HSBC Bank Canada

First Quarter 2018 Interim Report

HSBC

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Highlights

For the quarter ended 31 March 2018 compared with the same period in the prior year.

- Strong growth in operating income of $35m, or 6.9%, from $506m to $541m.
- Profit before income tax expense increased by $8m or 3.3%, from $243m to $251m.
- Profit attributable to the common shareholder decreased by $4m, or 2.3%, from $177m to $173m.
- Return on average common equity[1] was 15.5% compared with 15.4%.
- The cost efficiency ratio[1] decreased to 58.8% from 61.5%.
- Total assets increased by $1.76bn, or 1.8%, from $96.38bn as at 31 December 2017 to $98.14bn as at 31 March 2018.
- Common equity tier 1 capital ratio was 10.1%, the tier 1 ratio was 12.0% and the total capital ratio was 14.2% compared with 10.5%, 12.4% and 14.7% as at 31 December 2017 respectively.

1 *For additional information, see the 'Use of non-IFRS financial measures' section of the MD&A.*

Contents

Management's Discussion and Analysis

HSBC Bank Canada ('the bank', 'we', 'our') is an indirectly wholly-owned subsidiary of HSBC Holdings plc ('HSBC Holdings'). Throughout the Management's Discussion and Analysis ('MD&A'), the HSBC Holdings Group is defined as the 'HSBC Group' or the 'Group'.

The MD&A is provided to enable readers to assess our financial condition and results of operations for the quarter ended 31 March 2018, compared to the same period in the preceding year. The MD&A should be read in conjunction with our unaudited interim condensed consolidated financial statements and related notes for the quarter ended 31 March 2018 ('consolidated financial statements') and our Annual Report and Accounts 2017. This MD&A is dated 2 May 2018, the date that our consolidated financial statements and MD&A were approved by our Board of Directors ('the Board').

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

The references to 'notes' throughout this MD&A refer to notes on the consolidated financial statements for the quarter ended 31 March 2018.

Our continuous disclosure materials, including interim and annual filings are available through a link on the bank's website at www.hsbc.ca. These documents and the 2017 Annual Information Form are also available on the Canadian Securities Administrators' website at www.sedar.com.

Complete financial, operational and investor information for HSBC Holdings and the HSBC Group, including HSBC Bank Canada, can be obtained from its website, www.hsbc.com, including copies of HSBC Holdings Annual Report and Accounts 2017. Information contained in or otherwise accessible through the websites mentioned does not form part of this report.

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Caution regarding forward-looking statements

This document contains forward-looking information, including statements regarding the business and anticipated actions of the bank. These statements can be identified by the fact that they do not pertain strictly to historical or current facts. Forward-looking statements often include words such as 'anticipates,' 'estimates', 'expects,' 'projects,' 'intends,' 'plans,' 'believes' and words and terms of similar substance in connection with discussions of future operating or financial performance. By their very nature, these statements require us to make a number of assumptions and are subject to a number of inherent risks and uncertainties that may cause actual results to differ materially from those contemplated by the forward-looking statements. We caution you to not place undue reliance on these statements as a number of risk factors could cause our actual results to differ materially from the expectations expressed in such forward-looking statements. The Risk Management section in the MD&A of our Annual Report and Accounts 2017 describes the most significant risks to which the bank is exposed and, if not managed appropriately, could have a material impact on our future financial results. These risk factors include: credit risk, liquidity and funding risk, market risk and structural interest rate risk. Additional risks that could cause our actual results to differ materially from the expectations expressed in such forward-looking statements include: operational risks (including compliance, regulatory, financial crime, security and fraud, and fiduciary risks) and reputational risks. Other factors that may cause our actual results to differ materially from the expectations expressed in such forward-looking statements include: general economic and market conditions, fiscal and monetary policies, changes in laws, regulations and approach to supervision, level of competition and disruptive technology, changes to our credit rating, and operational, infrastructure and other risks. Refer to the 'Factors that may affect future results' section of our Annual Report and Accounts 2017 for a description of these risk factors. We caution you that the risk factors disclosed above are not exhaustive, and there could be other uncertainties and potential risk factors not considered here which may adversely affect our results and financial condition. Any forward-looking statements in this document speak only as of the date of this document. We do not undertake any obligation to, and expressly disclaim any obligation to, update or alter our forward-looking statements, whether as a result of new information, subsequent events or otherwise, except as required under applicable securities legislation.

Who are we

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

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

The HSBC Group is one of the world's largest banking and financial services groups with assets of US$2,652bn at 31 March 2018. HSBC serves customers worldwide through an international network of about 3,900 offices in 67 countries and territories in Europe, Asia, North and Latin America, and the Middle East and North Africa.

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

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

Financial Summary

($ millions, except where otherwise stated)	Quarter ended	
	31 Mar 2018[1]	31 Mar 2017
Financial performance for the period		
Total operating income	**541**	506
Profit before income tax expense	**251**	243
Profit attributable to the common shareholder	**173**	177
Basic earnings per common share ($)	**0.35**	0.35
Performance ratios (%)[2]		
Return ratios (%)		
Return on average common shareholder's equity	**15.5**	15.4
Post-tax return on average total assets	**0.72**	0.76
Pre-tax return on average risk-weighted assets[3]	**2.2**	2.3
Credit coverage ratios (%)[2]		
Change in expected credit losses to total operating income[4]	**n/a**	n/a
Change in expected credit losses to average gross customer advances and acceptances[4]	**n/a**	n/a
Total allowance for expected credit losses to impaired loans and acceptances at year end[4]	**59.5**	60.7
Efficiency and revenue mix ratios (%)[2]		
Cost efficiency ratio	**58.8**	61.5
Adjusted cost efficiency ratio	**58.8**	61.1
As a percentage of total operating income:		
– net interest income	**56.6**	55.7
– net fee income	**28.7**	31.6
– net income from financial instruments held for trading	**6.7**	6.1

	At period ended	
	31 Mar 2018[1]	31 Dec 2017
Financial position at period end		
Total assets	**98,140**	96,379
Loans and advances to customers	**50,743**	50,337
Customer accounts	**55,814**	57,054
Ratio of customer advances to customer accounts (%)	**90.9**	88.2
Shareholders' equity	**5,663**	5,710
Average total shareholders' equity to average total assets (%)[2]	**5.9**	5.9
Capital measures[3]		
Common equity tier 1 capital ratio ('CET1') (%)	**10.1**	10.5
Tier 1 ratio (%)	**12.0**	12.4
Total capital ratio (%)	**14.2**	14.7
Leverage ratio (%)	**4.8**	4.9
Risk-weighted assets ($m)	**46,241**	45,035

1 *Effective 1 January 2018 the bank adopted IFRS 9 Financial Instruments ('IFRS 9') on a retrospective basis without restatement of prior periods. Results from prior periods are reported in accordance with IAS 39 Financial Instruments: Recognition and Measurement ('IAS 39').*

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

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

4 *Effective 1 January 2018 under IFRS 9 the term 'Change in expected credit losses' is used. The equivalent term prior to 1 January 2018 under IAS 39 is 'Loan impairment charges and other credit risk provisions'.The bank is in a net recovery position for both periods shown. Where this results in a negative ratio n/a is shown.*

Management's Discussion and Analysis (continued)

Use of non-IFRS financial measures

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

Financial position ratios

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

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

Return ratios

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

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

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

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

Credit coverage ratios

Credit coverage ratios are useful to management as a measure of the extent of the change in expected credit losses relative to the bank's performance and size of its customer loan portfolio during the period.

Change in expected credit losses to total operating income is calculated as the change in expected credit losses for the period, as a percentage of total operating income for the period.

Change in expected credit losses to average gross customer advances and acceptances is calculated as the annualized change in expected credit losses for the period as a percentage of average gross customer advances and acceptances (determined using month-end balances during the period).

Total allowance for expected credit losses to impaired loans and acceptances is calculated as total allowance for expected credit losses for customer advances and acceptances as a percentage of impaired loans and acceptances using period-end balances.

Efficiency and revenue mix ratios

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

Cost efficiency ratio is calculated as total operating expenses as a percentage of total operating income for the period.

Adjusted cost efficiency ratio is similar to the cost efficiency ratio; however, total operating income excludes gains and losses from financial instruments designated at fair value, as the movement in value of the bank's own subordinated debt issues are primarily driven by changes in market rates and are not under the control of management.

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

Financial performance

Summary consolidated income statement

	Quarter ended	
	31 Mar 2018[1]	31 Mar 2017
	$m	$m
Net interest income	**306**	282
Net fee income	**155**	160
Net income from financial instruments held for trading (2017: Trading income)	**36**	31
Changes in fair value of long-term debt (2017: Net expense from financial instruments designated at fair value)	**—**	(3)
Gains less losses from financial investments	**22**	18
Other operating income	**22**	18
Total operating income	**541**	506
Change in expected credit losses	**28**	n/a
Loan impairment recoveries and other credit risk provisions	**n/a**	49
Net operating income	**569**	555
Total operating expenses	**(318)**	(311)
Operating profit	**251**	244
Share of profit/(loss) in associates	**—**	(1)
Profit before income tax expense	**251**	243
Income tax expense	**(68)**	(57)
Profit for the period	**183**	186

1 *Effective 1 January 2018 the bank adopted IFRS 9 on a retrospective basis without restatement of prior periods. Results from prior periods are reported in accordance with IAS 39.*

Overview

HSBC Bank Canada reported strong growth in operating income of $35m, or 6.9%, compared with the same period in the prior year. Results in the quarter were driven by strong performance in operating income across all of our global lines of business led by loan growth, the benefit of higher interest rates, as well as strong credit performance.

We remain in a net recovery position on the change in expected credit losses, although this has reduced from the historically high recovery levels experienced in 2017.

Operating expenses increased by $7m, or 2.3%, as we continued to invest in growing our business. While profit before income tax increased by $8m, or 3.3%, it was negatively impacted by this increase in costs.

Income tax expense returned to more normal levels after a lower charge in the prior year due to an adjustment to the prior years' provision for tax, leading to a decrease in profit for the period of $3m, or 1.6%.

Commenting on the results, Sandra Stuart, President and Chief Executive Officer of HSBC Bank Canada, said:

"Our investments and innovations to better serve our customers are continuing to drive growth, with revenue up 7% over the same period last year. In Commercial Banking, our investments led to increased loans, advances and foreign exchange revenues; in Retail Banking and Wealth Management, customers appreciate the improvements to our products and services and are rewarding us with more of their business; while in Global Banking and Markets, derivative sales and interest income were the main drivers of growth. In fact, revenue growth, coupled with credit impairment recoveries, were the main contributors to profit before taxes. Higher costs, due to our planned investments to continue building our business did affect overall results.

"As we look ahead, we will continue to bring Canada to the world and the world to Canada, building on our considerable strengths and leveraging our global network, particularly in the North American and China trade corridors, to help our customers and Canada thrive. In that vein we are particularly pleased to be recognized by The Asset Magazine as the best RMB bank in Canada for our robust suite of renminbi products and services."

Management's Discussion and Analysis (continued)

Performance by income and expense item

Net interest income

Net interest income for the first quarter of 2018 was $306m, an increase of $24m, or 8.5%, compared with the same period in the prior year. Contributing to the strong growth is higher loans and advances, particularly mortgage balances, and margin improvements from the impact of the Bank of Canada interest rate increases in 2017 and early 2018. This was partly offset by lower interest recoveries on impaired loans.

Summary of interest income by types of assets

	Quarter ended					
	31 Mar 2018[1]			31 Mar 2017[2]		
	Average balance	**Interest income**	**Yield**	Average balance	Interest income	Yield
	$m	**$m**	**%**	$m	$m	%
Interest income						
Short-term funds and loans and advances to banks	**886**	**1**	**0.35**	1,038	2	0.95
Loans and advances to customers	**50,042**	**422**	**3.42**	45,990	365	3.17
Reverse repurchase agreements - non-trading	**6,175**	**24**	**1.61**	7,549	11	0.56
Financial investments	**23,480**	**91**	**1.57**	23,586	73	1.26
Other interest-earning assets	**338**	**2**	**2.18**	1	—	0.00
Total interest-earning assets	**80,921**	**540**	**2.71**	78,164	451	2.34
Trading assets and financial assets designated at fair value[3]	**5,211**	**24**	**1.86**	6,602	15	0.94
Non-interest-earning assets	**11,548**	**—**	**—**	11,510	—	—
Total	**97,680**	**564**	**2.34**	96,276	466	1.96

Summary of interest expense by type of liabilities and equity

	Quarter ended					
	31 Mar 2018			31 Mar 2017[2]		
	Average balance	**Interest income**	**Yield**	Average balance	Interest income	Yield
	$m	**$m**	**%**	$m	$m	%
Interest expense						
Deposits by banks[4]	**810**	**1**	**0.51**	947	—	0.09
Financial liabilities designated at fair value - own debt issued	**—**	**—**	**—**	402	1	1.19
Customer accounts[5]	**50,739**	**131**	**1.04**	49,342	84	0.69
Repurchase agreements - non-trading	**6,075**	**23**	**1.57**	5,396	8	0.60
Debt securities in issue and subordinated debt	**11,663**	**69**	**2.39**	10,367	67	2.63
Other interest-bearing liabilities	**1,863**	**10**	**2.09**	2,797	9	1.32
Total interest bearing liabilities	**71,150**	**234**	**1.33**	69,251	169	0.99
Trading liabilities and financial liabilities designated at fair value (excluding own debt issued)[3]	**2,902**	**15**	**2.10**	3,820	10	1.11
Non-interest bearing current accounts	**6,223**	**—**	**—**	6,176	—	—
Total equity and other non-interest bearing liabilities	**17,405**	**—**	**—**	17,029	—	—
Total	**97,680**	**249**	**1.03**	96,276	179	0.75
Net interest income		**306**			282	

1 *Effective 1 January 2018 the bank adopted IFRS 9 on a retrospective basis without restatement of prior periods. Results from prior periods are reported in accordance with IAS 39. Refer to the table "Reconciliation of consolidated balance sheet as at 31 December 2017 and 1 January 2018" in note 1 of the consolidated financial statements for further details of balance sheet presentation changes.*

2 *Certain prior period amounts have been reclassified to conform with the current period presentation.*

3 *Interest income and expense on trading assets and liabilities is reported as `Net income from financial instruments held for trading' in the consolidated income statement.*

4 *Includes interest-bearing bank deposits only.*

5 *Includes interest-bearing customer accounts only.*

Net fee income

	Quarter ended	
	31 Mar 2018	31 Mar 2017[1]
	$m	$m
Account services	**16**	16
Broking income	**1**	2
Cards	**13**	13
Credit facilities	**67**	67
Funds under management	**47**	45
Imports/exports	**2**	3
Insurance agency commission	**2**	2
Other	**13**	9
Remittances	**8**	8
Underwriting	**7**	12
Fee income	**176**	177
Less: fee expense	**(21)**	(17)
Net fee income	**155**	160

1 *Certain prior period amounts have been reclassified to conform with the current period presentation.*

Net fee income for the first quarter of 2018 was $155m, a decrease of $5m, or 3.1%, compared with the same period in the prior year. The decrease was driven by lower underwriting fees, which was partially offset by an increase in other income relating to higher sales credits, and an increase in fee expenses driven by higher investment advisory fees.

Net income from financial instruments held for trading

	Quarter ended	
	31 Mar 2018	31 Mar 2017
	$m	$m
Trading activities	**27**	26
Credit valuation, debit valuation, and funding fair value adjustments	**1**	—
Net interest from trading activities	**9**	5
Hedge ineffectiveness	**(1)**	—
Net income from financial instruments held for trading (2017: Net trading income)	**36**	31

Net income from financial instruments held for trading for the first quarter of 2018 was $36m, an increase of $5m, or 16.1%, compared with the same period in the prior year. The increase is primarily due to an accounting adjustment relating to funding charges which resulted in higher net interest from trading activities of $4m compared with the same period in the prior year, with a corresponding decrease shown in net interest income.

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Management's Discussion and Analysis (continued)

Other items of income

	Quarter ended	
	31 Mar 2018	31 Mar 2017
	$m	$m
Changes in fair value of long-term debt (2017: Net expense from financial instruments designated at fair value)	**—**	(3)
Gains less losses from financial investments	**22**	18
Other operating income	**22**	18
Other items of income	**44**	33

Changes in fair value of long-term debt for the first quarter of 2018 was nil. In the prior year the bank reported a loss of $3m relating to the movement in the value of the bank's own subordinated debentures, which were measured at fair value. On 10 April 2017 these debentures were fully redeemed in accordance with their contractual terms.

The bank realizes gains and losses from the disposal of debt instruments measured at fair value through other comprehensive income ('FVOCI') (2017: available–for–sale) financial investments due to balance sheet management activities. Gains less losses from financial investments for the first quarter of 2018 were $22m, an increase of $4m, or 22.2%, compared with the same period in 2017 due to the rebalancing of the bank's liquid asset portfolio.

Other operating income for the first quarter of 2018 was $22m, an increase of $4m, or 22.2%, compared with the same period in the prior year. The increase was primarily due to higher income from HSBC Group entities for software development activities performed by the bank.

Change in expected credit losses[1]

	Quarter ended
	31 Mar 2018[1]
	$m
Change in expected credit loss- performing loans (stage 1 and 2)	**18**
Change in expected credit loss- non-performing loans (stage 3)	**(46)**
Change in expected credit loss	**(28)**

IAS 39 comparative

	Quarter ended
	31 Mar 2017[1]
	$m
Collectively assessed releases	(10)
Individually assessed releases	(37)
Loan impairment recoveries	(47)
Other credit risk provisions	(2)
Net loan impairment recoveries and other credit risk provisions	(49)

1 *Effective 1 January 2018 the bank adopted IFRS 9 on a retrospective basis without restatement of prior periods. Results from prior periods are reported in accordance with IAS 39.*

Change in expected credit losses for the first quarter of 2018 were a recovery of $28m, compared with loan impairment recoveries and other credit risk provisions of $49m in the same period of the prior year. The recovery in 2017 was driven by significant reversals of specific provisions in the oil and gas industry, as well as releases in collective provisions, reflecting overall improvement in credit quality.

Improvements in several sectors, most notably oil and gas services, together with recoveries related to certain construction, contracting and real estate companies led to a net recovery on non-performing loans of $46m for the first quarter of 2018. This was partially offset by a charge of $18m against performing loans due to growth in the loan portfolio as well as the adoption of IFRS 9 and the resulting increase in expected credit losses due to the application of forward looking economic guidance. More information on IFRS 9 can be found in note 1 of the consolidated financial statements.

Total operating expenses

	Quarter ended	
	31 Mar 2018	31 Mar 2017
	$m	$m
Employee compensation and benefits	**182**	181
General and administrative expenses	**126**	121
Depreciation of property, plant and equipment	**8**	7
Amortization of intangible assets	**2**	2
Total operating expenses	**318**	311

Total operating expenses for the first quarter of 2018 increased by $7m, or 2.3% compared with the same period in the prior year. The increase relates to higher strategic spending to drive future growth, which was partially offset by a one-off provision release in the quarter.

Share of profit/loss in associates

Share of profit/loss in associates for the first quarter of 2018 was a nil compared with a loss of $1m in the first quarter of 2017. The share of profits represents changes in the value of the bank's investments in private equity funds.

Income taxes expense

The effective tax rate in the first quarter of 2018 was 27.1%, which is close to the statutory tax rate. The effective tax rate for the first quarter of 2017 was 23.6% due to a favourable adjustment to the prior years' provision for tax.

Management's Discussion and Analysis (continued)

Movement in financial position

Consolidated balance sheet

	31 Mar 2018[1]	31 Dec 2017
	$m	$m
ASSETS		
Cash and balances at central bank	**69**	411
Items in the course of collection from other banks	**20**	25
Trading assets	**6,094**	5,373
Other financial assets mandatorily measured at fair value through profit or loss	**9**	n/a
Derivatives	**3,354**	3,675
Loans and advances to banks	**550**	1,221
Loans and advances to customers	**50,743**	50,337
Reverse repurchase agreements – non-trading	**5,504**	6,153
Financial investments	**23,519**	22,913
Other assets	**2,250**	899
Prepayments and accrued income	**297**	213
Customers' liability under acceptances	**5,374**	4,801
Current tax assets	**46**	44
Property, plant and equipment	**107**	106
Goodwill and intangible assets	**96**	90
Deferred taxes	**108**	118
Total assets	**98,140**	96,379
LIABILITIES AND EQUITY		
Liabilities		
Deposits by banks	**971**	1,696
Customer accounts	**55,814**	57,054
Repurchase agreements – non-trading	**8,821**	4,604
Items in the course of transmission to other banks	**246**	299
Trading liabilities	**2,799**	3,701
Derivatives	**3,349**	3,516
Debt securities in issue	**10,613**	10,820
Other liabilities	**2,691**	2,217
Acceptances	**5,381**	4,801
Accruals and deferred income	**365**	475
Retirement benefit liabilities	**327**	346
Subordinated liabilities	**1,039**	1,039
Provisions	**45**	61
Current tax liabilities	**16**	40
Total liabilities	**92,477**	90,669
Equity		
Common shares	**1,225**	1,225
Preferred shares	**850**	850
Other reserves	**(108)**	(61)
Retained earnings	**3,696**	3,696
Total equity	**5,663**	5,710
Total liabilities and equity	**98,140**	96,379

1 *Effective 1 January 2018 the bank adopted IFRS 9 on a retrospective basis without restatement of prior periods. Results from prior periods are reported in accordance with IAS 39. Refer to the table 'Reconciliation of consolidated balance sheet as at 31 December 2017 and 1 January 2018' in note 1 of the consolidated financial statements for further details of balance sheet presentation changes.*

Assets

Total assets at 31 March 2018 were $98.1bn, an increase of $1.8bn, or 1.8%, from 31 December 2017. This is primarily due an increase in other assets of $1.4bn relating to higher cash collateral posted as a result of movements in the fair value of the derivative portfolio, higher unsettled balances at the period end and presentation changes[1]. Trading assets increased by $0.7bn due to higher trading debt securities held, offset in part by a decrease in treasury and other eligible bills and presentation changes[1]. Financial investments increased by $0.6bn as a result of balance sheet management activities. Customers' liability under acceptances increased by $0.6bn, due to an increase in the volume of acceptances. Loans and advances to customers increased by $0.4bn due to higher term-lending facility utilization in Commercial Banking and higher residential mortgages in Retail Banking and Wealth Management, partly offset by lower client lending in Global Banking, consistent with lower levels of capital expenditure within the corporate sector.

These increases in assets were partially offset by a decline in loans and advances to banks of $0.7bn and non-trading reverse repurchase agreements of $0.6bn, due to cash management activities. Cash and balances at central banks decreased by $0.3bn due to the settlement of the redemption of preferred shares Class 1, Series C and D.

Liabilities

Total liabilities at 31 March 2018 were $92.5bn, an increase of $1.8bn, or 2.0%, from 31 December 2017. Increased repurchase activity and balance sheet management activities led to an increase in non-trading repurchase agreements of $4.2bn. In addition, acceptances increased by $0.6bn which corresponds to the movement within assets. Retail Banking and Wealth Management customer accounts increased by $1.8bn as a result of successful campaigns run in the quarter.

These increases in liabilities were partially offset by a reduction in customer accounts of $1.2bn due to expected seasonal reductions in Commercial and Global Banking deposits, and macroeconomic factors. Trading liabilities decreased by $0.9bn due to lower short positions held at period end and presentation changes[1]. Deposits by banks decreased by $0.7bn due to cash management activities.

Equity

Total equity at 31 March 2018 was $5.6bn, a decrease of $0.05bn from 31 December 2017, due to a loss in the financial assets at FVOCI reserve of $0.05bn relating to higher interest rates and the recycling of gains to the income statement on the disposal of securities.

1 *Refer to the table 'Reconciliation of consolidated balance sheet as at 31 December 2017 and 1 January 2018' in note 1 for further details of balance sheet presentation changes.*

Global businesses

We manage and report our operations around the following global businesses: Commercial Banking, Global Banking and Markets, and Retail Banking and Wealth Management.

Commercial Banking

Commercial Banking offers a full range of commercial financial services and tailored solutions to customers ranging from small and medium-sized enterprises to publicly quoted companies.

Review of financial performance

	Quarter ended	
	31 Mar 2018[1]	31 Mar 2017
	$m	$m
Net interest income	**139**	133
Net fee income	**74**	70
Net income from financial instruments held for trading (2017: Net trading income)	**9**	7
Other operating income	**4**	6
Total operating income	**226**	216
Change in expected credit losses	**34**	n/a
Loan impairment recoveries and other credit risk provisions	**n/a**	39
Net operating income	**260**	255
Total operating expenses	**(103)**	(94)
Profit before income tax expense	**157**	161

1 *Effective 1 January 2018 the bank adopted IFRS 9 on a retrospective basis without restatement of prior periods. Results from prior periods are reported in accordance with IAS 39.*

Management's Discussion and Analysis (continued)

Overview

Commercial Banking total operating income for the first quarter of 2018 was $226m, an increase of $10m, or 4.6%, compared with the first quarter of 2017.

Our strategic priorities are to build on our expansion in 2017 through sales transformation; increase new to bank customer acquisition and product penetration; improve positioning in key trade corridors; and invest in technology and streamline processes to remove roadblocks. We made good progress in the first quarter with record lending balance growth and double digit revenue growth in a number of business segments, including Ontario region, Commercial Real Estate and International Subsidiary Banking. There was also a 21% increase in customers rating our domestic account opening as 'excellent' between December 2017 and February 2018.

Profit before income tax for the first quarter of 2018 was $157m, a decrease of $4m, or 2.5%, compared with the same period in the prior year. The decrease was primarily driven by lower net loan impairment recovery and higher operating expenses, offset partially by higher operating income.

Financial performance by income and expense item

Net interest income for the first quarter of 2018 was $139m, an increase of $6m, or 4.5%, compared with the same period in the prior year. The growth reflects higher loans and advances and favourable margins from the Bank of Canada interest rate increases, partly offset by lower interest recoveries on impaired loans and lower deposit balances.

Net fee income for the first quarter of 2018 was $74m, an increase of $4m or 5.7%, compared with the same period in the prior year, primarily driven by higher Bankers Acceptance fees as a result of higher balances.

Net income from financial instruments held for trading for the first quarter of 2018 was $9m, an increase of $2m, or 28.6%, compared with the same period in the prior year, due to higher foreign exchange revenues.

Other operating income for the first quarter of 2018 was $4m, a decrease of $2m, or 33.3%, compared with the same period in the prior year, driven by lower income from HSBC Group for support services provided by the bank.

Change in expected credit losses for the first quarter of 2018 were a recovery of $34m, compared with loan impairment recoveries and other credit risk provisions of $39m in the same period of the prior year. The recovery in 2017 was driven by significant reversals of specific provisions in the oil and gas industry, as well as releases in collective provisions, reflecting overall improvement in credit quality. The recovery in 2018 was driven by additional reversals relating to non-performing (stage 3) loans, mostly from accounts in the oil and gas industry.

Total operating expenses for the first quarter of 2018 were $103m, an increase of $9m, or 9.6%, compared with the same period in the prior year. The increase reflects investments in our people and technology to better serve our customers and grow market share in support of our strategic plan.

Global Banking and Markets

Global Banking and Markets provides tailored financial solutions to major government, corporate and institutional clients worldwide.

Review of financial performance

	Quarter ended	
	31 Mar 2018[1]	31 Mar 2017
	$m	$m
Net interest income	**23**	21
Net fee income	**29**	37
Net income from financial instruments held for trading (2017: Net trading income)	**20**	12
Total operating income	**72**	70
Change in expected credit losses	**3**	n/a
Loan impairment recoveries and other credit risk provisions	**n/a**	5
Net operating income	**75**	75
Total operating expenses	**(38)**	(35)
Profit before income tax expense	**37**	40

1 *Effective 1 January 2018 the bank adopted IFRS 9 on a retrospective basis without restatement of prior periods. Results from prior periods are reported in accordance with IAS 39.*

Overview

Global Banking and Markets operating income for the first quarter of 2018 was $72m, an increase of $2m, or 2.9%, compared with the same period in the prior year driven by increased derivative sales to our global clients in Rates and FX products and higher interest income from the impact of increased interest rates.

We continued to leverage HSBC's global network to provide products and solutions to meet our global clients' needs with growth focused on the North American and China trade corridors.

Profit before income tax expense was $37m for the first quarter of 2018, a decrease of $3m, or 7.5% compared with the same period in the prior year. The decrease was driven by lower loan impairment recoveries than in the prior year, and higher risk and compliance costs, partially offset by higher revenues.

Financial performance by income and expense item

Net interest income for the first quarter of 2018 was $23m, an increase of $2m, or 9.5%, compared with the same period in the prior year, mainly due to the Bank of Canada interest rate increases in 2017 and early 2018.

Net fee income for the first quarter of 2018 was $29m, a decrease of $8m, or 21.6%, compared with the same period in the prior year, primarily due to lower debt capital markets fees and advisory fees.

Net income from financial instruments held for trading for the first quarter of 2018 was $20m, an increase of $8m, or 66.7%, compared with the same period in the prior year. The increase was primarily due to higher derivative trading income from higher client volumes.

Change in expected credit losses remained in a net recovery position of $3m compared with loan impairment recoveries and other credit risk provisions of $5m for the same period in the prior year. Both years reflect the continued improvements in the oil and gas industry, although recoveries are reducing from the historically high levels throughout 2017.

Total operating expenses for 2018 were $38m, an increase of $3m, or 8.6%, compared with the same period in the prior year. The increase was mainly caused by investments in risk and compliance initiatives.

Retail Banking and Wealth Management

Retail Banking and Wealth Management offers a full range of competitive banking products and services for all Canadians to help them manage their finances and protect and build for their financial future.

Review of financial performance

	Quarter ended	
	31 Mar 2018[1]	31 Mar 2017
	$m	$m
Net interest income	**114**	96
Net fee income	**52**	53
Net income from financial instruments held for trading (2017: Net trading income)	**7**	6
Other operating income	**2**	1
Total operating income	**175**	156
Change in expected credit losses	**(9)**	n/a
Loan impairment recoveries and other credit risk provisions	**n/a**	5
Net operating income	**166**	161
Total operating expenses	**(163)**	(140)
Profit before income tax expense	**3**	21

1 *Effective 1 January 2018 the bank adopted IFRS 9 on a retrospective basis without restatement of prior periods. Results from prior periods are reported in accordance with IAS 39.*

Management's Discussion and Analysis (continued)

Profit before income tax

	Quarter ended	
	31 Mar 2018	31 Mar 2017
	$m	$m
Ongoing Retail Banking and Wealth Management business	**1**	16
Run-off consumer finance portfolio	**2**	5
Profit before income tax expense	**3**	21

Overview

Retail Banking and Wealth Management operating income for the first quarter of 2018 was $175m, an increase of $19m, or 12.2%, compared with the same period in the prior year. We continued to achieve strong growth in total relationship balances (comprised of lending, deposits and wealth balances) due to strong branding, innovation and strategic investments to make our bank simpler, faster and better for our clients.

Profit before income tax expense for the first quarter of 2018 was $3m, a decrease of $18m, or 85.7%, compared with the same period in the prior year. The decrease is primarily due to the continued investment to grow our business and the higher cost base associated with offering an enhanced service model to our clients and the growth already achieved. For example, we continued to invest in the roll-out of retail business banking and unsecured lending in addition to investing in Jade, an exclusive service for high-net-worth customers. We also continued to invest in digital technologies to improve customer experience. Profit before income tax was further impacted by the change in expected credit losses charge, which is discussed in more detail below. These increases were partly offset by higher revenues as the business continues to grow as a result of our investments, and benefit from higher interest rates

Profit before income tax expense relating to the run-off consumer finance portfolio for the first quarter of 2018 was $2m, a decrease of $3m, or 60.0%, compared with the same period in the prior year. This was the result of change in expected credit loss recoveries in the prior year period and lower interest income in the current year due to declining balances.

Financial performance of the ongoing business by income and expense item

Net interest income for the first quarter of 2018 was $111m, an increase of $19m, or 21%, compared with the same period in the prior year, primarily due to higher margins on deposits and volume growth on both lending and deposits.

Net fee income for the first quarter of 2018 was $52m, a decrease of $1m, or 2%, compared with the same period in the prior year, as higher assets under management were largely offset by lower income from credit cards.

Net income from financial instruments held for trading for the first quarter of 2018 was $7m, an increase of $1m, or 17%, compared with the same period in the prior year, primarily due to higher foreign exchange revenue.

Other operating income was $2m, an increase of $1m compared with the same period in the prior year due. This was partially due to a gain related to the reorganization of Interac this quarter.

Change in expected credit losses were a charge $9m compared with loan impairment recoveries and other credit risk provisions of $2m in the first quarter of 2017. The charge is primarily due to growth in the portfolio as well as the increased volatility experienced under IFRS 9 due to the application of forward looking economic guidance. More information on IFRS 9 can be found in note 1 and note 6 of the consolidated financial statements. The prior year quarter benefitted from the higher release of collective allowances, net of write-offs.

Total operating expenses for the first quarter of 2018 were $162m, an increase of $24m, or 17%, compared with the same period in the prior year. This was primarily due to strategic investments to grow our business in Canada, examples of which are provided in the overview above, and the higher cost base associated with offering an enhanced service model to our clients and the growth already achieved.

Corporate Centre

Corporate Centre contains Balance Sheet Management, interests in associates and joint ventures, the results of movements in the fair value of own debt, and income related to information technology services provided to HSBC Group companies which do not directly relate to our global businesses.

Review of financial performance

	Quarter ended	
	31 Mar 2018	31 Mar 2017
	$m	$m
Net interest income	**30**	32
Net income from financial instruments held for trading (2017: Net trading income)	**—**	6
Changes in fair value of long-term debt (2017: Net expense from financial instruments designated at fair value)	**—**	(3)
Gains less losses from financial investments	**22**	18
Other operating income	**16**	11
Total operating income	**68**	64
Total operating expenses	**(14)**	(42)
Operating profit	**54**	22
Share of profit/(loss) in associates	**—**	(1)
Profit before income tax expense	**54**	21

Operating income for the first quarter of 2018 was $68m, an increase of $4m, or 6.3%, compared with the first quarter of 2017 due to an increase in other operating income of $5m, or 45.5%, attributable to higher income from HSBC Group entities for software development activities performed by the bank. In addition, gains less losses from financial investments increased by $4m, or 22.2%, relating to the disposal of securities as part of balance sheet management activities.

Lower spending on strategic cost saving initiatives in the first quarter of 2018 led to a decrease in operating expenses of $28m, or 66.7%. This led to an overall increase in profit before income tax of $33m compared with the same period in the prior year.

Summary quarterly performance

Refer to the 'Summary quarterly performance' section of our Annual Report and Accounts 2017 for more information regarding quarterly trends in performance for 2017 and 2016.

Summary consolidated income statement

	Quarter ended							
	31 Mar	31 Dec	30 Sep	30 June	31 Mar	31 Dec	30 Sep	30 June
	2018	2017	2017	2017	2017	2016	2016	2016
	$m	$m	$m	$m	$m	$m	$m	$m
Total operating income	**541**	540	528	496	506	512	498	525
Profit for the period	**183**	152	162	168	186	188	100	121
Profit attributable to common shareholder	**173**	142	153	158	177	178	91	111
Profit attributable to preferred shareholders	**10**	10	9	10	9	10	9	10
Basic earnings per common share ($)	**0.35**	0.28	0.31	0.32	0.35	0.36	0.18	0.22

Management's Discussion and Analysis (continued)

Accounting matters

The results of the bank are sensitive to the accounting policies that underlie the preparation of our consolidated financial statements. The bank has adopted IFRS 15 *Revenue from Contracts with Customers* and IFRS 9 *Financial Instruments* effective 1 January 2018 as disclosed in note 1 of the consolidated financial statements for the first quarter ended 31 March 2018.

A summary of our other significant accounting policies are provided in note 2 of our Annual Report and Accounts 2017.

Transition to IFRS 9 - Effect on business model

The implementation of IFRS 9 does not result in a significant change to our business model, or that of our three HSBC global businesses that operate in Canada. This includes our strategy, product offerings and target customer segments.

Exposures in certain industry sectors, in particular those most sensitive to changes in economic conditions, were expected to be affected to a greater degree under IFRS 9. However, we have established credit risk management processes in place and we actively assess the impact of economic developments in key markets on specific customers, customer segments or portfolios. If we foresee changes in credit conditions, we will take mitigating action, including the revision of risk appetites or limits and tenors, as appropriate. In addition, we continue to evaluate the terms under which we provide credit facilities within the context of individual customer requirements, the quality of the relationship, local regulatory requirements, market practices and our local market position.

Under IFRS 9, we recognize expected credit losses on committed, undrawn exposures, including credit cards, loan commitments and financial guarantees. We continue to manage undrawn exposures and credit limits as part of our overall approach to capital management.

Critical accounting estimates and judgments

The preparation of financial information requires the use of estimates and judgments about future conditions and are contained in the 'Critical accounting estimates and judgments' section of the Management's Discussion and Analysis of our Annual Report and Accounts 2017, except those noted below relating to expected credit losses (which replaces 'impairment of loans and advances') resulting from the adoption of the new IFRS standards as disclosed in note 1 of consolidated financial statements for the first quarter ended 31 March 2018 ('note 1').

Business model assessment

A business model refers to the actual management of financial assets in order to generate cash flows and create value and whether likely inflows will result primarily from the collection of contractual cash flows, sales proceeds or both. It reflects the strategic purpose and intention for the portfolio and how its performance is measured by the bank. This assessment of the business model primarily takes place when a financial asset is initially recognized and is a matter of fact, not an accounting policy choice.

Expected credit losses

The recognition and measurement of expected credit losses ('ECL') is highly complex and involves the use of significant judgment and estimation, including in the formulation and incorporation of multiple forward-looking economic conditions into the ECL estimates to meet the measurement objectives of IFRS 9.

In determining ECL, management is required to exercise judgment in defining what is considered to be a significant increase in credit risk and in making assumptions and estimates to incorporate relevant information about past events, current conditions and forecasts of economic conditions. Further information about the key judgments involved is included in note 1 under sections 'Significant increase in credit risk (stage 2)' and 'Forward-looking economic inputs'. In addition, as set out in the section 'Period over which ECL is measured' of note 1, judgment has been applied in determining the lifetime and point of initial recognition of revolving facilities.

The Probability of Default ('PD'), Loss Given Default ('LGD') and Exposure at Default ('EAD') models which support these determinations are reviewed regularly in light of differences between loss estimates and actual loss experience.

Management exercises judgment in making estimations that require the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions. Many of the factors have a high degree of interdependency and there is no single factor to which loan impairment allowances as a whole are sensitive.

Regulatory developments

In January 2018, OSFI announced its decision to update the existing capital floor for institutions using advanced approaches for credit risk and operational risk. The current capital floor of 90%, based on the Basel I capital accord, will be replaced by capital floor based on the Standardized approach under Basel II framework. It will be implemented effective Q2 2018 with the floor factor transitioned in over three quarters. The floor factor will be set at 70% in Q2 2018, increasing to 72.5% in Q3 2018 and 75% in Q4 2018. This interim step will improve the risk-sensitivity of the capital floor while ensuring the objectives of the floor continue to be met until the proposed implementation of the Basel III capital floor begins in 2022. The banks' pro-forma CET1 ratio for Q1 2018, adjusted for this methodology change will increase the current CET1 ratio of 10.1% by approximately 210 basis points.

Off-balance sheet arrangements

As part of our banking operations, we enter into a number of off-balance sheet financial transactions that have a financial impact, but may not be recognized in our consolidated financial statements. These types of arrangements are contingent and may not necessarily, but in certain circumstances could, involve us incurring a liability in excess of amounts recorded in our consolidated balance sheet. These arrangements include: guarantees and letters of credit and are described in the 'Off-balance sheet arrangements' section of our Annual Report and Accounts 2017.

Related party transactions

We enter into transactions with other HSBC affiliates as part of the normal course of business, such as banking and operational services. In particular, as a member of one of the world's largest financial services organizations, we share in the expertise and economies of scale provided by the HSBC Group. We provide and receive services or enter into transactions with a number of HSBC Group companies, including sharing in the cost of development for technology platforms used around the world and benefit from worldwide contracts for advertising, marketing research, training and other operational areas. These related party transactions are on terms similar to those offered to non-related parties and are subject to formal approval procedures that have been approved by the bank's Conduct Review Committee. For further information refer to note 30 of our Annual Report and Accounts 2017.

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

Disclosure controls and procedures and internal control over financial reporting

The Chief Executive Officer and Chief Financial Officer have signed certifications relating to the appropriateness of the financial disclosures in interim filings with the Canadian Securities Administrators, including this MD&A and the accompanying consolidated financial statements for the quarter ended 31 March 2018, and their responsibility for the design and maintenance of disclosure controls and procedures and internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting in accordance with IFRSs. There have been no changes in internal controls over financial reporting during the quarter ended 31 March 2018 that have materially affected or are reasonably likely to affect internal control over financial reporting. On 1 January 2018, HSBC Bank Canada adopted IFRS 9. Relevant internal controls over financial reporting have been updated and modified as a result of the new accounting standard.

Management's Discussion and Analysis (continued)

Risk management

Refer to the "Risk management" section of our Annual Report and Accounts 2017 for a description of how the bank manages risk on an enterprise wide level, as well as the management of reputation and operational risk.

Credit risk

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

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

– to maintain a strong culture of responsible lending, supported by a robust risk policy and control framework;

– to both partner with and challenge businesses in defining, implementing and continually re-evaluating our risk appetite under actual and scenario conditions; and

– to ensure there is independent, expert scrutiny of credit risks, their costs and their mitigation.

Refer to the 'Risk management' section of our Annual Report and Accounts 2017 for a discussion of how the bank manages credit risk, collateral and other credit risk enhancements, as well as a more in depth explanation of our credit risk measures.

Adoption of IFRS 9

Effective 1 January 2018, the bank adopted IFRS 9 which introduces ECL and replaces the incurred loss model under IAS 39.

The impairment requirements apply to financial assets measured at amortized cost and FVOCI, lease receivables and certain loan commitments and financial guarantee contracts.

At initial recognition, an impairment allowance is required for 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 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 recognized are considered to be '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 are considered to be in default or otherwise credit impaired are in 'stage 3'.

The bank determines that a financial instrument is credit-impaired and in stage 3 by considering relevant objective evidence, primarily whether:

– contractual payments of either principal or interest are past due for more than 90 days;

– there are other indications that the borrower is unlikely to pay such as that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and

– the loan is otherwise considered to be in default.

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due. Therefore the definitions of credit-impaired and default are aligned as far as possible so that stage 3 represents all loans which are considered defaulted or otherwise credit-impaired. Interest income on stage 3 exposures is recognized by applying the effective interest rate to the amortized cost amount, i.e. gross carrying amount less ECL allowance.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted, and incorporates 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 takes into account the time value of money. As a result, the recognition and measurement of impairment is more forward-looking than under IAS 39 and the resulting impairment charge will tend to be more volatile.

More information on IFRS 9 and ECL can be found in note 1 and note 6 of the consolidated financial statements.

Credit risk profile

The following tables and analysis provide information on financial instruments to which the impairment requirements of IFRS 9 are applied. In addition to the analysis below, further information on the credit quality of our portfolio is available in note 6 of the consolidated financial statements.

Allowance for expected credit losses

	31 Mar 2018	1 Jan 2018[1]
	$m	$m
Retail:		
Performing loans (stage 1 and 2)	**41**	31
Non-performing loans (stage 3)	**19**	20
Total Retail allowance for expected credit losses	**60**	51
Wholesale:		
Performing loans (stage 1 and 2)	**113**	104
Non-performing loans (stage 3)	**139**	208
Total Wholesale allowance for expected credit losses	**252**	312
Allowance for expected credit losses	**312**	363
By global business:		
Commercial Banking	**234**	291
Global Banking and Markets	**18**	21
Retail Banking and Wealth Management	**60**	51
Allowance for expected credit losses	**312**	363

1 *The comparative period presented above represents the opening allowance for credit losses under IFRS 9, which differs from the closing allowance for impaired loans under IAS 39. Further information on the transition from IAS 39 to IFRS 9, including a reconciliation of the consolidated balance sheet as at 31 December 2017 and 1 January 2018 can be found in note 1 of the consolidated financial statements.*

The Retail allowance for ECL increased by $9m primarily relating to performing (stage 1 and 2) assets as a result of growth in the loan portfolio and increased volatility experienced under IFRS 9 from the application of forward looking economic guidance.

The Wholesale allowance for ECL decreased by $60m, primarily relating to non-performing (stage 3) assets as a result of improvements in several sectors, most notably the oil and gas services sector together with allowance reversals relating to certain construction, contracting services and real estate companies. In Q1 2018, write-downs on non-performing loans further contributed to this decrease in the allowance for non-performing loans.

Change in expected credit losses

The table and analysis below provides an overview of the change in expected credit losses charge or (release) to the income statement.

	Quarter ended
	31 Mar 2018
	$m
Retail:	
Performing loans (stage 1 and 2)	**10**
Non-performing loans (stage 3)	**(1)**
Total Retail change in expected credit losses	**9**
Wholesale:	
Performing loans (stage 1 and 2)	**8**
Non-performing loans (stage 3)	**(45)**
Total Wholesale change in expected credit losses	**(37)**
Change in expected credit losses	**(28)**

Management's Discussion and Analysis (continued)

IAS 39 Comparative

	Quarter ended 31 Mar 2017 $m
Retail:	
Collectively assessed allowances	(4)
Individually assessed allowances	—
Total Retail loan impairment recoveries and other credit risk provisions	(4)
Wholesale:	
Collectively assessed allowances	(8)
Individually assessed allowances	(37)
Total Wholesale loan impairment recoveries and other credit risk provisions	(45)
Total loan impairment recoveries and other credit risk provisions	(49)

The Retail change in expected credit losses resulted in a charge of $9m compared with a recovery of $4m for the same period in the prior year. This was primarily driven by the charge of $10m relating to performing assets (stage 1 and 2), compared with a recovery of $4m for the same period in the prior year. This was due to growth in the loan portfolio as well as the application of forward looking economic guidance under IFRS 9.

The Wholesale change in expected credit losses remained in a net recovery position, continuing to reduce from the historically high levels throughout 2017, as a result of continuing improvements in several sectors, most notably oil and gas services, together with recoveries related to certain construction, contracting and real estate companies.

Impaired assets - stage 3

The following table provides an analysis of the gross carrying value of financial assets measured at amortized cost including loan commitments and financial guarantees that are determined to be impaired (stage 3 financial assets).

	31 Mar 2018 $m	31 Dec 2017[1] $m
Corporate and commercial[2]		
– Mining and quarrying[3]	**91**	103
– Manufacture	**85**	89
– Construction	**30**	18
– Wholesale and retail trade, repair of motor vehicles and motorcycles	**43**	41
– Transportation and storage	**11**	11
– Accommodation and food	**1**	1
– Publishing, audiovisual and broadcasting	**8**	6
– Real estate	**58**	46
– Professional, scientific and technical activities	**34**	55
Total corporate and commercial	**361**	370
Financial institutions	**5**	6
Households[4]	**76**	78
Total on-balance sheet exposures	**442**	454
Off-balance sheet exposures	**141**	131
Total impaired financial assets	**583**	**585**

1 *Effective 1 January 2018 the bank adopted IFRS 9 on a retrospective basis without restatement of prior periods. Results from prior periods are reported in accordance with IAS 39.*

2 *The corporate and commercial categories reported above are derived from from Nomenclature des Activités Économiques dans la Communauté Européenne ('NACE') codes- a European industry standard classification system. These are not directly comparable to the industry sectors previously disclosed under IAS 39.*

3 *Mining and quarrying includes energy related exposures.*

4 *Households includes the Retail portfolio.*

Impaired assets decreased from $585m as at 31 December 2017 to $583m as at 31 March 2018. This was primarily as a result of improvements in several sectors, most notably mining and quarrying and professional, scientific and technical activities, which was partially offset by an increase in construction and real estate. Impaired assets were comprised of $401m loans and advances to customers, $41m other financial assets, $98m loans and other credit related commitments and $43m financial guarantees and similar commitments.

Days past due but not impaired loans and advances

The aging analysis below includes past due loans on which stage 1 and stage 2 allowances have been assessed, though at their early stage of arrears there is normally no identifiable impairment.

	31 Mar 2018	31 Dec 2017
	$m	$m
Up to 29 days	**1,893**	1,577
30-59 days	**84**	125
60-89 days	**65**	63
90-179 days	**1**	—
Over 180 days	**—**	—
	2,043	1,765

Mortgages and home equity lines of credit

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

	31 Mar 2018						
	Residential mortgages					**HELOC[2]**	
Insurance and geographic distribution[1]	**Insured[3]**		**Uninsured**		**Total**	**Uninsured**	
	$m	**%**	**$m**	**%**	**$m**	**$m**	**%**
British Columbia	736	5	13,017	95	13,753	842	100
Western Canada[4]	281	21	1,048	79	1,329	209	100
Ontario	731	10	6,744	90	7,475	549	100
Quebec and Atlantic provinces	204	18	947	82	1,151	83	100
Total	1,952	8	21,756	92	23,708	1,683	100

	31 Dec 2017						
	Residential mortgages					HELOC[2]	
Insurance and geographic distribution[1]	Insured[3]		Uninsured		Total	Uninsured	
	$m	%	$m	%	$m	$m	%
British Columbia	759	6	12,850	94	13,609	867	100
Western Canada[4]	289	22	1,040	78	1,329	220	100
Ontario	747	10	6,573	90	7,320	591	100
Quebec and Atlantic provinces	207	18	951	82	1,158	94	100
Total	2,002	9	21,414	91	23,416	1,772	100

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

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

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

4 *Western Canada excludes British Columbia.*

Management's Discussion and Analysis (continued)

Amortization period[1]	Residential mortgages				
	Less than 20 years	20 - 24 years	25- 29 years	30 - 34 years	35 years and greater
Total at 31 March 2018	**20.4%**	**34.6%**	**44.8%**	**0.2%**	**—%**
Total at 31 December 2017	20.8%	33.0%	45.9%	0.2%	—%

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

Average loan-to-value ratios of new originations[1, 2]

	Uninsured % LTV[3]	
	Residential mortgages %	HELOC %
British Columbia	**56.6**	**48.7**
Western Canada[4]	**65.3**	**64.4**
Ontario	**60.5**	**54.1**
Quebec and Atlantic provinces	**63.2**	**57**
Total Canada for the three months ended 31 March 2018	**59.2**	**52.4**
Total Canada for the three months ended 31 December 2017	60.1	54.7

1 *All new loans and home equity lines of credit were originated by the bank; there were no acquisitions during the period.*

2 *New originations excludes existing mortgage renewals.*

3 *Loan-to-value ratios are simple averages, based on property values at the date of mortgage origination.*

4 *Western Canada excludes British Columbia.*

Potential impact of an economic downturn on residential mortgage loans and home equity lines of credit

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

Liquidity and funding risk

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

Funding risk is the risk that funding considered to be sustainable, and therefore used to fund assets, is not sustainable over time. The risk arises when the funding needed for illiquid asset positions cannot be obtained at the expected terms and when required.

Liquidity and funding risk management

Our liquidity and funding management strategy as described in the 'Liquidity and funding risk' section of our Annual Report and Accounts 2017 continues to apply. The bank's internal liquidity and funding risk management framework uses the liquidity coverage ratio ('LCR') and net stable funding ratio ('NSFR') regulatory framework as a foundation, but adds additional metrics, limits and overlays to address the risks that the bank considers are not adequately reflected by the external regulatory framework.

We continue to monitor liquidity and funding risk within our stated risk appetite and management framework.

Liquid assets

The table below shows the estimated liquidity value unweighted (before assumed haircuts) of assets categorized as liquid and used for the purpose of calculating the OSFI LCR metric. The level of liquid assets reported reflects the stock of unencumbered liquid assets at the reporting date, using the regulatory definition of liquid assets. Liquid assets consist of cash or assets that can be converted into cash at little or no loss of value.

Our liquid assets decreased by $2.9 billion from 31 December 2017, primarily due to growth in loans and the impact of seasonal attrition and macroeconomic factors on commercial deposits.

Liquid assets [1]

	31 Mar 2018	31 Dec 2017
	$m	$m
Level 1	**17,259**	20,307
Level 2a	**4,594**	4,491
Level 2b	**159**	119
	22,012	24,917

1 *The liquid asset balances stated here are as at the above dates (spot rate) and are unweighted and therefore do not match the liquid asset balances stated in the LCR ratio calculations which are the average for the quarter and are weighted.*

Liquidity regulation

In accordance with OSFI's Liquidity Adequacy Requirements ('LAR') guideline, which incorporates Basel liquidity standards effective 1 January 2015, the bank is required to maintain a LCR above 100% as well as monitor the Net Cumulative Cash Flow ('NCCF'). The LCR estimates the adequacy of liquidity over a 30 day stress period while the NCCF calculates a horizon for net positive cash flows in order to capture the risk posed by funding mismatches between assets and liabilities. As at 31 March 2018, the bank was compliant with both requirements.

As a basis to determine the bank's stable funding requirement, the bank calculates NSFR according to Basel Committee on Banking Supervision ('BCBS') publication number 295, pending its implementation in Canada and Europe expected in 2020 and 2021 respectively. The NSFR requires banks to maintain a stable funding profile relative to the composition of their assets and off-balance sheet activities 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.

The bank's OSFI LCR is summarized in the following table. For the quarter ended 31 March 2018, the bank's average LCR of 136% is calculated as the ratio of High-Quality Liquid Assets (HQLA) to the total net stressed cash outflows over the next 30 calendar days. HQLA is substantially comprised of Level 1 assets such as cash, deposits with central banks and highly rated securities issued or guaranteed by governments, central banks and supranational entities. The average LCR decreased this quarter over the average for the previous quarter mainly due to a decrease in HQLA, driven by growth in loans and the impact of seasonal attrition and macroeconomic factors on commercial deposits.

OSFI liquidity coverage ratio[1]

	Average for the three months ended[1]	
	31 Mar 2018	31 Dec 2017
Total HQLA[2]($m)	**22,658**	23,594
Total net cash outflows[2] ($m)	**16,676**	17,185
Liquidity coverage ratio (%)	**136**	137

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

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

Management's Discussion and Analysis (continued)

Market risk

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

Market risk management is independent of the business and is responsible for establishing the policies, procedures and limits that align with the risk appetite of the bank. The objective of market risk management is to identify, measure and control market risk exposures in order to optimize return on risk and to remain within the bank's risk appetite.

Refer to the 'Risk management' section of our Annual Report and Accounts 2017 for a discussion of how the bank manages market risk as well as a more in depth explanation of our market risk measures.

Value at Risk ('VaR')

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

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

Total VaR decreased from March 2017 to March 2018 mainly due to a decrease in interest rate risk in the non-trading activities and an inclusion of more granular risks into the VaR calculation. Over the same period, the average non-trading VaR decreased by $20.9m to $12.3m. The average trading VaR, over the same period, increased by $0.5m to $1.8m due to an increase in interest rate risk from an increase in trading activities.

Total VaR

	Quarter ended	
	31 Mar 2018	31 Mar 2017
	$m	$m
At period end	**11.7**	37.6
Average	**12.6**	33.5
Minimum	**8.5**	27.7
Maximum	**16.8**	43.1

Non-trading VaR

	Quarter ended	
	31 Mar 2018	31 Mar 2017
	$m	$m
At period end	**12.1**	37.0
Average	**12.3**	33.2
Minimum	**8.3**	28.2
Maximum	**16.7**	41.5

Trading VaR (by risk type)[1]

	Foreign exchange and commodity	Interest rate	Equity	Credit Spread	Portfolio diversification[2]	Total[3]
	$m	$m	$m	$m	$m	$m
January - March 2018						
At period end	—	**2.0**	—	**0.4**	**(0.3)**	**2.1**
Average	—	**1.7**	—	**0.5**	**(0.4)**	**1.8**
Minimum[4]	—	**1.0**	—	**0.4**		**1.0**
Maximum[4]	—	**3.1**	—	**0.7**		**3.1**

	Foreign exchange and commodity	Interest rate	Equity	Credit Spread	Portfolio diversification[2]	Total[3]
	$m	$m	$m	$m	$m	$m
January - March 2017						
At period end................................	—	1.8	—	0.4	(0.2)	2.0
Average	—	1.2	—	0.4	(0.4)	1.3
Minimum[4]	—	0.8	—	0.2		0.9
Maximum[4]....................................	0.1	2.0	—	1.7		2.0

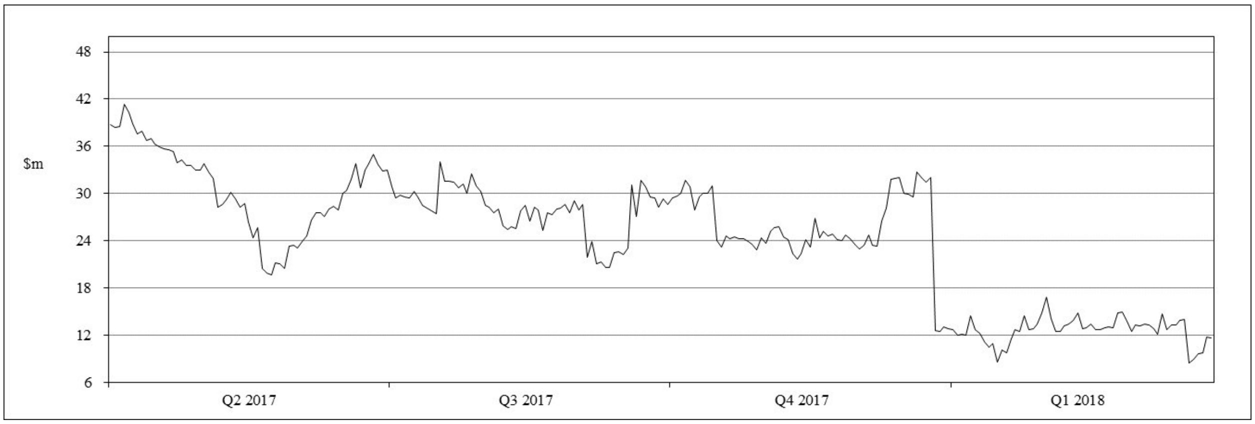
1 *Trading portfolios comprise positions arising from the market-making of financial instruments and customer-driven derivatives positions.*

2 *Portfolio diversification is the market risk dispersion effect of holding a portfolio containing different risk types. It represents the reduction in unsystematic market risk that occurs when combining a number of different risk types, for example, interest rate, equity and foreign exchange, together in one portfolio. It is measured as the difference between the combined total VaR and the sum of the VaRs by individual risk type. A negative number represents the benefit of portfolio diversification.*

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

4 *As the maximum and minimum occur on different days for different risk types, it is not meaningful to calculate a portfolio diversification benefit for these measures.*

Daily total VaR- 1 year history of daily figures



Structural interest rate risk

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

Refer to the 'Structural Interest Rate Risk' section of our Annual Report and Accounts 2017 for a discussion of how the bank manages structural interest rate risk as well as an explanation of our monitoring measures.

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

	Quarter ended			
	31 Mar 2018		31 Mar 2017	
Before-tax impact resulting from an immediate and sustained shift in interest rates	**Economic value of equity**	**Earnings at risk**	Economic value of equity	Earnings at risk
	$m	**$m**	$m	$m
100 basis point increase	**(302)**	**72**	(312)	87
100 basis point decrease..	**252**	**(86)**	309	(88)

Management's Discussion and Analysis (continued)

Factors that may affect future results

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

Refer to the 'Factors that may affect future results' section of our Annual Report and Accounts 2017 for a description of additional factors which may affect future financial results.

Capital

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

Refer to the 'Capital' section of our Annual Report and Accounts 2017 for a discussion of how the bank manages its capital.

Regulatory capital and capital ratios in the tables below are presented under a Basel III 'all-in' basis, under which non-qualifying capital instruments are phased out over 10 years starting 1 January 2013.

The bank remained within its required regulatory capital limits during the quarter ended 31 March 2018.

Regulatory capital ratios

Actual regulatory capital ratios and capital requirements

	31 Mar 2018	31 Dec 2017
Actual regulatory capital ratios[1]		
Common equity tier 1 capital ratio	**10.1%**	10.5%
Tier 1 capital ratio	**12.0%**	12.4%
Total capital ratio	**14.2%**	14.7%
Leverage ratio[2]	**4.8%**	4.9%
Regulatory capital requirements		
Minimum common equity tier 1 capital ratio	**7.0%**	7.0%
Minimum tier 1 capital ratio	**8.5%**	8.5%
Minimum total capital ratio	**10.5%**	10.5%

1 *Presented under a Basel III basis with non-qualifying capital instruments phased out over 10 years starting 1 January 2013.*

2 *OSFI target capital ratios on an 'all-in' basis including mandated capital conservation buffer.*

Regulatory capital

Regulatory capital and risk-weighted assets

	31 Mar 2018 $m	31 Dec 2017 $m
Tier 1 capital	**5,536**	5,589
Common equity tier 1 capital	**4,686**	4,739
Gross common equity[1]	**4,813**	4,860
Regulatory adjustments	**(127)**	(121)
Additional tier 1 eligible capital[2]	**850**	850
Tier 2 capital[3]	**1,043**	1,042
Total capital available for regulatory purposes	**6,579**	6,631
Total risk-weighted assets	**46,241**	45,035

1 *Includes common share capital, retained earnings and accumulated other comprehensive income.*

2 *Includes capital instruments subject to phase out.*

3 *Includes capital instruments subject to phase out and collective allowances.*

Outstanding shares and dividends

	31 Mar 2018			31 Dec 2017		
	Dividend	**Number of issued shares**	**Carrying value**	Dividend	Number of issued shares	Carrying value
	$ per share	**000's**	**$m**	$ per share	000's	$m
Common shares	**0.40107**	**498,668**	**1,225**	0.471	498.668	1,225
Class 1 preferred shares[1]						
Series C[2]	—	—	—	1.275	—	—
Series D[2]	—	—	—	1.250	—	—
Series G	**0.250**	**20,000**	**500**	1.000	20,000	500
Series I[3]	**0.370**	**14,000**	**350**	0.000	14,000	350

1 *Cash dividends on preferred shares are non-cumulative and are payable quarterly.*

2 *Preferred shares – Class 1, Series C and D were redeemed on 31 December 2017.*

3 *Preferred shares - Class 1 Series I were issued on 7 December 2017; initial dividends were declared during the first quarter of 2018 and paid in accordance with their terms in the usual manner on 31 March 2018 or the first business day thereafter.*

During the first quarter of 2018, the bank declared and paid $200m in dividends on HSBC Bank Canada common shares, an increase of $153m compared with the same quarter of the prior year, and $10m in dividends on all series of HSBC Bank Canada Class 1 preferred shares.

On 2 May 2018, the bank declared a first interim dividend of $70m and a special dividend of $400m on HSBC Bank Canada common shares in respect of the financial year ending 31 December 2018, and will be paid on or before 30 June 2018 to the shareholder of record on 15 June 2018.

On 2 May 2018, the bank also declared regular quarterly dividends for the second quarter 2018 on all series of HSBC Bank Canada Class 1 preferred shares, and will be paid in accordance with their terms in the usual manner on 30 June 2018 or the first business day thereafter to shareholders of record on 15 June 2018.

As the first interim dividend on common shares for 2018 and the quarterly dividends on preferred shares for the second quarter 2018 were declared after 31 March 2018, the amounts have not been included in the balance sheet of the bank as a liability.

Interim Condensed Consolidated Financial Statements (unaudited)

Consolidated Financial Statements and Notes on the Financial Statements

Consolidated income statement (unaudited)

		Quarter ended	
		31 Mar 2018[1]	31 Mar 2017
	Notes	**$m**	$m
Interest income		**540**	451
Interest expense		**(234)**	(169)
Net interest income		**306**	282
Fee income		**176**	177
Fee expense		**(21)**	(17)
Net fee income		**155**	160
Net income from financial instruments held for trading (2017: Net trading income)		**36**	31
Changes in fair value of long-term debt (2017: Net expense from financial instruments designated at fair value)		**—**	(3)
Gains less losses from financial investments		**22**	18
Other operating income		**22**	18
Total operating income		**541**	506
Change in expected credit losses	6	**28**	n/a
Loan impairment recoveries and other credit risk provisions		**n/a**	49
Net operating income		**569**	555
Employee compensation and benefits	2	**(182)**	(181)
General and administrative expenses		**(126)**	(121)
Depreciation of property, plant and equipment		**(8)**	(7)
Amortization of intangible assets		**(2)**	(2)
Total operating expenses		**(318)**	(311)
Operating profit		**251**	244
Share of profit/(loss) in associates		**—**	(1)
Profit before income tax expense		**251**	243
Income tax expense		**(68)**	(57)
Profit for the period		**183**	186
Profit attributable to the common shareholder		**173**	177
Profit attributable to preferred shareholders		**10**	9
Profit attributable to shareholders		**183**	186
Average number of common shares outstanding (000's)		**498,668**	498,668
Basic earnings per common share		**$ 0.35**	$ 0.35

1 *Effective 1 January 2018 the bank adopted IFRS 9 Financial instruments ('IFRS 9') on a retrospective basis without restatement of prior periods. Results from prior periods are reported in accordance with IAS 39 Financial Instruments: Recognition and Measurement ('IAS 39').*

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

Consolidated statement of comprehensive income (unaudited)

	Quarter ended	
	31 Mar 2018	31 Mar 2017
	$m	$m
Profit for the period	**183**	186
Other comprehensive income/(loss)		
Items that will be reclassified subsequently to profit or loss when specific conditions are met:		
Debt instruments at fair value through other comprehensive income	**(42)**	n/a
– fair value losses	**(36)**	n/a
– fair value gains transferred to income statement on disposal	**(22)**	n/a
– income taxes	**16**	n/a
Available-for-sale investments	**n/a**	33
– fair value gains	**n/a**	63
– fair value gains transferred to income statement on disposal	**n/a**	(18)
– income taxes	**n/a**	(12)
Cash flow hedges	**(4)**	1
– fair value losses	**(160)**	(35)
– fair value losses transferred to income statement	**154**	36
– income taxes	**2**	—
Items that will not be reclassified subsequently to profit or loss:		
Remeasurement of defined benefit plans	**14**	(1)
– before income taxes	**19**	(1)
– income taxes	**(5)**	—
Changes in fair value of financial liabilities designated at fair value due to movement in own credit risk	**—**	3
– before income taxes	**—**	3
– income taxes	**—**	—
Equity instruments designated at fair value through other comprehensive income	**(1)**	n/a
– fair value losses	**(1)**	n/a
– income taxes	**—**	n/a
Other comprehensive (loss)/income for the period, net of tax	**(33)**	36
Total comprehensive income for the period attributable to shareholders	**150**	222

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

Consolidated balance sheet (unaudited)

	Notes	31 Mar 2018[1] $m	31 Dec 2017 $m
ASSETS			
Cash and balances at central bank		**69**	411
Items in the course of collection from other banks		**20**	25
Trading assets	4	**6,094**	5,373
Other financial assets mandatorily measured at fair value through profit or loss		**9**	n/a
Derivatives	5	**3,354**	3,675
Loans and advances to banks		**550**	1,221
Loans and advances to customers	6	**50,743**	50,337
Reverse repurchase agreements – non-trading		**5,504**	6,153
Financial investments	7	**23,519**	22,913
Other assets		**2,250**	899
Prepayments and accrued income		**297**	213
Customers' liability under acceptances		**5,374**	4,801
Current tax assets		**46**	44
Property, plant and equipment		**107**	106
Goodwill and intangible assets		**96**	90
Deferred taxes		**108**	118
Total assets		**98,140**	96,379
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks		**971**	1,696
Customer accounts		**55,814**	57,054
Repurchase agreements – non-trading		**8,821**	4,604
Items in the course of transmission to other banks		**246**	299
Trading liabilities	8	**2,799**	3,701
Derivatives	5	**3,349**	3,516
Debt securities in issue		**10,613**	10,820
Other liabilities		**2,691**	2,217
Acceptances		**5,381**	4,801
Accruals and deferred income		**365**	475
Retirement benefit liabilities		**327**	346
Subordinated liabilities		**1,039**	1,039
Provisions		**45**	61
Current tax liabilities		**16**	40
Total liabilities		**92,477**	90,669
Equity			
Common shares		**1,225**	1,225
Preferred shares		**850**	850
Other reserves		**(108)**	(61)
Retained earnings		**3,696**	3,696
Total equity		**5,663**	5,710
Total liabilities and equity		**98,140**	96,379

1 *Effective 1 January 2018 the bank adopted IFRS 9 on a retrospective basis without restatement of prior periods. Results from prior periods are reported in accordance with IAS 39. Refer to the table 'Reconciliation of consolidated balance sheet as at 31 December 2017 and 1 January 2018' in note 1 of the consolidated financial statements for further details of balance sheet presentation changes.*

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

Consolidated statement of cash flows (unaudited)

		Quarter ended	
		31 Mar 2018	31 Mar 2017
	Notes	**$m**	$m
Cash flows from operating activities			
Profit before tax		**251**	243
Adjustments for:			
– non-cash items included in profit before tax	10	**(15)**	(33)
– change in operating assets	10	**(3,232)**	(2,846)
– change in operating liabilities	10	**3,169**	(134)
– tax paid		**(73)**	(45)
Net cash from operating activities		**100**	(2,815)
Cash flows from investing activities			
Purchase of financial investments		**(3,847)**	(2,352)
Proceeds from the sale and maturity of financial investments		**3,173**	4,792
Purchase of intangibles and property, plant and equipment		**(17)**	(12)
Net cash from investing activities		**(691)**	2,428
Cash flows from financing activities			
Dividends paid to shareholders		**(205)**	(56)
Redemption of preferred shares		**(350)**	—
Net cash from financing activities		**(555)**	(56)
Net decrease in cash and cash equivalents		**(1,146)**	(443)
Cash and cash equivalents at the beginning of the period		**1,880**	1,650
Cash and cash equivalents at the end of the period	10	**734**	1,207
Interest			
Interest paid		**(241)**	(198)
Interest received		**415**	419

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

Consolidated statement of changes in equity (unaudited)

	Share capital[1]	Retained earnings	Other reserves: Available-for-sale fair value reserve	Other reserves: Financial assets at FVOCI reserve	Other reserves: Cash flow hedging reserve	Other reserves: Total other reserves	Total equity
	$m	$m	$m	$m	$m	$m	$m
At 1 January 2018	**2,075**	**3,696**	**(12)**	**n/a**	**(49)**	**(61)**	**5,710**
Changes on initial application of IFRS 9	—	11	12	(12)	—	—	11
Restated balance at 1 January 2018 under IFRS 9	**2,075**	**3,707**	—	**(12)**	**(49)**	**(61)**	**5,721**
Profit for the period	—	183	n/a	—	—	—	183
Other comprehensive income/(loss), net of tax	—	14	n/a	(43)	(4)	(47)	(33)
– debt instruments at fair value through other comprehensive income	—	—	n/a	(42)	—	(42)	(42)
– equity instruments designated at fair value through other comprehensive income	—	—	n/a	(1)	—	(1)	(1)
– cash flow hedges	—	—	n/a	—	(4)	(4)	(4)
– remeasurement of defined benefit asset/liability	—	14	n/a	—	—	—	14
Total comprehensive income for the period	—	197	n/a	(43)	(4)	(47)	150
Dividends paid on common shares	—	(200)	n/a	—		—	(200)
Dividends paid on preferred shares	—	(10)	n/a	—	—	—	(10)
Shares issued under employee remuneration and share plan	—	2	n/a	—	—	—	2
At 31 March 2018	**2,075**	**3,696**	**n/a**	**(55)**	**(53)**	**(108)**	**5,663**

	Share capital[1]	Retained earnings	Other reserves: Available-for-sale fair value reserve	Other reserves: Cash flow hedging reserve	Other reserves: Total other reserves	Total equity
	$m	$m	$m	$m	$m	$m
At 1 January 2017	2,075	3,313	(30)	57	27	5,415
Profit for the period	—	186	—	—	—	186
Other comprehensive income/(loss), net of tax	—	2	33	1	34	36
– available-for-sale investments	—	—	33	—	33	33
– cash flow hedges	—	—	—	1	1	1
– remeasurement of defined benefit asset/liability	—	(1)	—	—	—	(1)
– changes in fair value of financial liabilities designated at fair value arising from changes in own credit risk	—	3	—	—	—	3
Total comprehensive income for the period	—	188	33	1	34	222
Dividends paid on common shares	—	(47)	—	—	—	(47)
Dividends paid on preferred shares	—	(9)	—	—	—	(9)
At 31 March 2017	2,075	3,445	3	58	61	5,581

1 *Share capital is comprised of common shares of $1,225m and preferred shares of $850m.*

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

Notes on the Consolidated Financial Statements (unaudited)

1 Basis of preparation and significant accounting policies

HSBC Bank Canada ('the bank', 'we', 'our') is an indirectly wholly-owned subsidiary of HSBC Holdings plc. ('the Parent', 'HSBC Holdings', 'HSBC Group'). Throughout these interim condensed consolidated financial statements ('consolidated financial statements'), the 'HSBC Group' means the Parent and its subsidiary companies.

a *Compliance with International Financial Reporting Standards*

The consolidated financial statements have been prepared in accordance with International Accounting Standard ('IAS') 34 'Interim Financial Reporting' as issued by the International Accounting Standards Board ('IASB') and should be read in conjunction with the bank's 2017 audited annual consolidated financial statements. The bank's 2017 audited annual consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRSs') and accounting guidelines as issued by the Office of the Superintendent of Financial Institutions Canada ('OSFI'), as required under Section 308(4) of the Bank Act.

IFRSs comprise accounting standards as issued or adopted by the IASB and its predecessor body as well as interpretations issued or adopted by the IFRS Interpretations Committee and its predecessor body.

b *Standards adopted during the first quarter ended 31 March 2018*

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* ('IFRS 9') were adopted effective 1 January 2018. IFRS 9 includes an accounting policy choice to retain the hedge accounting requirements of IAS 39 *Financial Instruments: Recognition and Measurement* ('IAS 39'), which the bank has exercised. The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, 1 January 2018, with no requirement to restate comparative periods. The bank did not restate the comparative periods. Impacts on adoption on net assets at 1 January 2018 are set out on pages 44 to 45.

In addition, the bank has adopted from 1 January 2018 the requirements of IFRS 15 *Revenue from Contracts with Customers* ('IFRS 15'), which provides a principles-based approach for revenue recognition, and introduces the concept of recognizing revenue for performance obligations as they are satisfied. The IFRS 15 transition requirements allow an entity to apply the standard retrospectively with the cumulative effect of initially applying the Standard recognized at the date of initial application as an adjustment to the opening balance of retained earnings at the date of initial application. The bank has assessed the impact of IFRS 15 and has determined that the standard has no significant effect when applied to its consolidated financial statements at the date of initial application, 1 January 2018. Therefore, no adjustment to retained earnings has been made to the consolidated financial statements.

c *Future accounting developments*

Future accounting developments have been disclosed in note 1 (c) on the 2017 annual consolidated financial statements of the bank's Annual Report and Accounts 2017, excluding the changes noted in (b) above which have been implemented during the period.

d *Presentation of information*

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

e *Critical accounting estimates and assumptions*

The preparation of financial information requires the use of estimates and judgments about future conditions. Management's selection of accounting policies which contain critical estimates and judgments include:

- valuation of financial instruments
- deferred tax assets
- defined benefit obligations

In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of these items, it is possible that the outcomes in future reporting periods could differ from those on which management's estimates are based, resulting in materially different conclusions from those reached by management for the purposes of the consolidated financial statements. These items are described further in the 'Critical accounting estimates and judgments' section of the Management's Discussion and Analysis of the bank's Annual Report and Accounts 2017.

As a result of adopting IFRS 9 from 1 January 2018, 'impairment of loans and advances' noted in the bank's Annual Report and Accounts 2017 has been replaced with 'expected credit losses', as described in the 'Critical accounting estimates and judgments' section of the Management's Discussion and Analysis for this quarter ended 31 March 2018.

f *Consolidation*

The consolidated financial statements comprise the consolidated financial statements of the bank and its subsidiaries as at 31 March 2018. The method adopted by the bank to consolidate its subsidiaries is described in note 2 (a) of the 2017 annual consolidated financial statements of the bank's Annual Report and Accounts 2017.

g *Significant accounting policies*

Except as indicated in note (b) above, the consolidated financial statements have been prepared using the same accounting policies used in preparation of our audited 2017 annual consolidated financial statements. The bank adopted IFRS 15 on 1 January 2018 on a retrospective basis, recognizing the cumulative effect, which was nil, of initially applying the standard as an adjustment to the opening balance of retained earnings. Set out below under (h) is the accounting policy of the Bank for fee income under IFRS 15. Further, the policies under (h) will replace existing policy relating to "Fee income" under note 2 (b) in the bank's Annual Report and Accounts 2017.

As noted in (b) above, the bank also adopted IFRS 9 which replaces IAS 39. Set out below under (i) are the new or substantially revised accounting policies resulting from implementing IFRS 9. The accounting policies on hedge accounting are unchanged and are not repeated. Further, the policies under (i) will replace existing policies (d), (e) and (f) in the bank's Annual Report and Accounts 2017.

h *Fee income*

Revenue is recognized when (or as) the bank satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.

The recognition of revenue can be either over time or at a point in time depending on when the performance obligation is satisfied. When control of a good or service is transferred over time, if the customer simultaneously receives and consumes the benefits provided by the bank's performance as we perform, the bank satisfies the performance obligation and recognizes revenue over time. Otherwise, revenue is recognized at the point in time at which we transfer control of the good or service to the customer.

Variable consideration, where applicable, is measured using either the expected value method or the most likely amount method depending on which method the bank expects to better predict the amount of consideration to which it will be entitled. This is the estimated amount of variable consideration, or the portion, if any, of that amount for which it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur.

For all fee types, where there is a single performance obligation, the transaction price is allocated in its entirety to that performance obligation. Where there are multiple performance obligations, the transaction price is allocated to the performance obligation to which it relates based on stand-alone selling prices.

The bank has applied the practical expedient in IFRS 15.121(a) as all of its performance obligations remaining on adoption of IFRS 15 were part of contracts that have an original expected duration of one year or less.

Income which forms an integral part of the effective interest rate of a financial instrument (for example, certain loan commitment fees) is recognized as an adjustment to the effective interest rate and recorded in 'Interest income'.

The main types of fee income arising from contracts with customers, including information about performance obligations, determining the timing and satisfaction of performance obligations and determining the transaction price and the amounts allocated to performance are as follows:

Credit facilities

Credit facility fees include fees generated from providing a credit facility that are not included within the Effective Interest Rate ('EIR'), such as annual facility fees (commitment fees), standby fees and other transaction based fees charged for late payments, return payments, over credit charges and foreign usage. Fees associated with loan commitments and standby letters of credit are billed upfront and recognized on a straight-line basis over the period the service is performed and the

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

performance obligation is met (e.g. the commitment period). In the event a loan commitment or standby letter of credit is exercised, the remaining unamortized fee is recognized as an adjustment to yield over the loan term. The transaction price (excluding any interest element) usually includes an annual facility fee which could be a fixed charge or a percentage of the approved credit limit; and other transaction-based charges which could be either a fixed price or a percentage of the transaction value. Although fees charged can be variable (percentage of credit limit or transaction value), the uncertainty is resolved by the time the revenue is recognised as the credit limit or transaction value is known on the contract or transaction date. Therefore, there is no need to estimate the variable consideration or apply the constraint. On the basis that the services are provided evenly over the term of the agreement, the fee is recognized on a straight line basis over the commitment period.

Funds under management

Funds under management include management fees, administration fees and transaction based fees.

Management fees are generally percentage based and therefore represent variable consideration. This amount is subject to the variable consideration constraint and is only included in the transaction price to the extent that it is highly probable that a significant reversal of cumulative revenue will not occur when the uncertainty associated with the variable consideration is subsequently resolved. At the end of each payment period, or at each reporting date, the management fee is allocated to the distinct management services that have been provided during that period. Fee income from management fees is recognised as performance obligations that are satisfied by transferring services. Therefore management fees are recognized as the services are provided. The fee percentage and payment period are agreed with the customer upfront. Generally, payment periods are monthly or quarterly and coincide with our reporting periods, thereby resolving the uncertainty of the variable consideration by the reporting date. For payment periods that do not coincide with our reporting periods, judgment is required to estimate the fee and determine the amount to include in an accrual, but an accrual is only recorded to the extent it is highly probably that a significant reversal of revenue will not occur. In most cases, a significant reversal of revenue is not highly probable.

Administration fees, where applicable, are agreed with the customer and based on the terms of each contract. These fees are either fixed upfront charges or percentage based fees calculated as a percentage of the average value of a customer's assets at the end of an agreed period. Percentage based administrative fees are included in the transaction price only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved.

Other fees are transaction based and are recognized and billed at the point in time the transaction occurs and the performance obligation is met.

Cards

Credit card arrangements involve numerous contracts between various parties. The bank has determined that the more significant contracts within the scope of IFRS 15 are:

– the contract between the bank and the credit card holder ('Cardholder Agreement') under which we earn miscellaneous fees (e.g., late payment fees, over-limit fees, foreign exchange fees, etc.) and for some products annual fees; and

– an implied contract between the bank and merchants who accept our credit cards in connection with the purchase of their goods and/or services ('Merchant Agreement') under which we earn interchange fees.

The Cardholder Agreement obligates the bank, as the card issuer, to perform activities such as redeem loyalty points by providing goods, cash or services to the cardholder; provide ancillary services such as concierge services, travel insurance, airport lounge access and the like; process late payments; provide foreign exchange services and others. The primary fees arising under cardholder agreements which are in scope of IFRS 15 include annual fees, transaction based fees, and penalty fees for late payments. The amount of each fee stated in the contract represents the transaction price for that performance obligation. Annual fees on credit cards are billed upfront and recognized on a straight-line basis. Other credit card fees, as noted above, are transaction based and are recognized and billed at the point in time the transaction occurs and the performance obligation is met.

Interchange fees

The implied contract between the bank and the merchant results in the bank receiving an interchange fee from the merchant. The interchange fee represents the transaction price associated with the implied contract between the bank and the merchant because it represents the amount of consideration to which the bank expects to be entitled in exchange for transferring the promised service (i.e., purchase approval and payment remittance) to the merchant. The performance obligation associated with the implied contract between the bank and the merchant is satisfied upon performance and simultaneous consumption by the customer of the underlying service (i.e. purchase approval and payment remittance). Therefore, the interchange fee is recognized as revenue each time the bank approves a purchase and remits payment to the merchant.

Account services

The bank provides services for current accounts that generate fees from various activities including: accounts statements, ATM transactions, cash withdrawals, wire transfers, utilization of cheques, debit cards and internet and phone banking. The fees for these services are established in the customer account agreement and are either billed individually at the time the service is performed and the performance obligation is met, or on a monthly basis for a package or bundle of services as the services are performed and the performance obligation is met. Customer account agreements typically include a package of services with multiple performance obligations or a bundle of services making up a single performance obligation. In the case of a package of services, the pattern of transfer to the customer is the same for all services (stand ready obligation) therefore, all the goods and services are treated as a single performance obligation. The transaction price is allocated in its entirety to the single performance obligation. The performance obligation associated with account services will be satisfied as a stand ready obligation to provide services evenly over time, and therefore, the fee income from account services would be recognized evenly over time.

i *Accounting policies resulting from implementing IFRS 9*

Classification and Measurement of Financial Assets

The Bank classifies its financial instruments under IFRS 9 into the following categories:

i) Financial instruments measured at amortized cost;

ii) Financial assets measured at fair value through other comprehensive income (‘FVOCI’);

iii) Equity securities measured at fair value with fair value movements presented in other comprehensive income (‘OCI’); and

iv) Financial instruments designated and otherwise mandatorily measured at fair value through profit or loss.

(i) Financial instruments measured at amortized cost

Financial assets that are held to collect the contractual cash flows and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest, such as most loans and advances to banks and customers and some debt securities, are measured at amortized cost and are presented net of an allowance for expected credit losses. In addition, most financial liabilities are measured at amortized cost. The carrying value of these financial assets at initial recognition includes any directly attributable transaction 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 recognized over the life of the loan through the recognition of interest income, unless the loan becomes impaired. The bank 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 bank intends to hold the loan, the loan commitment is included in the impairment calculations set out below.

(ii) Financial assets measured at FVOCI

Financial assets held for a business model that is achieved by both collecting contractual cash flows and selling and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest are measured at FVOCI. These comprise primarily debt securities. They are recognized on the trade date when the bank enters into contractual arrangements to purchase and are normally derecognized when they are either sold or redeemed. They are subsequently remeasured at fair value and changes therein (except for those relating to impairment, interest income and foreign currency exchange gains and losses) are recognized in other comprehensive income until the assets are sold. Upon disposal, the cumulative gains or losses in other comprehensive income are recognized in the income statement as ‘Gains less losses from financial investments’. Financial assets measured at FVOCI are included in the impairment calculations set out below and impairment is recognized in profit or loss.

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

(iii) Equity securities measured at fair value with fair value movements presented in OCI

The equity securities for which fair value movements are shown in OCI are business facilitation and other similar investments. Gains or losses on the derecognition of these equity securities are not transferred to profit or loss. Otherwise equity securities are measured at fair value through profit or loss (except for dividend income which is recognized in profit or loss).

(iv) Financial instruments designated and otherwise mandatorily measured at fair value through profit or loss

Equity securities for which the fair value movements are not shown in OCI are mandatorily classified in this category.

Additionally, 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 and liabilities or a group of financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; and
- where the financial liability contains one or more non-closely related embedded derivatives.

Designated financial assets are recognized when the bank enters into contracts with counterparties, which is generally on trade date, and are normally derecognized when the rights to the cash flows expire or are transferred. Designated financial liabilities are recognized when the bank enters into contracts with counterparties, which is generally on settlement date, and are normally derecognized when extinguished. Subsequent changes in fair values are recognized in the income statement in 'Changes in fair value of long-term debt'.

Under the above criterion, there are no such financial instruments designated at fair value by the bank at 31 March 2018.

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 recognized initially and are subsequently measured at fair value. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative. This includes embedded derivatives in financial liabilities which are bifurcated from the host contract when they meet the definition of a derivative on a stand-alone basis when the entire contract, including the host instrument, is not designated at fair value through profit or loss.

Where the derivatives are managed with debt securities issued by the bank that are designated at fair value, the contractual interest is shown in 'Interest expense' together with the interest payable on the issued debt.

Impairment of amortized cost and FVOCI financial assets

Expected credit losses ('ECL') are recognized for loans and advances to banks and customers, non-trading reverse repurchase agreements, other financial assets held at amortized cost, debt instruments measured at fair value through other comprehensive income, and certain loan commitments and financial guarantee contracts. At the end of the first reporting period after initial recognition, an allowance (or provision in the case of some loan commitments and financial guarantees) is required for ECL resulting from default events that are possible within the next 12 months (or less, where the remaining life is less than 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 recognized are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit-impaired are in 'stage 3'.

Credit-impaired (stage 3)

The bank determines that a financial instrument is credit-impaired and in stage 3 by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are past due for more than 90 days;
- there are other indications that the borrower is unlikely to pay such as that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and

– the loan is otherwise considered to be in default.

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due, even where regulatory rules permit default to be defined based on 180 days past due. Therefore the definitions of credit-impaired and default are aligned as far as possible so that stage 3 represents all loans which are considered defaulted or otherwise credit-impaired. Interest income is recognized by applying the effective interest rate to the amortized cost amount, i.e. gross carrying amount less ECL allowance.

Write-off

Financial assets (and the related impairment allowances) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realization of security. In circumstances where the net realizable value of any collateral has been determined and there is no reasonable expectation of further recovery, write-off may be earlier.

Renegotiation

Loans are identified as renegotiated and classified as credit impaired when we modify the contractual payment terms due to significant credit distress of the borrower. Renegotiated loans remain classified as credit-impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of nonpayment of future cash flows and retain the designation of renegotiated until maturity or derecognition.

A loan that is renegotiated is derecognized if the existing agreement is canceled and a new agreement is made on substantially different terms or if the terms of an existing agreement are modified such that the renegotiated loan is a substantially different financial instrument. Any new loans that arise following derecognition events in these circumstances are considered to be purchased or originated credit-impaired financial assets ('POCI') and will continue to be disclosed as negotiated loans.

Other than originated credit-impaired loans, all other modified loans could be transferred out of stage 3 if they no longer exhibit any evidence of being credit-impaired and, in the case of renegotiated loans, there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, over the minimum observation period, and there are no other indicators of impairment. These loans could be transferred to stage 1 or 2 based on the mechanism as described below by comparing the risk of a default occurring at the reporting date (based on the modified contractual terms) and the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms). Any amount written off as a result of the modification of contractual terms would not be reversed.

Loan modifications that are not credit-impaired

Loan modifications that are not identified as renegotiated are considered to be commercial restructuring. Where a commercial restructuring results in a modification (whether legalized through an amendment to the existing terms or the issuance of a new loan contract) such that the bank's rights to the cash flows under the original contract have expired, the old loan is derecognized and the new loan is recognized at fair value. The rights to cash flows are generally considered to have expired if the commercial restructure is at market rates and no payment-related concession has been provided.

Significant increase in credit risk (stage 2)

An assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. The assessment explicitly or implicitly compares the risk of default occurring at the reporting date compared to that at initial recognition, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. The assessment is unbiased, probability-weighted, and to the extent relevant, uses forward-looking information consistent with that used in the measurement of ECL. The analysis of credit risk is multi-factor.

The determination of whether a specific factor is relevant and its weight compared with other factors depends on the type of product, the characteristics of the financial instrument and the borrower, and the geographical region. Therefore, it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk and these criteria will differ for different types of lending, particularly between retail and wholesale. However, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when payments are 30 days past due. In addition, wholesale loans that are individually assessed, typically corporate and commercial customers, and included on a watch or worry list are included in stage 2.

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

For wholesale portfolios, the quantitative comparison assesses default risk using a lifetime probability of default which encompasses a wide range of information including the obligor's customer risk rating, macroeconomic condition forecasts and credit transition probabilities. Significant increase in credit risk is measured by comparing the average PD for the remaining term estimated at origination with the equivalent estimation at reporting date. The significance of changes in PD was informed by expert credit risk judgment, referenced to historical credit migrations and to relative changes in external market rates.

For loans originated prior to the implementation of IFRS 9, the origination PD does not include adjustments to reflect expectations of future macroeconomic conditions since these are not available without the use of hindsight. In the absence of this data, the origination PD is approximated assuming through-the-cycle ('TTC') PDs and TTC migration probabilities, consistent with the instrument's underlying modeling approach and the credit risk rating ('CRR') at origination.

For certain portfolios of debt securities where external market ratings are available and credit ratings are not used in credit risk management, the debt securities will be in stage 2 if their credit risk increases to the extent they are no longer considered investment grade. Investment grade is where the financial instrument has a low risk of incurring losses, the structure has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil their contractual cash flow obligations.

For retail portfolios, default risk is assessed using a reporting date 12-month PD derived from credit scores which incorporate all available information about the customer. This PD is adjusted for the effect of macroeconomic forecasts for periods longer than 12 months and is considered to be a reasonable approximation of a lifetime PD measure. Retail exposures are first segmented into homogeneous portfolios, generally by country, product and brand. Within each portfolio, the stage 2 accounts are defined as accounts with an adjusted 12-month PD greater than the average 12-month PD of loans in that portfolio 12 months before they become 30 days past due. The expert credit risk judgment is that no prior increase in credit risk is significant. This portfolio-specific threshold identifies loans with a PD higher than would be expected from loans that are performing as originally expected and higher than that which would have been acceptable at origination. It therefore approximates a comparison of origination to reporting date PDs.

Unimpaired and without significant increase in credit risk (stage 1)

ECL resulting from default events that are possible within the next 12 months ('12-month ECL') are recognized for financial instruments that remain in stage 1.

Movement between stages

Financial assets can be transferred between the different categories depending on their relative increase or decrease in credit risk since initial recognition. Financial instruments are transferred out of stage 2 if their credit risk is no longer considered to be significantly increased since initial recognition based on the assessments described above. Except for renegotiated loans, financial instruments are transferred out of stage 3 when they no longer exhibit any evidence of credit impairment as described above. Renegotiated loans will continue to be in stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, observed over a minimum one-year period and there are no other indicators of impairment. For loans that are assessed for impairment on a portfolio 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.

Measurement of ECL

The assessment of credit risk, and the estimation of ECL, are unbiased and probability-weighted, and incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. In general, the bank calculates ECL using three main components, a probability of default, a loss given default and the exposure at default ('EAD').

The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated using the lifetime PD instead. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument respectively. The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of committed facilities. The LGD represents expected losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realized and the time value of money. The bank leverages the Basel II IRB framework where possible, with recalibration to meet the differing IFRS 9 requirements as follows:

Model	Regulatory capital	IFRS 9
PD	– Through the cycle (represents long-run average PD through a full economic cycle) – The definition of default includes a backstop of 90+ days past due	– Point in time (based on current conditions, adjusted to take into account estimates of future conditions that will impact PD) – Default backstop of 90+ days past due
EAD	– Cannot be lower than current balance	– Amortization captured for term products
LGD	– Downturn LGD (consistent losses expected to be suffered during a severe but plausible economic downturn) – Regulatory floors may apply to mitigate risk of underestimating downturn LGD due to lack of historical data – Discounted using cost of capital – All collection costs included	– Expected LGD (based on estimate of loss given default including the expected impact of future economic conditions such as the change in value of collateral – No floors – Discounted using the original effective interest rate of the loan – Only costs associated with obtaining/selling collateral included
Other		– Discounted back from point of default to balance sheet date

While 12-month PDs are recalibrated from Basel models where possible, the lifetime PDs are determined by projecting the 12-month PD using a term structure. For the wholesale methodology, the lifetime PD also takes into account credit migration, i.e. a customer migrating through the CRR bands over its life. The ECL for wholesale stage 3 is determined on an individual basis using a discounted cash flow ('DCF') methodology. The expected future cash flows are based on the credit risk officer's estimates as at the reporting date, reflecting reasonable and supportable assumptions and projections of future recoveries and expected future receipts of interest. Collateral is taken into account if it is likely that the recovery of the outstanding amount will include realization of collateral based on its estimated fair value of collateral at the time of expected realization, less costs for obtaining and selling the collateral. The cash flows are discounted at a reasonable approximation of the original effective interest rate. For significant cases, cash flows under four different scenarios are probability-weighted by reference to the three economic scenarios applied more generally by the bank and the judgment of the credit risk officer in relation to the likelihood of the workout strategy succeeding or receivership being required. For less significant cases, the effect of different economic scenarios and work-out strategies is approximated and applied as an adjustment to the most likely outcome. The movements associated with these variables are referred to as 'Changes to risk parameters (model inputs)' in note 6 'Allowance for expected credit losses'.

Period over which ECL is measured

ECL is measured at each reporting date after the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the bank is exposed to credit risk. For wholesale overdrafts, credit risk management actions are taken no less frequently than on an annual basis and therefore this period is to the expected date of the next substantive credit review. The date of the substantive credit review also represents the initial recognition of the new facility. However, where the financial instrument includes both a drawn and undrawn commitment and the contractual ability to demand repayment and cancel the undrawn commitment does not serve to limit the bank's exposure to credit risk to the contractual notice period, the contractual period does not determine the maximum period considered. Instead, ECL is measured over the period the bank remains exposed to credit risk that is not mitigated by credit risk management actions. This applies to retail overdrafts and credit cards, where the period is the average time taken for stage 2 exposures to default or close as performing accounts, determined on a portfolio basis and ranging from between two and six years. In addition, for these facilities it is not possible to identify the ECL on the loan commitment component separately from the financial asset component. As a result, the total ECL is recognized in the loss allowance for the financial asset unless the total ECL exceeds the gross carrying amount of the financial asset, in which case the ECL is recognized as a provision.

Forward-looking economic inputs

The bank will in general apply three forward-looking global economic scenarios determined with reference to external forecast distributions, the Consensus Economic Scenario approach. This approach is considered sufficient to calculate unbiased expected loss in most economic environments. They represent a 'most likely outcome' (the Central scenario) and two, less likely, 'Outer' scenarios on either side of the Central, referred to as an Upside and a Downside scenario respectively.

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

The Central scenario is used by the annual operating planning process and, with regulatory modifications, will also be used in enterprise-wide stress tests. The Upside and Downside are constructed following a standard process supported by a scenario narrative reflecting the bank's current top and emerging risks. The relationship between the Outer scenarios and Central scenario will generally be fixed with the Central scenario being assigned a weighting of 80% and the Upside and Downside scenarios 10% each, with the difference between the Central and Outer scenarios in terms of economic severity being informed by the spread of external forecast distributions among professional industry forecasts. The Outer scenarios are economically plausible, internally consistent states of the world and will not necessarily be as severe as scenarios used in stress testing.

The period of forecast is five years, after which the forecasts will revert to a view based on average past experience. The economic factors include, but are not limited to, gross domestic product, unemployment, interest rates, inflation and commercial property prices. In general, the consequences of the assessment of credit risk and the resulting ECL outputs will be probability-weighted using the standard probability weights. This probability weighting may be applied directly or the effect of the probability weighting determined on a periodic basis, at least annually, and then applied as an adjustment to the outcomes resulting from the central economic forecast. The central economic forecast is updated quarterly. The bank recognizes that the Consensus Economic Scenario approach using three scenarios will be insufficient in certain economic environments. Additional analysis may be requested at management's discretion, including the production of extra scenarios. If conditions warrant, this could result in a management overlay for economic uncertainty which is included in the ECL estimates.

Reconciliation of consolidated balance sheet as at 31 December 2017 and 1 January 2018

	IAS 39 measurement category	IFRS 9 measurement category	IAS 39 carrying amount as at 31 Dec 2017	Other changes in classification[1]	IFRS 9 reclassification to: Fair value through profit and loss	IFRS 9 reclassification to: Fair value through other comprehensive income	IFRS 9 reclassification to: Amortized cost	Carrying amount post reclassification	IFRS 9 remeasurement including ECL	IFRS 9 carrying amount at 1 Jan 2018
Assets										
Cash and balances at central bank	Amortized cost	Amortized cost	**411**	—	—	—	—	**411**	—	**411**
Items in the course of collection from other banks	Amortized cost	Amortized cost	**25**	—	—	—	—	**25**	—	**25**
Trading assets	FVPL	FVPL	**5,373**	**(248)**	—	—	—	**5,125**	—	**5,125**
Other financial assets mandatorily measured at FVPL	FVPL	FVPL	—	—	**9**	—	—	**9**	—	**9**
Derivatives	FVPL	FVPL	**3,675**	—	—	—	—	**3,675**	—	**3,675**
Loans and advances to banks	Amortized cost	Amortized cost	**1,221**	**(59)**	—	—	—	**1,162**	—	**1,162**
Loans and advances to customers	Amortized cost	Amortized cost	**50,337**	**(28)**	—	—	—	**50,309**	**(4)**	**50,305**
Reverse repurchase agreements - non-trading	Amortized cost	Amortized cost	**6,153**	—	—	—	—	**6,153**	—	**6,153**
Financial investments	FVOCI (Available-for-sale - debt instruments)	FVOCI	**22,884**	—	—	—	—	**22,884**	—	**22,884**
	FVOCI (Available-for-sale - equity instruments)	FVOCI	**20**	—	—	—	—	**20**	—	**20**
		FVPL	**9**	—	—	**(9)**	—	—	—	—
Other assets	Amortized cost	Amortized cost	**899**	**335**	—	—	—	**1,234**	—	**1,234**
Prepayments and accrued income	Amortized cost	Amortized cost	**213**	—	—	—	—	**213**	**12**	**225**
Customers' liability under acceptances	Amortized cost	Amortized cost	**4,801**	—	—	—	—	**4,801**	**(5)**	**4,796**
Current tax assets	n/a	n/a	**44**	—	—	—	—	**44**	—	**44**
Property, plant and equipment	n/a	n/a	**106**	—	—	—	—	**106**	—	**106**
Goodwill and intangible assets	n/a	n/a	**90**	—	—	—	—	**90**	—	**90**
Deferred taxes	n/a	n/a	**118**	—	—	—	—	**118**	**(4)**	**114**
Total assets			**96,379**	—	**9**	**(9)**	—	**96,379**	**(1)**	**96,378**

1 *Effective 1 January 2018, settlement accounts of $248m have been reclassified from 'Trading assets' to 'Other assets', and cash collateral accounts of $59m and $28m, respectively, have been reclassified from 'Loans and advances to banks' and 'Loans and advances to customers' to 'Other assets'.*

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

	IAS 39 measurement category	IFRS 9 measurement category	IAS 39 carrying amount as at 31 Dec 2017	Other changes in classification[1]	IFRS 9 reclassification to: Fair value through profit and loss	IFRS 9 reclassification to: Fair value through other comprehensive income	IFRS 9 reclassification to: Amortized cost	Carrying amount post reclassification	IFRS 9 remeasurement including ECL	IFRS 9 carrying amount at 1 Jan 2018
Liabilities										
Deposits by banks	Amortized cost	Amortized cost	**1,696**	**(227)**	—	—	—	**1,469**	—	**1,469**
Customer accounts	Amortized cost	Amortized cost	**57,054**	**(8)**	—	—	—	**57,046**	—	**57,046**
Repurchase agreements – non-trading	Amortized cost	Amortized cost	**4,604**	—	—	—	—	**4,604**	—	**4,604**
Items in the course of transmission to other banks	Amortized cost	Amortized cost	**299**	—	—	—	—	**299**	—	**299**
Trading liabilities	FVPL	FVPL	**3,701**	**(160)**	—	—	—	**3,541**	—	**3,541**
Derivatives	FVPL	FVPL	**3,516**	—	—	—	—	**3,516**	—	**3,516**
Debt securities in issue	Amortized cost	Amortized cost	**10,820**	—	—	—	—	**10,820**	—	**10,820**
Other liabilities	Amortized cost	Amortized cost	**2,217**	**395**	—	—	—	**2,612**	—	**2,612**
Acceptances	Amortized cost	Amortized cost	**4,801**	—	—	—	—	**4,801**	—	**4,801**
Accruals and deferred income	Amortized cost	Amortized cost	**475**	—	—	—	—	**475**	—	**475**
Retirement benefit liabilities	n/a	n/a	**346**	—	—	—	—	**346**	—	**346**
Subordinated liabilities	Amortized cost	Amortized cost	**1,039**	—	—	—	—	**1,039**	—	**1,039**
Provisions	n/a	n/a	**61**	—	—	—	—	**61**	**(12)**	**49**
Current tax liabilities	n/a	n/a	**40**	—	—	—	—	**40**	—	**40**
Total liabilities			**90,669**	—	—	—	—	**90,669**	**(12)**	**90,657**
Equity										
Common shares			**1,225**	—	—	—	—	**1,225**	—	**1,225**
Preferred shares			**850**	—	—	—	—	**850**	—	**850**
Other reserves			**(61)**	—	—	—	—	**(61)**	—	**(61)**
Retained earnings			**3,696**	—	—	—	—	**3,696**	**11**	**3,707**
Total equity			**5,710**	—	—	—	—	**5,710**	**11**	**5,721**
Total equity and liabilities			**96,379**	—	—	—	—	**96,379**	**(1)**	**96,378**

1 *Effective 1 January 2018, cash collateral accounts of $227m and $8m, respectively, have been reclassified from 'Deposits by banks' and 'Customer accounts' to 'Other liabilities', and settlement accounts of $160m have been reclassified from 'Trading liabilities' to 'Other liabilities'.*

Allowance for credit losses

The following table is a comparison of impairment allowances determined in accordance with IAS 39 and IAS 37 to the corresponding impairment allowance determined in accordance with IFRS 9 as at 1 January 2018.

	IAS 39 / IAS 37 as at 31 December 2017				**IFRS 9 as at 1 January 2018**			
	Collectively assessed	Individually assessed	Total	Transition adjustments[1]	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans at amortized cost	134	149	283	4	**30**	**77**	**180**	**287**
Customers' liability under acceptances at amortized cost	—	—	—	5	**4**	**1**	—	**5**
Prepayments and accrued income at amortized cost	—	—	—	41	—	—	**41**	**41**
Off-balance sheet loan commitments and financial guarantees	41	1	42	(12)	**8**	**15**	**7**	**30**
Total allowance for credit losses	175	150	325	38	**42**	**93**	**228**	**363**

1 *Included in the transition adjustments is a reclassification of $53m from interest receivable to allowance for credit losses. The impact of transition adjustments to retained earnings before tax is $15m.*

2 Employee compensation and benefits

Included within 'Employee compensation and benefits' are components of net periodic benefit cost related to the bank's pension plans and other post-employment benefits, as follows:

	Quarter ended	
	31 Mar 2018	31 Mar 2017
	$m	$m
Pension plans – defined benefit	**5**	5
Pension plans – defined contribution	**10**	9
Healthcare and other post retirement benefit plans	**3**	3
	18	17

3 Segment analysis

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

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

	Quarter ended	
	31 Mar 2018	31 Mar 2017
	$m	$m
Commercial Banking		
Net interest income	**139**	133
Net fee income	**74**	70
Net income from financial instruments held for trading (2017: Net trading income)	**9**	7
Other operating income	**4**	6
Total operating income	**226**	216
Change in expected credit losses	**34**	n/a
Loan impairment recoveries and other credit risk provisions	**n/a**	39
Net operating income	**260**	255
Total operating expenses	**(103)**	(94)
Profit before income tax expense	**157**	161
Global Banking and Markets		
Net interest income	**23**	21
Net fee income	**29**	37
Net income from financial instruments held for trading (2017: Net trading income)	**20**	12
Total operating income	**72**	70
Change in expected credit losses	**3**	n/a
Loan impairment recoveries and other credit risk provisions	**n/a**	5
Net operating income	**75**	75
Total operating expenses	**(38)**	(35)
Profit before income tax expense	**37**	40
Retail Banking and Wealth Management		
Net interest income	**114**	96
Net fee income	**52**	53
Net income from financial instruments held for trading (2017: Net trading income)	**7**	6
Other operating income	**2**	1
Total operating income	**175**	156
Change in expected credit losses	**(9)**	n/a
Loan impairment recoveries and other credit risk provisions	**n/a**	5
Net operating income	**166**	161
Total operating expenses	**(163)**	(140)
Profit before income tax expense	**3**	21
Corporate Centre		
Net interest income	**30**	32
Net income from financial instruments held for trading (2017: Net trading income)	**—**	6
Changes in fair value of long-term debt (2017: Net expense from financial instruments designated at fair value)	**—**	(3)
Gains less losses from financial investments	**22**	18
Other operating income	**16**	11
Net operating income	**68**	64
Total operating expenses	**(14)**	(42)
Operating profit	**54**	22
Share of profit/(loss) in associates	**—**	(1)
Profit before income tax expense	**54**	21

Net fee income

	Quarter ended				
	31 Mar 2018				31 Mar 2017
	Commercial Banking	**Global Banking and Markets**	**Retail Banking and Wealth Management**	**Total**	Total
	$m	**$m**	**$m**	**$m**	$m
Account services	**11**	**1**	**4**	**16**	16
Funds under management	**—**	**—**	**47**	**47**	45
Cards	**4**	**—**	**9**	**13**	13
Credit facilities	**50**	**17**	**—**	**67**	67
Broking income	**—**	**(2)**	**3**	**1**	2
Imports/exports	**2**	**—**	**—**	**2**	2
Remittances	**5**	**2**	**1**	**8**	8
Underwriting	**—**	**7**	**—**	**7**	12
Insurance agency commission	**—**	**—**	**2**	**2**	2
Other	**6**	**6**	**1**	**13**	10
Fee income	**78**	**31**	**67**	**176**	177
Less: fee expense	**(4)**	**(2)**	**(15)**	**(21)**	(17)
Net Fee income	**74**	**29**	**52**	**155**	160

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

	Commercial Banking	**Global Banking and Markets**	**Retail Banking and Wealth Management**	**Corporate Centre**	**Total**
	$m	**$m**	**$m**	**$m**	**$m**
Quarter ended 31 March 2018					
Net operating income:	**260**	**75**	**167**	**67**	**569**
External	**259**	**71**	**166**	**73**	**569**
Inter-segment	**1**	**4**	**1**	**(6)**	**—**
Quarter ended 31 March 2017					
Net operating income:	255	75	161	64	555
External	258	72	168	57	555
Inter-segment	(3)	3	(7)	7	—

Balance sheet information

	Commercial Banking	**Global Banking and Markets**	**Retail Banking and Wealth Management**	**Corporate Centre**	**Intersegment**	**Total**
	$m	**$m**	**$m**	**$m**	**$m**	**$m**
At 31 March 2018						
Loans and advances to customers	**20,370**	**3,348**	**27,025**	**—**	**—**	**50,743**
Customers' liability under acceptances	**3,965**	**1,395**	**14**	**—**	**—**	**5,374**
Total assets	**27,025**	**18,623**	**33,012**	**26,495**	**(7,015)**	**98,140**
Customer accounts	**19,179**	**4,655**	**29,736**	**2,244**	**—**	**55,814**
Acceptances	**3,984**	**1,397**	**—**	**—**	**—**	**5,381**
Total liabilities	**23,920**	**17,248**	**31,914**	**26,410**	**(7,015)**	**92,477**

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

	Commercial Banking	Global Banking and Markets	Retail Banking and Wealth Management	Corporate Centre	Intersegment	Total
	$m	$m	$m	$m	$m	$m
At 31 Dec 2017						
Loans and advances to customers	19,856	3,537	26,944	—	—	50,337
Customers' liability under acceptances	3,431	1,370	—	—	—	4,801
Total assets	28,900	19,796	31,768	27,430	(11,515)	96,379
Customer accounts[1]	21,128	6,449	27,887	1,590	—	57,054
Acceptances	3,431	1,370	—	—	—	4,801
Total liabilities	25,761	18,467	30,893	27,063	(11,515)	90,669

1 *Effective 1 January 2018, $696m of Customer accounts from Commercial Banking were reclassified to Retail Banking and Wealth Management and $557m from Global Banking and Markets were reclassified to Corporate Centre to conform with changes in management reporting.*

4 Trading assets

	31 Mar 2018	31 Dec 2017
	$m	$m
Trading assets:		
Not subject to repledge or resale by counterparties	**3,156**	3,424
Which may be repledged or resold by counterparties	**2,938**	1,949
	6,094	5,373
Canadian and Provincial Government bonds[1]	**4,144**	3,249
Debt securities	**1,410**	1,041
Total debt securities	**5,554**	4,290
Customer trading assets[2]	**—**	93
Trading assets from other banks[2]	**—**	155
Treasury and other eligible bills	**540**	835
	6,094	5,373

1 *Including government guaranteed bonds.*

2 *Settlement accounts of $248m at 31 December 2017 have been reclassified from 'Trading assets' to 'Other assets'. See note 1 for more information.*

5 Derivatives

For a detailed description of the type and use of derivatives by the bank, please refer to the bank's accounting policies disclosed in note 2 of the bank's Annual Report and Accounts 2017.

Fair values of derivatives by product contract type held

	31 Mar 2018					
	Assets			**Liabilities**		
	Trading	**Hedging**	**Total**	**Trading**	**Hedging**	**Total**
	$m	**$m**	**$m**	**$m**	**$m**	**$m**
Foreign exchange	**1,539**	**24**	**1,563**	**1,484**	**181**	**1,665**
Interest rate	**1,593**	**170**	**1,763**	**1,554**	**102**	**1,656**
Commodity	**28**	—	**28**	**28**	—	**28**
Equity	—	—	—	—	—	—
Gross total fair values	**3,160**	**194**	**3,354**	**3,066**	**283**	**3,349**

	31 Dec 2017					
	Assets			Liabilities		
	Trading	Hedging	Total	Trading	Hedging	Total
	$m	$m	$m	$m	$m	$m
Foreign exchange	1,445	76	1,521	1,390	70	1,460
Interest rate	1,987	148	2,135	1,936	103	2,039
Commodity	17	—	17	17	—	17
Equity	2	—	2	—	—	—
Gross total fair values	3,451	224	3,675	3,343	173	3,516

Trading derivatives

Notional contract amounts of derivatives held for trading purposes by product type

	31 Mar 2018	31 Dec 2017
	$m	$m
Foreign exchange	**103,037**	108,943
Interest rate	**221,656**	282,198
Commodity	**134**	226
Equity	**3**	7
	324,830	391,374

The notional or contractual amounts of these instruments indicate the nominal value of transactions outstanding at the reporting date; they do not represent amounts at risk.

Hedging instruments

Notional contract amounts of derivatives held for hedging purposes by product type

	31 Mar 2018		31 Dec 2017	
	Cash flow hedge	**Fair value hedge**	Cash flow hedge	Fair value hedge
	$m	**$m**	$m	$m
Foreign exchange	**2,398**	—	2,398	—
Interest rate	**4,697**	**10,877**	4,697	12,056

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

Fair value of derivatives designated as fair value hedges

	31 Mar 2018		31 Dec 2017	
	Assets	**Liabilities**	Assets	Liabilities
	$m	**$m**	$m	$m
Interest rate	**170**	**26**	146	31

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

	Quarter ended	
	31 Mar 2018	31 Mar 2017
	$m	$m
Gains/(losses):		
– on hedging instruments	**73**	4
– on hedged items attributable to the hedged risk	**(73)**	(4)

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

Fair value of derivatives designated as cash flow hedges

	31 Mar 2018		31 Dec 2017	
	Assets	**Liabilities**	Assets	Liabilities
	$m	**$m**	$m	$m
Foreign exchange	**24**	**181**	77	70
Interest rate	**—**	**76**	2	72

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

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

Gains or losses arising from the change in fair value of cash flow hedges due to hedge ineffectiveness for the quarter ended 31 March 2018 was nil (2017: nil).

6 Allowance for expected credit losses

Allowance for expected credit losses ('ECL')

Reconciliation of allowances/provision for financial assets measured at amortized cost including loan commitments and financial guarantees

	Non credit - impaired		Credit - impaired	
	Stage 1	Stage 2	Stage 3	Total
	Allowance/ provision for ECL	Allowance/ provision for ECL	Allowance/ provision for ECL	Allowance/ provision for ECL
As at 1 January 2018	**42**	**93**	**228**	**363**
Transfers of financial instruments:				
Transfers from stage 1 to stage 2	**(1)**	**1**	**—**	**—**
Transfers from stage 2 to stage 1	**6**	**(6)**	**—**	**—**
Transfers to stage 3	**(1)**	**(1)**	**2**	**—**
Transfers from stage 3	**1**	**13**	**(14)**	**—**
Net remeasurement of ECL arising from transfer of stage	**(5)**	**(4)**	**5**	**(4)**
New financial assets originated or purchased	**8**	**3**	**—**	**11**
Changes to risk parameters (model inputs)	**—**	**17**	**(37)**	**(20)**
Assets derecognized (including final repayments)	**(9)**	**(4)**	**—**	**(13)**
Assets written off	**—**	**—**	**(22)**	**(22)**
Foreign exchange	**—**	**1**	**—**	**1**
Others	**—**	**—**	**(4)**	**(4)**
As at 31 March 2018	**41**	**113**	**158**	**312**
ECL income statement (release)/charge for the period	**(1)**	**19**	**(44)**	**(26)**
Add: recoveries	**—**	**—**	**(2)**	**(2)**
Total ECL income statement (release)/charge for the period	**(1)**	**19**	**(46)**	**(28)**

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

Wholesale portfolio

	Non credit - impaired		Credit - impaired	
	Stage 1	Stage 2	Stage 3	Total
	Allowance/ provision for ECL	Allowance/ provision for ECL	Allowance/ provision for ECL	Allowance/ provision for ECL
As at 1 January 2018	**33**	**71**	**208**	**312**
Transfers of financial instruments:				
Transfers from stage 1 to stage 2	**(1)**	**1**	**—**	**—**
Transfers from stage 2 to stage 1	**2**	**(2)**	**—**	**—**
Transfers to stage 3	**(1)**	**—**	**1**	**—**
Transfers from stage 3	**—**	**12**	**(12)**	**—**
Net remeasurement of ECL arising from transfer of stage	**(1)**	**(8)**	**5**	**(4)**
New financial assets originated or purchased	**7**	**3**	**—**	**10**
Changes to risk parameters (model inputs)	**(3)**	**11**	**(40)**	**(32)**
Assets derecognized (including final repayments)	**(8)**	**(4)**	**—**	**(12)**
Assets written off	**—**	**—**	**(19)**	**(19)**
Foreign exchange	**—**	**1**	**—**	**1**
Others	**—**	**—**	**(4)**	**(4)**
As at 31 March 2018	**28**	**85**	**139**	**252**
ECL income statement (release)/charge for the period	**(5)**	**13**	**(46)**	**(38)**
Add: others	**—**	**—**	**1**	**1**
Total ECL income statement (release)/charge for the period	**(5)**	**13**	**(45)**	**(37)**

Retail portfolio

	Non credit - impaired		Credit - impaired	
	Stage 1	Stage 2	Stage 3	Total
	Allowance/ provision for ECL	Allowance/ provision for ECL	Allowance/ provision for ECL	Allowance/ provision for ECL
As at 1 January 2018	**9**	**22**	**20**	**51**
Transfers of financial instruments:				
Transfers from stage 1 to stage 2	**—**	**—**	**—**	**—**
Transfers from stage 2 to stage 1	**4**	**(4)**	**—**	**—**
Transfers to stage 3	**—**	**(1)**	**1**	**—**
Transfers from stage 3	**1**	**1**	**(2)**	**—**
Net remeasurement of ECL arising from transfer of stage	**(4)**	**4**	**—**	**—**
New financial assets originated or purchased	**1**	**—**	**—**	**1**
Changes to risk parameters (model inputs)	**3**	**6**	**3**	**12**
Assets derecognized (including final repayments)	**(1)**	**—**	**—**	**(1)**
Assets written off	**—**	**—**	**(3)**	**(3)**
Foreign exchange	**—**	**—**	**—**	**—**
Others	**—**	**—**	**—**	**—**
As at 31 March 2018	**13**	**28**	**19**	**60**
ECL income statement charge for the period	**4**	**6**	**2**	**12**
Add: recoveries	**—**	**—**	**(2)**	**(2)**
Add: others	**—**	**—**	**(1)**	**(1)**
Total ECL income statement charge/(release) for the period	**4**	**6**	**(1)**	**9**

The following table shows the continuity of our allowance for credit losses under IAS 39:

Movement in impairment allowances and provision for credit losses

	Quarter ended 31 March 2017			
	Customers individually assessed	Customers collectively assessed	Other credit risk provisions	Total
	$m	$m	$m	$m
Opening balance at the beginning of the period	252	187	89	528
Movement				
Loans and advances written off net of recoveries of previously written off amounts[1]	(19)	(2)	—	(21)
(Recovery)/charge to income	(36)	(10)	(2)	(48)
Other movements	(7)	—	—	(7)
Closing balance at the end of the period	190	175	87	452

1 *Recovered $4m of loans and advances written off in prior periods*

Credit quality

Quality classification definitions

- ‘Strong’ exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default.
- ‘Good’ exposures demonstrate a good capacity to meet financial commitments, with low default risk.
- ‘Satisfactory’ exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk.
- ‘Sub-standard’ exposures require varying degrees of special attention and default risk is of greater concern.
- ‘Credit-impaired’ exposures have been assessed as impaired.

The five credit quality classifications defined above each encompass 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, as shown in the table below. Under IAS 39 retail lending credit quality was disclosed based on expected-loss percentages. Under IFRS 9 retail lending credit quality is now disclosed based on a twelve-month probability-weighted PD. The credit quality classifications for wholesale lending are unchanged and are based on internal credit risk ratings.

Quality classification	**External credit rating**	**Internal credit rating**	**12 month probability of default %**
Strong	A– and above	CRR1 to CRR2	0 - 0.50
Good	BBB+ to BBB-	CCR3	0.50 - 1.50
Satisfactory	BB+ to B+	CCR4 to CCR5	1.50 - 20.0
Sub-standard	B to C	CRR6 to CRR8	20.00 - 99.99
Impaired	Default	CRR9 to CRR10	100

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

The following table shows the distribution of financial instruments to which the impairment requirements in IFRS 9 are applied, by credit quality and stage allocation.

	Gross carrying/notional amount							
	Strong	Good	Satisfactory	Sub-standard	Credit impaired	Total	Allowance/ provision for ECL	Net
	$m	$m	$m	$m	$m	$m	$m	$m
Debt instruments at fair value through other comprehensive income	23,502	—	—	—	—	23,502	—	23,502
– stage 1	23,502	—	—	—	—	23,502	—	23,502
– stage 2	—	—	—	—	—	—	—	—
– stage 3	—	—	—	—	—	—	—	—
Loans and advances to customers at amortized cost	25,607	14,154	9,708	1,107	399	50,975	(232)	50,743
– stage 1	25,604	13,951	7,731	76	—	47,362	(31)	47,331
– stage 2	3	203	1,977	1,031	—	3,214	(85)	3,129
– stage 3	—	—	—	—	399	399	(116)	283
Loans and advances to banks at amortized cost	550	—	—	—	—	550	—	550
– stage 1	550	—	—	—	—	550	—	550
– stage 2	—	—	—	—	—	—	—	—
– stage 3	—	—	—	—	—	—	—	—
Other financial assets at amortized cost	8,063	3,497	1,760	84	43	13,447	(46)	13,401
– stage 1	8,063	3,497	1,643	10	—	13,213	(3)	13,210
– stage 2	—	—	117	74	—	191	(3)	188
– stage 3	—	—	—	—	43	43	(40)	3
Loan and other credit-related commitments	14,600	18,199	7,400	1,219	98	41,516	(29)	41,487
– stage 1	14,331	17,367	5,777	98	—	37,573	(6)	37,567
– stage 2	269	832	1,623	1,121	—	3,845	(23)	3,822
– stage 3	—	—	—	—	98	98	—	98
Financial guarantees and similar commitments	2,192	2,092	905	146	43	5,378	(5)	5,373
– stage 1	2,192	1,993	783	9	—	4,977	(1)	4,976
– stage 2	—	99	122	137	—	358	(2)	356
– stage 3	—	—	—	—	43	43	(2)	41
At 31 March 2018	74,514	37,942	19,773	2,556	583	135,368	(312)	135,056

In assessing and monitoring for credit risk concentration under IAS 39, exposures were measured at exposure at default ('EAD'), which reflects drawn balances as well as an allowance for undrawn amounts of commitments and contingent exposures.

Credit quality of wholesale portfolio

	31 December 2017		
	EAD Drawn	EAD Undrawn	EAD Total
	$m	$m	$m
Strong	29,961	3,066	33,027
Good	16,922	6,398	23,320
Satisfactory	11,279	2,862	14,141
Sub-standard	1,411	608	2,019
Impaired	376	29	405
	59,949	12,963	72,912

Credit quality of retail portfolio

	31 December 2017		
	EAD Drawn	EAD Undrawn	EAD Total
	$m	$m	$m
Strong	13,895	1	13,896
Good	10,157	1,308	11,465
Satisfactory	1,760	332	2,092
Sub-standard	528	58	586
Impaired	82	—	82
	26,422	1,699	28,121

7 Financial investments

	31 Mar 2018	31 Dec 2017
	$m	$m
Financial investments		
Not subject to repledge or resale by counterparties	**19,756**	20,724
Which may be repledged or resold by counterparties	**3,763**	2,189
	23,519	22,913

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

	31 Mar 2018	31 Dec 2017
	$m	$m
Financial investments measured at fair value through other comprehensive income		
Canadian and Provincial Government bonds[1]	**16,222**	n/a
International Government bonds[1]	**3,673**	n/a
Other debt securities issued by banks and financial institutions	**3,318**	n/a
Treasury and eligible bills	**289**	n/a
Other securities	**17**	n/a
	23,519	n/a
Available-for-sale securities at fair value		
Canadian and Provincial Government bonds[1]	**n/a**	15,782
International Government bonds[1]	**n/a**	3,486
Other debt securities issued by banks and financial institutions	**n/a**	3,326
Treasury and eligible bills	**n/a**	290
Other securities	**n/a**	29
	n/a	22,913
	23,519	22,913

1 *Includes government guaranteed bonds.*

8 Trading liabilities

	31 Mar 2018	31 Dec 2017
	$m	$m
Other liabilities – net short positions	**2,795**	3,533
Customer trading liabilities[1]	**4**	168
	2,799	3,701

1 *Settlement accounts of $160m at 31 December 2017 have been reclassified from 'Trading liabilities' to 'Other liabilities'. See note 1 for more information.*

9 Fair values of financial instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the bank has access to at that date. The fair value of a liability reflects its non-performance risk.

Fair values are determined according to the following hierarchy:

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

(b) *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.

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

For a detailed description of fair value and the classification of financial instruments by the bank, please refer to the bank's accounting policies disclosed in note 24 of the bank's Annual Report and Accounts 2017.

The table below provides an analysis of the fair value hierarchy which has been deployed for valuing financial assets and financial liabilities measured at fair value in the consolidated financial statements.

	Valuation techniques			
	Level 1 Quoted market price	Level 2 using observable inputs	Level 3 with significant unobservable inputs	Total
	$m	$m	$m	$m
At 31 March 2018				
Assets				
Trading assets	**5,814**	**280**	**—**	**6,094**
Derivatives	**—**	**3,350**	**4**	**3,354**
Financial investments: measured at fair value through other comprehensive income	**22,322**	**1,197**	**—**	**23,519**
Liabilities				
Trading liabilities	**2,788**	**11**	**—**	**2,799**
Derivatives	**—**	**3,345**	**4**	**3,349**
At 31 December 2017				
Assets				
Trading assets	4,695	678	—	5,373
Derivatives	—	3,674	1	3,675
Financial investments: available-for-sale	21,849	1,064	—	22,913
Liabilities				
Trading liabilities	3,503	197	1	3,701
Derivatives	—	3,515	1	3,516

During the first quarter ended 31 March 2018, there were no significant transfers between Level 1 and 2.

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

	Assets		Liabilities	
	FVOCI	Derivatives	Held for trading	Derivatives
	$m	$m	$m	$m
At 1 January 2018	**—**	**1**	**1**	**1**
Settlements	**—**	**—**	**(1)**	**—**
Transfer in	**—**	**3**	**—**	**3**
At 31 March 2018	**—**	**4**	**—**	**4**
Total gains or losses recognized in profit or loss relating to those assets and liabilities held at the end of the reporting period	**—**	**—**	**—**	**—**
At 1 January 2017	—	1	3	1
Settlements	—	—	(1)	—
At 31 March 2017	—	1	2	1
Total gains or losses recognized in profit or loss relating to those assets and liabilities held at the end of the reporting period	—	—	—	—

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

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

	31 Mar 2018		31 Dec 2017	
	Carrying amount	**Fair value**	Carrying amount	Fair value
	$m	**$m**	$m	$m
Assets				
Loans and advances to customers[1]	**50,743**	**50,583**	50,337	50,227
Liabilities				
Customer accounts	**55,814**	**55,813**	57,054	57,071
Debt securities in issue	**10,613**	**10,586**	10,820	10,836
Subordinated liabilities	**1,039**	**1,031**	1,039	1,035

1 *Loans and advances to customers specifically relating to Canada at 31 March 2018: Carrying amount $47,433m and Fair value $47,284m.*

10 Notes on the statement of cash flows

	Quarter ended	
	31 Mar 2018	31 Mar 2017
	$m	$m
Non-cash items included in profit before tax		
Depreciation and amortization	**10**	9
Share-based payment expense	**1**	2
Change in expected credit losses	**(28)**	n/a
Loan impairment recoveries and other credit risk provisions	**n/a**	(49)
Charge for defined benefit pension plans	**2**	5
	(15)	(33)
Change in operating assets		
Change in prepayment and accrued income	**(71)**	(35)
Change in net trading securities and net derivatives	**(1,578)**	(1,091)
Change in loans and advances to banks - non-cash	**(59)**	—
Change in loans and advances to customers	**(410)**	(11)
Change in reverse repurchase agreements - non-trading	**482**	(1,336)
Change in other assets	**(1,596)**	(373)
	(3,232)	(2,846)
Change in operating liabilities		
Change in accruals and deferred income	**(110)**	(112)
Change in deposits by banks	**(498)**	(16)
Change in customer accounts	**(1,232)**	(2,391)
Change in repurchase agreements – non-trading	**4,217**	3,355
Change in debt securities in issue	**(207)**	(915)
Change in financial liabilities designated at fair value	**—**	(3)
Change in other liabilities	**999**	(52)
	3,169	(134)

Cash and cash equivalents

	31 Mar 2018	31 Mar 2017
	$m	$m
Cash and balances at central bank	**69**	57
Items in the course of collection from other banks, net	**(226)**	(204)
Loans and advances to banks of one month or less	**550**	891
Reverse repurchase agreements with banks of one month or less	**248**	237
T-Bills and certificates of deposits – three months or less	**93**	226
	734	1,207

11 Legal proceedings and regulatory matters

The bank is subject to a number of legal proceedings and regulatory matters arising in the normal course of our business. The bank does not expect the outcome of any of these proceedings, in aggregate, to have a material effect on its consolidated balance sheet or its consolidated income statement.

12 Events after the reporting period

On 2 May 2018, the bank declared a first interim dividend of $70m and a special dividend of $400m on HSBC Bank Canada common shares in respect of the financial year ending 31 December 2018, and will be paid on or before 30 June 2018 to the shareholder of record on 15 June 2018.

On 2 May 2018, the bank also declared regular quarterly dividends for the second quarter 2018 on all series of HSBC Bank Canada Class 1 preferred shares, and will be paid in accordance with their terms in the usual manner on 30 June 2018 or the first business day thereafter to shareholders of record on 15 June 2018.

As the first interim dividend on common shares for 2018 and the quarterly dividends on preferred shares for the second quarter 2018 were declared after 31 March 2018, the amounts have not been included in the balance sheet of the bank as a liability.

There have been no other material events after the reporting period which would require disclosure or adjustment to the 31 March 2018 consolidated financial statements.

These consolidated financial statements were approved by the Board of Directors on 2 May 2018 and authorized for issue.

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