the group will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors that are considered in this regard are, *inter alia*:

- the extent to which prices may be expected to represent genuine traded or tradable prices;
- the degree of similarity between financial instruments;
- the degree of consistency between different sources;
- the process followed by the pricing provider to derive the data;
- the elapsed time between the date to which the market data relates and the balance sheet date; and
- the manner in which the data was sourced.

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

Financial liabilities measured at fair value

In certain circumstances, the group records its own debt in issue at fair value, based on quoted prices in an active market for the specific instrument. When quoted market prices are unavailable, the own debt in issue is valued using valuation techniques, the inputs for which are based either on quoted prices in an inactive market for the instrument or are estimated by comparison with quoted prices in an active market for similar instruments. In both cases, the fair value includes the effect of applying the credit spread that is appropriate to the group's liabilities.

Structured notes issued and certain other hybrid instruments are included within trading liabilities and are measured at fair value. The spread applied to these instruments is derived from the spreads at which the group issues structured notes.

Fair value hierarchy

Fair values of financial assets and liabilities are determined according to the following hierarchy:

- Level 1 – valuation technique using quoted market price: financial instruments with quoted prices for identical instruments in active markets that HSBC can access at the measurement date.
- Level 2 – valuation technique using observable inputs: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
- Level 3 – valuation technique with significant unobservable inputs: financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

Financial instruments carried at fair value and bases of valuation

The group	2017 Level 1 £m	2017 Level 2 £m	2017 Level 3 £m	2017 Total £m	2016 Level 1 £m	2016 Level 2 £m	2016 Level 3 £m	2016 Total £m
Recurring fair value measurements at 31 Dec								
Assets								
Trading assets	**92,032**	**51,409**	**2,284**	**145,725**	72,327	50,021	2,721	125,069
Financial assets designated at fair value	**8,936**	**276**	**54**	**9,266**	8,048	276	21	8,345
Derivatives	**234**	**141,337**	**1,764**	**143,335**	242	197,026	2,151	199,419
Financial investments: available-for-sale	**46,967**	**9,598**	**1,435**	**58,000**	69,288	12,865	982	83,135
Liabilities								
Trading liabilities	**31,396**	**74,096**	**1,004**	**106,496**	22,165	71,007	762	93,934
Financial liabilities designated at fair value	**3,082**	**15,167**	**—**	**18,249**	3,446	15,035	5	18,486
Derivatives	**597**	**138,140**	**1,333**	**140,070**	763	187,452	1,877	190,092

The bank	2017 Level 1 £m	2017 Level 2 £m	2017 Level 3 £m	2017 Total £m	2016 Level 1 £m	2016 Level 2 £m	2016 Level 3 £m	2016 Total £m
Recurring fair value measurements at 31 Dec								
Assets								
Trading assets	**74,535**	**47,200**	**2,359**	**124,094**	55,375	44,310	2,722	102,407
Financial assets designated at fair value	**—**	**—**	**—**	**—**	—	—	—	—
Derivatives	**69**	**133,359**	**1,808**	**135,236**	19	183,518	2,242	185,779
Financial investments: available-for-sale	**27,493**	**2,817**	**1,072**	**31,382**	44,657	3,389	1,426	49,472
Liabilities								
Trading liabilities	**10,529**	**66,042**	**732**	**77,303**	9,781	61,859	499	72,139
Financial liabilities designated at fair value	**—**	**11,006**	**—**	**11,006**	—	10,175	—	10,175
Derivatives	**425**	**131,003**	**1,607**	**133,035**	390	176,976	2,115	179,481

Transfers between Level 1 and Level 2 fair values

	Assets				Liabilities		
	Available for sale £m	Held for trading £m	Designated at fair value £m	Derivatives £m	Held for trading £m	Designated at fair value £m	Derivatives £m
At 31 Dec 2017							
Transfers from Level 1 to Level 2	**714**	**29**	**—**	**—**	**11**	**—**	**—**
Transfers from Level 2 to Level 1	**—**	**84**	**—**	**—**	**28**	**—**	**—**
At 31 Dec 2016							
Transfers from Level 1 to Level 2	—	—	—	377	—	—	166
Transfers from Level 2 to Level 1	978	—	—	—	—	—	—

Fair value adjustments

Fair value adjustments are adopted when the group determines there are additional factors considered by market participants that are not incorporated within the valuation model. Movements in the level of fair value adjustments do not necessarily result in the recognition of profits or losses within the income statement, such as when models are enhanced and fair value adjustments may no longer be required.

Bid-offer

IFRS 13 'Fair value measurement' requires use of the price within the bid-offer spread that is most representative of fair value. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the extent to which bid-offer costs would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the position.

Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, an adjustment may be necessary to reflect the likelihood that market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model.

Credit and debit valuation adjustments

The CVA is an adjustment to the valuation of over-the-counter ('OTC') derivative contracts to reflect the possibility that the counterparty may default, and that the group may not receive the full market value of the transactions.

The DVA is an adjustment to the valuation of OTC derivative contracts to reflect the possibility that HSBC may default, and that it may not pay the full market value of the transactions.

HSBC calculates a separate CVA and DVA for each legal entity, and for each counterparty to which the entity has exposure. With the exception of central clearing parties, all third-party counterparties are included in the CVA and DVA calculations, and these adjustments are not netted across Group entities.

HSBC calculates the CVA by applying the probability of default ('PD') of the counterparty, conditional on the non-default of HSBC, to HSBC's expected positive exposure to the counterparty and multiplying the result by the loss expected in the event of default.

Conversely, HSBC calculates the DVA by applying the PD of HSBC, conditional on the non-default of the counterparty, to the expected positive exposure of the counterparty to HSBC and multiplying the result by the proportional loss expected in the event of default. Both calculations are performed over the life of the potential exposure.

For most products, HSBC uses a simulation methodology, which incorporates a range of potential exposures over the life of the portfolio, to calculate the expected positive exposure to a counterparty. The simulation methodology includes credit mitigants, such as counterparty netting agreements and collateral agreements with the counterparty.

The methodologies do not, in general, account for 'wrong-way risk', which arises when the underlying value of the derivative prior to any CVA is positively correlated to the PD of the counterparty. When there is significant wrong-way risk, a trade-specific approach is applied to reflect this risk in the valuation.

Funding fair value adjustment

The FFVA is calculated by applying future market funding spreads to the expected future funding exposure of any uncollateralised component of the OTC derivative portfolio. The expected future funding exposure is calculated by a simulation methodology, where available, and is adjusted for events that may terminate the exposure, such as the default of HSBC or the counterparty. The FFVA and DVA are calculated independently.

Model limitation

Models used for portfolio valuation purposes may be based upon a simplified set of assumptions that do not capture all current and future material market characteristics. In these circumstances, model limitation adjustments are adopted.

Inception profit (Day 1 P&L reserves)

Inception profit adjustments are adopted when the fair value estimated by a valuation model is based on one or more significant unobservable inputs. The accounting for inception profit adjustments is discussed in Note 1.

Fair value valuation bases

Financial instruments measured at fair value using a valuation technique with significant unobservable inputs – Level 3

	Assets					Liabilities			
	Available for sale	Held for trading	Designated at fair value	Derivatives	Total	Held for trading	Designated at fair value	Derivatives	Total
The group	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Private equity including strategic investments	**547**	**15**	**54**	**—**	**616**	**14**	**—**	**—**	**14**
Asset-backed securities	**879**	**888**	**—**	**—**	**1,767**	**—**	**—**	**—**	**—**
Structured notes	**—**	**2**	**—**	**—**	**2**	**990**	**—**	**—**	**990**
Derivatives	**—**	**—**	**—**	**1,764**	**1,764**	**—**	**—**	**1,333**	**1,333**
Other portfolios	**9**	**1,379**	**—**	**—**	**1,388**	**—**	**—**	**—**	**—**
At 31 Dec 2017	**1,435**	**2,284**	**54**	**1,764**	**5,537**	**1,004**	**—**	**1,333**	**2,337**
Private equity including strategic investments	425	21	17	—	463	21	—	—	21
Asset-backed securities	528	538	—	—	1,066	—	—	—	—
Structured notes	—	2	—	—	2	741	—	—	741
Derivatives	—	—	—	2,151	2,151	—	—	1,877	1,877
Other portfolios	29	2,160	4	—	2,193	—	5	—	5
At 31 Dec 2016	982	2,721	21	2,151	5,875	762	5	1,877	2,644

	Assets					Liabilities			
	Available for sale	Held for trading	Designated at fair value	Derivatives	Total	Held for trading	Designated at fair value	Derivatives	Total
The bank	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Private equity including strategic investments	**347**	**—**	**—**	**—**	**347**	**—**	**—**	**—**	**—**
Asset-backed securities	**725**	**980**	**—**	**—**	**1,705**	**—**	**—**	**—**	**—**
Structured notes	**—**	**—**	**—**	**—**	**—**	**732**	**—**	**—**	**732**
Derivatives	**—**	**—**	**—**	**1,808**	**1,808**	**—**	**—**	**1,607**	**1,607**
Other portfolios	**—**	**1,379**	**—**	**—**	**1,379**	**—**	**—**	**—**	**—**
At 31 Dec 2017	**1,072**	**2,359**	**—**	**1,808**	**5,239**	**732**	**—**	**1,607**	**2,339**
Private equity including strategic investments	210	—	—	—	210	—	—	—	—
Asset-backed securities	1,216	561	—	—	1,777	—	—	—	—
Structured notes	—	—	—	—	—	499	—	—	499
Derivatives	—	—	—	2,242	2,242	—	—	2,115	2,115
Other portfolios	—	2,161	—	—	2,161	—	—	—	—
At 31 Dec 2016	1,426	2,722	—	2,242	6,390	499	—	2,115	2,614

Level 3 instruments are present in both ongoing and legacy businesses. Loans held for securitisation, derivatives with monolines, certain 'other derivatives' and predominantly all Level 3 ABSs are legacy positions. HSBC has the capability to hold these positions.

Private equity including strategic investments

The investment's fair value is estimated: on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors; by reference to market valuations for similar entities quoted in an active market; or the price at which similar companies have changed ownership.

Asset-backed securities

While quoted market prices are generally used to determine the fair value of these securities, valuation models are used to substantiate the reliability of the limited market data available and to identify whether any adjustments to quoted market prices are required. For certain ABSs, such as residential mortgage-backed securities, the valuation uses an industry standard model with assumptions relating to prepayment speeds, default rates and loss severity based on collateral type, and performance, as appropriate. The valuations output is benchmarked for consistency against observable data for securities of a similar nature.

Structured notes

The fair value of Level 3 structured notes is derived from the fair value of the underlying debt security, and the fair value of the embedded derivative is determined as described in the paragraph below on derivatives. These structured notes comprise principally equity-linked notes, issued by HSBC, which provide the counterparty with a return linked to the performance of equity securities and other portfolios. Examples of the unobservable parameters include long-dated equity volatilities and correlations between equity prices, and interest and foreign exchange rates.

Derivatives

OTC derivative valuation models calculate the present value of expected future cash flows, based upon 'no-arbitrage' principles. For many vanilla derivative products, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some differences in market practice. Inputs to valuation models are determined from observable market data, wherever possible, including prices available from exchanges, dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices through model calibration procedures or estimated from historical data or other sources.

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

Movement in Level 3 financial instruments

	Assets				Liabilities		
	Available for sale	Held for trading	Designated at fair value	Derivatives	Held for trading	Designated at fair value	Derivatives
The group	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
At 1 Jan 2017	**982**	**2,721**	**21**	**2,151**	**762**	**5**	**1,877**
Total gains/(losses) recognised in profit or loss	**(24)**	**(171)**	**(3)**	**36**	**52**	**(5)**	**433**
– trading income/(expense) excluding net interest income	**—**	**(171)**	**—**	**36**	**52**	**—**	**433**
– gains less losses from financial investments	**(24)**	**—**	**(3)**	**—**	**—**	**(5)**	**—**
Total gains/(losses) recognised in other comprehensive income ('OCI')[1]	**108**	**(121)**	**1**	**(26)**	**8**	**—**	**(30)**
– available-for-sale investments: fair value gains/(losses)	**146**	**—**	**—**	**—**	**—**	**—**	**—**
– cash flow hedges: fair value gains/(losses)	**—**	**—**	**—**	**(18)**	**—**	**—**	**(28)**
– exchange differences	**(38)**	**(121)**	**1**	**(8)**	**8**	**—**	**(2)**
Purchases	**112**	**1,026**	**36**	**2**	**4**	**—**	**—**
New issuances	**—**	**—**	**—**	**—**	**776**	**—**	**—**
Sales	**(131)**	**(1,464)**	**—**	**(6)**	**(9)**	**—**	**(12)**
Settlements	**(46)**	**(230)**	**—**	**(12)**	**(459)**	**—**	**(272)**
Transfers out	**(269)**	**(101)**	**(1)**	**(595)**	**(144)**	**—**	**(814)**
Transfers in	**703**	**624**	**—**	**214**	**14**	**—**	**151**
At 31 Dec 2017	**1,435**	**2,284**	**54**	**1,764**	**1,004**	**—**	**1,333**
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 31 Dec 2017	**17**	**22**	**4**	**76**	**156**	**—**	**173**
– trading income/(expense) excluding net interest income	**—**	**22**	**—**	**76**	**156**	**—**	**173**
– net income/(expense) from other financial instruments designated at fair value	**—**	**—**	**4**	**—**	**—**	**—**	**—**
– loan impairment charges and other credit risk provisions	**17**	**—**	**—**	**—**	**—**	**—**	**—**
At 1 Jan 2016	1,465	2,442	2	1,458	497	2	745
Total gains/(losses) recognised in profit or loss	(3)	15	—	994	208	—	1,046
– trading income/(expense) excluding net interest income	—	15	—	994	208	—	1,046
– gains less losses from financial investments	(3)	—	—	—	—	—	—
Total gains/(losses) recognised in other comprehensive income ('OCI')[1]	262	26	—	43	33	—	6
– available-for-sale investments: fair value gains/(losses)	181	—	—	—	—	—	—
– cash flow hedges: fair value gains/(losses)	—	—	—	—	—	—	—
– exchange differences	81	26	—	43	33	—	6
Purchases	120	452	21	—	16	4	—
New issuances	—	—	—	—	850	—	—
Sales	(532)	(1,150)	(2)	—	(30)	(1)	—
Settlements	(49)	(194)	—	(168)	(635)	—	(7)
Transfers out	(704)	(99)	—	(183)	(178)	—	(176)
Transfers in	423	1,229	—	7	1	—	263
At 31 Dec 2016	982	2,721	21	2,151	762	5	1,877
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 31 Dec 2016	25	(135)	(1)	306	(58)	—	(149)
– trading income/(expense) excluding net interest income	—	(135)	—	306	(58)	—	(149)
– net income from other financial instruments designated at fair value	—	—	(1)	—	—	—	—
– loan impairment charges and other credit risk provisions	25	—	—	—	—	—	—

1 *Included in 'Available-for-sale investments: fair value gains/(losses)' and 'Exchange differences' in the consolidated statement of comprehensive income.*

Movement in Level 3 financial instruments (continued)

	Assets			Liabilities	
	Available for sale	Held for trading	Derivatives	Held for trading	Derivatives
The bank[1]	£m	£m	£m	£m	£m
At 1 Jan 2017	**1,426**	**2,722**	**2,242**	**499**	**2,115**
Total gains/(losses) recognised in profit or loss	**–**	**(139)**	**33**	**28**	**427**
– trading income/(expense) excluding net interest income	**–**	**(139)**	**33**	**28**	**427**
– gains less losses from financial investments	**–**	**–**	**–**	**–**	**–**
Total gains/(losses) recognised in other comprehensive income ('OCI')[2]	**189**	**(122)**	**(42)**	**–**	**(30)**
– available-for-sale investments: fair value gains/(losses)	**197**	**–**	**–**	**–**	**–**
– cash flow hedges: fair value gains/(losses)	**–**	**–**	**(25)**	**–**	**(28)**
– exchange differences	**(8)**	**(122)**	**(17)**	**–**	**(2)**
Purchases	**846**	**1,097**	**1**	**–**	**15**
New issuances	**–**	**–**	**–**	**756**	**–**
Sales	**(1,131)**	**(1,491)**	**(6)**	**(6)**	**(9)**
Settlements	**(224)**	**(222)**	**(3)**	**(416)**	**(244)**
Transfers out	**(51)**	**(106)**	**(649)**	**(129)**	**(847)**
Transfers in	**17**	**620**	**232**	**–**	**180**
At 31 Dec 2017	**1,072**	**2,359**	**1,808**	**732**	**1,607**
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 31 Dec 2017	**–**	**22**	**(38)**	**130**	**177**
– trading income/(expense) excluding net interest income	**–**	**22**	**(38)**	**130**	**177**
– net income/(expense) from other financial instruments designated at fair value	**–**	**–**	**–**	**–**	**–**
– loan impairment charges and other credit risk provisions	**–**	**–**	**–**	**–**	**–**
At 1 Jan 2016	1,778	2,432	1,501	331	917
Total gains/(losses) recognised in profit or loss	(5)	11	1,091	124	1,138
– trading income/(expense) excluding net interest income	–	11	1,091	124	1,138
– gains less losses from financial investments	(5)	–	–	–	–
Total gains/(losses) recognised in other comprehensive income ('OCI')[2]	381	21	–	–	(1)
– available-for-sale investments: fair value gains/(losses)	381	–	–	–	–
– cash flow hedges: fair value gains/(losses)	–	–	–	–	–
– exchange differences	–	21	–	–	(1)
Purchases	82	464	–	–	–
New issuances			–	843	–
Sales	(756)	(1,158)	–	(27)	–
Settlements	(26)	(178)	(164)	(599)	(35)
Transfers out	(88)	(99)	(191)	(174)	(173)
Transfers in	60	1,229	5	1	269
At 31 Dec 2016	1,426	2,722	2,242	499	2,115
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 31 Dec 2016	(13)	(135)	348	(66)	(154)
– trading income/(expense) excluding net interest income	–	(135)	348	(66)	(154)
– net income from other financial instruments designated at fair value	–	–	–	–	–
– loan impairment charges and other credit risk provisions	(13)	–	–	–	–

1 The bank had no level 3 assets or liabilities designated at fair value in 2017 (2016: nil).
2 Included in 'Available-for-sale investments: fair value gains/(losses)' and 'Exchange differences' in the consolidated statement of comprehensive income.

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

Sensitivity of Level 3 fair values to reasonably possible alternative assumptions

	2017				2016			
	Reflected in profit or loss		Reflected in OCI		Reflected in profit or loss		Reflected in OCI	
	Favourable changes	Un-favourable changes	Favourable changes	Un-favourable changes	Favourable changes	Un-favourable changes	Favourable changes	Un-favourable changes
The group	£m	£m	£m	£m	£m	£m	£m	£m
Derivatives, trading assets and trading liabilities[1]	150	(141)	–	–	136	(128)	–	–
Financial assets and liabilities designated at fair value	3	(3)	–	–	–	(1)	–	–
Financial investments: available-for-sale	53	(77)	2	(2)	10	(3)	62	(54)
At 31 Dec	206	(221)	2	(2)	146	(132)	62	(54)
The bank								
Derivatives, trading assets and trading liabilities[1]	136	(127)	–	–	115	(107)	–	–
Financial assets and liabilities designated at fair value	–	–	–	–	–	–	–	–
Financial investments: available-for-sale	43	(40)	–	–	10	(30)	26	(22)
At 31 Dec	179	(167)	–	–	125	(137)	26	(22)

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

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

	2017				2016			
	Reflected in profit or loss		Reflected in OCI		Reflected in profit or loss		Reflected in OCI	
	Favourable changes	Un-favourable changes	Favourable changes	Un-favourable changes	Favourable changes	Un-favourable changes	Favourable changes	Un-favourable changes
	£m	£m	£m	£m	£m	£m	£m	£m
Private equity including strategic investments	55	(53)	2	(2)	7	(5)	41	(33)
Asset-backed securities	34	(40)	–	–	30	(7)	21	(21)
Structured notes	6	(6)	–	–	5	(6)	–	–
Derivatives	82	(84)	–	–	71	(70)	–	–
Other portfolios	29	(38)	–	–	33	(44)	–	–
At 31 Dec	206	(221)	2	(2)	146	(132)	62	(54)

The sensitivity analysis aims to measure a range of fair values consistent with the application of a 95% confidence interval. Methodologies take account of the nature of the valuation technique employed, as well as the availability and reliability of observable proxy and historical data.

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

Key unobservable inputs to Level 3 financial instruments

Quantitative information about significant unobservable inputs in Level 3 valuations

	2017									2016			
	Fair value												
	Assets	Liabilities	Valuation techniques	Key unobservable inputs	Full range of inputs		Core range of inputs[1]			Full range of inputs		Core range of inputs[1]	
	£m	£m			Lower	Higher	Lower	Higher		Lower	Higher	Lower	Higher
Private equity including	616	14	See page	See page	n/a	n/a	n/a	n/a		n/a	n/a	n/a	n/a
Asset-backed securities	1,767	–											
– CLO/CDO[2]	325	–	Market proxy	Bid quotes	–	101	13	57		–	101	42	94
– Other ABSs	1,442	–	Market proxy	Bid quotes	–	103	35	99		–	96	57	90
Structured notes	2	990											
– equity-linked notes	–	725	Model-Option model	Equity volatility	7%	57%	11%	24%		12%	96%	13%	40%
	–	228	Model-Option model	Equity correlation	34%	91%	41%	60%		33%	91%	43%	80%
– fund-linked notes	–	5	Model-Option model	Fund volatility	6%	15%	6%	15%		6%	11%	6%	11%
– FX-linked notes	–	32	Model-Option model	FX volatility	4%	20%	5%	17%		6%	24%	6%	24%
– other	2	–											
Derivatives	1,764	1,333											
Interest rate derivatives:	1,348	753											
– securitisation swaps	211	596	Model-Discounted cash flow	Prepayment rate	20%	90%	20%	90%		–	90%	8%	27%
– long-dated swaptions	915	49	Model-Option model	IR volatility	8%	41%	16%	34%		8%	101%	21%	39%
– other	222	108											
FX derivatives:	154	143											
– FX options	154	143	Model-Option model	FX Volatility	1%	26%	6%	15%		1%	26%	11%	17%
Equity derivatives:	239	413											
– long-dated single stock options	82	135	Model-Option model	Equity volatility	8%	49%	12%	36%		11%	84%	15%	34%
– other	157	278											
Credit derivatives:	23	24											
Other portfolios	1,388	–											
– structured certificates	895	–	Model-Discounted cash flow	Credit volatility	2%	4%	2%	4%		3%	4%	3%	4%
– other	493	–											
At 31 Dec	5,537	2,337											

1 The core range of inputs is the estimated range within which 90% of the inputs fall.
2 Collateralised loan obligation/collateralised debt obligation.

Private equity including strategic investments

Given the bespoke nature of the analysis in respect of each holding, it is not practical to quote a range of key unobservable inputs.

Prepayment rates

Prepayment rates are a measure of the anticipated future speed at which a loan portfolio will be repaid in advance of the due date. They vary according to the nature of the loan portfolio and expectations of future market conditions, and may be estimated using a variety of evidence, such as prepayment rates implied from proxy observable security prices, current or historical prepayment rates and macroeconomic modelling.

Market proxy

Market proxy pricing may be used for an instrument when specific market pricing is not available, but there is evidence from instruments with common characteristics. In some cases, it might be possible to identify a specific proxy, but more generally evidence across a wider range of instruments will be used to understand the factors that influence current market pricing and the manner of that influence.

Volatility

Volatility is a measure of the anticipated future variability of a market price. It varies by underlying reference market price, and by strike and maturity of the option.

Certain volatilities, typically those of a longer-dated nature, are unobservable and estimated from observable data. The range of unobservable volatilities reflects the wide variation in volatility inputs by reference market price. The core range is significantly narrower than the full range because these examples with extreme volatilities occur relatively rarely within the HSBC portfolio.

Correlation

Correlation is a measure of the inter-relationship between two market prices, and is expressed as a number between minus one and one. It is used to value more complex instruments where the payout is dependent upon more than one market price. There is a wide range of instruments for which correlation is an input, and consequently a wide range of both same-asset correlations and cross-asset correlations is used. In general, the range of same-asset correlations will be narrower than the range of cross-asset correlations.

Unobservable correlations may be estimated based upon a range of evidence, including consensus pricing services, HSBC trade prices, proxy correlations and examination of historical price relationships. The range of unobservable correlations quoted in the table reflects the wide variation in correlation inputs by market price pair.

Credit spread

Credit spread is the premium over a benchmark interest rate required by the market to accept lower credit quality. In a discounted cash flow model, the credit spread increases the discount factors applied to future cash flows, thereby reducing the value of an asset. Credit spreads may be implied from market prices and may not be observable in more illiquid markets.

Inter-relationships between key unobservable inputs

Key unobservable inputs to Level 3 financial instruments may not be independent of each other. As described above, market variables may be correlated. This correlation typically reflects the manner in which different markets tend to react to macroeconomic or other events. Furthermore, the effect of changing market variables on the HSBC portfolio will depend on HSBC's net risk position in respect of each variable.

10 Fair values of financial instruments not carried at fair value

Fair values of financial instruments not carried at fair value and bases of valuation

		Fair value			
	Carrying amount	Quoted market price Level 1	Observable inputs Level 2	Significant unobservable inputs Level 3	Total
The group	**£m**	**£m**	**£m**	**£m**	**£m**
At 31 Dec 2017					
Assets					
Loans and advances to banks	**14,149**	**–**	**13,302**	**847**	**14,149**
Loans and advances to customers	**280,402**	**–**	**1,245**	**280,518**	**281,763**
Reverse repurchase agreements – non-trading	**45,808**	**–**	**45,808**	**–**	**45,808**
Liabilities					
Deposits by banks	**29,349**	**–**	**29,328**	**–**	**29,328**
Customer accounts	**381,546**	**–**	**380,646**	**897**	**381,543**
Repurchase agreements – non-trading	**37,775**	**–**	**37,775**	**–**	**37,775**
Debt securities in issue	**13,286**	**–**	**13,296**	**–**	**13,296**
Subordinated liabilities	**16,494**	**–**	**16,982**	**–**	**16,982**
At 31 Dec 2016					
Assets					
Loans and advances to banks	21,363	–	20,555	809	21,364
Loans and advances to customers	272,760	–	374	273,385	273,759
Reverse repurchase agreements – non-trading[1]	31,660	–	31,149	511	31,660
Liabilities					
Deposits by banks	23,682	–	23,673	–	23,673
Customer accounts	375,252	–	374,380	907	375,287
Repurchase agreements – non-trading	19,709	–	19,710	–	19,710
Debt securities in issue	16,140	–	16,141	–	16,141
Subordinated liabilities	8,421	–	8,515	–	8,515

1 *Restated to include instruments that are valued using observable inputs in Level 2 rather than Level 3.*

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

		Fair value			
	Carrying amount	Quoted market price Level 1	Observable inputs Level 2	Significant unobservable inputs Level 3	Total
The bank	£m	£m	£m	£m	£m
At 31 Dec 2017					
Assets					
Loans and advances to banks	**15,160**	**–**	**15,122**	**38**	**15,160**
Loans and advances to customers	**220,450**	**–**	**1,125**	**220,420**	**221,545**
Reverse repurchase agreements – non-trading	**36,627**	**–**	**36,627**	**–**	**36,627**
Liabilities					
Deposits by banks	**24,626**	**–**	**24,626**	**–**	**24,626**
Customer accounts	**320,026**	**–**	**320,026**	**–**	**320,026**
Repurchase agreements – non-trading	**35,220**	**–**	**35,220**	**–**	**35,220**
Debt securities in issue	**6,108**	**–**	**6,108**	**–**	**6,108**
Subordinated liabilities	**15,930**	**–**	**16,392**	**–**	**16,392**
At 31 Dec 2016					
Assets					
Loans and advances to banks	16,713	–	16,625	87	16,712
Loans and advances to customers	215,084	–	374	215,088	215,462
Reverse repurchase agreements – non-trading	23,351	–	23,351	–	23,351
Liabilities					
Deposits by banks	26,184	–	26,184	–	26,184
Customer accounts	303,571	–	303,571	–	303,571
Repurchase agreements – non-trading	15,420	–	15,420	–	15,420
Debt securities in issue	6,866	–	6,866	–	6,866
Subordinated liabilities	7,362	–	7,424	–	7,424

Other financial instruments not carried at fair value are typically short-term in nature and reprice to current market rates frequently. Accordingly, their carrying amount is a reasonable approximation of fair value.

Valuation

Fair value is an estimate of the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It does not reflect the economic benefits and costs that HSBC expects to flow from an instrument's cash flow over its expected future life. Our valuation methodologies and assumptions in determining fair values for which no observable market prices are available may differ from those of other companies.

Financial investments

The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that incorporate the prices and future earnings streams of equivalent quoted securities.

Deposits by banks and customer accounts

The fair values of on-demand deposits are approximated by their carrying value. For deposits with longer-term maturities, fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities.

Debt securities in issue and subordinated liabilities

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

Repurchase and reverse repurchase agreements – non-trading

Fair values approximate carrying amounts as balances are generally short dated.

11 Financial assets designated at fair value

	2017	2016
	£m	£m
Debt securities	**1,034**	1,239
Equity securities	**8,226**	7,042
Securities designated at fair value	**9,260**	8,281
Loans and advances to banks	**6**	64
At 31 Dec	**9,266**	8,345

12 Derivatives

Notional contract amounts and fair values of derivatives by product contract type held

	Notional contract amount		Fair value – Assets			Fair value – Liabilities		
	Trading	Hedging	Trading	Hedging	Total	Trading	Hedging	Total
The group	£m	£m	£m	£m	£m	£m	£m	£m
Foreign exchange	**3,172,038**	**2,334**	**41,100**	**39**	**41,139**	**(38,709)**	**(135)**	**(38,844)**
Interest rate	**9,973,858**	**60,496**	**156,780**	**571**	**157,351**	**(152,079)**	**(1,390)**	**(153,469)**
Equities	**448,156**	**–**	**7,393**	**–**	**7,393**	**(9,795)**	**–**	**(9,795)**
Credit	**306,855**	**–**	**3,566**	**–**	**3,566**	**(4,087)**	**–**	**(4,087)**
Commodity and other	**38,939**	**–**	**622**	**–**	**622**	**(611)**	**–**	**(611)**
Offset (Note 26)					**(66,736)**			**66,736**
At 31 Dec 2017	**13,939,846**	**62,830**	**209,461**	**610**	**143,335**	**(205,281)**	**(1,525)**	**(140,070)**
Foreign exchange	3,232,608	3,885	72,307	139	72,446	(65,787)	(323)	(66,110)
Interest rate	8,052,578	96,380	180,914	1,072	181,986	(174,713)	(2,280)	(176,993)
Equities	396,683	–	7,170	–	7,170	(8,716)	–	(8,716)
Credit	343,887	–	3,954	–	3,954	(4,560)	–	(4,560)
Commodity and other	45,795	–	1,245	–	1,245	(1,095)	–	(1,095)
Offset (Note 26)					(67,382)			67,382
At 31 Dec 2016	12,071,551	100,265	265,590	1,211	199,419	(254,871)	(2,603)	(190,092)

	Notional contract amount		Fair value – Assets			Fair value – Liabilities		
	Trading	Hedging	Trading	Hedging	Total	Trading	Hedging	Total
The bank	£m	£m	£m	£m	£m	£m	£m	£m
Foreign exchange	**3,202,826**	**1,153**	**40,818**	**29**	**40,847**	**(38,603)**	**(108)**	**(38,711)**
Interest rate	**8,627,923**	**51,387**	**137,241**	**552**	**137,793**	**(133,750)**	**(1,142)**	**(134,892)**
Equities	**437,029**	**–**	**7,367**	**–**	**7,367**	**(9,690)**	**–**	**(9,690)**
Credit	**306,633**	**–**	**3,569**	**–**	**3,569**	**(4,088)**	**–**	**(4,088)**
Commodity and other	**39,389**	**–**	**620**	**–**	**620**	**(614)**	**–**	**(614)**
Offset					**(54,960)**			**54,960**
At 31 Dec 2017	**12,613,800**	**52,540**	**189,615**	**581**	**135,236**	**(186,745)**	**(1,250)**	**(133,035)**
Foreign exchange	3,243,869	2,971	72,220	87	72,307	(65,970)	(294)	(66,264)
Interest rate	7,090,194	66,300	157,744	896	158,640	(154,601)	(1,851)	(156,452)
Equities	390,810	–	6,966	–	6,966	(8,444)	–	(8,444)
Credit	343,642	–	3,955	–	3,955	(4,559)	–	(4,559)
Commodity and other	46,254	–	1,245	–	1,245	(1,096)	–	(1,096)
Offset					(57,334)			57,334
At 31 Dec 2016	11,114,769	69,271	242,130	983	185,779	(234,670)	(2,145)	(179,481)

The notional contract amounts of derivatives held for trading purposes and derivatives designated in qualifying hedge accounting indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Use of derivatives

We undertake derivative activity for three primary purposes: to create risk management solutions for clients, to manage the portfolio risks arising from client business, and to manage and hedge our own risks.

Trading derivatives

Most of the group's derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities include market-making and risk management. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume. Risk management activity is undertaken to manage the risk arising from client transactions, with the principal purpose of retaining client margin. Other derivatives classified as held for trading include non-qualifying hedging derivatives.

Derivatives valued using models with unobservable inputs

The difference between the fair value at initial recognition (the transaction price) and the value that would have been derived had the valuation techniques used for subsequent measurement been applied at initial recognition, less subsequent releases, is as follows:

Unamortised balance of derivatives valued using models with significant unobservable inputs

	The group		The bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Unamortised balance at 1 Jan	**72**	57	**69**	55
Deferral on new transactions	**126**	107	**126**	107
Recognised in the income statement during the year:	**(123)**	(92)	**(123)**	(92)
– amortisation	**(60)**	(46)	**(60)**	(46)
– subsequent to unobservable inputs becoming observable	**–**	(2)	**–**	(2)
– maturity, termination or offsetting derivative	**(63)**	(44)	**(63)**	(44)
Exchange differences and other	**(3)**	–	**(3)**	(1)
Unamortised balance at 31 Dec[1]	**72**	72	**69**	69

1 *This amount is yet to be recognised in the consolidated income statement.*

Hedge accounting derivatives

Fair value hedges

The group's fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate, long-term financial instruments due to movements in market interest rates.

Notional contract amounts and fair values of derivatives designated as fair value hedges by product type

	2017			2016		
	Notional	**Assets**	**Liabilities**	Notional	Assets	Liabilities
	£m	**£m**	**£m**	£m	£m	£m
The group						
Foreign exchange	**1,145**	**10**	**(26)**	708	8	(28)
Interest rate	**32,161**	**364**	**(1,290)**	45,150	391	(2,153)
At 31 Dec	**33,306**	**374**	**(1,316)**	45,858	399	(2,181)
The bank						
Interest rate	**27,791**	**411**	**(1,069)**	31,634	457	(1,807)
At 31 Dec	**27,791**	**411**	**(1,069)**	31,634	457	(1,807)

Gains or losses arising from fair value hedges

	2017	2016
	£m	£m
The group		
Gains/(losses):		
– on hedging instruments	**243**	(565)
– on the hedged items attributable to the hedged risk	**(232)**	594
Year ended 31 Dec	**11**	29
The bank		
Gains/(losses):		
– on hedging instruments	**87**	(643)
– on the hedged items attributable to the hedged risk	**(83)**	663
Year ended 31 Dec	**4**	20

Cash flow hedges

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

Notional contract amounts and fair values of derivatives designated as cash flow hedges by product type

	2017			2016		
	Notional	**Assets**	**Liabilities**	Notional	Assets	Liabilities
	£m	**£m**	**£m**	£m	£m	£m
The group						
Foreign exchange	**1,189**	**29**	**(109)**	3,177	131	(295)
Interest rate	**28,335**	**207**	**(100)**	51,230	681	(127)
At 31 Dec	**29,524**	**236**	**(209)**	54,407	812	(422)
The bank						
Foreign exchange	**1,153**	**29**	**(108)**	2,971	87	(294)
Interest rate	**23,596**	**141**	**(73)**	34,666	439	(44)
At 31 Dec	**24,749**	**170**	**(181)**	37,637	526	(338)

Forecast principal balances on which interest cash flows are expected to arise

The group	3 months or less	More than 3 months but less than 1 year	5 years or less but more than 1 year	More than 5 years
	£m	£m	£m	£m
Net cash inflows/(outflows) exposure				
Assets	**26,735**	**23,631**	**16,200**	**677**
Liabilities	**(2,794)**	**(2,500)**	**(1,462)**	**–**
At 31 Dec 2017	**23,941**	**21,131**	**14,738**	**677**
Net cash inflows/(outflows) exposure				
Assets	43,390	37,669	30,294	1,939
Liabilities	(5,984)	(5,849)	(4,928)	(407)
At 31 Dec 2016	37,406	31,820	25,366	1,532
The bank	**£m**	**£m**	**£m**	**£m**
Net cash inflows/(outflows) exposure				
Assets	**24,765**	**21,664**	**14,234**	**–**
Liabilities	**–**	**–**	**–**	**–**
At 31 Dec 2017	**24,765**	**21,664**	**14,234**	**–**
Net cash inflows/(outflows) exposure				
Assets	37,637	33,889	27,550	–
Liabilities	–	–	–	–
At 31 Dec 2016	37,637	33,889	27,550	–

This table reflects the interest rate repricing profile of the underlying hedged items. During the year to 31 December 2017, a net loss of £8m (2016: loss of £12m) was recognised due to hedge ineffectiveness.

In late 2016, a macro cash flow hedge was identified as having not met the hedge accounting criteria of IAS 39 during the half year to 30 June 2016 and was partially discontinued as a result. £150m should have been transferred from the cash flow hedge reserve to the income statement during the half year to 30 June 2016 and the comparatives have therefore been restated in the 30 June 2017 Interim Report to reflect this error. As at 31 December 2016, £103m was transferred from the cash flow hedge reserve to the income statement in respect of the partial discontinuation of this hedge.

13 Financial investments

Carrying amount of financial investments

	The group		The bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Available-for-sale securities at fair value				
– Treasury and other eligible bills	**3,043**	3,859	**2,292**	2,724
– Debt securities	**54,295**	78,515	**28,683**	46,376
– Equity securities	**662**	761	**407**	372
At 31 Dec	**58,000**	83,135	**31,382**	49,472

For the group, £7,241m (2016: £11,590m), and for the bank, £4,819m (2016: £7,631m), of the debt securities issued by banks and other financial institutions are guaranteed by various governments.

14 Assets pledged, collateral received and assets transferred

Assets pledged

Financial assets pledged as collateral

	The group		The bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Treasury bills and other eligible securities	**745**	525	**–**	–
Loans and advances to banks	**7,084**	8,815	**4,914**	6,092
Loans and advances to customers	**32,528**	39,535	**9,863**	17,465
Debt securities	**48,247**	43,987	**30,322**	31,295
Equity securities	**24,562**	2,150	**24,473**	2,101
Other	**226**	152	**39**	12
Assets pledged at 31 Dec	**113,392**	95,164	**69,611**	56,965

Assets pledged as collateral include all assets categorised as encumbered in the disclosure on page 50.

The amount of assets pledged to secure liabilities may be greater than the book value of assets utilised as collateral. For example, in the case of securitisations and covered bonds, the amount of liabilities issued, plus mandatory over-collateralisation, is less than the book value of the pool of assets available for use as collateral. This is also the case where assets are placed with a custodian or a settlement agent that has a floating charge over all the assets placed to secure any liabilities under settlement accounts.

These transactions are conducted under terms that are usual and customary to collateralised transactions including, where relevant, standard securities lending and borrowing, repurchase agreements and derivative margining. The group places both cash and non-cash collateral in relation to derivative transactions.

Financial assets pledged as collateral that the counterparty has the right to sell or repledge

	The group		The bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Trading assets	**41,593**	21,416	**32,036**	12,850
Financial investments	**7,198**	953	**2,833**	570
At 31 Dec	**48,791**	22,369	**34,869**	13,420

Collateral received

The fair value of assets accepted as collateral, relating primarily to standard securities lending, reverse repurchase agreements and derivative margining, that the group is permitted to sell or repledge in the absence of default was £173,386m (2016: £112,322m) (the bank: 2017 £136,570m; 2016: £82,600m). The fair value of any such collateral sold or repledged was £130,430m (2016: £81,156m) (the bank: 2017 £98,215m; 2016: £56,312m). Comparatives have been restated to include collateral received relating to derivative margining. The group is obliged to return equivalent securities. These transactions are conducted under terms that are usual and customary to standard securities lending, reverse repurchase agreements and derivative margining.

Assets transferred

The assets pledged include transfers to third parties that do not qualify for derecognition, notably secured borrowings such as debt securities held by counterparties as collateral under repurchase agreements and equity securities lent under securities lending agreements, as well as swaps of equity and debt securities. For secured borrowings, the transferred asset collateral continues to be recognised in full and a related liability, reflecting the group's obligation to repurchase the assets for a fixed price at a future date is also recognised on the balance sheet. Where securities are swapped, the transferred asset continues to be recognised in full. There is no associated liability as the non-cash collateral received is not recognised on the balance sheet. The group is unable to use, sell or pledge the transferred assets for the duration of these transactions, and remains exposed to interest rate risk and credit risk on these pledged assets. With the exception of 'Other sales' in the table below, the counterparty's recourse is not limited to the transferred assets.

Transferred financial assets not qualifying for full derecognition and associated financial liabilities

	Carrying amount of:		**Fair value of:**		
	transferred assets	**associated liabilities**	**transferred assets**	**associated liabilities**	**Net position**
The group	**£m**	**£m**	**£m**	**£m**	**£m**
At 31 Dec 2017					
Repurchase agreements	**24,323**	**23,004**	**–**	**–**	**–**
Securities lending agreements	**24,562**	**2,385**	**–**	**–**	**–**
Other sales (recourse to transferred assets only)	**–**	**–**	**–**	**–**	**–**
At 31 Dec 2016					
Repurchase agreements	19,750	19,800	–	–	–
Securities lending agreements	2,142	2,113	–	–	–
Other sales (recourse to transferred assets only)	367	386	367	367	–
The bank					
At 31 Dec 2017					
Repurchase agreements	**10,401**	**8,979**	**–**	**–**	**–**
Securities lending agreements	**24,473**	**2,338**	**–**	**–**	**–**
Other sales (recourse to transferred assets only)	**–**	**–**	**–**	**–**	**–**
At 31 Dec 2016					
Repurchase agreements	11,319	11,319	–	–	–
Securities lending agreements	2,101	2,101	–	–	–
Other sales (recourse to transferred assets only)	367	386	367	367	–

15 Interests in associates and joint ventures

Principal associates of the group and the bank

Business Growth Fund Plc ('BGF') is a principal associate of the group. BGF is an independent company, established in 2011 to provide investment to growing small and medium sized British businesses. BGF is backed by five of the UK's main banking groups: Barclays, HSBC, Lloyds, RBS and Standard Chartered. At 31 December 2017, the group had a 24.4% interest in the equity capital of BGF.

Interests in significant joint ventures

Vaultex UK Limited is a joint venture of the bank and the group. Vaultex UK Limited is incorporated in England and its principal activity is that of cash management services. At 31 December 2017 and 31 December 2016, the group had a 50% interest in the £10m issued equity capital. A list of all associates and joint ventures is set out on page 143.

16 Investments in subsidiaries

Principal subsidiary undertakings of HSBC Bank plc

	Country of incorporation or registration	HSBC Bank plc's interest in equity capital	Share class
		%	
HSBC Asset Finance (UK) Limited	England	100.00	Ordinary £1
HSBC Invoice Finance (UK) Limited	England	100.00	Ordinary £1
HSBC Life (UK) Limited	England	100.00	Ordinary £1
HSBC Private Bank (UK) Limited	England	100.00	Ordinary £10
HSBC Trust Company (UK) Limited	England	100.00	Ordinary £5
Marks and Spencer Retail Financial Services Holdings Limited	England	100.00	Ordinary £1
HSBC France	France	99.99	€5 Actions
HSBC Trinkaus & Burkhardt AG	Germany	80.67	Stückaktien
HSBC Private Bank (C.I.) Limited	Guernsey	100.00	Ordinary US$1
HSBC Bank International Limited	Jersey	100.00	Ordinary £1
HSBC Bank Malta p.l.c	Malta	70.03	Ordinary €0.30

All the above prepare their financial statements up to 31 December.

Details of all group subsidiaries, as required under Section 409 of the Companies Act 2006, are set out in Note 33. The principal countries of operation are the same as the countries of incorporation.

Transfer of HSBC Bank A.S.

On 29 June 2017, HSBC Bank plc transferred its shareholding in HSBC Bank A.S. to HSBC Middle East Holdings B.V. (89.99%) and HSBC Bank Middle East Limited (10.01%). The transfer was made as a dividend in-specie to HSBC Holdings plc. Established in 1990, HSBC Bank A.S. runs an international banking model, with a restructuring plan currently underway to focus the business on wholesale banking and premium retail banking.

As a result of the transfer, the total assets excluding goodwill of the group reduced by £4,831m and the total liabilities reduced by £4,265m. Total risk-weighted assets reduced by £4,080m and the common equity tier 1 reduced by £530m.

The transfer passes through equity as a dividend in-specie that reduces reserves by £643m. This comprises HSBC Bank A.S.'s net asset value of £566m plus attributable goodwill of £77m.

There was no gain or loss recognised in the group as a result of this transfer. The results of HSBC Bank A.S. for the period up to the transfer are included in the group results.

The transfer does not include customer positions held directly by HSBC Bank plc.

Impairment testing of investments in subsidiaries

At each reporting period end, HSBC Bank plc reviews investments in subsidiaries for indicators of impairment. An impairment is recognised when the carrying amount exceeds the recoverable amount for that investment.

The recoverable amount is the higher of the investment's fair value less costs of disposal and its value in use. The value in use is calculated by discounting management's cash flow projections for the investment.

- The cash flow projections for each investment are based on the latest approved plans and a long-term growth rate is used to extrapolate the cash flows in perpetuity.
- The growth rate reflects GDP and inflation for the country within which the investment operates and is based on the long-term average growth rates.
- The rate used to discount the cash flows is based on the cost of capital assigned to each investment, which is derived using a capital asset pricing model ('CAPM'). CAPM depends on a number of inputs reflecting financial and economic variables, including the risk-free rate and a premium to reflect the inherent risk of the business being evaluated. These variables are based on the market's assessment of the economic variables and management's judgement. The discount rates for each investment are refined to reflect the rates of inflation for the countries within which the investment operates. In addition, for the purposes of testing investments for impairment, management supplements this process by comparing the discount rates derived using the internally generated CAPM, with cost of capital rates produced by external sources for businesses operating in similar markets.

An impairment of £29m was recognised as a result of the impairment test performed in 2017. This related to an investment in HSBC Polska.

An impairment of £2,148m was recognised as a result of the impairment test performed in 2016. £2,081m of this related to an investment in HSBC France.

Impairment test results

Investment	Carrying amount	Recoverable amount	Discount rate	Nominal growth rate beyond initial cash flow projections	Impairment
	£m	£m	%	%	£m
HSBC Polska	131	102	9.2	4.8	29

17 Structured entities

The group is mainly involved with both consolidated and unconsolidated structured entities through the securitisation of financial assets, conduits and investment funds, established either by HSBC or a third party.

The presentation of this disclosure has been updated. Comparative data have been re-presented accordingly and certain prior period data have been restated to be on a consistent basis with the current year.

Consolidated structured entities

Total assets of the group's consolidated structured entities, split by entity type

	Conduits	Securitisations	Group managed funds	Other	Total
	£m	£m	£m	£m	£m
At 31 Dec 2017	**9,551**	**330**	**3,210**	**3,500**	**16,591**
At 31 Dec 2016	12,821	1,558	2,898	2,907	20,184

Conduits

The group has established and manages two types of conduits: securities investment conduits ('SICs') and multi-seller conduits.

Securities investment conduits

The SICs purchase highly rated ABSs to facilitate tailored investment opportunities.

- Solitaire – At 31 December 2017, Solitaire, the group's principal SIC held £2.4bn of ABSs (2016: £3.8bn). These are included within the disclosures of ABSs on page 48. It is currently funded entirely by commercial paper ('CP') issued to the group. Although the group continues to provide a liquidity facility, Solitaire has no need to draw on it as long as the group purchases its issued CP, which the group intends to do for the foreseeable future. At 31 December 2017, the group held £3.4bn of CP (2016: £4.9bn).
- Mazarin, Barion and Malachite - All three SICs are now funded by medium-term notes, and are no longer funded by repurchase agreements. HSBC's primary exposure to Mazarin, Barion and Malachite is represented by the amortised cost of the debt required to support the non-cash assets of the vehicles. At 31 December 2017, this amounted to £0.7bn (2016 £1.0bn). For all three SICs, first loss protection is provided through the capital notes issued by these vehicles, which are held substantially by third parties.

Multi-seller conduit

The group's multi-seller conduit was established to provide access to flexible market-based sources of finance for its clients. Currently, the group bears risk equal to transaction-specific facilities offered to the multi-seller conduit, amounting to £9.4bn at 31 December 2017 (2016: £10.6bn). First loss protection is provided by the originator of the assets, and not by the group, through transaction-specific credit enhancements. A layer of secondary loss protection is provided by the group in the form of programme-wide enhancement facilities.

Securitisations

The group uses structured entities to securitise customer loans and advances it originates in order to group its sources of funding for asset origination and capital efficiency purposes. The loans and advances are transferred by the group to the structured entities for cash or synthetically through credit default swaps, and the structured entities issue debt securities to investors.

Group managed funds

The group has established a number of money market and non-money market funds. Where it is deemed to be acting as principal rather than agent in its role as investment manager, the group controls these funds.

Other

The group has also entered into a number of transactions in the normal course of business which include asset and structured finance transactions where it has control of the structured entity. In addition, the group is deemed to control a number of third-party managed funds through its involvement as a principal in the funds.

Unconsolidated structured entities

The term 'unconsolidated structured entities' refers to all structured entities not controlled by the group. The group enters into transactions with unconsolidated structured entities in the normal course of business to facilitate customer transactions and for specific investment opportunities.

Nature and risks associated with group's interests in unconsolidated structured entities

£m	Securitisations	Group managed funds	Non-group managed funds	Other	Total
0 – 400	**11**	**82**	**1,327**	**190**	**1,610**
400 – 1,500	**1**	**6**	**512**	**3**	**522**
1,500 – 4,000	**—**	**—**	**229**	**—**	**229**
4,000 – 20,000	**—**	**—**	**80**	**2**	**82**
20,000+	**—**	**—**	**4**	**—**	**4**
Number of entities at 31 Dec 2017	**12**	**88**	**2,152**	**195**	**2,447**
0 – 400	33	125	1,498	86	1,742
400 – 1,500	7	5	463	6	481
1,500 – 4,000	—	—	190	2	192
4,000 – 20,000	—	1	45	1	47
20,000+	—	—	2	—	2
Number of entities at 31 Dec 2016	40	131	2,198	95	2,464

	£m	£m	£m	£m	£m
Total assets in relation to the group's interests in the unconsolidated structured entities	**1,016**	**1,286**	**4,286**	**2,033**	**8,621**
– trading assets	**—**	**—**	**126**	**1,895**	**2,021**
– financial assets designated at fair value	**—**	**1,277**	**3,843**	**—**	**5,120**
– loans and advances to banks	**—**	**—**	**—**	**—**	**—**
– loans and advances to customers	**1,016**	**—**	**—**	**23**	**1,039**
– financial investments	**—**	**9**	**317**	**115**	**441**
– other assets	**—**	**—**	**—**	**—**	**—**
Total liabilities in relation to group's interests in the unconsolidated structured entities	**—**	**6**	**2**	**—**	**8**
Other off-balance sheet commitments	**—**	**—**	**33**	**—**	**33**
The group's maximum exposure at 31 Dec 2017	**1,016**	**1,280**	**4,317**	**2,033**	**8,646**
Total assets in relation to the group's interests in the unconsolidated structured entities	1,644	1,427	3,175	3,734	9,980
– trading assets	—	6	107	1,783	1,896
– financial assets designated at fair value	—	1,353	2,840	—	4,193
– loans and advances to banks	—	—	—	—	—
– loans and advances to customers	1,644	—	—	1,802	3,446
– financial investments	—	68	226	149	443
– other assets	—	—	2	—	2
Total liabilities in relation to group's interests in the unconsolidated structured entities	—	—	6	—	6
Other off balance sheet commitments	41	—	847	12	900
The group's maximum exposure at 31 Dec 2016	1,685	1,427	4,016	3,746	10,874

The maximum exposure to loss from the group's interests in unconsolidated structured entities represents the maximum loss it could incur as a result of its involvement with these entities regardless of the probability of the loss being incurred.

- For commitments, guarantees and written credit default swaps, the maximum exposure to loss is the notional amount of potential future losses.
- For retained and purchased investments in and loans to unconsolidated structured entities, the maximum exposure to loss is the carrying value of these interests at the balance sheet reporting date.

The maximum exposure to loss is stated gross of the effects of hedging and collateral arrangements entered into to mitigate the group's exposure to loss.

Securitisations

The group has interests in unconsolidated securitisation vehicles through holding notes issued by these entities. In addition, the group has investments in ABSs issued by third-party structured entities as set out on page 48.

Group managed funds

The group establishes and manages money market funds and non-money market investment funds to provide customers with investment opportunities.

The group, as fund manager, may be entitled to receive management and performance fees based on the assets under management. The group may also retain units in these funds.

Non-group managed funds

The group purchases and holds units of third-party managed funds in order to facilitate business and meet customer needs. In addition to the entities, asset and liability classes disclosed above HSBC enters into derivative contracts with Non-HSBC managed funds. These interests arise in the normal course of business for the facilitation of third-party transactions and risk management solutions. Note 12 provides information on the types, fair values and notional values of derivatives entered into by HSBC.

Other

The group has established structured entities in the normal course of business, such as structured credit transactions for customers, to provide finance to public and private sector infrastructure projects, and for asset and structured finance transactions. In addition to the entities, asset and liability classes disclosed above HSBC enters into derivative contracts with Other Structured Entities. These interests arise in the normal course of business for the facilitation of third-party transactions and risk management solutions. Note 12 provides information on the types, fair values and notional values of derivatives entered into by HSBC.

Group sponsored structured entities

The amount of assets transferred to and income received from such sponsored entities during 2017 and 2016 were not significant.

18 Goodwill and intangible assets

	The group		The bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Goodwill[1]	**4,559**	4,487	**369**	356
Present value of in-force long-term insurance business	**572**	577	**—**	—
Other intangible assets[1, 2]	**805**	671	**679**	564
At 31 Dec	**5,936**	5,735	**1,048**	920

1 *For 2017, the amortisation and impairment of intangible assets totalled £236m (Nil for goodwill and £236m for other intangibles).*
2 *Included within the group's other intangible assets is internally generated software with a net carrying value of £736m (2016: £576m).*

Movement analysis of goodwill

	The group		The bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
At 1 Jan	**4,487**	5,818	**356**	347
Impairment	**—**	(2,182)	**—**	—
Exchange differences	**149**	857	**(6)**	12
Other	**(77)**	(6)	**19**	(3)
At 31 Dec	**4,559**	4,487	**369**	356

Impairment testing

The group's impairment test in respect of goodwill allocated to each CGU is performed as at 1 July each year, with a review for indicators of impairment at 30 June and 31 December. At 31 December 2017, this review did not identify any indicators of impairment. As a result, no impairment tests have been performed as at 31 December 2017. For all CGUs, the annual test performed as at 1 July remains the latest impairment test and the disclosures given are as at 1 July. The testing at 1 July resulted in no impairment of goodwill. GB&M is excluded from the 1 July testing as goodwill was fully impaired at 31 December 2016.

Basis of the recoverable amount

The recoverable amount of all CGUs to which goodwill has been allocated was equal to its VIU at each respective testing date for 2016 and 2017.

For each CGU, the VIU is calculated by discounting management's cash flow projections for the CGU.

Key assumptions in VIU calculation

	Annual Impairment Test 2017			Annual Impairment Test 2016			
	Goodwill at: 1 Jul 2017	**Discount rate**	**Nominal growth rate beyond initial cash flow projections**	Goodwill at: 1 Jul 2016	Goodwill after impairment at: 31 Dec 2016	Discount rate	Nominal growth rate beyond initial cash flow projections
Cash-generating unit	**£m**	**%**	**%**	£m	£m	%	%
RBWM	**2,062**	**8.9**	**3.7**	1,977	2,046	8.9	3.5
CMB	**1,798**	**9.9**	**3.7**	1,733	1,792	9.7	3.9
GB&M	**—**	**—**	**—**	2,099	—	10.7	3.8
GPB	**665**	**9.7**	**3.6**	666	649	9.7	3.7
Total	**4,525**			6,475	4,487		

Management's judgement in estimating the cash flows of a CGU: the cash flow projections for each CGU are based on the latest plans approved by the Board. For the goodwill impairment test conducted at 1 July 2017, management's cash flow projections until the end of 2021 were used.

Nominal long-term growth rate: the long-term growth rate is used to extrapolate the cash flows in perpetuity. The growth rate reflects GDP and inflation for the countries within which the CGU operates or derives revenue from. The rates are based on 20-year forecast growth rates, as they represent an objective estimate of likely future trends.

Discount rate: the rate used to discount the cash flows is based on the cost of capital assigned to each CGU, which is derived using a capital asset pricing model ('CAPM'). CAPM depends on a number of inputs reflecting financial and economic variables, including the risk-free rate and a premium to reflect the inherent risk of the business being evaluated. These variables are based on the market's assessment of the economic variables and management's judgement. The discount rates for each CGU are refined to reflect the rates of inflation for the countries within which the CGU operates. In addition, for the purposes of testing goodwill for impairment, management

supplements this process by comparing the discount rates derived using the internally generated CAPM, with cost of capital rates produced by external sources for businesses operating in similar markets. In all periods, internal rates were adjusted to reflect the uncertainty of the cash flows used in the test.

Sensitivities of key assumptions in calculating VIU

At 1 July 2017, there were no CGUs deemed sensitive to reasonably possible changes in the key assumptions supporting the recoverable amount.

In making an estimate of reasonably possible changes to assumptions, management considers the available evidence in respect of each input to the model. These include the external range of observable discount rates, historical performance against forecast and risks attaching to the key assumptions underlying cash flow projections.

Present value of in-force long-term insurance business

When calculating the present value of in force insurance business ('PVIF'), expected cash flows are projected after adjusting for a variety of assumptions made by each insurance operation to reflect local market conditions and management's judgement of future trends, and after applying risk margins to reflect any uncertainty in the underlying assumptions. Variations in actual experience and changes to assumptions can contribute to volatility in the results of the insurance business.

Actuarial Control Committees of each key insurance entity meet on a quarterly basis to review and approve PVIF assumptions. All changes to non-economic assumptions, economic assumptions that are not observable and model methodology must be approved by the Actuarial Control Committee.

Movements in PVIF

	2017	2016
	£m	£m
PVIF at 1 Jan	**577**	546
Change in PVIF of long-term insurance business	**(23)**	(26)
– value of new business written during the year	**29**	43
– expected return[1]	**(65)**	(96)
– assumption changes and experience variances[2]	**33**	15
– other adjustments	**(20)**	12
Exchange differences and other	**18**	57
PVIF at 31 Dec	**572**	577

1 *'Expected return' represents the unwinding of the discount rate and reversal of expected cash flows for the period.*
2 *Represents the effect of changes in assumptions on expected future profits and the difference between assumptions used in the previous PVIF calculation and actual experience observed during the year to the extent that this affects future profits.*

Key assumptions used in the computation of PVIF for main life insurance operations

Economic assumptions are set in a way that is consistent with observable market values. The valuation of PVIF is sensitive to observed market movements, and the impact of such changes is included in the sensitivities presented below.

	2017		2016	
	UK	France[1]	UK	France[1]
	%	%	%	%
Weighted average risk free rate	**1.15**	**1.50**	1.00	0.99
Weighted average risk discount rate	**1.65**	**2.20**	1.50	1.84
Expense inflation	**4.55**	**1.48**	3.83	1.66

1 *For 2017, the calculation of France's PVIF assumes a risk discount rate of 2.20% (2016: 1.84%) plus a risk margin of £59m (2016: £82m).*

Sensitivity to changes in economic assumptions

The group sets the risk discount rate applied to the PVIF calculation by starting from a risk-free rate curve and adding explicit allowances for risks not reflected in the best estimate cash flow modelling. Where the insurance operations provide options and guarantees to policyholders the cost of these options and guarantees is an explicit reduction to PVIF, unless it is already allowed for as an explicit addition to the technical provisions required by regulators. See page 54 for further details of these guarantees and the impact of changes in economic assumptions on our insurance manufacturing subsidiaries.

Sensitivity to changes in non-economic assumptions

Policyholder liabilities and PVIF for life manufacturers are determined by reference to non-economic assumptions, including mortality and/or morbidity, lapse rates and expense rates. See page 55 for further details on the impact of changes in non-economic assumptions on our insurance manufacturing subsidiaries.

19 Prepayments, accrued income and other assets

	The group		The bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Prepayments and accrued income	**2,047**	2,247	**1,131**	1,246
Assets held for sale	**461**	94	**6**	79
Bullion	**2,608**	2,554	**2,606**	2,546
Endorsements and acceptances	**210**	291	**171**	254
Reinsurers' share of liabilities under insurance contracts (Note 2)	**336**	283	**—**	—
Employee benefit assets (Note 4)	**6,066**	3,480	**6,066**	3,478
Other accounts	**2,276**	2,270	**1,945**	1,933
Property, plant and equipment	**2,022**	1,996	**933**	1,007
At 31 Dec	**16,026**	13,215	**12,858**	10,543

Prepayments, accrued income and other assets include £4,738m (2016: £4,586m) of financial assets, the majority of which are measured at amortised cost.

Assets held for sale

	The group		The bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Property, plant and equipment	**15**	32	**6**	22
Assets of disposal groups held for sale	**446**	—	**—**	—
Interest in associates	**—**	62	**—**	57
Assets classified as held for sale at 31 Dec	**461**	94	**6**	79

20 Trading liabilities

	The group		The bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Deposits by banks[1]	**33,092**	33,187	**30,811**	30,282
Customer accounts[1]	**20,594**	19,352	**18,826**	17,147
Other debt securities in issue[2]	**19,374**	15,837	**15,155**	12,243
Other liabilities – net short positions in securities	**33,436**	25,558	**12,511**	12,467
At 31 Dec	**106,496**	93,934	**77,303**	72,139

1 *'Deposits by banks' and 'Customer accounts' include repos, settlement accounts, stock lending and other amounts.*
2 *'Other debt securities in issue' comprises structured notes issued by the group for which market risks are actively managed as part of trading portfolios.*

21 Financial liabilities designated at fair value

	The group		The bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Deposits by banks and customer accounts	**108**	110	**—**	—
Liabilities to customers under investment contracts	**547**	1,072	**—**	—
Debt securities in issue	**13,343**	15,286	**6,755**	8,157
Subordinated liabilities (Note 24)	**3,912**	1,685	**4,251**	2,018
Preferred securities (Note 24)	**339**	333	**—**	—
At 31 Dec	**18,249**	18,486	**11,006**	10,175

The group

The carrying amount of financial liabilities designated at fair value was £1,095m higher than the contractual amount at maturity (2016: £1,184m higher). The cumulative own credit loss recognised was £312m (2016: loss of £127m).

The bank

The carrying amount of financial liabilities designated at fair value was £826m higher than the contractual amount at maturity (2016: £825m higher). The cumulative own credit loss recognised was £204m (2016: loss of £43m).

22 Accruals, deferred income and other liabilities

	The group		The bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Accruals and deferred income	**2,342**	2,822	**1,371**	1,767
Liabilities of disposal groups held for sale	**454**	—	**—**	—
Amount due to investors in funds consolidated by the group	**636**	358	**—**	—
Endorsements and acceptances	**208**	285	**171**	254
Employee benefit liabilities (Note 4)	**338**	364	**123**	143
Share-based payment liability to HSBC Holdings	**146**	150	**128**	130
Other liabilities	**2,491**	2,813	**1,574**	2,195
At 31 Dec	**6,615**	6,792	**3,367**	4,489

For the group, accruals, deferred income and other liabilities include £5,728m (2016: £5,861m), and for the bank £2,861m (2016: £3,957m) of financial liabilities, the majority of which are measured at amortised cost.

23 Provisions

	Customer remediation	**Legal proceedings and regulatory matters**	**Restructuring costs**	**Contractual commitments**	**Other provisions**	**Total**
The group	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
At 1 Jan 2017	**897**	**1,095**	**253**	**53**	**133**	**2,431**
Additions[1]	**625**	**116**	**45**	**34**	**127**	**947**
Amounts utilised	**(412)**	**(85)**	**(127)**	**(1)**	**(37)**	**(662)**
Unused amounts reversed	**(39)**	**(653)**	**(54)**	**(26)**	**(50)**	**(822)**
Exchange and other movements	**(6)**	**(67)**	**(23)**	**(5)**	**3**	**(98)**
At 31 Dec 2017	**1,065**	**406**	**94**	**55**	**176**	**1,796**
At 1 Jan 2016	868	884	163	27	115	2,057
Additions[1]	568	131	178	36	91	1,004
Amounts utilised	(473)	(34)	(68)	—	(65)	(640)
Unused amounts reversed	(64)	(67)	(31)	(21)	(39)	(222)
Exchange and other movements	(2)	181	11	11	31	232
At 31 Dec 2016	897	1,095	253	53	133	2,431

1 *Other provisions includes unwinding of discounts of £5m (2016: £3m) in relation to vacant space provisions.*

	Customer remediation	**Legal proceedings and regulatory matters**	**Restructuring costs**	**Contractual commitments**	**Other provisions**	**Total**
The bank	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
At 1 Jan 2017	**650**	**980**	**154**	**29**	**72**	**1,885**
Additions[1]	**556**	**99**	**36**	**27**	**83**	**801**
Amounts utilised	**(315)**	**(15)**	**(107)**	**(1)**	**(11)**	**(449)**
Unused amounts reversed	**(34)**	**(649)**	**(46)**	**(21)**	**(35)**	**(785)**
Exchange and other movements	**(7)**	**(60)**	**—**	**(1)**	**10**	**(58)**
At 31 Dec 2017	**850**	**355**	**37**	**33**	**119**	**1,394**
At 1 Jan 2016	694	814	124	11	59	1,702
Additions[1]	433	75	71	28	40	647
Amounts utilised	(411)	(29)	(25)	—	(12)	(477)
Unused amounts reversed	(63)	(44)	(17)	(14)	(16)	(154)
Exchange and other movements	(3)	164	1	4	1	167
At 31 Dec 2016	650	980	154	29	72	1,885

1 *Other provisions includes unwinding of discounts of £5m (2016: £3m) in relation to vacant space provisions.*

Customer remediation

Provisions include £1.1bn (2016: £897m) in respect of customer redress programmes. The most significant of these provisions relates to Payment Protection Insurance.

Payment Protection Insurance

£869m (2016: £746m) of customer remediation relates to the estimated liability for redress in respect of the possible mis-selling of Payment Protection Insurance ('PPI') policies in previous years. Cumulative provisions made since the Judicial Review ruling in the first half of 2011 amount to £3.8bn of which £2.9bn has been paid as at 31 December 2017.

An increase in provisions of £495m was recognised during the year, primarily reflecting an adjustment to expected future complaint volumes; in light of additional detail becoming available around the likely impact and profile of regulatory media campaigns during the remainder of the period during which complaints could be received.

The estimated liability for redress is calculated on the basis of the total premiums paid by the customer plus simple interest of 8% per annum (or the rate inherent in the related loan product where higher). The basis for calculating the redress liability is the same for single premium and regular premium policies. Future estimated redress levels are based on the historically observed redress per policy.

A total of 5.4 million PPI policies have been sold since 2000, generating estimated revenues of £2.6bn at 2017. The gross written premiums on these policies was approximately £3.4bn. At 31 December 2017, the estimated total complaints expected to be received were 2.2 million, representing 41% of total policies sold. It is estimated that contact will be made with regard to 2.6 million policies, representing 48% of total policies sold. This estimate includes inbound complaints as well as the group's proactive contact exercise on certain policies ('outbound contact').

The following table details the cumulative number of complaints received at 31 December 2017 and the number of claims expected in the future:

Cumulative PPI complaints received to 31 December 2017 and future claims expected

	Cumulative actual to 31 Dec 2017	Future expected
Inbound complaints ('000s of policies)[1]	**1,555**	363
Outbound contact ('000s of policies)	**685**	—
Response rate to outbound contact	**44%**	n/a
Average uphold rate per claim[2]	**76%**	84%
Average redress per claim (£)	**1,992**	2,242
Complaints to Financial Ombudsman Service ('FOS') ('000s of policies)	**144**	26
Average uphold rate per FOS claim	**40%**	47%

1 *Excludes invalid claims for which no PPI policy exists and FOS complaints.*
2 *Claims include inbound and responses to outbound contact, but exclude FOS complaints.*

A 100,000 increase/decrease in the total inbound complaints would increase/decrease the redress provision by approximately £151m.

Legal proceedings and regulatory matters

Further details of legal proceedings and regulatory matters are set out in Note 30. Legal proceedings include civil court, arbitration or tribunal proceedings brought against HSBC companies (whether by way of claim or counterclaim), or civil disputes that may, if not settled, result in court, arbitration or tribunal proceedings. Regulatory matters refer to investigations, reviews and other actions carried out by, or in response to the actions of, regulatory or law enforcement agencies in connection with alleged wrongdoing.

24 Subordinated liabilities

Subordinated liabilities

	The group		The bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
At amortised cost	**16,494**	8,421	**15,930**	7,362
– subordinated liabilities	**15,794**	7,721	**15,930**	7,362
– preferred securities	**700**	700	**—**	—
Designated at fair value (Note 21)	**4,251**	2,018	**4,251**	2,018
– subordinated liabilities	**3,912**	1,685	**4,251**	2,018
– preferred securities	**339**	333	**—**	—
At 31 Dec	**20,745**	10,439	**20,181**	9,380

Subordinated liabilities rank behind senior obligations and consist of capital instruments and other instruments. Capital instruments generally count towards the capital base of the group and may be called and redeemed by the group subject to prior notification to the PRA and, where relevant, the consent of the local banking regulator. If not redeemed at the first call date, coupons payable may step up or become floating rate based on interbank rates. On capital instruments other than floating rate notes, interest is payable at fixed rates of up to 7.65%.

The balance sheet amounts disclosed below are presented on an IFRS basis and do not reflect the amount that the instruments contribute to regulatory capital due to the inclusion of issuance costs, regulatory amortisation and regulatory eligibility limits prescribed in the grandfathering provisions under CRD IV.

Subordinated liabilities of the group

			Carrying amount	
			2017	2016
		Footnotes	**£m**	£m
Capital instruments				
Additional tier 1 instruments guaranteed by the bank				
£300m	5.862% Non-cumulative Step-up Perpetual Preferred Securities	1	**339**	333
£700m	5.844% Non-cumulative Step-up Perpetual Preferred Securities	2	**700**	700
Tier 2 instruments				
$1,450m	Floating Rate Subordinated Loan 2021	3	**—**	1,176
$450m	Subordinated Floating Rate Notes 2021		**333**	365
£350m	5% Callable Subordinated Notes 2023	4	**367**	378
£300m	6.5% Subordinated Notes 2023		**299**	299
€650m	Floating Rate Subordinated Loan 2023		**577**	556
€120m	Floating Rate Subordinated Loan 2025	5	**—**	107
$275m	Floating Rate Subordinated Loan 2025	6	**—**	235
$300m	7.65% Subordinated Notes 2025		**277**	301
$1,400m	Floating Rate Subordinated Loan 2025		**1,036**	1,136
$1,300m	Floating Rate Subordinated Loan 2026		**962**	1,055
€300m	Floating Rate Subordinated Loan 2027	7	**266**	—
€260m	Floating Rate Subordinated Loan 2029		**231**	222
£350m	5.375% Callable Subordinated Step-up Notes 2030	8	**432**	397
£500m	5.375% Subordinated Notes 2033		**675**	608
£225m	6.25% Subordinated Notes 2041		**224**	224
£600m	4.75% Subordinated Notes 2046		**594**	593
$750m	Undated Floating Rate Primary Capital Notes		**555**	609
$500m	Undated Floating Rate Primary Capital Notes		**370**	406
$300m	Undated Floating Rate Primary Capital Notes (Series 3)		**222**	243
Other Tier 2 instruments each less than £100m			**322**	496
Other instruments				
Subordinated loan instruments not eligible for inclusion in regulatory capital				
€1,500m	Floating Rate Subordinated Loan 2021	9	**1,331**	—
$750m	3.43% Subordinated Loan 2022	9	**568**	—
€2,000m	0.6633% Subordinated Loan 2022	10	**1,775**	—
$2,000m	3.5404% Subordinated Loan 2023	10	**1,480**	—
€1,500m	Floating Rate Subordinated Loan 2023	11	**1,331**	—
€2,000m	1.125% Subordinated Loan 2024	11	**1,775**	—
£1,000m	2.6% Subordinated Loan 2026	10, 12	**1,012**	—
$750m	4.186% Subordinated Loan 2027	9	**583**	—
€1,250m	1.4648% Subordinated Loan 2027	10	**1,109**	—
£1,000m	2.948% Subordinated Loan 2028	10	**1,000**	—
At 31 Dec			**20,745**	10,439

1 *In April 2020, the distribution rate changes to six month sterling LIBOR plus 1.85%.*
2 *In November 2031, the distribution rate changes to six month sterling LIBOR plus 1.76%.*
3 *In September 2017, the bank converted its $1,450m Floating Rate Subordinated Loan 2021 from HSBC Holdings plc into common equity tier 1.*
4 *In January 2018, the bank gave notice that it will call and redeem its £350m 5% Callable Subordinated Notes 2023 on 20 March 2018.*
5 *In March 2017, HSBC Bank A.S. repaid its €120m Floating Rate Subordinated Loan 2025 from HSBC Finance (Netherlands).*
6 *In June 2017, the $275m Floating Rate Subordinated Loan 2025 to HSBC Bank A.S. was removed from subordinated liabilities as a consequence of the transfer of HSBC Bank A.S. to HSBC Middle East Holdings B.V. and HSBC Bank Middle East Limited.*
7 *In June 2017, the bank received the €300m Floating Rate Subordinated Loan 2027 from HSBC Holdings plc.*
8 *In November 2025, the interest rate changes to three month sterling LIBOR plus 1.50%.*
9 *In March 2017, the bank received the $750m 3.43% Subordinated Loan 2022, the $750m 4.186% Subordinated Loan 2027 and the €1,500m Floating Rate Subordinated Loan 2021 from HSBC Holdings plc.*
10 *In November 2017, the bank received the €2,000m 0.6633% Subordinated Loan 2022, the $2,000m 3.5404% Subordinated Loan 2023, the £1,000m 2.6% Subordinated Loan 2026, the €1,250m 1.4648% Subordinated Loan 2027 and the £1,000m 2.948% Subordinated Loan 2028 from HSBC Holdings plc.*
11 *In October 2017, the bank received the €1,500m Floating Rate Subordinated Loan 2023 and the €2,000m 1.125% Subordinated Loan 2024 from HSBC Holdings plc.*
12 *In November 2025, the interest rate changes to one year sterling mid-swaps plus 1.355%. This instrument is redeemable at the option of the bank on the date of the change in the interest rate.*

Footnotes 1, 2, 4 and 8 all relate to instruments that are redeemable at the option of the issuer on the date of the change in the distribution or interest rate, and on subsequent rate reset and payment dates in some cases, subject to prior notification to the PRA.

25 Maturity analysis of assets, liabilities and off-balance sheet commitments

The following table provides an analysis of consolidated total assets, liabilities and off-balance sheet commitments by residual contractual maturity at the balance sheet date. These balances are included in the maturity analysis as follows.

- Trading assets and liabilities (including trading derivatives but excluding reverse repos, repos and debt securities in issue) are included in the 'On demand' time bucket, because trading balances are typically held for short periods of time.
- Financial assets and liabilities with no contractual maturity (such as equity securities) are included in the 'Due after 5 years' time bucket. Undated or perpetual instruments are classified based on the contractual notice period which the counterparty of the instrument is entitled to give. Where there is no contractual notice period, undated or perpetual contracts are included in the 'Due after 5 years' time bucket.
- Non-financial assets and liabilities with no contractual maturity are included in the 'Due after 5 years' time bucket.
- Financial instruments included within assets and liabilities of disposal groups held for sale are classified on the basis of the contractual maturity of the underlying instruments and not on the basis of the disposal transaction.
- Liabilities under insurance contracts are included in the 'Due after 5 years' time bucket. Liabilities under investment contracts are classified in accordance with their contractual maturity. Undated investment contracts are classified based on the contractual notice period investors are entitled to give. Where there is no contractual notice period, undated contracts are included in the 'Due after 5 years' time bucket. and
- Loan and other credit-related commitments are classified on the basis of the earliest date they can be drawn down.

Cash flows payable under financial liabilities by remaining contractual maturities

The group	On demand	Due within 3 months	Due between 3 and 12 months	Due between 1 and 5 years	Due after 5 years	Total
	£m	£m	£m	£m	£m	£m
Deposits by banks	**16,922**	**5,215**	**1,336**	**5,372**	**578**	**29,423**
Customer accounts	**326,674**	**43,742**	**9,143**	**1,347**	**793**	**381,699**
Repurchase agreements	**10,257**	**26,012**	**1,503**	**—**	**—**	**37,772**
Trading liabilities	**106,496**	**—**	**—**	**—**	**—**	**106,496**
Financial liabilities designated at fair value	**510**	**476**	**3,793**	**9,318**	**5,148**	**19,245**
Derivatives	**138,555**	**113**	**256**	**928**	**428**	**140,280**
Debt securities in issue	**5**	**4,469**	**6,864**	**1,656**	**468**	**13,462**
Subordinated liabilities	**2**	**47**	**86**	**3,962**	**13,540**	**17,637**
Other financial liabilities	**3,964**	**1,495**	**446**	**101**	**832**	**6,838**
	603,385	**81,569**	**23,427**	**22,684**	**21,787**	**752,852**
Loan commitments	**139,916**	**923**	**1,248**	**188**	**3**	**142,278**
Financial guarantee contracts	**4,462**	**1,406**	**3,851**	**2,581**	**1,018**	**13,318**
At 31 Dec 2017	**747,763**	**83,898**	**28,526**	**25,453**	**22,808**	**908,448**
Deposits by banks	14,255	3,299	1,588	4,304	302	23,748
Customer accounts	315,818	32,901	12,429	4,648	9,944	375,740
Repurchase agreements	10,166	8,030	1,440	—	—	19,636
Trading liabilities	93,934	—	—	—	—	93,934
Financial liabilities designated at fair value	1,038	1,410	1,434	11,801	4,171	19,854
Derivatives	187,501	157	773	1,548	711	190,690
Debt securities in issue	5	5,256	7,772	2,195	1,585	16,813
Subordinated liabilities	1	107	74	2,650	6,730	9,562
Other financial liabilities	4,166	1,253	498	91	539	6,547
	626,884	52,413	26,008	27,237	23,982	756,524
Loan commitments	148,975	849	566	119	2	150,511
Financial guarantee contracts	3,818	1,620	3,351	2,869	1,237	12,895
At 31 Dec 2016	779,677	54,882	29,925	30,225	25,221	919,930

The bank	On demand	Due within 3 months	Due between 3 and 12 months	Due between 1 and 5 years	Due after 5 years	Total
	£m	£m	£m	£m	£m	£m
Deposits by banks	**16,613**	**3,233**	**4,359**	**370**	**54**	**24,629**
Customer accounts	**275,845**	**38,670**	**4,878**	**891**	**359**	**320,643**
Repurchase agreements	**10,232**	**23,655**	**1,330**	**—**	**—**	**35,217**
Trading liabilities	**77,303**	**—**	**—**	**—**	**—**	**77,303**
Financial liabilities designated at fair value	**22**	**476**	**2,598**	**5,524**	**3,299**	**11,919**
Derivatives	**131,790**	**108**	**196**	**807**	**404**	**133,305**
Debt securities in issue	**5**	**1,453**	**4,019**	**226**	**582**	**6,285**
Subordinated liabilities	**—**	**46**	**40**	**3,780**	**13,176**	**17,042**
Other financial liabilities	**2,676**	**666**	**97**	**10**	**—**	**3,449**
	514,486	**68,307**	**17,517**	**11,608**	**17,874**	**629,792**
Loan commitments	**98,319**	**476**	**982**	**34**	**3**	**99,814**
Financial guarantee contracts	**1,482**	**829**	**3,232**	**2,293**	**1,383**	**9,219**
At 31 Dec 2017	**614,287**	**69,612**	**21,731**	**13,935**	**19,260**	**738,825**
Deposits by banks	13,383	6,211	2,521	3,672	402	26,189
Customer accounts	258,398	23,301	9,520	3,530	9,838	304,587
Repurchase agreements	10,044	3,931	1,371	—	—	15,346
Trading liabilities	72,139	—	—	—	—	72,139
Financial liabilities designated at fair value	13	108	1,432	8,192	1,772	11,517
Derivatives	177,490	153	725	1,108	657	180,133
Debt securities in issue	6	1,994	3,563	837	613	7,013
Subordinated liabilities	—	46	37	2,424	5,937	8,444
Other financial liabilities	3,428	623	135	14	—	4,200
	534,901	36,367	19,304	19,777	19,219	629,568
Loan commitments	107,370	137	69	7	2	107,585
Financial guarantee contracts	486	986	2,651	3,793	1,173	9,089
At 31 Dec 2016	642,757	37,490	22,024	23,577	20,394	746,242

Maturity analysis of financial assets and financial liabilities

	2017			2016		
	Due within 1 year	**Due after more than 1 year**	**Total**	Due within 1 year	Due after more than 1 year	Total
The group	**£m**	**£m**	**£m**	£m	£m	£m
Assets						
Financial assets designated at fair value	**67**	**9,199**	**9,266**	164	8,181	8,345
Loans and advances to banks	**10,697**	**3,452**	**14,149**	19,536	1,827	21,363
Loans and advances to customers	**93,239**	**187,163**	**280,402**	88,429	184,331	272,760
Reverse repurchase agreement – non-trading	**40,020**	**5,788**	**45,808**	31,504	156	31,660
Financial investments	**10,832**	**47,168**	**58,000**	15,394	67,741	83,135
Other financial assets	**2,475**	**306**	**2,781**	2,344	63	2,407
At 31 Dec	**157,330**	**253,076**	**410,406**	157,371	262,299	419,670
Liabilities						
Deposits by banks	**23,434**	**5,915**	**29,349**	19,022	4,660	23,682
Customer accounts	**379,463**	**2,083**	**381,546**	360,744	14,508	375,252
Repurchase agreements – non-trading	**37,775**	**—**	**37,775**	19,709	—	19,709
Financial liabilities designated at fair value	**3,768**	**14,481**	**18,249**	3,279	15,207	18,486
Debt securities in issue	**11,188**	**2,098**	**13,286**	13,297	2,843	16,140
Other financial liabilities	**2,900**	**703**	**3,603**	2,858	412	3,270
Subordinated liabilities	**40**	**16,454**	**16,494**	85	8,336	8,421
At 31 Dec	**458,568**	**41,734**	**500,302**	418,994	45,966	464,960
The bank						
Assets						
Loans and advances to banks	**9,379**	**5,781**	**15,160**	11,900	4,813	16,713
Loans and advances to customers	**74,941**	**145,509**	**220,450**	74,597	140,487	215,084
Reverse repurchase agreement – non-trading	**30,838**	**5,789**	**36,627**	23,195	156	23,351
Financial investments	**6,023**	**25,359**	**31,382**	11,813	37,659	49,472
Other financial assets	**2,090**	**2**	**2,092**	2,151	6	2,157
At 31 Dec	**123,271**	**182,440**	**305,711**	123,656	183,121	306,777
Liabilities						
Deposits by banks	**24,202**	**424**	**24,626**	22,110	4,074	26,184
Customer accounts	**319,369**	**657**	**320,026**	290,939	12,632	303,571
Repurchase agreements – non-trading	**35,220**	**—**	**35,220**	15,420	—	15,420
Financial liabilities designated at fair value	**2,435**	**8,571**	**11,006**	1,209	8,966	10,175
Debt securities in issue	**5,457**	**651**	**6,108**	5,577	1,289	6,866
Other financial liabilities	**1,636**	**—**	**1,636**	2,327	5	2,332
Subordinated liabilities	**—**	**15,930**	**15,930**	—	7,362	7,362
At 31 Dec	**388,319**	**26,233**	**414,552**	337,582	34,328	371,910

26 Offsetting of financial assets and financial liabilities

The ‘Amounts not set off in the balance sheet’ include transactions where:

- The counterparty has an offsetting exposure with the group and a master netting or similar arrangement is in place with a right of set off only in the event of default, insolvency or bankruptcy, or the offset criteria are not otherwise satisfied.
- In the case of derivatives and reverse repurchase/repurchase, stock borrowing/lending and similar agreements, cash and non-cash collateral has been received/pledged.

For risk management purposes, the net amounts of loans and advances to customers are subject to limits, which are monitored and the relevant customer agreements are subject to review and updated, as necessary, to ensure that the legal right of offset remains appropriate.

	Amounts subject to enforceable netting arrangements								
				Amounts not set off in the balance sheet					
	Gross amounts	Amounts offset	Net amounts in the balance sheet	Financial instruments	Non-cash collateral	Cash collateral	Net amount	Amounts not subject to enforceable netting arrangements[5]	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Financial assets									
Derivatives[1] (Note 12)	**208,031**	**(66,736)**	**141,295**	**(105,613)**	**(7,524)**	**(26,037)**	**2,121**	**2,040**	**143,335**
Reverse repos, stock borrowing and similar agreements classified as:									
– trading assets[2]	**10,298**	**–**	**10,298**	**(319)**	**(9,979)**	**–**	**–**	**878**	**11,176**
– non-trading assets	**100,249**	**(59,103)**	**41,146**	**(2,748)**	**(38,368)**	**(30)**	**–**	**4,662**	**45,808**
Loans and advances to customers[3]	**30,499**	**(7,716)**	**22,783**	**(19,073)**	**–**	**(134)**	**3,576**	**–**	**22,783**
At 31 Dec 2017	**349,077**	**(133,555)**	**215,522**	**(127,753)**	**(55,871)**	**(26,201)**	**5,697**	**7,580**	**223,102**
Derivatives[1] (Note 12)	264,119	(67,382)	196,737	(150,086)	(7,508)	(31,755)	7,388	2,682	199,419
Reverse repos, stock borrowing and similar agreements classified as:									
– trading assets[2]	6,930	–	6,930	(385)	(6,545)	–	–	241	7,171
– non-trading assets	76,904	(46,819)	30,085	(3,245)	(26,714)	(126)	–	1,575	31,660
Loans and advances to customers[3]	35,128	(10,274)	24,854	(19,181)	–	(201)	5,472	–	24,854
At 31 Dec 2016	383,081	(124,475)	258,606	(172,897)	(40,767)	(32,082)	12,860	4,498	263,104
Financial liabilities									
Derivatives[1] (Note 12)	**205,836**	**(66,736)**	**139,100**	**(105,614)**	**(10,164)**	**(18,283)**	**5,039**	**970**	**140,070**
Repos, stock lending and similar agreements classified as:									
– trading liabilities[2]	**22,291**	**–**	**22,291**	**(319)**	**(21,972)**	**–**	**–**	**47**	**22,338**
– non-trading liabilities	**93,940**	**(59,103)**	**34,837**	**(2,747)**	**(31,912)**	**(178)**	**–**	**2,938**	**37,775**
Customer accounts[4]	**30,382**	**(7,716)**	**22,666**	**(19,073)**	**–**	**(139)**	**3,454**	**117**	**22,783**
At 31 Dec 2017	**352,449**	**(133,555)**	**218,894**	**(127,753)**	**(64,048)**	**(18,600)**	**8,493**	**4,072**	**222,966**
Derivatives[1] (Note 12)	255,079	(67,382)	187,697	(150,062)	(11,529)	(21,424)	4,682	2,395	190,092
Repos, stock lending and similar agreements classified as:									
– trading liabilities[2]	15,361	–	15,361	(385)	(14,976)	–	–	37	15,398
– non-trading liabilities	66,386	(46,819)	19,567	(3,205)	(16,243)	(119)	–	142	19,709
Customer accounts[4]	34,098	(10,274)	23,824	(19,181)	–	(201)	4,442	185	24,009
At 31 Dec 2016	370,924	(124,475)	246,449	(172,833)	(42,748)	(21,744)	9,124	2,759	249,208

1 *At 31 December 2017, the amount of cash margin received that had been offset against the gross derivatives assets was £3,247m (2016: £2,083m). The amount of cash margin paid that had been offset against the gross derivatives liabilities was £3,428m (2016: £4,406m).*
2 *For the amount of repos, reverse repos, stock lending, stock borrowing and similar agreements recognised on the balance sheet within 'Trading assets' £145,725m (2016: £125,069m) and 'Trading liabilities' £106,496m (2016: £93,934m), see the 'Funding sources and uses' table on page 49.*
3 *At 31 December 2017, the total amount of 'Loans and advances to customers' recognised on the balance sheet was £280,402m (2016: £272,760m) of which £22,783m (2016: £24,854m) was subject to offsetting.*
4 *At 31 December 2017, the total amount of 'Customer accounts' recognised on the balance sheet was £381,546m (2016: £375,252m) of which £22,666m (2016: £23,824m) was subject to offsetting.*
5 *These exposures continue to be secured by financial collateral, but we may not have sought or been able to obtain a legal opinion evidencing enforceability of the right of offset.*

27 Called up share capital and other equity instruments

Issued and fully paid

HSBC Bank plc £1.00 ordinary shares

	2017		2016	
	Number	£m	Number	£m
At 1 Jan and 31 Dec	**796,969,110**	**797**	796,969,110	797

HSBC Bank plc £1.00 preferred ordinary shares

	2017		2016	
	Number	£000	Number	£000
At 1 Jan and 31 Dec	**1**	**–**	1	–

The preferred ordinary share ranks *pari passu* in all respects with the ordinary shares and with all other shares expressed to rank *pari passu* therewith. It carries the same rights, and is subject to the same limitations, as the ordinary shares, but in addition the preferred ordinary share confers:

- On each and any distribution of profits by the bank on any class of share (other than the ordinary shares), the right to receive, in priority to any other share, the first £100 of any amount so distributed.

- On any distribution on a winding-up of the bank (but not on any redemption, reduction or purchase of any share capital), the right to receive out of the assets of the bank available for distribution, in priority to any other share, a sum equal to the nominal amount of the preferred ordinary share and any premium paid on the issue thereof.

HSBC Bank plc $0.01 non-cumulative third dollar preference shares

	2017		2016	
	Number	£000	Number	£000
At 1 Jan and 31 Dec	**35,000,000**	**172**	35,000,000	172

The bank has no obligation to redeem the preference shares but may redeem them in part or in whole at any time, subject to the prior notification of the Prudential Regulation Authority. Dividends on the preference shares in issue are paid annually at the sole and absolute discretion of the Board of Directors. The Board of Directors will not declare a dividend on the preference shares in issue if payment of the dividend would cause the bank not to meet the capital adequacy requirements of the Prudential Regulation Authority or the profit of the bank, available for distribution as dividends, is not sufficient to enable the bank to pay in full both dividends on the preference shares in issue and dividends on any other shares that are scheduled to be paid on the same date and have an equal right to dividends or if payment of the dividend is prohibited by the rights attached to any class of shares in the capital of the bank, excluding ordinary shares. The preference shares in issue carry no rights to conversion into ordinary shares of the bank. Holders of the preference shares in issue will be able to attend any general meetings of shareholders of the bank and to vote on any resolution proposed to vary or abrogate any of the rights attaching to the preference shares or any resolution proposed to reduce the paid up capital of the preference shares. If the dividend payable on the preference shares in issue has not been paid in full for the most recent dividend period or any resolution is proposed for the winding-up of the bank or the sale of its entire business then, in such circumstances, holders of preference shares will be entitled to vote on all matters put to general meetings. In the case of unpaid dividends, the holders of preference shares in issue will be entitled to attend and vote at any general meetings until such time as dividends on the preference shares have been paid in full, or a sum set aside for such payment in full, in respect of one dividend period. All shares in issue are fully paid.

Other equity instruments

HSBC Bank plc additional tier 1 instruments

		2017	2016
		£m	£m
£1,096m	Undated Subordinated Additional Tier 1 instrument issued 2014 (Callable December 2019 onwards)	**1,096**	1,096
£1,100m	Undated Subordinated Additional Tier 1 instrument issued 2014 (Callable December 2024 onwards)	**1,100**	1,100
€1,900m	Undated Subordinated Resettable Additional Tier 1 instruments issued 2015 (Callable December 2020 onwards)	**1,388**	1,388
€235m	Undated Subordinated Resettable Additional Tier 1 instruments issued 2016 (Callable January 2022 onwards)	**197**	197
At 31 Dec		**3,781**	3,781

The bank has issued capital instruments that are included in the group's capital base as fully CRD IV compliant additional tier 1 capital.

Interest on these instruments will be due and payable only at the sole discretion of the bank, and the bank has sole and absolute discretion at all times and for any reason to cancel (in whole or in part) any interest payment that would otherwise be payable on any date. There are limitations on the payment of principal, interest or other amounts if such payments are prohibited under UK banking regulations, or other requirements, if the bank has insufficient distributable items or if the bank fails to satisfy the solvency condition as defined in the instruments' terms.

The instruments are undated and are repayable, at the option of the bank, in whole at the initial call date, or on any Interest Payment Date after the initial call date. In addition, the instruments are repayable at the option of the bank in whole for certain regulatory or tax reasons. Any repayments require the prior consent of the Prudential Regulation Authority. These instruments rank *pari passu* with the bank's most senior class or classes of issued preference shares and therefore ahead of ordinary shares. These instruments will be written down in whole, together with any accrued but unpaid interest if either the group's solo or consolidated Common Equity Tier 1 Capital Ratio falls below 7.00%.

28 Contingent liabilities, contractual commitments and guarantees

	The group		The bank	
	2017	2016	2017	2016
	£m	£m	£m	£m
Guarantees and other contingent liabilities:				
– Financial guarantees and similar contracts	**13,316**	12,895	**9,219**	9,089
– Other guarantees	**9,250**	8,290	**9,149**	8,207
– Other contingent liabilities	**353**	268	**351**	267
At 31 Dec	**22,919**	21,453	**18,719**	17,563
Commitments:				
– Documentary credits and short-term trade-related transactions	**2,877**	3,548	**1,933**	2,136
– Forward asset purchases and forward deposits placed	**241**	322	**–**	–
– Standby facilities, credit lines and other commitments to lend	**139,160**	146,641	**97,881**	105,449
At 31 Dec	**142,278**	150,511	**99,814**	107,585

The above table discloses the nominal principal amounts, which represents the maximum amounts at risk should the contracts be fully drawn upon and clients default. As a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not indicative of future liquidity requirements.

In December 2017, HM Revenue & Customs ('HMRC') challenged the VAT status of certain UK branches of HSBC overseas entities. HMRC has issued notices of assessments totalling £147m. HSBC is reviewing the position and will respond to HMRC in due course. At

this time, no provision has been recognised in respect of this matter. Contingent liabilities arising from legal proceedings, regulatory and other matters against group companies are disclosed in Note 30.

Financial Services Compensation Scheme

The Financial Services Compensation Scheme ('FSCS') has provided compensation to consumers following the collapse of a number of deposit takers. The compensation paid out to consumers is currently funded through loans from HM Treasury, which at 31 December 2017 stood at approximately £4.7bn. The bank could be liable to pay a proportion of the outstanding amount that the FSCS has borrowed from HM Treasury. The ultimate FSCS levy to the industry as a result of the collapses cannot currently be estimated reliably, as it is dependent on various uncertain factors, including the potential recoveries of assets by the FSCS and changes in the level of protected deposits and the population of FSCS members at the time.

Guarantees

	The group				The bank			
	At 31 Dec 2017		At 31 Dec 2016		**At 31 Dec 2017**		At 31 Dec 2016	
	In favour of third parties	**By the group in favour of other Group entities**	In favour of third parties	By the group in favour of other Group entities	**In favour of third parties**	**By the bank in favour of other Group entities**	In favour of third parties	By the bank in favour of other Group entities
	£m	**£m**	£m	£m	**£m**	**£m**	£m	£m
Financial guarantees and similar contracts[1]	**12,515**	**801**	12,072	823	**7,015**	**2,204**	7,149	1,940
Other guarantees	**8,329**	**921**	7,596	694	**7,222**	**1,927**	6,499	1,708
Total	**20,844**	**1,722**	19,668	1,517	**14,237**	**4,131**	13,648	3,648

1 *Financial guarantees contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due, in accordance with the original or modified terms of a debt instrument. The amounts in the above table are nominal principal amounts.*

The group provides guarantees and similar undertakings on behalf of both third-party customers and other entities within the Group. These guarantees are generally provided in the normal course of the group's banking businesses. Guarantees with terms of more than one year are subject to the group's annual credit review process.

29 Lease commitments

Operating lease commitments

At 31 December 2017, future minimum lease payments under non-cancellable operating leases for land, buildings and equipment were £1,206m (2016: £1,329m).

Finance lease receivables

The group leases a variety of assets to third parties under finance leases, including transport assets (such as aircraft), property and general plant and machinery. At the end of lease terms, assets may be sold to third parties or leased for further terms. Rentals are calculated to recover the cost of assets less their residual value, and earn finance income.

	2017			2016		
	Total future minimum payments	**Unearned finance income**	**Present Value**	Total future minimum payments	Unearned finance income	Present Value
	£m	**£m**	**£m**	£m	£m	£m
Lease receivables						
– No later than one year	**1,891**	**(156)**	**1,735**	1,710	(167)	1,543
– Later than one year and no later than 5 years	**3,634**	**(294)**	**3,340**	3,554	(322)	3,232
– Later than 5 years	**1,283**	**(151)**	**1,132**	1,306	(159)	1,147
At 31 Dec	**6,808**	**(601)**	**6,207**	6,570	(648)	5,922

30 Legal proceedings and regulatory matters

The group is party to legal proceedings and regulatory matters in a number of jurisdictions arising out of its normal business operations. Apart from the matters described below, the group considers that none of these matters are material. The recognition of provisions is determined in accordance with the accounting policies set out in Note 1 of the *Annual Report and Accounts 2017.* While the outcome of legal proceedings and regulatory matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of these matters at 31 December 2017 (see Note 23). Where an individual provision is material, the fact that a provision has been made is stated and quantified, except to the extent doing so would be seriously prejudicial. Any provision recognised does not constitute an admission of wrongdoing or legal liability. It is not practicable to provide an aggregate estimate of potential liability for our legal proceedings and regulatory matters as a class of contingent liabilities.

Bernard L. Madoff Investment Securities LLC

Bernard L. Madoff ('Madoff') was arrested in December 2008 and later pleaded guilty to running a Ponzi scheme. His firm, Bernard L. Madoff Investment Securities LLC ('Madoff Securities'), is being liquidated in the US by a trustee (the 'Trustee').

Various non-US HSBC companies provided custodial, administration and similar services to a number of funds incorporated outside the US whose assets were invested with Madoff Securities. Based on information provided by Madoff Securities, at 30 November 2008, the purported aggregate value of these funds was $8.4bn, including fictitious profits reported by Madoff.

Based on information available to HSBC, the funds' actual transfers to Madoff Securities minus their actual withdrawals from Madoff Securities during the time HSBC serviced the funds are estimated to have totalled approximately $4bn. Various HSBC companies have been named as defendants in lawsuits arising out of Madoff Securities' fraud.

US/UK litigation: The Trustee has brought lawsuits against various HSBC companies in the US Bankruptcy Court and in the English High Court, seeking recovery of transfers from Madoff Securities to HSBC in an amount not yet pleaded or determined. HSBC and other parties to the action have moved to dismiss the Trustee's US actions. The US Bankruptcy Court granted HSBC's motion to dismiss with respect to certain of the Trustee's claims in November 2016. In September 2017, the US Court of Appeals for the Second Circuit (the 'Second Circuit Court of Appeals') agreed to hear the Trustee's appeal of the US Bankruptcy Court's decision, where this matter is pending.

The deadline by which the Trustee must serve HSBC with his English action has been extended to September 2018 for UK-based defendants and November 2018 for all other defendants.

Fairfield Sentry Limited, Fairfield Sigma Limited and Fairfield Lambda Limited (together, 'Fairfield') (in liquidation since July 2009) have brought lawsuits in the US and the British Virgin Islands ('BVI') against fund shareholders, including HSBC companies that acted as nominees for clients, seeking restitution of redemption payments. In October 2016, the liquidators for Fairfield (the 'Fairfield Liquidators') filed a motion seeking leave to amend their complaints in the US Bankruptcy Court. In January 2017, the defendants moved to dismiss and oppose the Fairfield Liquidators' motion. These motions are pending.

In December 2014, three additional actions were filed in the US. A purported class of direct investors in Madoff Securities asserted common law claims against various HSBC companies in the US District Court for the Southern District of New York (the 'New York District Court'). In September 2016, the New York District Court granted HSBC's motion to dismiss this action and the plaintiffs' failure to appeal renders the court's ruling final. Two investors in Hermes International Fund Limited ('Hermes') also asserted common law claims against various HSBC companies in the New York District Court. In March 2017, the court granted HSBC's motion to dismiss, which dismissal was upheld by the Second Circuit Court of Appeals in November 2017. In addition, SPV Optimal SUS Ltd ('SPV OSUS'), the purported assignee of the Madoff-invested company, Optimal Strategic US Equity Ltd ('Optimal'), filed a lawsuit in New York state court against various HSBC companies and others, seeking damages on various alleged grounds, including breach of fiduciary duty and breach of trust. This action has been stayed pending the issuance of a potentially dispositive decision in an action initiated by Optimal regarding the validity of the assignment of its claims to SPV OSUS.

Cayman Islands litigation: In February 2013, Primeo Fund Limited ('Primeo') (in liquidation since April 2009) brought an action against HSBC Securities Services Luxembourg ('HSSL') and Bank of Bermuda (Cayman) Limited, alleging breach of contract and breach of fiduciary duty, and claiming damages and equitable compensation. The trial concluded in February 2017, and in August 2017, the court dismissed all claims against the defendants. In September 2017, Primeo appealed to the Court of Appeal of the Cayman Islands, where the matter is pending.

Luxembourg litigation: In April 2009, Herald Fund SPC ('Herald') (in liquidation since July 2013) brought an action against HSSL before the Luxembourg District Court, seeking restitution of cash and securities Herald purportedly lost because of Madoff Securities' fraud, or money damages. The Luxembourg District Court dismissed Herald's securities restitution claim, but reserved Herald's cash restitution claim and its claim for money damages. Herald has appealed this judgment to the Court of Appeal, where this matter is pending.

In March 2010, Herald (Lux) SICAV ('Herald (Lux)') (in liquidation since April 2009) brought an action against HSSL before the Luxembourg District Court seeking restitution of securities, or the cash equivalent, or money damages. Herald (Lux) has also requested the restitution of fees paid to HSSL. In 2017, the parties agreed a settlement, which was approved by the Luxembourg court in November 2017. The settlement was concluded in January 2018.

In October 2009, Alpha Prime and, in December 2014, Senator, each brought an action against HSSL before the Luxembourg District Court, seeking the restitution of securities, or the cash equivalent, or money damages. Both actions have been temporarily suspended at the plaintiffs' request. In April 2015, Senator commenced an action against the Luxembourg branch of HSBC Bank plc asserting identical claims before the Luxembourg District Court. HSSL has also been named as a defendant in various actions by shareholders in Primeo Select Fund, Herald, Herald (Lux) and Hermes. Most of these actions have been dismissed, suspended or postponed.

Ireland litigation: In November 2013, Defender Limited brought an action against HSBC Institutional Trust Services (Ireland) Limited ('HTIE') and others, alleging breach of contract and claiming damages and indemnification for fund losses. A provisional trial date has been scheduled for October 2018.

SPV OSUS's action against HTIE and HSBC Securities Services (Ireland) Limited alleging breach of contract and claiming damages and indemnification for fund losses was dismissed by the Irish High Court in October 2015. In March 2017, the Irish Court of Appeal affirmed the dismissal. In April 2017, SPV OSUS filed an application seeking leave to appeal the dismissal to the Irish Supreme Court. The application was heard by the Irish Supreme Court in February 2018 and judgment is pending.

There are many factors that may affect the range of possible outcomes, and the resulting financial impact, of the various Madoff-related proceedings described above, including but not limited to the multiple jurisdictions in which the proceedings have been brought. Based upon the information currently available, management's estimate of the possible aggregate damages that might arise as a result of all claims in the various Madoff-related proceedings is up to or exceeding $500m, excluding costs and interest. Due to uncertainties and limitations of this estimate, the ultimate damages could differ significantly from this amount.

Anti-money laundering and sanctions-related matters

In October 2010, HSBC Bank USA N.A. ('HSBC Bank USA') entered into a consent cease and desist order with the Office of the Comptroller of the Currency ('OCC'), and HSBC North America Holdings ('HNAH') entered into a consent cease and desist order with the Federal Reserve Board ('FRB'). In 2012, HSBC Bank USA further entered into an enterprise-wide compliance consent order (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. While these Orders remain open, HSBC Bank USA and HNAH believe that they have taken appropriate steps to bring themselves into compliance with the requirements of the Orders.

In December 2012, HSBC Holdings plc ('HSBC Holdings'), HNAH and HSBC Bank USA entered into agreements with US and UK government and regulatory 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 US Department of Justice ('DoJ') (the 'AML DPA'); and HSBC Holdings consented to a cease and desist order, and HSBC Holdings and HNAH consented to a civil money penalty order with the FRB. HSBC Holdings also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions, as well as an undertaking with the UK Financial Conduct Authority (the 'FCA'), to comply with certain forward-looking AML and sanctions-related obligations. In addition,

HSBC Bank USA entered into civil money penalty orders with the Financial Crimes Enforcement Network of the US Treasury Department ('FinCEN') 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 retain an independent compliance monitor (who is, for FCA purposes, a 'skilled person' under section 166 of the Financial Services and Markets Act) to produce annual assessments of the Group's AML and sanctions compliance programme (the 'Monitor'). Under the cease and desist order issued by the FRB in 2012, the Monitor also serves as an independent consultant to conduct annual assessments. In February 2018, the Monitor delivered his fourth annual follow-up review report.

Through his country-level reviews, the Monitor identified potential anti-money laundering and sanctions compliance issues that HSBC is reviewing further with the DoJ, FRB and/or FCA. In particular, the DoJ is investigating HSBC's handling of a corporate customer's accounts. In addition, FinCEN as well as the Civil Division of the US Attorney's Office for the Southern District of New York are investigating the collection and transmittal of third-party originator information in certain payments instructed over HSBC's proprietary payment systems. The FCA is also conducting an investigation into HSBC Bank plc's compliance with UK money laundering regulations and financial crime systems and controls requirements. HSBC is cooperating with all of these investigations.

In December 2017, the AML DPA expired and the charges deferred by the AML DPA were dismissed. The Monitor will continue working in his capacity as a skilled person and independent consultant for a period of time at the FCA's and FRB's discretion. The role of the Monitor and his fourth annual follow-up review report, as well as the AML DPA and related agreements and consent orders are discussed on page 34.

Concurrent with entry into the AML DPA, HSBC Bank USA also entered into two consent orders with the OCC. The first, discussed above, required HSBC Bank USA to adopt an enterprise-wide compliance programme. The second required HSBC Bank USA to correct the circumstances noted in the OCC's report and imposed restrictions on HSBC Bank USA 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.

Since November 2014, three lawsuits have been filed in federal court in New York and Illinois, against various HSBC companies and others, on behalf of plaintiffs who are, or are related to, victims of terrorist attacks in Iraq. In each case, it is alleged that the defendants aided and abetted the unlawful conduct of various sanctioned parties in violation of the US Anti-Terrorism Act One action was voluntarily dismissed in October 2017. The two remaining actions are pending in federal court in New York and are at an early stage.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these matters, including the timing or any possible impact on HSBC, which could be significant.

Mossack Fonseca & Co.

HSBC has received requests for information from various regulatory and law enforcement authorities around the world concerning persons and entities believed to be linked to Mossack Fonseca & Co., a service provider of personal investment companies. HSBC is cooperating with the relevant authorities.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of this matter, including the timing or any possible impact on HSBC, which could be significant.

London interbank offered rates, European interbank offered rates and other benchmark interest rate investigations and litigation

Various regulators and competition and law enforcement authorities around the world, including in the UK, the US, the EU and Switzerland, are conducting investigations and reviews related to certain past submissions made by panel banks and the processes for making submissions in connection with the setting of London interbank offered rates ('Libor'), European interbank offered rates ('Euribor') and other benchmark interest rates. As certain HSBC companies are members of such panels, HSBC has been the subject of regulatory demands for information and is cooperating with those investigations and reviews.

In December 2016, the European Commission (the 'Commission') issued a decision finding that HSBC, among other banks, engaged in anti-competitive practices in connection with the pricing of euro interest rate derivatives in early 2007. The Commission imposed a fine on HSBC based on a one-month infringement. HSBC has appealed the decision.

US dollar Libor: Beginning in 2011, HSBC and other panel banks have been named as defendants in a number of private lawsuits filed in the US with respect to the setting of US dollar Libor. The complaints assert claims under various US laws, including US antitrust and racketeering laws, the US Commodity Exchange Act ('US CEA'), and state law. The lawsuits include individual and putative class actions, most of which have been transferred and/or consolidated for pre-trial purposes before the New York District Court.

The New York District Court has issued decisions dismissing certain of the claims in response to motions filed by the defendants. Those decisions resulted in the dismissal of the plaintiffs' federal and state antitrust claims, racketeering claims and unjust enrichment claims. The dismissal of the antitrust claims was appealed to the US Court of Appeals for the Second Circuit, which reversed the decisions in May 2016. In July 2016, the defendants filed a joint motion to dismiss the antitrust claims on additional grounds not previously addressed by the court and, in December 2016, the New York District Court granted in part and denied in part the motion, leaving only certain antitrust claims to be litigated. Certain plaintiffs have appealed the December 2016 order to the US Court of Appeals for the Second Circuit. Separately, in October 2016, the New York District Court granted a motion to dismiss claims brought by certain individual plaintiffs for lack of personal jurisdiction, which is also on appeal to the Second Circuit. Finally, in January 2017, the District Court granted the defendants' motion to dismiss certain of the remaining antitrust claims against defendants that did not serve on the US dollar Libor submission panel. In the New York District Court, the cases with remaining claims against HSBC have been stayed while the court considers motions to certify classes in several putative class actions that are pending against HSBC's co-defendants.

In 2017, HSBC reached agreements with plaintiffs to resolve three putative class actions brought on behalf of persons who purchased US dollar Libor-indexed bonds, persons who purchased US Libor-indexed-exchange-traded instruments and US based lending institutions that made or purchased US dollar Libor-indexed loans. In February 2018, HSBC reached an agreement with plaintiffs to resolve a putative class action brought on behalf of persons who purchased US dollar Libor-indexed interest rate swaps and other instruments directly from the defendant banks and their affiliates. These settlements are subject to court approval.

Euribor: In November 2013, HSBC and other panel banks were named as defendants in a putative class action filed in the New York District Court on behalf of persons who transacted in euro futures contracts and other financial instruments allegedly related to Euribor. The complaint alleges, among other things, misconduct related to Euribor in violation of US antitrust laws, the US CEA and state law. In December 2016, HSBC reached an agreement with plaintiffs to resolve this action, subject to court approval. The court issued an order granting preliminary approval in January 2017, and has scheduled the final approval hearing in May 2018.

Canadian Dealer Offered Rate: In January 2018, various HSBC entities and other banks were named as defendants in a putative class action filed in the New York District Court in relation to the Canadian Dealer Offered Rate. The claim, which is at an early stage, asserts various breaches of US laws, including US antitrust and racketeering laws, the US CEA, and common law.

There are many factors that may affect the range of outcomes, and the resulting financial impact, of these matters, which could be significant.

Supranational, sovereign and agency bonds

In April 2017, various HSBC companies, among other banks, were added as defendants in a putative class action alleging a conspiracy to manipulate the market for US dollar-denominated supranational, sovereign and agency bonds between 2005 and 2015 in violation of US antitrust laws. In November 2017, the plaintiffs filed an amended consolidated complaint which omitted certain HSBC defendants. The remaining HSBC defendants moved to dismiss the amended consolidated complaint, and this motion remains pending.

In November 2017, various HSBC companies and other financial institutions were named as defendants in a putative class action issued in Canada making similar allegations under Canadian law. The claim has not yet been served.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these matters, including the timing or any possible impact on HSBC, which could be significant.

Foreign exchange rate investigations and litigation

Various regulators and competition and law enforcement authorities around the world, including in the US, the EU, Switzerland, Brazil, South Korea and South Africa, are conducting civil and criminal investigations and reviews into trading by HSBC and others on the foreign exchange markets. HSBC is cooperating with these investigations and reviews.

In August 2016, the DoJ indicted two now-former HSBC employees and charged them with wire fraud and conspiracy relating to a 2011 foreign exchange transaction. In October 2017, one of the former employees was found guilty after trial. In January 2018, HSBC Holdings entered into a three-year deferred prosecution agreement with the Criminal Division of the DoJ (the 'FX DPA'), regarding fraudulent conduct in connection with two particular transactions in 2010 and 2011. This concluded the DoJ's investigation into HSBC's historical foreign exchange activities. Under the terms of the FX DPA, HSBC has a number of ongoing obligations, including continuing to cooperate with authorities and implementing enhancements to its internal controls and procedures in its Global Markets business, which will be the subject of annual reports to the DoJ. In addition, HSBC agreed to pay a financial penalty and restitution.

In September 2017, HSBC Holdings and HNAH consented to a civil money penalty order with the FRB in connection with its investigation into HSBC's foreign exchange activities. Under the terms of the order, HSBC Holdings and HNAH agreed to undertake certain remedial steps and to pay a civil money penalty to the FRB.

In December 2016, HSBC Bank plc entered into a settlement with Brazil's Administrative Council of Economic Defense ('CADE') in connection with its investigation into 15 banks, including HSBC Bank plc, as well as 30 individuals, relating to practices in the offshore foreign exchange market. Under the terms of the settlement, HSBC Bank plc agreed to pay a financial penalty to CADE. CADE has also publicly announced that it is initiating a separate investigation into the onshore foreign exchange market and has identified a number of banks, including HSBC, as subjects of its investigation.

In February 2017, the Competition Commission of South Africa referred a complaint for proceedings before the South African Competition Tribunal against 18 financial institutions, including HSBC Bank plc, for alleged misconduct related to the foreign exchange market in violation of South African antitrust laws. In April 2017, HSBC filed an exception to the complaint, based on a lack of jurisdiction and statute of limitations. These proceedings are at an early stage.

In late 2013 and early 2014, HSBC and other banks were named as defendants in various putative class actions consolidated in the New York District Court. The consolidated complaint alleged, among other things, that the defendants conspired to manipulate the WM/Reuters foreign exchange benchmark rates. In September 2015, HSBC reached an agreement with plaintiffs to resolve the consolidated action, subject to court approval. In December 2015, the court granted preliminary approval of the settlement, and HSBC made payment of the agreed settlement amount into an escrow account. The settlement remains subject to final approval by the court.

In June 2015, a putative class action was filed in the New York District Court making similar allegations on behalf of Employee Retirement Income Security Act of 1974 ('ERISA') plan participants. The court dismissed the claims in the ERISA action, and the plaintiffs have appealed to the US Court of Appeals for the Second Circuit. In May 2015, another complaint was filed in the US District Court for the Northern District of California making similar allegations on behalf of retail customers. HSBC filed a motion to transfer that action from California to New York, which was granted in November 2015. In March 2017, the New York District Court dismissed the retail customers' complaint in response to the defendants' joint motion to dismiss. In August 2017, the retail customer plaintiffs filed an amended complaint and the defendants moved to dismiss. The motion remains pending. In April and June 2017, putative class actions making similar allegations on behalf of purported 'indirect' purchasers of foreign exchange products were filed in New York. Those plaintiffs subsequently filed a consolidated amended complaint. HSBC's motion to dismiss the consolidated amended complaint was filed in August 2017 and remains pending.

In September 2015, two additional putative class actions making similar allegations under Canadian law were issued in Canada against various HSBC companies and other financial institutions. In June 2017, HSBC reached an agreement with the plaintiffs to resolve these actions. The settlement received final court approval in October 2017.

At 31 December 2017, the bank has recognised a provision for these and similar matters in the amount of £259m. There are many factors that may affect the range of outcomes, and the resulting financial impact, of these matters. Due to uncertainties and limitations of these estimates, the ultimate penalties could differ significantly from the amount provided.

Precious metals fix-related investigations and litigation

Various regulators and competition and law enforcement authorities, including in the US and the EU, are conducting investigations and reviews relating to HSBC's precious metals operations and trading. HSBC is cooperating with these investigations and reviews. In November 2014, the Antitrust Division and Criminal Fraud Section of the DoJ issued a document request to HSBC Holdings, seeking the voluntary production of certain documents in connection with a criminal investigation that the DoJ is conducting of alleged anti-competitive and manipulative conduct in precious metals trading. In January 2016, the Antitrust Division of the DoJ informed HSBC that it was closing its investigation.

Gold: Beginning in March 2014, numerous putative class actions were filed in the New York District Court and the US District Courts for the District of New Jersey and the Northern District of California, naming HSBC and other members of The London Gold Market Fixing Limited as defendants. The complaints allege that, from January 2004 to June 2013, the defendants conspired to manipulate the price of gold and gold derivatives for their collective benefit in violation of US antitrust laws, the US CEA and New York state law. The actions were consolidated in the New York District Court. The defendants' motion to dismiss the consolidated action was granted in part and denied in part in October 2016. In June 2017, the court granted the plaintiffs leave to file a third amended complaint, which names a new defendant. The court has denied the pre-existing defendants' request for leave to file a joint motion to dismiss. HSBC and the other pre-existing defendants have requested a stay of discovery.

Beginning in December 2015, numerous putative class actions under Canadian law were filed in the Ontario and Quebec Superior Courts of Justice against various HSBC companies and other financial institutions. The plaintiffs allege that, among other things, from January 2004 to March 2014, the defendants conspired to manipulate the price of gold and gold derivatives in violation of the Canadian Competition Act and common law. These actions are at an early stage.

Silver: Beginning in July 2014, numerous putative class actions were filed in the US District Courts for the Southern and Eastern Districts of New York, naming HSBC and other members of The London Silver Market Fixing Ltd as defendants. The complaints allege that, from January 2007 to December 2013, the defendants conspired to manipulate the price of silver and silver derivatives for their collective benefit in violation of US antitrust laws, the US CEA and New York state law. The actions were consolidated in the New York District Court. The defendants' motion to dismiss the consolidated action was granted in part and denied in part in October 2016. In June 2017, the court granted the plaintiffs leave to file a third amended complaint, which names several new defendants. The court has denied the pre-existing defendants' request for leave to file a joint motion to dismiss. HSBC and the other pre-existing defendants have requested a stay of discovery.

In April 2016, two putative class actions under Canadian law were filed in the Ontario and Quebec Superior Courts of Justice against various HSBC companies and other financial institutions. The plaintiffs in both actions allege that, from January 1999 to August 2014, the defendants conspired to manipulate the price of silver and silver derivatives in violation of the Canadian Competition Act and common law. The Ontario action is at an early stage. The Quebec action has been temporarily stayed.

Platinum and palladium: Between late 2014 and early 2015, numerous putative class actions were filed in the New York District Court, naming HSBC and other members of The London Platinum and Palladium Fixing Company Limited as defendants. The complaints allege that, from January 2008 to November 2014, the defendants conspired to manipulate the price of platinum group metals ('PGM') and PGM-based financial products for their collective benefit in violation of US antitrust laws and the US CEA. In March 2017, the defendants' motion to dismiss the second amended consolidated complaint was granted in part and denied in part. In June 2017, the plaintiffs filed a third amended complaint. The defendants filed a joint motion to dismiss which remains pending.

There are many factors that may affect the range of outcomes, and the resulting financial impact, of these matters, which could be significant.

Interest rate swap and credit default swap litigation

In February 2016, various HSBC companies, among others, were added as defendants in a putative class action filed in the New York District Court. The complaint alleged that the defendants violated US antitrust laws by, among other things, conspiring to boycott and eliminate various entities and practices that would have brought exchange trading to buy-side investors in the interest rate swaps marketplace. In June 2016, this action along with other complaints filed in the New York District Court and the Illinois District Court were consolidated in the New York District Court and, in January 2017, the defendants filed a motion to dismiss. In July 2017, the court granted HSBC's motion to dismiss.

In June 2017, certain plaintiffs in the consolidated action brought a separate individual action in the New York District Court against most of the same defendants, alleging similar violations of federal and state antitrust laws and breaches of common law in relation to the credit default swap market.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these matters, including the timing or any possible impact on HSBC, which could be significant.

Fédération Internationale de Football Association ('FIFA') related investigations

HSBC has received enquiries from the DoJ regarding its banking relationships with certain individuals and entities that are or may be associated with FIFA. The DoJ is investigating whether multiple financial institutions, including HSBC, permitted the processing of suspicious or otherwise improper transactions, or failed to observe applicable AML laws and regulations. HSBC is cooperating with the DoJ's investigation.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of this matter, including the timing or any possible impact on HSBC, which could be significant.

Film finance litigation

In July and November 2015, respectively, two actions were brought against HSBC Private Bank (UK) Limited in the High Court of England and Wales seeking damages on various alleged grounds, including breach of duty by HSBC Private Bank (UK) Limited in the provision of certain historic services relating to the participation by the claimants in certain film finance transactions. These actions are ongoing.

It is possible that additional actions or investigations will be initiated against HSBC Private Bank (UK) Limited as a result of its historic involvement in the provision of certain film finance related services.

Based on the facts currently known, it is not practicable to estimate the resolution of these matters, including the timing or possible aggregate impact, which could be significant.

Stanford litigation

In January 2018, HSBC Bank plc received a letter of claim from the Antiguan Joint Liquidators of Stanford International Bank Ltd ('SIB') asserting various claims in connection with HSBC Bank plc's role as a correspondent bank to SIB from 2003 to 2009. HSBC Bank plc denies the allegations and is preparing its response.

HSBC Bank plc continues to defend putative class action lawsuits in the US District Court for the Northern District of Texas against HSBC Bank plc and other bank and individual defendants. The complaints, filed by the Official Stanford Investors Committee and a putative class of persons who held monies on deposit and/or certificates of deposit issued by SIB, allege various fraudulent transfer, statutory and tort claims. In November 2017, the court denied the class plaintiffs' motion for class certification. Permission to appeal that ruling has been requested by the class plaintiffs.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these matters, including the timing or any possible impact on HSBC, which could be significant.

31 Related party transactions

The immediate and ultimate parent company of the group is HSBC Holdings plc, which is incorporated in England.

Copies of the Group financial statements may be obtained from the following address:

HSBC Holdings plc

8 Canada Square

London E14 5HQ

The group's related parties include the parent, fellow subsidiaries, associates, joint ventures, post-employment benefit plans for HSBC employees, Key Management Personnel, close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced by Key Management Personnel or their close family members.

Particulars of transactions with related parties are tabulated below. The disclosure of the year-end balance and the highest amounts outstanding during the year are considered to be the most meaningful information to represent the amount of the transactions and outstanding balances during the year.

Key Management Personnel

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of HSBC Bank plc and the group, and include the Directors of HSBC Bank plc, HSBC Holdings plc and Group Managing Directors of HSBC Holdings plc.

IAS 24 'Related party disclosures' requires the following additional information for key management compensation.

The tables below represent the compensation for Directors and other Key Management Personnel of the bank in exchange for services rendered to the bank for the period they served during the year.

Compensation of Key Management Personnel

	2017	2016
	£000	£000
Short-term employee benefits	3,816	4,180
Post-employment benefits	10	14
Other long-term employee benefits	441	411
Share-based payments	1,359	1,579
Year ended 31 Dec	**5,626**	6,184

Shareholdings, options and other securities of Key Management Personnel[1]

	2017	2016
	(000s)	(000s)
Number of options held over HSBC Holdings ordinary shares under employee share plans	15	18
Number of HSBC Holdings ordinary shares held beneficially and non-beneficially	22,662	22,338
At 31 Dec	**22,677**	22,356

1 *Includes the holdings of Key Management Personnel of both the bank and its parent company, HSBC Holdings plc and their close family members.*

Transactions and balances during the year with Key Management Personnel

	2017		2016	
	Balance at 31 Dec[2]	**Highest amounts outstanding during year**[3]	Balance at 31 Dec	Highest amounts outstanding during year
	£m	**£m**	£m	£m
Key Management Personnel[1]				
Advances and credits	**244**	**260**	176	168
Guarantees	**5**	**40**	45	46
Deposits	**223**	**694**	189	517

1 *Includes Key Management Personnel of both the bank and its parent company, HSBC Holdings plc, close family members of Key Management Personnel and entities which are controlled or jointly controlled by Key Management Personnel or their close family members.*
2 *Exchange rate applied for non-GBP amounts is as at 31 December 2017.*
3 *Exchange rate applied for non-GBP amounts is the average for the year.*

The above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

In addition to the requirements of IAS 24, particulars of advances (loans and quasi-loans), credits and guarantees entered into by HSBC Bank plc and its subsidiaries with Directors of HSBC Bank plc are required to be disclosed pursuant to section 413 of the Companies Act 2006. Under the Companies Act, there is no requirement to disclose transactions with Key Management Personnel of the bank's parent company, HSBC Holdings plc.

Transactions with Directors: advances, credits and guarantees (Companies Act 2006)

	2017	2016
	Balance at 31 Dec	Balance at 31 Dec
	£000	£000
Directors		
Loans	**1,564**	9,527
Guarantees	**–**	–

Other related parties

Transactions and balances during the year with associates and joint ventures

	2017		2016	
	Balance at 31 Dec	**Highest balance during the year**	Balance at 31 Dec	Highest balance during the year
	£m	**£m**	£m	£m
Unsubordinated amounts due from joint ventures	**88**	**102**	92	102
Guarantees and commitments	**480**	**480**	480	610

The group provides certain banking and financial services to associates and joint ventures, including loans, overdrafts, interest and non-interest bearing deposits and current accounts. Details of the interests in associates and joint ventures are given in Note 15.

The group's transactions and balances during the year with HSBC Holdings plc and subsidiaries of HSBC Holdings plc

	2017				2016			
	Due to/from HSBC Holdings plc		Due to/from subsidiaries of HSBC Holdings plc		Due to/from HSBC Holdings plc		Due to/from subsidiaries of HSBC Holdings plc	
	31 Dec	Highest balance	31 Dec	Highest balance	31 Dec	Highest balance	31 Dec	Highest balance
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Trading assets	351	888	4,725	13,367	666	1,857	2,733	7,980
Derivatives	–	–	18,993	29,439	–	–	29,439	29,700
Financial assets designated at fair value	15	20	2	4	12	12	4	8
Loans and advances to banks	–	–	3,958	13,450	–	–	11,379	12,010
Loans and advances to customers	924	1,500	3,610	4,366	1,018	1,018	2,476	3,852
Financial investments	238	250	28	29	228	243	26	181
Total related party assets at 31 Dec	1,528	2,658	31,316	60,655	1,924	3,130	46,057	53,731
Liabilities								
Trading liabilities	968	2,650	18,634	28,316	2,650	2,650	17,572	21,610
Financial liabilities designated at fair value	2,161	2,161	–	–	–	–	–	–
Deposits by banks	–	1	4,901	5,460	–	–	3,766	8,042
Customer accounts	15,001	26,291	5,095	7,316	20,638	23,275	1,770	7,603
Derivatives	–	–	18,923	24,693	–	–	24,693	25,511
Subordinated liabilities	13,279	13,279	–	222	4,799	6,479	222	281
Total related party liabilities at 31 Dec	31,409	44,382	47,553	66,007	28,087	32,404	48,023	63,047
Guarantees and commitments	–	–	472	503	–	–	462	1,450

In June 2016, the three guarantees received from HSBC Holdings plc in respect of monies owing to the bank by its structured investment conduits (Solitaire, Mazarin, Barion and Malachite) and by its multi-seller conduit (Regency) were all cancelled.

	Due to/from HSBC Holdings plc		Due to/from subsidiaries of HSBC Holdings plc	
	2017	2016	2017	2016
	£m	£m	£m	£m
Income statement				
Interest income	–	3	53	55
Interest expense	481	324	81	75
Fee income	17	1	98	76
Dividend income	–	–	–	–
Fee expense	–	–	377	255
Trading income	16	–	212	75
Trading expense	–	(1)	–	–
Other operating income	276	156	383	130
General and administrative expenses	45	(45)	3,997	1,383

The above outstanding balances arose in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

The bank's transactions and balances during the year with HSBC Bank plc subsidiaries, HSBC Holdings plc and subsidiaries of HSBC Holdings plc

	2017						2016					
	Due to/from subsidiaries of HSBC Bank plc subsidiaries		Due to/from HSBC Holdings plc		Due to/from subsidiaries of HSBC Holdings plc		Due to/from subsidiaries of HSBC Bank plc subsidiaries		Due to/from HSBC Holdings plc		Due to/from subsidiaries of HSBC Holdings plc	
	31 Dec	Highest balance	31 Dec	Highest balance	31 Dec	Highest balance	31 Dec	Highest balance	31 Dec	Highest balance	31 Dec	Highest balance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets												
Trading assets	3,547	8,463	351	888	4,403	13,053	3,504	8,048	666	1,624	2,483	7,714
Derivatives	10,989	13,269	—	—	29,257	41,702	13,269	17,641	—	—	41,702	42,618
Loans and advances to banks	5,786	6,331	—	—	3,570	8,922	4,336	7,933	—	—	6,843	8,061
Loans and advances to customers	14,467	15,644	911	1,496	3,594	4,350	15,504	16,031	1,017	1,017	2,461	3,831
Financial investments	820	1,329	—	—	—	—	1,259	1,271	—	—	—	—
Total related party assets at 31 Dec	35,609	45,036	1,262	2,384	40,824	68,027	37,872	50,924	1,683	2,641	53,489	62,224
Liabilities												
Trading liabilities	679	8,246	968	2,650	18,543	27,925	1,040	8,803	2,650	2,650	17,432	21,235
Deposits by banks	4,777	14,162	—	—	4,666	5,061	11,229	14,655	—	—	2,680	7,132
Customer accounts	1,410	3,075	14,984	26,282	4,997	7,209	3,075	3,437	20,610	23,230	1,675	7,507
Derivatives	12,332	15,603	—	—	34,043	42,337	15,603	20,372	—	—	42,337	47,280
Subordinated liabilities	696	700	12,970	12,970	—	—	700	700	4,288	5,955	—	—
Total related party liabilities at 31 Dec	19,894	41,786	28,922	41,902	62,249	82,532	31,647	47,967	27,548	31,835	64,124	83,154
Guarantees and commitments	1,498	1,498	—	—	359	359	1,175	1,843	—	—	233	1,192

The above outstanding balances arose in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

Post-employment benefit plans

At 31 December 2017, fees of £3m (2016: £2m) were earned by group companies for management services related to the group's pension funds held under management. The group's pension funds had placed deposits of £608m (2016: £393m) with its banking subsidiaries.

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

The HSBC Bank (UK) Pension Scheme (the 'Scheme') entered into swap transactions with the bank to manage the inflation and interest rate sensitivity of the liabilities. At 31 December 2017, the gross notional value of the swaps was £8,345m (2016: £8,523m), the swaps had a negative fair value of £745m to the bank (2016: negative fair value of £712m) and the bank had delivered collateral of £745m (2016: £708m) to the Scheme in respect of these swaps. All swaps were executed at prevailing market rates and within standard market bid/ offer spreads.

32 Events after the balance sheet date

On 2 January 2018, the bank acquired 100% of the share capital of HSBC Investment Bank Holdings Limited from HSBC Holdings plc for a consideration of £135m. HSBC Investment Bank Holdings Limited is an investments holding company.

On 31 January 2018, the bank gave notice that it will call and redeem its issue of £350m 5% Callable Subordinated Notes 2023 on 20 March 2018.

A second interim dividend for 2017 of £583m to the shareholder of the parent company was declared on 12 February 2018 by the Directors.

33 HSBC Bank plc's subsidiaries, joint ventures and associates

In accordance with section 409 of the Companies Act 2006 a list of HSBC Bank plc subsidiaries, joint ventures and associates, the registered office address and the effective percentage of equity owned at 31 December 2017 is disclosed below.

Unless otherwise stated, the share capital comprises ordinary or common shares which are held by HSBC Bank plc subsidiaries. The ownership percentage is provided for each undertaking. The undertakings below are consolidated by HSBC Bank plc unless otherwise indicated.

Subsidiaries

The undertakings below are consolidated by HSBC.

Subsidiaries	% of share class held by immediate parent company (or by HSBC Bank plc where this varies)		Footnotes
Assetfinance December (F) Limited	100.00		15
Assetfinance December (H) Limited	100.00		15
Assetfinance December (M) Limited	100.00		15
Assetfinance December (P) Limited	100.00		2, 15
Assetfinance December (R) Limited	100.00		15
Assetfinance June (A) Limited	100.00		15
Assetfinance June (D) Limited	100.00		15
Assetfinance Limited	100.00		15
Assetfinance March (B) Limited	100.00		16
Assetfinance March (D) Limited	100.00		15
Assetfinance March (F) Limited	100.00		15
Assetfinance September (F) Limited	100.00		15
Assetfinance September (G) Limited	100.00		15
B&Q Financial Services Limited	100.00		2, 17
Banco Nominees (Guernsey) Limited	100.00		9, 18
Banco Nominees 2 (Guernsey) Limited	100.00		18
Beau Soleil Limited Partnership	n/a		7, 9, 19
Billingsgate Nominees Limited	100.00		2, 15
Canada Crescent Nominees (UK) Limited	100.00		2, 15
Canada Square Nominees (UK) Limited	100.00		2, 15
Canada Square Property Participations Limited	100.00		2, 15
Canada Water Nominees (UK) Limited	100.00		2, 15
CCF Charterhouse GmbH & Co Asset Leasing KG (In Liquidation)	100.00	(99.99)	20
CCF Charterhouse GmbH (In liquidation)	100.00	(99.99)	4, 20
CCF & Partners Asset Management Limited	99.99		15
CCF Holding (LIBAN) S.A.L. (in liquidation)	74.99		1, 21
Charterhouse Administrators (D.T.) Limited	100.00	(99.99)	9, 15
Charterhouse Management Services Limited	100.00	(99.99)	9, 15
Charterhouse Pensions Limited	100.00		2, 15
COIF Nominees Limited	100.00		2, 15
Dem 5	100.00	(99.99)	9, 4, 22
Dem 9	100.00	(99.99)	9, 4, 22
Dempar 1	100.00	(99.99)	9, 4, 23
Dempar 4	100.00	(99.99)	9, 23
Elysees GmbH (In liquidation)	100.00	(99.99)	20
Elysées Immo Invest	100.00	(99.99)	4, 24
EMTT Limited (In liquidation)	100.00		2, 15
Equator Holdings Limited (In liquidation)	100.00		2, 15
Eton Corporate Services Limited	100.00		18
Fdm 5 SAS	100.00	(99.99)	9, 4, 22
Finanpar 2	100.00	(99.99)	9, 4, 24
Finanpar 7	100.00	(99.99)	9, 4, 24
Flandres Contentieux S.A.	100.00	(99.99)	9, 1, 4, 25
Foncière Elysées	100.00	(99.99)	9,4,23
Forward Trust Rail Services Limited	100.00		15
Gesellschaft fur Industrielle Beteiligungen und Finanzierung mbH	100.00	(80.67)	9, 26
Griffin International Limited	100.00		15
HITG Administration GmbH	100.00		2, 27
Hongkong International Trade Finance (Holdings) Limited (in liquidation)	100.00		2, 15
HSBC (BGF) Investments Limited	100.00		2, 15
HSBC Alpha Funding (UK) Holdings LP (in liquidation)	n/a		2, 7, 28
HSBC Asset Finance (UK) Limited	100.00		15
HSBC Asset Finance Holdings Limited	100.00		2, 15
HSBC Asset Finance M.O.G. Holdings (UK) Limited	100.00		2, 15
HSBC Assurances Vie (France)	100.00	(99.99)	9, 4, 25
HSBC Bank (General Partner) Limited	100.00		2, 29
HSBC Bank (RR) (Limited Liability Company)	100.00		13, 30
HSBC Bank Armenia cjsc	70.00		31
HSBC Bank Capital Funding (Sterling 1) LP	n/a		7, 29
HSBC Bank Capital Funding (Sterling 2) LP	n/a		7, 29
HSBC Bank Egypt S.A.E	94.54		62
HSBC Bank International Limited	100.00		32
HSBC Bank Malta p.l.c.	70.03		33
HSBC Bank Nominee (Jersey) Limited	100.00		2, 32
HSBC Bank Pension Trust (UK) Limited	100.00		2, 15
HSBC Bank Polska S.A.	100.00		2, 3, 34
HSBC Branch Nominee (UK) Limited	100.00		2, 15
HSBC Client Holdings Nominee (UK) Limited	100.00		2, 15
HSBC Client Share Offer Nominee (UK) Limited	100.00		2, 15
HSBC Corporate Trustee Company (UK) Limited	100.00		2, 15
HSBC Custody Services (Guernsey) Limited	100.00		18
HSBC Enterprise Investment Company (UK) Limited	100.00		2, 15
HSBC Epargne Entreprise (France)	100.00	(99.99)	9, 4, 25
HSBC Equator (UK) Limited (in liquidation)	100.00		15
HSBC Equipment Finance (UK) Limited	100.00		15
HSBC Equity (UK) Limited	100.00		2, 15
HSBC Europe B.V.	100.00		15
HSBC European Clients Depositary Receipts Nominee (UK) Limited (in liquidation)	100.00		2, 15
HSBC Executor & Trustee Company (UK) Limited	100.00		15
HSBC Factoring (France)	100.00	(99.99)	9, 4, 23
HSBC Finance Limited	100.00		2, 15
HSBC France	99.99		2, 4, 23
HSBC Germany Holdings GmbH	100.00		2, 26
HSBC Global Asset Management (Deutschland) GmbH	100.00	(80.66)	9, 26
HSBC Global Asset Management (France)	100.00	(99.99)	9, 4, 35
HSBC Global Asset Management (International) Limited	100.00		2, 36
HSBC Global Asset Management (Malta) Limited	100.00	(70.03)	37
HSBC Global Asset Management (Oesterreich) GmbH	100.00	(80.66)	9, 6, 66
HSBC Global Asset Management (Switzerland) AG	100.00	(90.33)	9, 4, 38
HSBC Global Custody Nominee (UK) Limited	100.00		2, 15
HSBC Global Custody Proprietary Nominee (UK) Limited	100.00		2, 15
HSBC Global Shared Services (India) Private Limited (in liquidation)	100.00	(99.99)	9, 39
HSBC INKA Investment-AG TGV	100.00	(80.67)	9, 14, 40
HSBC Institutional Trust Services (Ireland) DAC	100.00		41
HSBC Insurance Management Services Limited (in liquidation)	100.00		42
HSBC Insurance Services Holdings Limited	100.00		2, 15
HSBC International Financial Services (UK) Limited (in liquidation)	100.00		2, 15
HSBC International Holdings (Jersey) Limited	100.00		32
HSBC International Trade Finance Limited (in liquidation)	100.00		15
HSBC Investment Bank Holdings Limited	100.00		2, 15
HSBC Invoice Finance (UK) Limited	100.00		43
HSBC Issuer Services Common Depositary Nominee (UK) Limited	100.00		2, 15
HSBC Issuer Services Depositary Nominee (UK) Limited	100.00		2, 15
HSBC Leasing (France)	100.00	(99.99)	9, 4, 22
HSBC Life (UK) Limited	100.00		2, 15
HSBC Life Assurance (Malta) Limited	100.00	(70.03)	37
HSBC LU Nominees Limited	100.00		2, 15
HSBC Marking Name Nominee (UK) Limited	100.00		2, 15
HSBC Middle East Leasing Partnership	n/a		7, 9, 44
HSBC Overseas Nominee (UK) Limited	100.00		2, 15
HSBC PB Corporate Services 1 Limited	100.00		45
HSBC Pension Trust (Ireland) DAC	100.00		2, 41

Subsidiaries	% of share class held by immediate parent company (or by HSBC Bank plc where this varies)		Footnotes
HSBC Preferential LP (UK)	100.00		2, 15
HSBC Private Bank (C.I.) Limited	100.00		2, 18
HSBC Private Bank (UK) Limited	100.00		2, 15
HSBC Private Banking Nominee 3 (Jersey) Limited	100.00		45
HSBC Private Equity Investments (UK) Limited	100.00		15
HSBC Rail (UK) Limited	100.00		15
HSBC Real Estate Leasing (France)	99.99		9, 4, 25
HSBC Reim (France)	100.00	(99.99)	9, 4, 25
HSBC Representative Office (Nigeria) Limited	100.00		2, 46
HSBC Securities (South Africa) (Pty) Limited	100.00		2, 47
HSBC Securities Services (Guernsey) Limited	100.00		18
HSBC Securities Services (Ireland) DAC	100.00		41
HSBC Securities Services (Luxembourg) S.A.	100.00		2, 48
HSBC Securities Services Holdings (Ireland) DAC	100.00		41
HSBC Services (France)	100.00	(99.99)	9, 4, 23
HSBC SFH (France)	100.00	(99.99)	9, 4, 25
HSBC Stockbroker Services (Client Assets) Nominees Limited	100.00		2, 15
HSBC Stockbrokers Nominee (UK) Limited	100.00		2, 15
HSBC Transaction Services GmbH	100.00	(80.67)	6, 49
HSBC Trinkaus & Burkhardt (International) S.A.	100.00	(80.67)	48
HSBC Trinkaus & Burkhardt AG	100.00	(80.67)	14, 26
HSBC Trinkaus & Burkhardt Gesellschaft fur Bankbeteiligungen mbH	100.00	(80.67)	26
HSBC Trinkaus Europa Immobilien-Fonds Nr. 5 GmbH	100.00	(80.67)	26
HSBC Trinkaus Family Office GmbH	100.00	(80.67)	6, 26
HSBC Trinkaus Immobilien Beteiligungs KG	100.00	(80.67)	26
HSBC Trinkaus Real Estate GmbH	100.00	(80.67)	6, 26
HSBC Trust Company (UK) Limited	100.00		2, 15
HSBC Trustee (C.I.) Limited	100.00		2, 45
HSBC Trustee (Guernsey) Limited	100.00		2, 18
HSBC Wealth Client Nominee Limited	100.00		2, 15
INKA Internationale Kapitalanlagegesellschaft mbH	100.00	(80.67)	49
James Capel & Co. Limited	100.00		2, 15
James Capel (Channel Islands) Nominees Limited	100.00		15
James Capel (Nominees) Limited	100.00		2, 15
James Capel (Second Nominees) Limited (in liquidation)	100.00		2, 15
James Capel (Taiwan) Nominees Limited	100.00		2, 15
John Lewis Financial Services Limited	100.00		2, 15
Keyser Ullmann Limited	100.00	(99.99)	9, 15
Kings Meadow Nominees Limited	100.00		50
Marks and Spencer Financial Services plc	100.00		50
Marks and Spencer Retail Financial Services Holdings Limited	100.00		2, 50
Marks and Spencer Savings and Investments Limited	100.00		50
Marks and Spencer Unit Trust Management Limited	100.00		50
Midcorp Limited	100.00		2, 15
Midland Bank (Branch Nominees) Limited	100.00		2, 15
Midland Nominees Limited	100.00		15
Prudential Client HSBC GIS Nominee (UK) Limited	100.00		2, 15
Republic Nominees Limited	100.00		2, 18
RLUKREF Nominees (UK) One Limited	100.00		2, 15
RLUKREF Nominees (UK) Two Limited	100.00		2, 15
S.A.P.C. - Ufipro Recouvrement	100.00	(99.97)	11, 22
Saf Baiyun	100.00	(99.99)	4, 9, 24
Saf Chang Jiang	100.00	(99.99)	4, 9, 24
Saf Chang Jiang Shi Liu	100.00	(99.99)	4, 9, 24

Subsidiaries	% of share class held by immediate parent company (or by HSBC Bank plc where this varies)		Footnotes
Saf Chang Jiang Shi Wu	100.00	(99.99)	1, 4, 9, 24
Saf Guangzhou	100.00	(99.99)	4, 9, 24
Saf Zhu Jiang	100.00	(99.99)	4, 9, 24
Saf Zhu Jiang Ba	100.00	(99.99)	4, 9, 24
Saf Zhu Jiang Er	100.00	(99.99)	4, 9, 24
Saf Zhu Jiang Jiu	100.00	(99.99)	4, 9, 24
Saf Zhu Jiang San	100.00	(99.99)	4, 9, 24
Saf Zhu Jiang Shi	100.00	(99.99)	4, 9, 24
Saf Zhu Jiang Shi Ba	100.00	(99.99)	4, 9, 24
Saf Zhu Jiang Shi Er	100.00	(99.99)	4, 9, 24
Saf Zhu Jiang Shi Jiu	100.00	(99.99)	4, 9, 24
Saf Zhu Jiang Shi Liu	100.00	(99.99)	4, 9, 24
Saf Zhu Jiang Shi Qi	100.00	(99.99)	4, 9, 24
Saf Zhu Jiang Shi Wu	100.00	(99.99)	4, 9, 24
Saf Zhu Jiang Shiyi	100.00	(99.99)	4, 9, 24
Samada Limited	100.00		45
SAS Bosquet -Audrain	100.00	(94.90)	1, 4, 65
SAS Cyatheas Pasteur	100.00	(94.93)	1, 4, 22
SAS Orona	100.00	(94.92)	1, 4, 65
SCI HSBC Assurances Immo	100.00	(99.99)	1, 9, 11, 25
SFSS Nominees (Pty) Limited	100.00		47
SNC Dorique	100.00	(99.99)	1, 9, 11, 51
SNC Kerouan	100.00	(99.99)	1, 9, 11, 24
SNC Les Mercuriales	100.00	(99.99)	1, 9, 11, 24
SNC Les Oliviers D'Antibes	59.99		11, 25
SNC Makala	100.00	(99.99)	1, 9, 11, 24
SNC Nuku-Hiva Bail	100.00	(99.99)	1, 9, 11, 24
SNCB/M6 - 2008 A	100.00	(99.99)	1, 4, 9, 24
SNCB/M6-2007 A	100.00	(99.99)	1, 4, 9, 24
SNCB/M6-2007 B	100.00	(99.99)	1, 4, 9, 24
Société CCF Finance Moyen-Orient S.A.L.	96.64	(99.08)	4, 9, 21
Société Financière et Mobilière	100.00	(99.99)	4, 9, 23
Société Française et Suisse	100.00	(99.99)	4, 9, 24
Somers Dublin DAC	100.00		41
Sopingest	100.00	(99.99)	4, 9, 24
South Yorkshire Light Rail Limited	100.00		15
St Cross Trustees Limited	100.00		15
Swan National Leasing (Commercials) Limited	100.00		15
Swan National Limited	100.00		15
Thasosfin	100.00	(99.99)	4, 9, 25
The Venture Catalysts Limited	100.00		2, 15
TKM International Limited (in liquidation)	100.00		15
Trinkaus Australien Immobilien Fonds Nr. 1 Brisbane GmbH & Co. KG	100.00	(80.67)	26
Trinkaus Australien Immobilien-Fonds Nr. 1 Treuhand-GmbH	100.00	(80.67)	6, 26
Trinkaus Canada Immobilien-Fonds Nr. 1 Verwaltungs-GmbH	100.00	(80.67)	26
Trinkaus Europa Immobilien-Fonds Nr.3 Objekt Utrecht Verwaltungs-GmbH	100.00	(80.67)	26
Trinkaus Immobilien-Fonds Geschaeftsfuehrungs-GmbH	100.00	(80.67)	6, 26
Trinkaus Immobilien-Fonds Verwaltungs-GmbH	100.00	(80.67)	6, 26
Trinkaus Private Equity Management GmbH	100.00	(80.67)	26
Trinkaus Private Equity Verwaltungs GmbH	100.00	(80.67)	6, 26
Turnsonic (Nominees) Limited	100.00		15
Valeurs Mobilières Elysées	100.00	(99.99)	4, 9, 52

Joint Ventures

The undertakings below are Joint Ventures and equity accounted.

Joint Ventures	% of share class held by immediate parent company or by HSBC Bank plc where this varies)	Footnotes
HCM Holdings Limited	50.99	58
Vaultex UK Limited	50.00	2, 54

Associates

The undertakings below are associates and equity accounted.

Associates	% of share class held by immediate parent company (or by HSBC Bank plc where this varies)	Footnotes
BGF Group Limited	24.40	55
CFAC Payment Scheme Limited	33.33	2, 56
HSBC Mortgage LLP	n/a	2, 7, 59
Services Epargne Entreprise SAS	14.35	63, 64

Footnotes

1	*Management has determined that these undertakings are excluded from consolidation in the Group accounts as these entities do not meet the definition of subsidiaries in accordance with IFRS. HSBC's consolidation policy is described in Note 1.2(a).*
2	*Directly held by HSBC Bank plc*

Description of shares

3	*Preference Shares*
4	*Actions*
5	*Redeemable Preference Shares*
6	*GmbH Anteil*
7	*This undertaking is a partnership and does not have share capital*
8	*Liquidating Share Class*
9	*In the prior period the Bank disclosed the immediate parent company's interest in this undertaking*
10	*Non-Participating Voting Shares*
11	*Parts*
12	*Registered Capital Shares*
13	*Russian Limited Liability Company Shares*
14	*Stückaktien*

Registered Offices

15	*8 Canada Square, London, United Kingdom, E14 5HQ*
16	*5 Donegal Square South, Belfast, Northern Ireland, BT1 5JP*
17	*Camden House West The Parade, Birmingham, United Kingdom, B1 3PY*
18	*Arnold House St Julians Avenue, St Peter Port, Guernsey, GY1 3NF*
19	*HSBC Main Building 1 Queen's Road Central, Hong Kong*
20	*Unsoeldstrasse 2, Munich, Germany, 80538*
21	*Solidere - Rue Saad Zaghloul Immeuble - 170 Marfaa, PO Box 17 5476 Mar Michael 11042040, Beyrouth, Lebanon*
22	*39, rue de Bassano, Paris, France, 75008*
23	*103, avenue des Champs-Elysées, Paris, France, 75008*
24	*64, rue Galilée, Paris, France, 75008*
25	*15, rue Vernet, Paris, France, 75008*
26	*Königsallee 21/23, Düsseldorf, Germany, 40212*
27	*11-17 Ludwig-Erhard-Str., Hamburg, Germany, 20459*
28	*PO Box 513 HSBC House, 68 West Bay Road, George Town, Grand Cayman, Cayman Islands, KY1-1102*
29	*HSBC House Esplanade, St. Helier, Jersey, JE4 8UB*
30	*2 Paveletskaya square, building 2, Moscow, Russian Federation, 115054*
31	*66 Teryan Street, Yerevan, Armenia, 0009*
32	*HSBC House Esplanade, St. Helier, Jersey, JE1 1HS*
33	*116 Archbishop Street, Valletta, Malta*
34	*Rondo ONZ 1, Warsaw, Poland, 00-124*
35	*Immeuble Coeur Défense 110, Esplanade du Général de Gaulle- La défense 4, Courbevoie, France, 92400*
36	*HSBC House Esplanade, St. Helier, Jersey, JE4 8WP*
37	*80 Mill Street, Qormi, Malta, QRM 3101*
38	*Gartenstrasse 26, Zurich, Switzerland*
39	*52/60 M G Road, Fort, Mumbai, India, 400 001*
40	*Breite Str. 29/31, Düsseldorf, Germany, 40213*
41	*1 Grand Canal Square Grand Canal Harbour, Dublin 2, D02 P820, Ireland*
42	*1 More London Place, London, United Kingdom, SE1 2AF*
43	*21 Farncombe Road, Worthing, United Kingdom, BN11 2BW*
44	*Level 3, Precinct Building 4 Gate District, PO Box 506553, Dubai, United Arab Emirates*
45	*HSBC House Esplanade, St. Helier, Jersey, JE1 1GT*
46	*St Nicholas House, 10th Floor Catholic Mission St Lagos, Nigeria*
47	*2 Exchange Square 85 Maude Street, Sandown, Sandton, South Africa, 2196*
48	*16 Boulevard d'Avranches, Luxembourg, L-1160*
49	*Yorckstraße 21 - 23 40476, Duesseldorf, Germany*
50	*Kings Meadow Chester Business Park, Chester, United Kingdom, CH99 9FB*
51	*43 rue de Paris, Saint Denis, 97400*
52	*109 avenue des Champs-Elysees, Paris, France, 75008*
53	*1st Floor Rose House, 51-59 Circular Road, Douglas, Isle Of Man, IM1 1RE*
54	*21 Garlick Hill, London, United Kingdom, EC4V 2AU*
55	*13 - 15 York Buildings, London, United Kingdom, WC2N 6JU*
56	*6th Floor 65 Gresham Street London EC2V 7NQ*
57	*37 avenue Henri Lafleur, Nouméa, New Caledonia, BP K3 98849*
58	*Hill House 1 Little New Street, London, United Kingdom, EC4A 3TR*
59	*35 Great St Helens, London, United Kingdom, EC3A 6AP*
60	*Lot n°5, la Rocade, Grand Camp, LES ABYMES, Guadeloupe, 97142*
61	*Ernst-Schneider-Platz 1, Duesseldorf, Germany, 40212*
62	*306 Corniche El Nil, Maadi, Egypt, 11728*
63	*32 Rue du Champ de Tir, 44300 NANTES*
64	*HSBC Bank plc exercises control or significant influence over this undertakings notwithstanding its equity interest*
65	*10, rue Jean Jaurès, Nouméa, Nouvelle Calédonie, BP Q5 98845*
66	*Herrengasse 1-3, 1010 Wien, Austria*

HSBC Bank plc

8 Canada Square
London E14 5HQ
United Kingdom
Telephone: 44 020 7991 8888
www.hsbc.co.uk