



**The Hongkong and Shanghai Banking  
Corporation Limited**

**Interim Report 2017**

## Contents

	Page
Certain defined terms	2
Cautionary statement regarding forward-looking statements	2
Chinese translation	2
<b>Financial Highlights</b>	<b>3</b>
<b>Consolidated income statement by global business</b>	<b>4</b>
<b>Financial Review</b>	<b>5</b>
<b>Capital Overview</b>	<b>9</b>
<b>Principal risks and uncertainties</b>	<b>10</b>
<b>Statement of Directors' Responsibilities</b>	<b>11</b>
<b>Independent Review Report by PricewaterhouseCoopers</b>	<b>12</b>
<b>Interim Condensed Consolidated Financial Statements</b>	<b>13</b>
Consolidated income statement	13
Consolidated statement of comprehensive income	14
Consolidated balance sheet	15
Consolidated statement of cash flows	16
Consolidated statement of changes in equity	17
<b>Notes on the Interim Condensed Consolidated Financial Statements</b>	<b>19</b>
1 Basis of preparation and significant accounting policies	19
2 Dividends	19
3 Derivatives	20
4 Loans and advances to customers	20
5 Impairment allowances against loans and advances to customers	22
6 Financial investments	22
7 Interests in associates and joint ventures	22
8 Prepayments, accrued income and other assets	23
9 Accruals and deferred income, other liabilities and provisions	23
10 Contingent liabilities, contractual commitments and guarantees	24
11 Segmental analysis	24
12 Fair values of financial instruments carried at fair value	25
13 Fair values of financial instruments not carried at fair value	25
14 Related party transactions	26
15 Legal proceedings and regulatory matters	26
16 Additional information	27
17 <i>Interim Report 2017</i> and statutory accounts	27
18 Ultimate holding company	27

## Certain defined terms

This document comprises the *Interim Report 2017* for The Hongkong and Shanghai Banking Corporation Limited ('the Bank') and its subsidiaries (together 'the group'). References to 'HSBC', 'the Group' or 'the HSBC Group' within this document mean HSBC Holdings plc together with its subsidiaries. Within this document the Hong Kong Special Administrative Region of the People's Republic of China is referred to as 'Hong Kong'. The abbreviations 'HK\$m' and 'HK\$bn' represent millions and billions (thousands of millions) of Hong Kong dollars respectively.

## Cautionary statement regarding forward-looking statements

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

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

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

## Chinese translation

A Chinese translation of the *Interim Report 2017* is available upon request from: Communications (Asia), Level 32, HSBC Main Building, 1 Queen's Road Central, Hong Kong. The report is also available, in English and Chinese, on the Bank's website at [www.hsbc.com.hk](http://www.hsbc.com.hk).

本《中期業績報告》備有中譯本，如欲查閱可向下列部門索取：香港皇后大道中 1 號滙豐總行大廈 32 樓企業傳訊部（亞太區）。本報告之中英文本亦載於本行之網站 [www.hsbc.com.hk](http://www.hsbc.com.hk)

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## Financial Highlights

- Profit before tax up 7% to HK\$57,378m (HK\$53,409m in the first half of 2016).
- Attributable profit up 8% to HK\$43,443m (HK\$40,200m in the first half of 2016).
- Return on average ordinary shareholders' equity of 14.0% (13.8% in the first half of 2016).
- Total assets up 2% to HK\$7,675bn (HK\$7,549bn at the end of 2016).
- Common equity tier 1 ratio of 15.2% (16.0% at the end of 2016), total capital ratio of 18.4% (19.0% at the end of 2016).
- Cost efficiency ratio of 41.9% (42.8% for the first half of 2016).

## Consolidated income statement by global business

	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Corporate Centre <sup>1</sup>	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>Half-year to 30 Jun 2017</b>						
Net interest income	24,280	14,616	9,169	831	3,680	52,576
Net fee income	10,026	5,387	5,093	780	94	21,380
Net trading income	1,486	1,608	8,226	542	539	12,401
Net income/(expense) from financial instruments designated at fair value	8,481	(259)	14	—	(51)	8,185
Gains less losses from financial investments	75	46	—	—	480	601
Dividend income	9	1	—	—	23	33
Net insurance premium income/(expense)	25,284	2,115	—	—	(16)	27,383
Other operating income	1,417	336	412	16	1,408	3,589
<b>Total operating income</b>	<b>71,058</b>	<b>23,850</b>	<b>22,914</b>	<b>2,169</b>	<b>6,157</b>	<b>126,148</b>
Net insurance claims and benefits paid and movement in liabilities to policyholders	(31,860)	(2,068)	—	—	—	(33,928)
<b>Net operating income before loan impairment charges and other credit risk provisions</b>	<b>39,198</b>	<b>21,782</b>	<b>22,914</b>	<b>2,169</b>	<b>6,157</b>	<b>92,220</b>
Loan impairment charges and other credit risk provisions	(1,109)	(1,742)	(598)	—	(34)	(3,483)
<b>Net operating income</b>	<b>38,089</b>	<b>20,040</b>	<b>22,316</b>	<b>2,169</b>	<b>6,123</b>	<b>88,737</b>
Operating expenses	(16,752)	(7,722)	(9,696)	(1,168)	(3,266)	(38,604)
<b>Operating profit</b>	<b>21,337</b>	<b>12,318</b>	<b>12,620</b>	<b>1,001</b>	<b>2,857</b>	<b>50,133</b>
Share of profit/(loss) in associates and joint ventures	(88)	—	—	—	7,333	7,245
<b>Profit before tax</b>	<b>21,249</b>	<b>12,318</b>	<b>12,620</b>	<b>1,001</b>	<b>10,190</b>	<b>57,378</b>
<b>Balance at 30 Jun 2017</b>						
Loans and advances to customers (net)	990,883	1,094,647	913,930	107,947	19,111	3,126,518
Customer accounts	2,640,254	1,251,010	852,312	186,751	33,737	4,964,064
<b>Half-year to 30 Jun 2016</b>						
<i>(Re-presented)</i>						
Net interest income	21,376	13,370	8,530	739	3,661	47,676
Net fee income	8,686	5,355	4,664	585	139	19,429
Net trading income	315	1,314	10,090	534	732	12,985
Net income/(expense) from financial instruments designated at fair value	223	(238)	82	—	285	352
Gains less losses from financial investments	139	117	32	—	577	865
Dividend income	7	1	—	—	193	201
Net insurance premium income/(expense)	26,385	1,843	—	—	(24)	28,204
Other operating income	3,656	433	541	11	1,177	5,818
<b>Total operating income</b>	<b>60,787</b>	<b>22,195</b>	<b>23,939</b>	<b>1,869</b>	<b>6,740</b>	<b>115,530</b>
Net insurance claims and benefits paid and movement in liabilities to policyholders	(28,527)	(1,893)	—	—	—	(30,420)
<b>Net operating income before loan impairment charges and other credit risk provisions</b>	<b>32,260</b>	<b>20,302</b>	<b>23,939</b>	<b>1,869</b>	<b>6,740</b>	<b>85,110</b>
Loan impairment (charges)/releases and other credit risk provisions	(1,184)	(1,194)	(613)	4	18	(2,969)
<b>Net operating income</b>	<b>31,076</b>	<b>19,108</b>	<b>23,326</b>	<b>1,873</b>	<b>6,758</b>	<b>82,141</b>
Operating expenses	(15,795)	(7,357)	(9,437)	(1,184)	(2,663)	(36,436)
<b>Operating profit</b>	<b>15,281</b>	<b>11,751</b>	<b>13,889</b>	<b>689</b>	<b>4,095</b>	<b>45,705</b>
Share of profit in associates and joint ventures	102	—	—	—	7,602	7,704
<b>Profit before tax</b>	<b>15,383</b>	<b>11,751</b>	<b>13,889</b>	<b>689</b>	<b>11,697</b>	<b>53,409</b>
<b>Balance at 30 Jun 2016</b>						
Loans and advances to customers (net)	921,244	949,678	737,052	101,996	24,264	2,734,234
Customer accounts	2,447,167	1,207,110	832,181	212,841	35,797	4,735,096

<sup>1</sup> Includes inter-segment elimination.

In the second half of 2016, we changed our reportable segments, the details of which are set out in note 37 'Segmental analysis' of the *Annual Report and Accounts 2016*. Comparative figures have been re-presented to conform to the current year presentation.

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## Financial Review

The group reported profit before tax of HK\$57,378m, an increase of 7% compared with the first half of 2016, driven by higher net interest income and higher insurance income (net of claims).

**Net interest income** increased by HK\$4,900m, or 10%, compared with the first half of 2016, mainly in Hong Kong driven by balance sheet growth, primarily in loans and advances to customers, coupled with improved deposit spreads which benefited from interest rate rises since late 2016.

**Net fee income** increased by HK\$1,951m, or 10%, compared with the first half of 2016, mainly in Hong Kong from higher unit trust, securities brokerage and funds under management fees due to strong equity market performance in the first half of 2017, and to a lesser extent from higher underwriting and mandatory provident fund fees.

**Net trading income** decreased by HK\$584m, or 4%, compared with the first half of 2016, driven by an unfavourable valuation adjustment on derivative contracts from the narrowing of own credit spreads.

**Net income from financial instruments designated at fair value** increased by HK\$7,833m compared with the first half of 2016, driven by revaluation gains on the equity portfolio held by the insurance business in Hong Kong from strong equity market performance in the first half of 2017. To the extent that revaluation is attributable to policyholders, there is an offsetting movement reported under 'Net insurance claims and benefits paid and movement in liabilities to policyholders'.

**Other operating income** decreased by HK\$2,229m, or 38%, compared with the first half of 2016, driven by the movement in the present value of in-force insurance business, mainly in Singapore and Hong Kong. This was largely offset by a corresponding movement in 'Net insurance claims and benefits paid and movement in liabilities to policyholders'.

**Loan impairment charges and other credit risk provisions** increased by HK\$514m, or 17%, compared with the first half of 2016, driven by Hong Kong mainly in Commercial Banking ('CMB'), partly offset by lower impairment charges in Australia, mainly in Global Banking and Markets ('GB&M') and impairment releases in Singapore, mainly in CMB.

**Total operating expenses** increased by HK\$2,168m, or 6%, compared with the first half of 2016, mainly in Corporate Centre and Retail Banking and Wealth Management ('RBWM'). The increase was largely driven by higher professional and consultancy expenses and IT-related costs, mainly to support regulatory and compliance programmes, transformation initiatives, and to support business growth initiatives.

**Share of profit in associates and joint ventures** decreased by HK\$459m, or 6%, compared with the first half of 2016, mainly from the impact of foreign exchange translation.

Net interest income

	Half-year to	
	30 Jun 2017	30 Jun 2016
	HK\$m	HK\$m
Net interest income	52,576	47,676
Average interest-earning assets	5,735,095	5,451,257
Net interest spread	1.76%	1.67%
Net interest margin	1.85%	1.76%

**Net interest income ('NII')** increased by HK\$4,900m compared with the first half of 2016. Excluding the impact from foreign exchange translation, NII rose by HK\$5,177m, or 11%, driven by Hong Kong from balance sheet growth, mainly in loans and advances to customers, coupled with improved deposit spreads which benefited from interest rate increases since late 2016. NII also increased in India from lower cost of funds and balance sheet growth, in mainland China mainly from balance sheet growth, and in Australia from lower cost of funds.

**Average interest-earning assets** increased by HK\$284bn, or 5%, compared with the first half of 2016, driven by Hong Kong from an increase in loans and advances to customers, notably in corporate term lending and residential mortgages.

**Net interest margin** increased by nine basis points compared with the first half of 2016. The increase in net interest margin was driven by Hong Kong, although increases were also noted in India, mainland China, Australia, Indonesia, Singapore and Malaysia.

In **Hong Kong**, the net interest margin for the Bank increased by nine basis points, primarily from wider customer deposit spreads and a change in asset portfolio mix due to growth in customer lending. Re-investment yields on financial investments also improved following interest rate increases and as funds were redeployed into financial investments with better yield. These increases were partly offset by debt issued to meet the 'Total Loss Absorbing Capacity' requirement at relatively high cost, coupled with compressed lending spreads.

At **Hang Seng Bank**, the net interest margin increased by nine basis points, mainly from improved deposit spreads and higher re-investment yields on financial investments following interest rate increases and portfolio mix changes, partly offset by compressed lending spreads.

In India and mainland China, the increase in net interest margin was driven by lower cost of funds, benefiting from increases in savings and current account deposits, and in Australia from lower cost of funds following successive interest rate cuts by the Reserve Bank of Australia in 2016.

Net fee income

	Half-year to	
	30 Jun 2017	30 Jun 2016
	HK\$m	HK\$m
Account services	1,447	1,570
Funds under management <sup>1</sup>	3,375	2,781
Cards	3,607	3,410
Credit facilities	1,606	1,480
Broking income	1,831	1,479
Imports/exports	1,830	1,931
Unit trusts	3,579	2,764
Underwriting	760	518
Remittances	1,625	1,662
Global custody	1,674	1,710
Insurance agency commission	964	805
Other	3,153	2,992
<b>Fee income</b>	<b>25,451</b>	<b>23,102</b>
Fee expense	(4,071)	(3,673)
<b>Net fee income</b>	<b>21,380</b>	<b>19,429</b>

<sup>1</sup> Includes Mandatory Provident Fund

With effect from April 2016, certain expenditure in respect of credit card loyalty programmes previously presented in 'General and administrative expenses' is presented in 'Fee expense' to

more appropriately reflect the nature of the expenditure. This accounted for the majority of the increase in fee expense against the first half of 2016.

## Net trading income

	Half-year to	
	30 Jun 2017 HK\$m	30 Jun 2016 HK\$m
Dealing profits	9,544	9,646
Net interest income on trading activities	1,318	1,990
Dividend income from trading securities	1,497	1,276
Net gain from hedging activities	42	73
<b>Net trading income</b>	<b>12,401</b>	<b>12,985</b>

## Other operating income

	Half-year to	
	30 Jun 2017 HK\$m	30 Jun 2016 HK\$m
Movement in present value of in-force insurance business	1,045	3,624
Gains/(losses) on investment properties	206	(25)
Gains/(losses) on disposal of property, plant and equipment, and assets held for sale	24	(19)
Other	2,314	2,238
<b>Other operating income</b>	<b>3,589</b>	<b>5,818</b>

## Insurance income

Included in net operating income are the following revenues earned by the insurance business

	Half-year to	
	30 Jun 2017 HK\$m	30 Jun 2016 HK\$m
Net interest income	6,058	5,614
Net fee income	1,390	902
Net trading income/(loss)	613	(698)
Net income/(expense) from financial instruments designated at fair value	8,222	(15)
Net insurance premium income	27,383	28,204
Movement in present value of in-force business	1,045	3,624
Other operating income	234	361
	<b>44,945</b>	<b>37,992</b>
Net insurance claims and benefits paid and movement in liabilities to policyholders	(33,928)	(30,420)
<b>Net operating income from insurance business</b>	<b>11,017</b>	<b>7,572</b>

Net operating income from the insurance business increased by HK\$3,445m, or 45%, driven by favourable market conditions in the first half of 2017.

Net interest income increased by 8% from growth in insurance fund size, reflecting net inflows from new and renewal of life insurance premiums.

Net trading income increased due to higher revaluation gains on cross currency swaps and equity derivatives supporting insurance business in Hong Kong. Net income from financial instruments designated at fair value increased significantly in Hong Kong, driven by revaluation gains on the equity portfolio from strong equity market performance in the first half of 2017. To the extent that these gains are attributable to policyholders, there is an offsetting movement reported under 'Net insurance claims and benefits paid and movement in liabilities to policyholders'.

Net insurance premium income decreased mainly due to a re-insurance arrangement entered into in the first half of 2017, partly offset by an increase in Hong Kong from new business sales and higher renewals. The decrease in net insurance premium was largely offset by a corresponding movement in 'Net insurance claims and benefits paid and movement in liabilities to policyholders'.

The movement in present value of in-force business, which was largely offset by a corresponding movement in 'Net insurance claims and benefits paid and movement in liabilities to policyholders', was driven by changes in actuarial assumptions as a result of regulatory driven changes and market interest rate movements in Singapore, and in Hong Kong from higher investment returns.

**Loan impairment charges and other credit risk provisions**

	Half-year to	
	30 Jun 2017 HK\$m	30 Jun 2016 HK\$m
Individually assessed impairment charges:		
– new charges	2,916	2,411
– releases	(935)	(765)
– recoveries	(71)	(57)
Collectively assessed impairment charges	1,558	1,313
Other credit risk provisions	15	67
<b>Loan impairment charges and other credit risk provisions</b>	<b>3,483</b>	<b>2,969</b>

Loan impairment charges as a percentage of average gross customer advances were 0.24% for the first half of 2017 (first half of 2016: 0.22%).

**Operating expenses**

	Half-year to	
	30 Jun 2017 HK\$m	30 Jun 2016 HK\$m
Employee compensation and benefits	20,065	19,424
General and administrative expenses	15,542	14,050
Depreciation of property, plant and equipment	2,295	2,294
Amortisation and impairment of intangible assets	702	668
<b>Operating expenses</b>	<b>38,604</b>	<b>36,436</b>

General and administrative expenses increased by HK\$1,492m, mainly in Corporate Centre and RBWM, from higher professional and consultancy expenses and higher IT-related costs to support regulatory and compliance programmes, transformation initiatives and business initiatives, including the

launch of credit cards in mainland China in late 2016, and in digital and insurance initiatives. These increases were partly offset by the reclassification of expenditure in respect of credit card loyalty programmes to fee expenses.

**Tax expenses**

	Half-year to	
	30 Jun 2017 HK\$m	30 Jun 2016 HK\$m
Current taxation	9,825	9,129
– Hong Kong taxation	5,305	4,625
– overseas taxation	4,520	4,504
Deferred taxation	378	1,035
<b>Tax expense</b>	<b>10,203</b>	<b>10,164</b>
Effective tax rate	17.8%	19.0%



## Capital Overview

The following tables show the capital ratios, risk-weighted assets ('RWAs') and capital base on a consolidated basis, in accordance with the Banking (Capital) Rules.

### Capital ratios and RWAs

	At	
	30 Jun 2017 %	31 Dec 2016 %
<b>Capital ratios (transitional basis)</b>		
Common equity tier 1 ('CET1') ratio	15.2	16.0
Tier 1 ratio	16.3	17.2
Total capital ratio	18.4	19.0
	HK\$m	HK\$m
<b>RWAs</b>	<b>2,709,315</b>	2,588,589

The following table sets out the composition of the group's capital base under Basel III at 30 June 2017. The position at 30 June 2017 benefits from transitional arrangements which will be phased out.

### Capital base

	At	
	30 Jun 2017 HK\$m	31 Dec 2016 HK\$m
<b>CET1 capital</b>		
Shareholders' equity	572,147	551,776
– shareholders' equity per balance sheet	655,675	628,006
– revaluation reserve capitalisation issue	(1,454)	(1,454)
– other equity instruments	(14,737)	(14,737)
– unconsolidated subsidiaries	(67,337)	(60,039)
Non-controlling interests	23,732	22,676
– non-controlling interests per balance sheet	52,813	51,130
– non-controlling interests in unconsolidated subsidiaries	(7,203)	(6,442)
– surplus non-controlling interests disallowed in CET1	(21,878)	(22,012)
Regulatory deductions to CET1 capital	(184,295)	(160,144)
– valuation adjustments	(1,756)	(2,020)
– goodwill and intangible assets	(14,643)	(14,029)
– deferred tax assets net of deferred tax liabilities	(1,800)	(1,566)
– cash flow hedging reserve	152	222
– changes in own credit risk on fair valued liabilities	(169)	(1,195)
– defined benefit pension fund assets	(68)	(62)
– significant capital investments in unconsolidated financial sector entities	(78,667)	(57,395)
– property revaluation reserves <sup>1</sup>	(61,706)	(58,168)
– regulatory reserve	(25,638)	(25,931)
<b>Total CET1 capital</b>	<b>411,584</b>	414,308
<b>Additional tier 1 ('AT1') capital</b>		
Total AT1 capital before regulatory deductions	39,090	47,897
– perpetual subordinated loans	14,737	14,737
– perpetual non-cumulative preference shares	19,343	25,228
– allowable non-controlling interests in AT1 capital	5,010	7,932
Regulatory deductions to AT1 capital	(9,157)	(17,333)
– significant capital investments in unconsolidated financial sector entities	(9,157)	(17,333)
<b>Total AT1 capital</b>	<b>29,933</b>	30,564
<b>Total tier 1 capital</b>	<b>441,517</b>	444,872
<b>Tier 2 capital</b>		
Total tier 2 capital before regulatory deductions	69,257	67,536
– perpetual cumulative preference shares	1,561	1,551
– perpetual subordinated debt	3,122	3,102
– term subordinated debt	20,755	21,472
– property revaluation reserves <sup>1</sup>	28,422	26,830
– impairment allowances and regulatory reserve eligible for inclusion in tier 2 capital	15,397	14,581
Regulatory deductions to tier 2 capital	(12,940)	(21,106)
– significant capital investments in unconsolidated financial sector entities	(12,940)	(21,106)
<b>Total tier 2 capital</b>	<b>56,317</b>	46,430
<b>Total capital</b>	<b>497,834</b>	491,302

<sup>1</sup> Includes the revaluation surplus on investment properties which is reported as part of retained profits and adjustments made in accordance with the Banking (Capital) Rules issued by the HKMA.

The following table shows the pro-forma Basel III end point basis position once all transitional arrangements have been phased out, based on the Transition Disclosures Template. It should be noted that the pro-forma Basel III end point basis position takes no account of, for example, any future profits or management actions. In addition, the current regulations or their application may change before full implementation.

Given this, the final impact on the group's capital ratios may differ from the pro-forma position, which is a mechanical application of the current rules to the balance sheet at 30 June 2017; it is not a projection. On this pro-forma basis, the group's CET1 ratio is 14.5% (14.7% at the end of 2016), which is above the Basel III minimum requirement plus expected regulatory capital buffer requirements.

**Reconciliation of regulatory capital from transitional basis to a pro-forma Basel III end point basis**

	At	
	30 Jun 2017 HK\$m	31 Dec 2016 HK\$m
CET1 capital on a transitional basis	411,584	414,308
Transitional provisions: Significant capital investments in unconsolidated financial sector entities	(18,314)	(34,666)
<b>CET1 capital end point basis</b>	<b>393,270</b>	<b>379,642</b>
AT1 capital on a transitional basis	29,933	30,564
Grandfathered instruments: Perpetual non-cumulative preference shares	(19,343)	(25,228)
Transitional provisions:	5,676	10,799
– allowable non-controlling interests in AT1 capital	(3,481)	(6,534)
– significant capital investments in unconsolidated financial sector entities	9,157	17,333
<b>AT1 capital end point basis</b>	<b>16,266</b>	<b>16,135</b>
Tier 2 capital on a transitional basis	56,317	46,430
Grandfathered instruments:	(5,299)	(6,115)
– perpetual cumulative preference shares	(1,561)	(1,551)
– perpetual subordinated debt	(3,122)	(3,102)
– term subordinated debt	(616)	(1,462)
Transitional provisions: Significant capital investments in unconsolidated financial sector entities	9,157	17,333
<b>Tier 2 capital end point basis</b>	<b>60,175</b>	<b>57,648</b>

## Principal risks and uncertainties

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

Our principal risks are credit risk, liquidity and funding risk, market risk, operational risk, regulatory compliance risk, financial crime risk, reputational risk, pension risk, sustainability risk and insurance risk. There is no material change in the principal risks and uncertainties for the remaining six months of the financial year, the description of which can be found in the risk report of the *Annual Report and Accounts 2016*.

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## Statement of Directors' Responsibilities

The Directors, the names of whom are set out below, confirm to the best of their knowledge that:

- the interim condensed consolidated financial statements have been prepared in accordance with Hong Kong Accounting Standard ('HKAS') 34 'Interim Financial Reporting'; and
- the interim report includes a fair review of the information required by DTR4.2.7R of the Disclosure Rules and Transparency Rules issued by the UK Financial Conduct Authority, being an indication of important events that have occurred during the first six months of the financial year ending 31 December 2017 and their impact on the interim condensed consolidated financial statements; and a description of the principal risks and uncertainties for the remaining six months of the financial year.

Stuart Gulliver (Chairman);

Peter Tung Shun Wong (Deputy Chairman & Chief Executive);

Laura May Lung Cha\*, GBS (Deputy Chairman);

Zia Mody\* (Deputy Chairman);

Graham John Bradley\*;

Dr Christopher Wai Chee Cheng\*, GBS, OBE;

Dr Raymond Kuo Fung Ch'ien\*, GBS, CBE;

Irene Yun-lien Lee\*;

Jennifer Xinzhe Li\*;

Victor Tzar Kuoi Li<sup>#</sup>;

John Robert Slosar\*;

Kevin Anthony Westley\*;

Marjorie Mun Tak Yang\*, GBS;

Tan Sri Dr Francis Sock Ping Yeoh\*, CBE

\* independent non-executive Director

<sup>#</sup> non-executive Director

On behalf of the Board

**Stuart Gulliver**

Chairman

31 July 2017

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## **Independent Review Report by PricewaterhouseCoopers**

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### **Report on Review of Interim Financial Information to the Board of Directors of The Hongkong and Shanghai Banking Corporation Limited**

#### **Introduction**

We have reviewed the interim condensed consolidated financial statements set out on pages 13 to 27, which comprises the consolidated balance sheet of The Hongkong and Shanghai Banking Corporation Limited (the 'Bank') and its subsidiaries (together, the 'group') as at 30 June 2017 and the related consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes. The directors of the Bank are responsible for the preparation and presentation of the interim condensed consolidated financial statements in accordance with Hong Kong Accounting Standard 34 'Interim Financial Reporting' issued by the Hong Kong Institute of Certified Public Accountants and the Disclosure Rules and Transparency Rules of the United Kingdom's Financial Conduct Authority. Our responsibility is to express a conclusion on the interim condensed consolidated financial statements on our review and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

#### **Scope of Review**

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the United Kingdom's Auditing Practices Board. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

#### **Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with Hong Kong Accounting Standard 34 'Interim Financial Reporting' and the Disclosure Rules and Transparency Rules of the United Kingdom's Financial Conduct Authority.

#### **PricewaterhouseCoopers**

Certified Public Accountants

Hong Kong  
31 July 2017

## Interim Condensed Consolidated Financial Statements

### Consolidated income statement

	Half-year to	
	30 Jun 2017 HK\$m	30 Jun 2016 HK\$m
Net interest income	52,576	47,676
– interest income	65,794	60,954
– interest expense	(13,218)	(13,278)
Net fee income	21,380	19,429
– fee income	25,451	23,102
– fee expense	(4,071)	(3,673)
Net trading income	12,401	12,985
Net income from financial instruments designated at fair value	8,185	352
Gains less losses from financial investments	601	865
Dividend income	33	201
Net insurance premium income	27,383	28,204
Other operating income	3,589	5,818
<b>Total operating income</b>	<b>126,148</b>	<b>115,530</b>
Net insurance claims and benefits paid and movement in liabilities to policyholders	(33,928)	(30,420)
<b>Net operating income before loan impairment charges and other credit risk provisions</b>	<b>92,220</b>	<b>85,110</b>
Loan impairment charges and other credit risk provisions	(3,483)	(2,969)
<b>Net operating income</b>	<b>88,737</b>	<b>82,141</b>
– employee compensation and benefits	(20,065)	(19,424)
– general and administrative expenses	(15,542)	(14,050)
– depreciation of property, plant and equipment	(2,295)	(2,294)
– amortisation and impairment of intangible assets	(702)	(668)
<b>Total operating expenses</b>	<b>(38,604)</b>	<b>(36,436)</b>
<b>Operating profit</b>	<b>50,133</b>	<b>45,705</b>
Share of profit in associates and joint ventures	7,245	7,704
<b>Profit before tax</b>	<b>57,378</b>	<b>53,409</b>
Tax expense	(10,203)	(10,164)
<b>Profit for the period</b>	<b>47,175</b>	<b>43,245</b>
Profit attributable to shareholders of the parent company	43,443	40,200
Profit attributable to non-controlling interests	3,732	3,045

## Consolidated statement of comprehensive income

	Half-year to	
	30 Jun 2017 HK\$m	30 Jun 2016 HK\$m
Profit for the period	47,175	43,245
Other comprehensive income/(expense)		
<b>Items that will be reclassified subsequently to the income statement when specific conditions are met:</b>		
Available-for-sale investments:	2,355	3,689
– fair value gains	4,169	7,760
– fair value gains reclassified to the income statement on disposal	(604)	(865)
– amounts reclassified to the income statement in respect of impairment losses	5	–
– fair value gains transferred to the income statement on hedged items	(1,039)	(2,482)
– income taxes	(176)	(724)
Cash flow hedges:	1,039	(205)
– fair value losses	(5,986)	(12,372)
– fair value losses reclassified to the income statement	7,226	12,132
– income taxes	(201)	35
Share of other comprehensive income/(expense) of associates and joint venture	(211)	249
Exchange differences	12,756	(1,029)
<b>Items that will not be reclassified subsequently to the income statement:</b>		
Changes in fair value of financial liabilities designated at fair value arising from changes in own credit risk <sup>1</sup>	(283)	–
– before income taxes	(337)	–
– income taxes	54	–
Property revaluation:	4,405	1,304
– fair value gains taken to equity	5,115	1,570
– income taxes	(710)	(266)
Remeasurement of defined benefit asset/liability:	428	(746)
– before income taxes	525	(899)
– income taxes	(97)	153
Other comprehensive income for the period, net of tax	20,489	3,262
<b>Total comprehensive income for the period</b>	<b>67,664</b>	<b>46,507</b>
Attributable to:		
– shareholders of the parent company	63,132	43,769
– non-controlling interests	4,532	2,738

<sup>1</sup> On 1 January 2017, the group adopted the requirements of Hong Kong Financial Reporting Standard ('HKFRS') 9 relating to the presentation of gains and losses on financial liabilities designated at fair value. As a result, the effect of changes in fair value of those liabilities arising from changes in own credit risk is presented in other comprehensive income. As permitted by the transitional requirements of HKFRS 9, comparatives have not been restated.

## Consolidated balance sheet

	Notes	At	
		30 Jun 2017 HK\$m	31 Dec 2016 HK\$m
<b>Assets</b>			
Cash and sight balances at central banks		190,947	213,783
Items in the course of collection from other banks		33,324	21,401
Hong Kong Government certificates of indebtedness		249,364	242,194
Trading assets		496,921	371,634
Derivatives	3	312,617	479,807
Financial assets designated at fair value		116,188	106,016
Reverse repurchase agreements – non-trading		331,807	271,567
Placings with and advances to banks		433,610	463,211
Loans and advances to customers	4	3,126,518	2,834,114
Financial investments	6	1,640,003	1,835,351
Amounts due from Group companies		254,269	242,773
Interests in associates and joint ventures	7	132,261	125,792
Goodwill and intangible assets		58,656	56,936
Property, plant and equipment		115,827	111,640
Deferred tax assets		1,743	1,503
Prepayments, accrued income and other assets	8	180,460	171,230
<b>Total assets</b>		<b>7,674,515</b>	<b>7,548,952</b>
<b>Liabilities</b>			
Hong Kong currency notes in circulation		249,364	242,194
Items in the course of transmission to other banks		44,375	37,753
Repurchase agreements – non-trading		58,149	27,810
Deposits by banks		181,425	192,479
Customer accounts		4,964,064	4,900,004
Trading liabilities		258,381	188,470
Derivatives	3	310,489	462,458
Financial liabilities designated at fair value		52,979	51,116
Debt securities in issue		28,349	25,235
Retirement benefit liabilities		3,450	3,867
Amounts due to Group companies		249,046	198,038
Accruals and deferred income, other liabilities and provisions	9	97,329	99,487
Liabilities under insurance contracts		415,236	386,170
Current tax liabilities		5,150	1,619
Deferred tax liabilities		23,198	21,401
Subordinated liabilities		4,034	4,836
Preference shares		21,009	26,879
<b>Total liabilities</b>		<b>6,966,027</b>	<b>6,869,816</b>
<b>Equity</b>			
Share capital		149,616	114,359
Other equity instruments		14,737	14,737
Other reserves		106,822	85,886
Retained profits		384,500	413,024
Total shareholders' equity		655,675	628,006
Non-controlling interests		52,813	51,130
<b>Total equity</b>		<b>708,488</b>	<b>679,136</b>
<b>Total equity and liabilities</b>		<b>7,674,515</b>	<b>7,548,952</b>

## Consolidated statement of cash flows

	Half-year to	
	30 Jun 2017 HK\$m	30 Jun 2016 HK\$m
<b>Operating activities</b>		
Cash generated from/(used in) operations	(106,472)	197,867
Interest received on financial investments	9,093	8,810
Dividends received on financial investments	29	276
Dividends received from associates	82	82
Taxation paid	(3,315)	(3,695)
<b>Net cash inflow/(outflow) from operating activities</b>	<b>(100,583)</b>	<b>203,340</b>
<b>Investing activities</b>		
Purchase of financial investments	(195,341)	(311,105)
Proceeds from sale or redemption of financial investments	290,586	237,050
Purchase of property, plant and equipment	(790)	(1,097)
Proceeds from sale of property, plant and equipment and assets held for sale	244	5
Purchase of other intangible assets	(1,087)	(815)
Net cash inflow from the sale of interests in business portfolios	54	–
<b>Net cash inflow/(outflow) from investing activities</b>	<b>93,666</b>	<b>(75,962)</b>
Net cash inflow/(outflow) before financing activities	(6,917)	127,378
<b>Financing activities</b>		
Issue of ordinary share capital	–	18,307
Repayment of subordinated liabilities	(900)	(3,110)
Issue of subordinated liabilities	27,320	–
Redemption of preference shares	(6,022)	(9,692)
Ordinary dividends paid	(35,438)	(25,565)
Dividends paid to non-controlling interests	(2,895)	(4,705)
Interest paid on preference shares	(332)	(669)
Interest paid on subordinated liabilities	(1,327)	(392)
<b>Net cash outflow from financing activities</b>	<b>(19,594)</b>	<b>(25,826)</b>
<b>Increase/(decrease) in cash and cash equivalents</b>	<b>(26,511)</b>	<b>101,552</b>
<b>Change in cash and cash equivalents</b>		
At 1 Jan	752,705	658,397
Net cash inflow/(outflow) before the effect of foreign exchange movements	(26,511)	101,552
Effect of foreign exchange movements	23,357	20,839
At 30 Jun	749,551	780,788



## Consolidated statement of changes in equity

	Half-year to 30 Jun 2017											
	Share capital	Other equity instruments	Retained profits	Other reserves					Total shareholders' equity	Non-controlling interests	Total equity	
				Property revaluation reserve	Available-for-sale investment reserve	Cash flow hedge reserve	Foreign exchange reserve	Other <sup>1</sup>				
HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m		
<b>At 1 Jan 2017</b>	<b>114,359</b>	<b>14,737</b>	<b>413,024</b>	<b>53,763</b>	<b>6,189</b>	<b>(793)</b>	<b>(31,861)</b>	<b>58,588</b>	<b>628,006</b>	<b>51,130</b>	<b>679,136</b>	
Profit for the period	–	–	43,443	–	–	–	–	–	43,443	3,732	47,175	
Other comprehensive income (net of tax)	–	–	96	4,077	1,795	975	12,571	175	19,689	800	20,489	
Available-for-sale investments	–	–	–	–	2,187	–	–	–	2,187	168	2,355	
Cash flow hedges	–	–	–	–	–	975	–	–	975	64	1,039	
Changes in fair value of financial liabilities designated at fair value arising from changes in own credit risk <sup>2</sup>	–	–	(281)	–	–	–	–	–	(281)	(2)	(283)	
Property revaluation	–	–	–	4,077	–	–	–	–	4,077	328	4,405	
Actuarial gains on defined benefit asset/liability	–	–	371	–	–	–	–	–	371	57	428	
Share of other comprehensive income/(expense) of associates and joint ventures	–	–	6	–	(392)	–	–	175	(211)	–	(211)	
Exchange differences	–	–	–	–	–	–	12,571	–	12,571	185	12,756	
<b>Total comprehensive income for the period</b>	<b>–</b>	<b>–</b>	<b>43,539</b>	<b>4,077</b>	<b>1,795</b>	<b>975</b>	<b>12,571</b>	<b>175</b>	<b>63,132</b>	<b>4,532</b>	<b>67,664</b>	
Shares issued	–	–	–	–	–	–	–	–	–	–	–	
Dividends paid	–	–	(35,438)	–	–	–	–	–	(35,438)	(2,895)	(38,333)	
Movement in respect of share-based payment arrangements	–	–	(23)	–	–	–	–	(25)	(48)	(3)	(51)	
Transfers and other movements <sup>4,5</sup>	35,257	–	(36,602)	(702)	–	–	–	2,070	23	49	72	
<b>At 30 Jun 2017</b>	<b>149,616</b>	<b>14,737</b>	<b>384,500</b>	<b>57,138</b>	<b>7,984</b>	<b>182</b>	<b>(19,290)</b>	<b>60,808</b>	<b>655,675</b>	<b>52,813</b>	<b>708,488</b>	
	Half-year to 30 Jun 2016											
				Other reserves								
At 1 Jan 2016	96,052	14,737	380,381	52,099	4,880	(35)	(16,991)	53,078	584,201	51,685	635,886	
Profit for the period	–	–	40,200	–	–	–	–	–	40,200	3,045	43,245	
Other comprehensive income/(expense) (net of tax)	–	–	(657)	1,340	3,965	(199)	(920)	40	3,569	(307)	3,262	
Available-for-sale investments	–	–	–	–	3,750	–	–	–	3,750	(61)	3,689	
Cash flow hedges	–	–	–	–	–	(199)	–	–	(199)	(6)	(205)	
Property revaluation	–	–	(123)	1,340	–	–	–	–	1,217	87	1,304	
Actuarial losses on defined benefit asset/liability	–	–	(528)	–	–	–	–	–	(528)	(218)	(746)	
Share of other comprehensive income/(expense) of associates and joint ventures	–	–	(6)	–	215	–	–	40	249	–	249	
Exchange differences	–	–	–	–	–	–	(920)	–	(920)	(109)	(1,029)	
<b>Total comprehensive income/(expense) for the period</b>	<b>–</b>	<b>–</b>	<b>39,543</b>	<b>1,340</b>	<b>3,965</b>	<b>(199)</b>	<b>(920)</b>	<b>40</b>	<b>43,769</b>	<b>2,738</b>	<b>46,507</b>	
Shares issued	18,307	–	–	–	–	–	–	–	18,307	–	18,307	
Dividends paid	–	–	(25,565)	–	–	–	–	–	(25,565)	(4,705)	(30,270)	
Movement in respect of share-based payment arrangements	–	–	166	–	–	–	–	187	353	2	355	
Transfers and other movements <sup>4,5</sup>	–	–	(1,756)	(718)	–	(10)	–	2,601	117	(117)	–	
<b>At 30 Jun 2016</b>	<b>114,359</b>	<b>14,737</b>	<b>392,769</b>	<b>52,721</b>	<b>8,845</b>	<b>(244)</b>	<b>(17,911)</b>	<b>55,906</b>	<b>621,182</b>	<b>49,603</b>	<b>670,785</b>	

Consolidated statement of changes in equity (continued)

	Half-year to 31 Dec 2016										
	Share capital	Other equity instruments	Retained profits	Property revaluation reserve	Other reserves				Total shareholders' equity	Non-controlling interests	Total equity
					Available-for-sale investment reserve	Cash flow hedge reserve	Foreign exchange reserve	Other <sup>1</sup>			
HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	
At 1 Jul 2016	114,359	14,737	392,769	52,721	8,845	(244)	(17,911)	55,906	621,182	49,603	670,785
Profit for the period	–	–	38,446	–	–	–	–	–	38,446	3,104	41,550
Other comprehensive income/ (expense) (net of tax)	–	–	1,199	1,783	(2,656)	(559)	(13,950)	545	(13,638)	78	(13,560)
Available-for-sale investments	–	–	–	–	(3,128)	–	–	–	(3,128)	(62)	(3,190)
Cash flow hedges	–	–	–	–	–	(559)	–	–	(559)	(38)	(597)
Property revaluation	–	–	(122)	1,783	–	–	–	–	1,661	182	1,843
Actuarial gains on defined benefit asset/ liability	–	–	1,321	–	–	–	–	–	1,321	258	1,579
Share of other comprehensive income of associates and joint ventures	–	–	–	–	472	–	–	545	1,017	–	1,017
Exchange differences	–	–	–	–	–	–	(13,950)	–	(13,950)	(262)	(14,212)
Total comprehensive income/ (expense) for the period	–	–	39,645	1,783	(2,656)	(559)	(13,950)	545	24,808	3,182	27,990
Dividends paid <sup>3</sup>	–	–	(17,731)	–	–	–	–	–	(17,731)	(1,592)	(19,323)
Movement in respect of share-based payment arrangements	–	–	69	–	–	–	–	(445)	(376)	(5)	(381)
Transfers and other movements <sup>5</sup>	–	–	(1,728)	(741)	–	10	–	2,582	123	(58)	65
At 31 Dec 2016	114,359	14,737	413,024	53,763	6,189	(793)	(31,861)	58,588	628,006	51,130	679,136

1 The other reserves mainly comprise share of associates' other reserves, purchase premium arising from transfer of business within the HSBC Group and the share-based payment reserve. The share-based payment reserve is used to record the amount relating to share awards and options granted to employees of the group directly by HSBC Holdings plc.

2 On 1 January 2017, the group adopted the requirements of Hong Kong Financial Reporting Standard ('HKFRS') 9 relating to the presentation of gains and losses on financial liabilities designated at fair value. As a result, the effect of changes in fair value of those liabilities arising from changes in own credit risk is presented in retained profits. As permitted by the transitional requirements of HKFRS 9, comparatives have not been restated.

3 Including distributions paid on perpetual subordinated loans classified as equity under HKFRS.

4 In the first half of 2017, the Bank redeemed US\$775m (HK\$6,022m) of preference shares which were classified as a financial liability in the consolidated balance sheet. The redemption was made by a payment out of distributable profits. The amount of preference shares has been credited to share capital with a corresponding adjustment to retained profits in accordance with the capital maintenance requirements of the Companies Ordinance. In 2013, the Bank redeemed US\$3,745m (HK\$29,235m) of preference shares in the same manner. This amount was also credited to share capital with a corresponding adjustment to retained profits in accordance with the capital maintenance requirements of the Companies Ordinance. The total amount credited to share capital with a corresponding adjustment to retained profits in the first half of 2017 in respect of these transactions was HK\$35,257m. This amount is non-distributable.

5 The movement from retained profits to other reserves includes the relevant transfers in associates according to local regulatory requirements.

# Notes on the Interim Condensed Consolidated Financial Statements

## 1 Basis of preparation and significant accounting policies

### (a) Compliance with Hong Kong Financial Reporting Standards

The interim condensed consolidated financial statements of the group have been prepared in accordance with HKAS 34 'Interim Financial Reporting' as issued by the Hong Kong Institute of Certified Public Accountants ('HKICPA'). These financial statements should be read in conjunction with the *Annual Report and Accounts 2016*.

### Standards applied during the half-year to 30 June 2017

The group has adopted the requirements of HKFRS 9 'Financial Instruments' relating to the presentation of gains and losses on financial liabilities designated at fair value from 1 January 2017. As a result, the effect of changes in fair value of those liabilities arising from changes in own credit risk is presented in other comprehensive income with the remaining effect presented, when required, in profit or loss. As permitted by the transitional requirements of HKFRS 9, comparatives have not been restated. The adoption increased profit before tax by HK\$337m with the opposite effect on other comprehensive income, with no effect on net assets.

### (b) Use of estimates and judgements

Management believes that the group's critical accounting estimates and judgements are those which relate to impairment of loans and advances, goodwill impairment, the valuation of financial instruments, deferred tax assets, provisions for liabilities and interests in associates. There was no change in the current period to the critical accounting estimates and judgements applied in 2016, which are stated in note 1 of the *Annual Report and Accounts 2016*.

### (c) Composition of group

There were no material changes in the composition of the group in the half-year to 30 June 2017.

### (d) Future accounting developments

Information on future accounting developments and their potential effect on the financial statements of the group is provided in note 1 of the *Annual Report and Accounts 2016*. In preparation for the implementation of HKFRS 9, the group is preparing for the parallel run of HKFRS 9 which will commence during the second half of 2017. Until this work is sufficiently advanced, we will not have a reliable understanding of the potential impact on the financial statements and any consequential effects on regulatory capital requirements.

### (e) Going concern

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the group and parent company have the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows and capital resources.

### (f) Accounting policies

Except as described above, the accounting policies applied by the group for these interim condensed consolidated financial statements are consistent with those described in note 1 of the *Annual Report and Accounts 2016*, as are the methods of computation.

## 2 Dividends

	Half-year to			
	30 Jun 2017		30 Jun 2016	
	HK\$ per share	HK\$m	HK\$ per share	HK\$m
Ordinary dividends paid				
– fourth interim dividend in respect of the previous financial year approved and paid during the half-year	0.56	25,438	0.44	17,065
– first interim dividend paid	0.22	10,000	0.20	8,500
<b>Total</b>	<b>0.78</b>	<b>35,438</b>	<b>0.64</b>	<b>25,565</b>

The Directors have declared a second interim dividend in respect of the half-year ended 30 June 2017 of HK\$0.22 per ordinary share (HK\$10,000m) (half-year ended 30 June 2016 of HK\$0.19 per ordinary share (HK\$8,500m)).

## Notes on the Interim Condensed Consolidated Financial Statements (unaudited)

### 3 Derivatives

#### Fair values of derivatives by product type

	Assets			Liabilities		
	Trading HK\$m	Hedging HK\$m	Total HK\$m	Trading HK\$m	Hedging HK\$m	Total HK\$m
Foreign Exchange	203,508	2,249	205,757	202,210	1,974	204,184
Interest rate	149,273	1,244	150,517	147,538	962	148,500
Equity	22,077	—	22,077	23,477	—	23,477
Credit	3,990	—	3,990	4,090	—	4,090
Commodity and other	3,330	—	3,330	3,292	—	3,292
<b>Gross total fair values</b>	<b>382,178</b>	<b>3,493</b>	<b>385,671</b>	<b>380,607</b>	<b>2,936</b>	<b>383,543</b>
Offset			(73,054)			(73,054)
<b>At 30 Jun 2017</b>			<b>312,617</b>			<b>310,489</b>
Foreign Exchange	363,707	6,570	370,277	350,787	1,322	352,109
Interest rate	150,263	2,556	152,819	150,590	1,060	151,650
Equity	22,350	—	22,350	24,653	—	24,653
Credit	2,431	—	2,431	2,437	—	2,437
Commodity and other	4,529	—	4,529	4,208	—	4,208
Gross total fair values	543,280	9,126	552,406	532,675	2,382	535,057
Offset			(72,599)			(72,599)
At 31 Dec 2016			479,807			462,458

#### Notional contract amounts of derivatives by product type

	At	
	30 Jun 2017 HK\$m	31 Dec 2016 HK\$m
Foreign Exchange	20,653,725	18,217,397
Interest rate	24,143,520	19,180,184
Equity	743,669	604,504
Credit	547,107	474,160
Commodity and other	173,779	140,339
	<b>46,261,800</b>	38,616,584

### 4 Loans and advances to customers

	At	
	30 Jun 2017 HK\$m	31 Dec 2016 HK\$m
Gross loans and advances to customers	3,141,077	2,846,806
Impairment allowances	(14,559)	(12,692)
	<b>3,126,518</b>	2,834,114

## Loans and advances to customers

The following analysis of loans and advances to customers is based on categories used by the HSBC Group.

	Hong Kong HK\$m	Rest of Asia-Pacific HK\$m	Total HK\$m
<b>At 30 Jun 2017</b>			
Residential mortgages	521,126	291,641	812,767
Credit card advances	53,674	24,785	78,459
Other personal	147,410	74,293	221,703
<b>Total personal</b>	<b>722,210</b>	<b>390,719</b>	<b>1,112,929</b>
Commercial, industrial and international trade	467,444	411,160	878,604
Commercial real estate	207,974	64,076	272,050
Other property-related lending	251,995	74,352	326,347
Government	36,857	2,155	39,012
Other commercial	163,872	147,589	311,461
<b>Total corporate and commercial</b>	<b>1,128,142</b>	<b>699,332</b>	<b>1,827,474</b>
Non-bank financial institutions	128,228	67,178	195,406
Settlement accounts	3,226	2,042	5,268
<b>Total financial</b>	<b>131,454</b>	<b>69,220</b>	<b>200,674</b>
<b>Gross loans and advances to customers</b>	<b>1,981,806</b>	<b>1,159,271</b>	<b>3,141,077</b>
Individually assessed impairment allowances	(4,276)	(5,121)	(9,397)
Collectively assessed impairment allowances	(2,548)	(2,614)	(5,162)
<b>Net loans and advances to customers</b>	<b>1,974,982</b>	<b>1,151,536</b>	<b>3,126,518</b>
<b>At 31 Dec 2016</b>			
Residential mortgages	492,989	267,619	760,608
Credit card advances	58,289	22,665	80,954
Other personal	132,171	70,947	203,118
Total personal	683,449	361,231	1,044,680
Commercial, industrial and international trade	428,035	384,227	812,262
Commercial real estate	198,579	55,786	254,365
Other property-related lending	221,919	69,911	291,830
Government	20,230	2,405	22,635
Other commercial	136,729	132,944	269,673
Total corporate and commercial	1,005,492	645,273	1,650,765
Non-bank financial institutions	103,311	45,611	148,922
Settlement accounts	1,337	1,102	2,439
Total financial	104,648	46,713	151,361
Gross loans and advances to customers	1,793,589	1,053,217	2,846,806
Individually assessed impairment allowances	(2,960)	(5,099)	(8,059)
Collectively assessed impairment allowances	(1,959)	(2,674)	(4,633)
Net loans and advances to customers	1,788,670	1,045,444	2,834,114

## Allowances as a percentage of gross loans and advances to customers

	At	
	30 Jun 2017	31 Dec 2016
Individually assessed	0.30%	0.28%
Collectively assessed	0.16%	0.16%
<b>Total allowances</b>	<b>0.46%</b>	<b>0.44%</b>

Gross loans and advances to customers in Hong Kong increased by HK\$188bn, or 10%, during the first half of 2017, largely from increases in corporate and commercial lending of HK\$123bn and lending to non-bank financial institutions of HK\$25bn due to higher demand, coupled with growth in residential mortgage lending of HK\$28bn.

In the Rest of Asia-Pacific, gross loans and advances to customers increased by HK\$106bn, or 10%, including favourable foreign exchange translation effects of HK\$49bn. Excluding this impact, the underlying increase of HK\$57bn was mainly from increases in corporate and commercial lending of HK\$26bn, mainly in mainland China, Singapore and Australia, and lending to non-bank financial institutions of HK\$20bn, mainly in Australia.

## 5 Impairment allowances against loans and advances to customers

	Individually assessed	Collectively assessed	Total
	HK\$m	HK\$m	HK\$m
<b>At 1 Jan 2017</b>	<b>8,059</b>	<b>4,633</b>	<b>12,692</b>
Amounts written off	(676)	(1,464)	(2,140)
Recoveries of loans and advances written off in previous years	71	349	420
Net charge to income statement	1,910	1,558	3,468
Unwinding of discount of loan impairment	(130)	(10)	(140)
Exchange and other adjustments	163	96	259
<b>At 30 Jun 2017</b>	<b>9,397</b>	<b>5,162</b>	<b>14,559</b>
At 1 Jan 2016	7,040	4,489	11,529
Amounts written off	(793)	(1,406)	(2,199)
Recoveries of loans and advances written off in previous years	57	462	519
Net charge to income statement	1,589	1,313	2,902
Unwinding of discount of loan impairment	(156)	(33)	(189)
Exchange and other adjustments	125	43	168
At 30 Jun 2016	7,862	4,868	12,730

## 6 Financial investments

	At	
	30 Jun 2017	31 Dec 2016
	HK\$m	HK\$m
Available-for-sale	1,355,020	1,574,584
– treasury and other eligible bills	527,507	688,369
– debt securities	818,949	877,504
– equity shares	8,564	8,711
Held-to-maturity	284,983	260,767
– debt securities	284,983	260,767
	<b>1,640,003</b>	<b>1,835,351</b>

## 7 Interests in associates and joint ventures

The group's principal associate is Bank of Communications Co., Limited ('BoCom').

### Impairment testing

At 30 June 2017, the fair value of the group's investment in BoCom had been below the carrying amount for approximately 62 months. As a result, the group performed an impairment test on the carrying amount, which confirmed that there was no impairment at 30 June 2017.

	At					
	30 Jun 2017			31 Dec 2016		
	VIU	Carrying value	Fair value	VIU	Carrying value	Fair value
	HK\$bn	HK\$bn	HK\$bn	HK\$bn	HK\$bn	HK\$bn
BoCom	131.6	129.4	77.7	124.8	122.8	79.2

### Basis of recoverable amount

The impairment test was performed by comparing the recoverable amount of BoCom, determined by a value-in-use ('VIU') calculation, with its carrying amount. The VIU calculation uses discounted cash flow projections based on management's estimates of earnings. Cash flows beyond the short to medium-term are then extrapolated in perpetuity using a long-term growth rate to derive a terminal value, which comprises the majority of the VIU. An imputed capital maintenance charge ('CMC') is calculated to reflect expected regulatory capital requirements, and is deducted from forecast cash flows. The principal inputs to the CMC calculation include estimates of asset growth, the ratio of risk-weighted assets to total assets, and the expected regulatory capital requirements. Additionally, management considers other factors (including qualitative factors) to ensure that the inputs to the VIU calculation remain appropriate. Significant management judgement is required in estimating the future cash flows of BoCom.

### Key assumptions in VIU calculation

Long-term profit growth rate: 5% (2016: 5%) for periods after 2020, which does not exceed forecast GDP growth in mainland China.

Long-term asset growth rate: 4% (2016: 4%) for periods after 2020, which is the rate of growth that assets are expected to grow to achieve long-term profit growth of 5%.

Discount rate: 13% (2016: 13%) which is derived from a range of values obtained by applying a Capital Asset Pricing Model ('CAPM') calculation for BoCom, using market data. Management also compares rates derived from the CAPM with discount rates from external sources and the Group's discount rate for evaluating investments in mainland China. The discount rate used is within the range of 9.5% to 15.0% (2016: 10.2% to 15%) indicated by the CAPM and external sources.

Loan impairment charge as a percentage of customer advances: ranges from 0.74% to 0.86% (2016: 0.72% to 0.87%) in the short- to medium-term and are based on the forecasts disclosed by external analysts. For periods after 2020, the ratio is 0.7% (2016: 0.7%), slightly higher than the historical average.

Risk-weighted assets as a percentage of total assets: 62% (2016: 62%) for all forecast periods. This is consistent with the medium-term forecasts disclosed by external analysts.

Cost-income ratio: ranges from 35.3% to 38% (2016: 40%) in the short- to medium-term. This is consistent with the forecasts disclosed by external analysts.

The following table shows the change to each key assumption in the VIU calculation that on its own would reduce the headroom to nil:

Key assumption	Changes to key assumption to reduce headroom to nil
• Long-term profit growth rate	• Decrease by 10 basis points
• Long-term asset growth rate	• Increase by 11 basis points
• Discount rate	• Increase by 13 basis points
• Loan impairment charge as a percentage of customer advances	• Increase by 2 basis points
• Risk-weighted assets as a percentage of total assets	• Increase by 65 basis points
• Cost-income ratio	• Increase by 46 basis points

## 8 Prepayments, accrued income and other assets

	At	
	30 Jun 2017 HK\$m	31 Dec 2016 HK\$m
Prepayments and accrued income	27,256	21,505
Bullion	69,282	69,894
Acceptances and endorsements	30,543	32,290
Reinsurers' share of liabilities under insurance contracts	15,890	11,368
Current tax assets	1,481	3,537
Other accounts	36,008	32,636
	<b>180,460</b>	<b>171,230</b>

## 9 Accruals and deferred income, other liabilities and provisions

	At	
	30 Jun 2017 HK\$m	31 Dec 2016 HK\$m
Accruals and deferred income	21,519	24,409
Acceptances and endorsements	30,543	32,290
Share based payment liability to HSBC Holdings plc	2,546	1,945
Other liabilities	41,785	39,676
Provisions for liabilities and charges	936	1,167
	<b>97,329</b>	<b>99,487</b>

## 10 Contingent liabilities, contractual commitments and guarantees

	At	
	30 Jun 2017 HK\$m	31 Dec 2016 HK\$m
Guarantees and contingent liabilities	273,996	259,559
Commitments	2,359,068	2,287,617
	<b>2,633,064</b>	<b>2,547,176</b>

The above table discloses the nominal principal amounts of commitments (excluding capital commitments), guarantees and other contingent liabilities, which represents the amounts at risk should contracts be fully drawn upon and clients default. The amount of commitments shown above reflects, where relevant, the expected level of take-up of pre-approved facilities. As a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not indicative of future liquidity requirements.

## 11 Segmental analysis

During 2016, following the changes in internal reporting to the chief operating decision-maker ('CODM'), the Executive Committee ('EXCO'), analysis by global business is considered more prominent than the geographical region view in the way the CODM assesses performance and allocates resources. The global businesses are therefore considered our reportable segments under HKFRS 8. The basis of identifying segments and measuring segmental results is set out in note 37 'Segmental Analysis' of the *Annual Report and Accounts 2016*. There have been no material changes to the reportable segments since 31 December 2016.

Financial performance by global business is set out in the Financial Review on page 4.

### Geographical regions

	Hong Kong HK\$m	Rest of Asia-Pacific HK\$m	Intra-segment elimination HK\$m	Total HK\$m
<b>Half-year to 30 Jun 2017</b>				
Total operating income	92,577	35,126	(1,555)	126,148
Profit before tax	35,105	22,273	–	57,378
Total assets	5,496,507	2,744,820	(566,812)	7,674,515
Total liabilities	5,136,986	2,395,853	(566,812)	6,966,027
<b>Half-year to 30 Jun 2016</b>				
Total operating income	80,626	36,758	(1,854)	115,530
Profit before tax	31,501	21,908	–	53,409
Total assets	5,140,101	2,726,376	(462,306)	7,404,171
Total liabilities	4,794,963	2,400,729	(462,306)	6,733,386



## 12 Fair values of financial instruments carried at fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The following table provides an analysis of the basis for the valuation of financial instruments carried at fair value:

	Valuation techniques			Third party total HK\$m	Inter-company <sup>2</sup> HK\$m	Total HK\$m
	Level 1 HK\$m	Level 2 HK\$m	Level 3 HK\$m			
<b>At 30 Jun 2017</b>						
<b>Assets</b>						
Trading assets <sup>1</sup>	292,111	204,209	601	496,921	–	496,921
Derivatives	3,881	229,137	551	233,569	79,048	312,617
Financial assets designated at fair value	82,953	27,299	5,936	116,188	–	116,188
Available-for-sale investments	829,755	520,583	4,682	1,355,020	–	1,355,020
Assets held for sale	–	–	1,692	1,692	–	1,692
<b>Liabilities</b>						
Trading liabilities <sup>1</sup>	74,279	176,546	7,556	258,381	–	258,381
Derivatives	3,819	230,319	1,518	235,656	74,833	310,489
Financial liabilities designated at fair value <sup>1</sup>	–	52,979	–	52,979	–	52,979
<b>At 31 Dec 2016</b>						
<b>Assets</b>						
Trading assets <sup>1</sup>	239,646	131,285	703	371,634	–	371,634
Derivatives	3,673	364,062	1,403	369,138	110,669	479,807
Financial assets designated at fair value	72,736	29,524	3,756	106,016	–	106,016
Available-for-sale investments	1,058,461	510,357	5,766	1,574,584	–	1,574,584
Assets held for sale	–	–	–	–	–	–
<b>Liabilities</b>						
Trading liabilities <sup>1</sup>	75,880	106,768	5,822	188,470	–	188,470
Derivatives	3,684	340,336	2,695	346,715	115,743	462,458
Financial liabilities designated at fair value <sup>1</sup>	–	50,875	241	51,116	–	51,116

<sup>1</sup> Amounts with HSBC Group entities are not reflected here.

<sup>2</sup> Derivatives balances with HSBC Group entities are largely under 'Level 2'.

Details of the control framework, fair values determined using valuation techniques, fair value adjustments, and the approach used to calculate the fair value of each type of financial instrument are included in note 39 of the *Annual Report and Accounts 2016*.

## 13 Fair values of financial instruments not carried at fair value

### Fair values of financial instruments not carried at fair value and bases of valuation

	At			
	30 Jun 2017		31 Dec 2016	
	Carrying amount HK\$m	Fair value HK\$m	Carrying amount HK\$m	Fair value HK\$m
<b>Assets</b>				
Reverse repurchase agreements – non-trading	331,807	332,118	271,567	272,006
Placings with and advances to banks	433,610	433,687	463,211	463,227
Loans and advances to customers	3,126,518	3,117,440	2,834,114	2,821,798
Financial investments – debt securities	284,983	294,876	260,767	262,389
<b>Liabilities</b>				
Repurchase agreements – non-trading	58,149	58,145	27,810	27,809
Deposits by banks	181,425	181,422	192,479	192,461
Customer accounts	4,964,064	4,963,917	4,900,004	4,900,114
Debt securities in issue	28,349	28,454	25,235	25,269
Subordinated liabilities	4,034	3,460	4,836	4,026
Preference Shares	21,009	21,811	26,879	27,285

Other financial instruments not carried at fair value are typically short-term in nature or re-price to current market rates frequently. Accordingly, their carrying amount is a reasonable approximation of fair value.

Details of how the fair values of financial instruments that are not carried at fair value on the balance sheet are calculated can be found in note 40 of the *Annual Report and Accounts 2016*.

### 14 Related party transactions

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There were no changes in the related party transactions described in the *Annual Report and Accounts 2016* that have had a material effect on the financial position or performance of the group in the half-year to 30 June 2017. All related party transactions that took place in the half-year to 30 June 2017 were similar in nature to those disclosed in the *Annual Report and Accounts 2016*.

### 15 Legal proceedings and regulatory matters

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The group is party to legal proceedings and regulatory matters in a number of jurisdictions arising out of its normal business operations. Apart from the matters described below, the Bank considers that none of these matters are material. The recognition of provisions is determined in accordance with the accounting policies set out in note 1(b)(x) of the *Annual Report and Accounts 2016*. While the outcome of legal proceedings and regulatory matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of these matters as at 30 June 2017. Any provision recognised does not constitute an admission of wrongdoing or legal liability. It is not practicable to provide an aggregate estimate of potential liability for our legal proceedings and regulatory matters as a class of contingent liabilities.

#### Anti-money laundering and sanctions-related matters

In October 2010, HSBC Bank USA entered into a consent order with the Office of the Comptroller of the Currency (the 'OCC') and the indirect parent of that company, HSBC North America Holdings Inc. ('HNAH'), entered into a consent order with the Federal Reserve Board (together the 'Orders'). These Orders required improvements to establish an effective compliance risk management programme across HSBC's US businesses, including risk management related to the US Bank Secrecy Act ('BSA') and anti-money laundering ('AML') compliance. HSBC Bank USA is not currently in compliance with the OCC Order. Steps are being taken to address the requirements of the Orders.

In December 2012, HSBC Holdings plc, HNAH and HSBC Bank USA entered into agreements with US and UK government and regulatory agencies regarding past inadequate compliance with the BSA, AML and sanctions laws. Among those agreements, HSBC Holdings plc and HSBC Bank USA entered into a five-year deferred prosecution agreement with, among others, the US Department of Justice ('DoJ') (the 'US DPA'); and HSBC Holdings plc consented to a cease-and-desist order and HSBC Holdings plc and HNAH consented to a civil money penalty order with the Federal Reserve Board. HSBC Holdings plc also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions, as well as an undertaking with the UK Financial Conduct Authority to comply with certain forward-looking AML and sanctions-related obligations. In addition, HSBC Bank USA entered into civil money penalty orders with the Financial Crimes Enforcement Network of the US Treasury Department and the OCC.

Under these agreements, HSBC Holdings plc and HSBC Bank USA made payments totalling US\$1.9bn to US authorities and undertook various further obligations, including, among others, to continue to cooperate fully with the DoJ in any and all investigations, not to commit any crime under US federal law subsequent to the signing of the agreement, and to retain an independent compliance monitor (the 'Monitor'). In February 2017, the Monitor delivered his third annual follow-up review report. Through his country-level reviews, the Monitor identified potential anti-money laundering and sanctions compliance issues that HSBC is reviewing further with the DoJ, Federal Reserve Board and/or Financial Conduct Authority.

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

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

#### Tax investigations

The Bank continues to cooperate with the relevant US and other authorities, including with respect to US-based clients of the Bank in India.

In addition, various tax administration, regulatory and law enforcement authorities around the world, including in India, are conducting investigations and reviews of HSBC Swiss Private Bank and other HSBC companies in connection with allegations of tax evasion or tax fraud, money laundering and unlawful cross-border banking solicitation. The Indian tax authority issued a summons and request for information to the Bank in India.

The Bank and other HSBC companies are cooperating with the relevant authorities. There are many factors that may affect the range of outcomes, and the resulting financial impact, of these investigations and reviews, which could be significant.

In light of the media attention regarding these matters, it is possible that other tax administration, regulatory or law enforcement authorities will also initiate or enlarge similar investigations or regulatory proceedings.

#### Mossack Fonseca & Co.

HSBC has received requests for information from various regulatory and law enforcement authorities around the world concerning persons and entities believed to be linked to Mossack Fonseca & Co., a service provider of personal investment companies. HSBC is cooperating with the relevant authorities.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of this matter, including the timing or any possible impact on HSBC, which could be significant.

## **Singapore Interbank Offered Rate ('SIBOR'), Singapore Swap Offer Rate ('SOR') and Australia Bank Bill Swap Rate ('BBSW')**

In July 2016 and August 2016, HSBC and other panel banks were named as defendants in two putative class actions filed in the New York District Court on behalf of persons who transacted in products related to the SIBOR, SOR and BBSW benchmark rates. The complaints allege, among other things, misconduct related to these benchmark rates in violation of US antitrust, commodities and racketeering laws, and state law.

The Defendants moved to dismiss the claims against them in the SIBOR and SOR case in November 2016 and in the BBSW case in February 2017. Those motions remain pending. There are many factors that may affect the range of outcomes, and the resulting financial impact, of these matters, which could be significant.

### **Foreign exchange rate investigations**

Various regulators and competition and law enforcement authorities around the world, including in South Korea, are conducting civil and criminal investigations and reviews into trading by HSBC and others on the foreign exchange markets. The Bank and other HSBC companies are cooperating with these investigations and reviews.

There are many factors that may affect the range of outcomes and the resulting financial impact of these investigations, which could be significant.

### **Hiring practices investigation**

The US Securities and Exchange Commission (the 'SEC') is investigating multiple financial institutions, including HSBC Holdings plc, in relation to hiring practices of candidates referred by or related to government officials or employees of state-owned enterprises in Asia-Pacific. HSBC has received various requests for information and is cooperating with the SEC's investigation.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of this matter, including the timing or any possible impact on HSBC, which could be significant.

## **16 Additional information**

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The *Interim Banking Disclosure Statement 2017*, which is prepared in accordance with the Banking (Disclosure) Rules made under section 60A of the Banking Ordinance, will be published on our website at [www.hsbc.com.hk](http://www.hsbc.com.hk).

## **17 Interim Report 2017 and statutory accounts**

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The information in this *Interim Report 2017* is unaudited and does not constitute statutory accounts. The *Interim Report 2017* was approved by the Board of Directors on 31 July 2017. The Bank's statutory annual consolidated accounts for the year ended 31 December 2016 have been delivered to the Registrar of Companies and the Hong Kong Monetary Authority. The auditor has reported on those financial statements in their report dated 21 February 2017. The auditor's report was unqualified; did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying its report; and did not contain a statement under sections 406(2), 407(2) or (3) of the Hong Kong Companies Ordinance (Cap. 622).

## **18 Ultimate holding company**

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The Hongkong and Shanghai Banking Corporation Limited is an indirectly-held, wholly-owned subsidiary of HSBC Holdings plc, which is incorporated in England.