HSBC Bank Middle East Limited – UAE Operations

Financial Statements

For the year ended 31 December 2017

Annual Report and Accounts 2017

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Presentation of Information

This document comprises the *financial statements* for HSBC Bank Middle East Limited – UAE Operations ('the Bank'). References to 'HSBC' or 'HSBC Group' within this document mean HSBC Holdings plc together with its subsidiaries.

Independent auditor's report to the directors of HSBC Bank Middle East Limited in respect of its UAE Operations

Report on the audit of the financial statements

Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of HSBC Bank Middle East Limited in respect of its UAE Operations (the "Bank") as at 31 December 2017, and its financial performance and its `cash flows for the year then ended in accordance with International Financial Reporting Standards.

What we have audited

The Bank's financial statements comprise:

- the statement of financial position as at 31 December 2017;
- the income statement for the year then ended
- the statement of comprehensive income for the year then ended;
- the statement of cash flows for the year then ended;
- the statement of changes in equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants ("IESBA Code") and the ethical requirements that are relevant to our audit of the financial statements in the United Arab Emirates. We have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

PricewaterhouseCoopers (Dubai Branch), License no. 102451
Emaar Square, Building 4, Level 8, PO Box 11987, Dubai - United Arab Emirates
T: +971 (0)4 304 3100, F: +971 (0)4 346 9150, www.pwc.com/me

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

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Independent auditor's report to the director of HSBC Bank Middle East Limited in respect of its UAE Operations (continued)

Auditor's responsibilities for the audit of the financial statements (continued)

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on other legal and regulatory requirements

Further, as required by the UAE Union Law No (10) of 1980, as amended, we report that we have obtained all the information and explanations we considered necessary for the purpose of the audit.

PricewaterhouseCoopers
20 March 2018

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ص.ب: ١١٩٨٧
دبي - ا.ع.م.
P. O. Box 11987
Dubai, U.A.E.
PricewaterhouseCoopers

Douglas O' Mahony
Registered Auditor Number 834
Place: Dubai, United Arab Emirates

Financial Statements

Income statement for the year ended 31 December 2017

	Notes	2017 AED000	2016 AED000
Interest income	5	**3,066,636**	3,005,628
Interest expense	5	**(511,857)**	(487,695)
Net interest income		**2,554,779**	2,517,933
Fee income	6	**1,481,594**	1,447,868
Fee expense	6	**(304,536)**	(185,826)
Net fee income		**1,177,058**	1,262,042
Trading income excluding net interest income		**637,110**	759,851
Net interest expense on trading activities		**(70,424)**	(70,627)
Net trading income		**566,686**	689,224
Net income/(expense) from financial instruments designated at fair value	4	**18,321**	(767)
Gains less losses from financial investments		**(7,858)**	5,497
Other operating income	7	**377,863**	284,336
Net operating income before loan impairment charges and other credit risk provisions		**4,686,849**	4,758,265
Loan impairment charges and other credit risk provisions	8	**(414,326)**	(435,405)
Net operating income		**4,272,523**	4,322,860
Employee compensation and benefits	9	**(1,529,562)**	(1,522,475)
General and administrative expenses		**(1,001,824)**	(845,616)
Depreciation and impairment of property, plant and equipment	20	**(33,272)**	(29,472)
Amortisation and impairment of intangible assets	19	**(19,550)**	(20,049)
Total operating expenses		**(2,584,208)**	(2,417,612)
Profit before tax		**1,688,315**	1,905,248
Tax expense	11	**(268,216)**	(343,384)
Profit for the year		**1,420,099**	1,561,864

The accompanying notes on pages 11 to 68 form an integral part of these financial statements.

Financial Statements (continued)

Statement of comprehensive income for the year ended 31 December 2017

	2017	2016
	AED000	AED000
Profit for the year	**1,420,099**	1,561,864
Other comprehensive income/(expense)		
Items that will be reclassified subsequently to profit or loss when specific conditions are met:		
Available-for-sale investments	**(1,664)**	(4,799)
– fair value losses	**(4,704)**	(6,121)
– others	**2,855**	789
– income taxes	**185**	533
Cash flow hedges	**(14,682)**	18,464
– fair value (losses)/gains	**(16,313)**	20,515
– income taxes	**1,631**	(2,051)
Items that will not be reclassified subsequently to profit or loss:		
Re-measurement of defined benefit asset/liability	**(60,021)**	(315)
– before income taxes (Note 9)	**(60,021)**	(315)
Changes in fair value of financial liabilities designated at fair value due to movement in own credit risk	**(13,137)**	-
– before income taxes	**(13,137)**	-
Total comprehensive income for the year	**1,330,595**	1,575,214

The accompanying notes on pages 11 to 68 form an integral part of these financial statements.

Financial Statements (continued)

Statement of financial position at 31 December 2017

	Notes	2017 AED000	2016 AED000
Assets			
Cash and balances at central bank	*13*	**7,098,868**	8,109,427
Trading assets	*16*	**1,618,520**	624,212
Derivatives	*17*	**3,278,003**	4,558,739
Loans and advances to banks	*14*	**14,023,961**	15,472,758
Loans and advances to customers	*15*	**54,824,297**	62,933,189
Reverse repurchase agreements – non-trading		**5,095,730**	3,859,692
Financial investments	*18*	**16,428,916**	16,110,930
Other assets	*21*	**1,536,965**	1,389,784
Intangible assets	*19*	**35,283**	45,842
Property, plant and equipment	*20*	**110,725**	147,613
Deferred tax assets	*22*	**702,702**	720,839
Total assets		**104,753,970**	113,973,025
Liabilities and equity			
Liabilities			
Deposits by banks		**8,498,803**	14,591,570
Customer accounts	*23*	**61,334,342**	60,867,651
Trading liabilities	*24*	**4,811,443**	5,496,794
Financial liabilities designated at fair value	*25*	**2,716,091**	1,475,028
Derivatives	*17*	**3,235,496**	4,896,867
Debt securities in issue	*26*	**3,825,214**	5,139,667
Subordinated liabilities	*33*	**2,756,823**	2,757,742
Other liabilities	*27*	**3,819,778**	3,878,369
Current tax liabilities		**282,862**	371,542
Accruals and deferred income		**490,042**	440,701
Provisions for liabilities & charges	*28*	**790,417**	573,915
Total liabilities		**92,561,311**	100,489,846
Head Office funds			
Allocated capital		**4,495,255**	4,495,255
Legal reserves		**2,050,128**	1,908,118
Other reserves		**(318,629)**	(218,407)
Retained earnings		**5,965,905**	7,298,213
Total Head Office funds		**12,192,659**	13,483,179
Total Head Office funds and liabilities		**104,753,970**	113,973,025

The accompanying notes on pages 11 to 68 form an integral part of these financial statements.

Abdulfattah Sharaf
Chief Executive Officer - UAE

20 MAR 2018

Financial Statements (continued)

Statement of cash flows for the year ended 31 December 2017

	Note	2017 AED000	2016 AED000
Cash flows from operating activities			
Profit before tax		**1,688,315**	1,905,248
Adjustments for:			
– Provision for liabilities and charges		**230,849**	130,909
– Allowance for impairment losses		**414,326**	435,405
– Depreciation and amortisation		**52,822**	49,521
– Share based payment expense including options		**33,015**	40,401
– Fair value movement on own debt		**(18,321)**	767
– Loss/(gain) on investment in shares		**7,858**	(5,497)
– (Gain) on derecognition of associate		**-**	(6,620)
– (Gain)/loss on disposal of property and equipment		**(65,362)**	375
Net cash generated before changes in operating assets / liabilities		**2,343,502**	2,550,509
– Change in loans and advances to banks and reverse repurchase agreements – non-trading		**(3,170,353)**	(848,662)
– Change in loans and advances to customers		**7,694,566**	4,492,620
– Change in other assets and derivatives		**1,118,869**	(653,609)
– Change in deposits by banks		**(6,092,768)**	1,972,288
– Change in customer accounts		**466,691**	(6,299,428)
– Change in other liabilities, accruals and deferred income and derivatives		**(1,748,293)**	434,599
– Retirement benefits and other charges paid		**(59,945)**	(76,077)
– Tax paid		**(336,943)**	(303,139)
Net cash generated from/(absorbed in) operating activities		**215,326**	1,269,101
Cash flows from investing activities			
– Purchase of financial assets and liabilities classified as fair value through profit and loss (net)		**(420,275)**	(1,348,864)
– Outflow from increase in investment in associate		**-**	283,691
– Purchase of available-for-sale investments (net)		**(1,318,347)**	(3,717,882)
– Purchase of property and equipment and intangible assets		**(45,500)**	(55,932)
– Sale of property and equipment and intangible assets		**105,488**	975
Net cash (absorbed in)/generated from investing activities		**(1,678,634)**	(4,838,012)
Cash flows from financing activities			
– Debt securities (repaid) (net)		**(1,315,372)**	(503,754)
– Dividend paid to Head Office		**(2,605,830)**	-
Net cash used in financing activities		**(3,921,202)**	(503,754)
Net (decrease) in cash and cash equivalents		**(5,384,510)**	(4,072,665)
Cash and cash equivalents as at 1 January		**26,123,062**	30,195,727
Cash and cash equivalents as at 31 December	*34*	**20,738,552**	26,123,062

The accompanying notes on pages 11 to 68 form an integral part of these financial statements.

Financial Statements (continued)

Statement of changes in equity for the year ended 31 December 2017

	2017							
			Other reserves					
	Allocated capital AED000	Legal Reserve AED000	Available-for-sale fair value reserve AED000	Cash flow hedging reserve AED000	Actuarial gains/(losses) reserve AED000	Other reserve AED000	Unremitted profits AED000	Total Head Office funds AED000
At 1 January 2017	**4,495,255**	**1,908,118**	**(12,841)**	**(12,329)**	**(233,627)**	**40,390**	**7,298,213**	**13,483,179**
Profit for the year	**-**	**-**	**-**	**-**	**-**	**-**	**1,420,099**	**1,420,099**
Other comprehensive income (net of tax)								
Available-for-sale investments	**-**	**-**	**(1,664)**	**-**	**-**	**-**	**-**	**(1,664)**
Cash flow hedges	**-**	**-**	**-**	**(14,682)**	**-**	**-**	**-**	**(14,682)**
Changes in fair value of financial liabilities designated at fair value due to movement in own credit risk	**-**	**-**	**-**	**-**	**-**	**(13,137)**	**-**	**(13,137)**
Actuarial losses on defined benefit plans	**-**	**-**	**-**	**-**	**(60,021)**	**-**	**-**	**(60,021)**
Total comprehensive income for the year	**-**	**-**	**(1,664)**	**(14,682)**	**(60,021)**	**(13,137)**	**-**	**(89,504)**
Transfer of profits to Head Office	**-**	**-**	**-**	**-**	**-**	**-**	**(2,605,830)**	**(2,605,830)**
Other movements	**-**	**142,010**	**-**	**-**	**-**	**(10,718)**	**(146,577)**	**(15,285)**
At 31 December 2017	**4,495,255**	**2,050,128**	**(14,505)**	**(27,011)**	**(293,648)**	**16,535**	**5,965,905**	**12,192,659**

The accompanying notes on pages 11 to 68 form an integral part of these financial statements.

Financial Statements (continued)

Statement of changes in equity for the year ended 31 December 2016

	2016							
			Other reserves					
	Allocated capital AED000	Legal Reserve AED000	Available-for-sale fair value reserve AED000	Cash flow hedging reserve AED000	Actuarial gains/(losses) reserve AED000	Other reserve AED000	Unremitted profits AED000	Total Head Office funds AED000
At 1 January 2016	4,495,255	1,751,932	(8,042)	(30,793)	(233,312)	26,342	5,872,034	11,873,416
Profit for the year	-	-	-	-	-	-	1,561,864	1,561,864
Other comprehensive income (net of tax)								
Available-for-sale investments	-	-	(4,799)	-	-	-	-	(4,799)
Cash flow hedges	-	-	-	18,464	-	-	-	18,464
Actuarial losses on defined benefit plans	-	-	-	-	(315)	-	-	(315)
Total comprehensive income for the year	-	-	(4,799)	18,464	(315)	-	-	13,350
Transfer of profits to Head Office	-	-	-	-	-	-	-	-
Other movements	-	156,186	-	-	-	14,048	(135,685)	34,549
At 31 December 2016	4,495,255	1,908,118	(12,841)	(12,329)	(233,627)	40,390	7,298,213	13,483,179

The accompanying notes on pages 11 to 68 form an integral part of these financial statements.

Notes on the Financial Statements

1 Legal status and principal activities

HSBC Bank Middle East Limited – United Arab Emirates ('UAE') Operations ('the Bank') is a branch of HSBC Bank Middle East Limited ('HBME'). HBME has its place of incorporation and head office in Dubai International Financial Centre ('DIFC'), in the United Arab Emirates, under a category 1 licence issued by the Dubai Financial Services Authority ('DFSA').

The immediate parent company of HBME is HSBC Middle East Holdings BV and the ultimate parent company of the Bank is HSBC Holdings plc, which is incorporated in England.

The Bank is regulated by the Central Bank of the UAE ('UAECB').

The principal activity of the Bank is to offer a comprehensive range of financial services to personal, commercial, corporate and institutional clients, which are carried out from it's branches as follows:

Abu Dhabi	Bur Dubai	Deira
Jumeirah	Jebel Ali	Sharjah
Ras Al Khaimah	Fujairah	

2 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB') as well as interpretations issued by the IFRS Interpretations Committee ('IFRS IC').

Standards adopted during the year ended 31 December 2017

The Bank has adopted the requirements of IFRS 9 'Financial Instruments' relating to the presentation of gains and losses on financial liabilities designated at fair value from 1 January 2017 in the financial statements. As a result, the effects of changes in those liabilities' credit risk is presented in other comprehensive income with the remaining effect presented in profit or loss. As permitted by the transitional requirements of IFRS 9, comparatives have not been restated. Adoption increased profit after tax by AED 13m with the opposite effect on other comprehensive income and no effect on net assets.

There were no other new standards applied in 2017. However, during 2017, the Bank adopted a number of interpretations and amendments to standards which had an insignificant effect on the financial statements of the Bank.

Future accounting developments

Minor amendments to IFRSs

The IASB has published a number of minor amendments to IFRSs in its 'Annual Improvements to IFRSs 2014-2016' and in a series of stand-alone amendments which are effective from 1 January 2018. The Bank expects they will have an insignificant effect, when adopted, on the financial statements of the Bank. The Bank has not early adopted any of the amendments effective after 31 December 2017.

Major new IFRSs

The IASB has published IFRS 9 'Financial Instruments', IFRS 15 'Revenue from Contracts with Customers', IFRS 16 'Leases' and IFRS 17 'Insurance contracts'.

IFRS 9 'Financial Instruments'

In July 2014, the IASB issued IFRS 9 'Financial Instruments', which is the comprehensive standard to replace IAS 39 'Financial Instruments: Recognition and Measurement', and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

Notes to the Financial Statements (continued)

Classification and measurement

The classification and measurement of financial assets will depend on how these are managed (the entity's business model) and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income ('FVOCI') or fair value through profit or loss ('FVPL'). The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of financial assets measured at amortised cost or fair value compared with IAS 39. In addition, on transition to IFRS 9 entities are required to revoke previous designations of financial assets and financial liabilities measured at fair value through profit or loss where the accounting mismatch no longer exists and are permitted to revoke such designations where accounting mismatches continue to exist.

Impairment

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, lease receivables and certain loan commitments and financial guarantee contracts. At initial recognition, an impairment allowance (or provision in the case of commitments and guarantees) is required for expected credit losses ('ECL') resulting from default events that are possible within the next 12 months ('12-month ECL'). In the event of a significant increase in credit risk, an allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are 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'.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under IAS 39 and the resulting impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks, but do not explicitly address macro hedge accounting strategies, which are particularly important for banks. As a result, IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting.

Transition

The requirements of IFRS 9 'Financial Instruments' will be adopted from 1 January 2018. IFRS 9 includes an accounting policy choice to continue IAS 39 hedge accounting, which the Bank has exercised, although it will implement the revised hedge accounting disclosures required by the related amendments to IFRS 7 'Financial Instruments: Disclosures'. The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The Bank does not intend to restate comparatives. For the financial statements of the Bank, adoption is expected to reduce net assets as at 1 January 2018 by AED 198m due to impairment reducing net assets by AED 235m, net of deferred tax of AED 37m. In addition, in line with the requirements of the UAECB, an impairment reserve of AED 497m is expected to be created. This impairment reserve will be created in relation to the difference between the IFRS 9 model ECLs for Stages 1 and 2 and the minimum general provision requirements of the UAECB as an appropriation of retained earnings and is not distributable. The IFRS 9 model ECLs for Stage 3 are above the minimum requirements of the UAECB and no impairment reserve is required.

IFRS 15 'Revenue from Contracts with Customers'

In May 2014, the IASB issued IFRS 15 'Revenue from Contracts with Customers' and it is effective for annual periods beginning on or after 1 January 2018. IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for performance obligations as they are satisfied. The Bank will adopt the standard on its mandatory effective date, and the standard will be applied on a modified retrospective basis, recognising the cumulative effect, if any, of initially applying the standard as an adjustment to the opening balance of retained earnings. The Bank has assessed the impact of IFRS 15 and expects that the standard will have no significant effect, when applied, on the financial statements of the Bank.

Notes to the Financial Statements (continued)

IFRS 16 'Leases'

In January 2016, the IASB issued IFRS 16 'Leases' with an effective date of annual periods beginning on or after 1 January 2019. IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under IAS 17 'Leases'. Lessees will recognise a 'right of use' asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as in IAS 17. The Bank is currently assessing the impact of IFRS 16 and it is not practicable to quantify the effect as at the date of the publication of these financial statements. Existing operating lease commitments are set out in Note 37.

IFRS 17 'Insurance contracts'

IFRS 17 'Insurance contracts' was issued in May 2017, and sets out the requirements that an entity should apply in accounting for insurance contracts it issues and reinsurance contracts it holds. IFRS 17 is effective from 1 January 2021. The Bank has assessed the impact of IFRS 17 and expects that the standard will have no significant effect, when applied, on the financial statements of the Bank.

(b) Functional Currency

The functional currency of the Bank is United Arab Emirates Dirham ('AED'), which is also the presentation currency of the financial statements of the Bank. The AED is also the Bank's functional currency because the AED is the most significant currency relevant to the underlying transactions, and represents a significant proportion of its funds generated from operating activities.

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange at the balance sheet date. Any resulting exchange differences are included in the income statement. Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Any exchange component of a gain or loss on a non-monetary item is recognised either in other comprehensive income or in the income statement depending where the gain or loss on the underlying non-monetary item is recognised.

(c) Critical accounting estimates and judgements

The preparation of financial information requires the use of estimates and judgements about future conditions. In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of items highlighted as the critical accounting estimates and judgements in section 3 below, it is possible that the outcomes in the next financial year 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 2017 Financial Statements. Management's selection of the Bank's accounting policies which contain critical estimates and judgements reflects the materiality of the items to which the policies are applied and the high degree of judgement and estimation uncertainty involved.

3 Summary of significant accounting policies

(a) Interest income and expense

Interest income and expense for all financial instruments except for those classified as held-for-trading or designated at fair value (other than debt securities issued by the Bank and derivatives managed in conjunction with such debt securities issued) are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

Notes to the Financial Statements (continued)

(b) Non-interest income and expense

Fee income is earned from a diverse range of services provided by the Bank to its customers. Fee income is accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as an arrangement for the acquisition of shares or other securities);
- income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees); and
- income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and recorded in 'Interest income' (Note 5).

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with related interest income, expense and dividends.

Net income/expense from financial instruments designated at fair value includes all gains and losses from changes in the fair value of financial assets and liabilities designated at fair value through profit or loss, including derivatives that are managed in conjunction with those financial assets and liabilities, and liabilities under investment contracts. Interest income, interest expense and dividend income in respect of those financial instruments are also included, except for interest arising from debt securities issued by the Bank and derivatives managed in conjunction with those debt securities, which is recognised in 'Interest expense'.

(c) Valuation of financial instruments

All financial instruments are recognised initially at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is the transaction price (that is, the fair value of the consideration given or received). In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Bank recognises a trading gain or loss on inception of the financial instrument, being the difference between the transaction price and the fair value. When unobservable market data have a significant impact on the valuation of financial instruments, the entire initial difference in fair value from the transaction price as indicated by the valuation model from the transaction price is not recognised immediately in the income statement. Instead, it is recognised over the life of the transaction on an appropriate basis, or when the inputs become observable, or the transaction matures or is closed out, or when the Bank enters into an offsetting transaction.

The fair value of financial instruments is generally measured on an individual basis. However, in cases where the Bank manages a group of financial assets and liabilities according to its net market or credit risk exposure, the Bank measures the fair value of the group of financial instruments on a net basis but presents the underlying financial assets and liabilities separately in the financial statements, unless they satisfy the IFRS offsetting criteria.

Critical accounting estimates and judgements

The majority of valuation techniques employ only observable market data. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, where the measurement of fair value is more judgemental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's inception profit or greater than 5% of the instrument's valuation is driven by unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

Subsequent to initial recognition, the fair values of financial instruments measured at fair value are determined in accordance with the Bank's valuation methodology which is described in Note 29.

(d) Joint arrangements

A joint arrangement is an investment in which the Bank, together with one or more parties, has joint control. Depending on the Bank's rights and obligations, the joint arrangement is classified as either a joint operation or a joint venture. The Bank classifies investments in entities over which it has significant influence, and that are neither subsidiaries nor joint arrangements, as associates. The Bank recognises its share of the assets, liabilities and results in a joint operation.

Notes to the Financial Statements (continued)

(e) Financial instruments measured at amortised cost

These include loans and advances originated by the Bank, not classified as held for trading or designated at fair value. They are recognised when cash is advanced to a borrower and are derecognised when either the borrower repays its obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment allowance.

The Bank may commit to underwrite 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, a provision on the loan commitment is only recorded where it is probable that the Bank will incur a loss.

Impairment of loans and advances

Losses for impaired loans are recognised when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Losses which may arise from future events are not recognised.

Individually assessed loans and advances

The factors considered in determining whether a loan is individually significant for the purposes of assessing impairment include the size of the loan, the number of loans in the portfolio, the importance of the individual loan relationship and how this is managed. Loans that are determined to be individually significant will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective methodology.

Loans considered as individually significant are typically to corporate and commercial customers, are for larger amounts and are managed on an individual basis. For these loans, the Bank considers on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired.

The determination of the realisable value of security is based on the most recently updated market value at the time the impairment assessment is performed. The value is not adjusted for expected future changes in market prices, though adjustments are made to reflect local conditions such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which include expected future receipts of contractual interest, at the loan’s original effective interest rate or an approximation thereof, and comparing the resultant present value with the loan’s current carrying amount.

Collectively assessed loans and advances

Impairment is assessed collectively to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment or for homogeneous groups of loans that are not considered individually significant, generally retail lending portfolios.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for a collective impairment assessment. This assessment captures impairment losses that the Bank has incurred as a result of events occurring before the balance sheet date which the Bank is not able to identify on an individual loan basis, and that can be reliably estimated. When information becomes available which identifies losses on individual loans within a group, those loans are removed from the group and assessed individually.

Notes to the Financial Statements (continued)

Homogeneous groups of loans and advances

Statistical methods are used to determine collective impairment losses for homogeneous groups of loans not considered individually significant. The methods that are used to calculate collective allowances are:

– When appropriate empirical information is available, the Bank utilises roll-rate methodology, which employs statistical analyses of historical data and experience of delinquency and default to reliably estimate the amount of loans that will eventually be written off as a result of the events occurring before the balance sheet date and which the Bank is not able to identify individually. Individual loans are grouped using ranges of past due days; statistical analysis is then used to estimate the likelihood that loans in each range will progress through the various stages of delinquency and become irrecoverable. Additionally, individual loans are segmented based on their credit characteristics as described above. In applying this methodology, adjustments are made to estimate the periods of time between a loss event occurring and its discovery, for example through a missed payment, (known as the emergence period) and the period of time between discovery and write-off (known as the outcome period). Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss.

– When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, the Bank adopts a basic formulaic approach based on historical loss rate experience, or a discounted cash flow model. Where a basic formulaic approach is undertaken, the period between a loss event occurring and its identification is explicitly estimated by local management, and is typically between six and 12 months.

Write-off of loans and advances

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

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognised in the income statement.

Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as up to date loans for measurement purposes once a minimum number of payments required have been received. Where collectively assessed loan portfolios include significant levels of renegotiated loans, these loans are segregated from other parts of the loan portfolio for the purposes of collective impairment assessment to reflect their risk profile. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired. The carrying amounts of loans that have been classified as renegotiated retain this classification until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms or if the terms of an existing agreement are modified such that the renegotiated loan is substantially a different financial instrument. Any new loans that arise following derecognition events will continue to be disclosed as renegotiated loans and are assessed for impairment as above.

Critical accounting estimates and judgements

Loan impairment allowances represent management's best estimate of losses incurred in the loan portfolios at the balance sheet date. Management is required to exercise judgement in making assumptions and estimates when calculating loan impairment allowances on both individually and collectively assessed loans and advances.

Collective impairment allowances are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan basis due to the large number of individually insignificant loans in the portfolio. The estimation methods include the use of statistical analyses of historical information, supplemented with significant management judgement, to assess whether current economic and credit conditions are such that the actual level of incurred losses is likely to be greater or less than historical experience. Where changes in economic, regulatory or behavioural conditions result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models, risk factors are taken into account by adjusting the impairment allowances derived solely from historical loss experience.

Notes to the Financial Statements (continued)

For individually assessed loans, judgement is required in determining whether there is objective evidence that a loss event has occurred and, if so, the measurement of the impairment allowance. In determining whether there is objective evidence that a loss event has occurred, judgement is exercised in evaluating all relevant information on indicators of impairment, including the consideration of whether payments are contractually past-due and the consideration of other factors indicating deterioration in the financial condition and outlook of borrowers affecting their ability to pay.

Non-trading reverse repurchase and repurchase agreements

When securities are sold subject to a commitment to repurchase them at a predetermined price ('repos'), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to resell ('reverse repos') are not recognised on the balance sheet and an asset is recorded in respect of the initial consideration paid. Non-trading repos and reverse repos are measured at amortised cost. The difference between the sale and repurchase price or between the purchase and resale price is treated as interest and recognised in net interest income over the life of the agreement.

(f) Financial instruments measured at fair value

Available-for-sale financial assets

Available-for-sale financial assets are recognised on the trade date when the Bank enters into contractual arrangements to purchase those instruments, and are normally derecognised when either the securities are sold or redeemed. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income until the assets are either sold or become impaired. Upon disposal, the cumulative gains or losses in other comprehensive income are recognised in the income statement as 'Gains less losses from financial investments'.

Impairment of available-for-sale financial assets

Available-for-sale financial assets are assessed at each balance sheet date for objective evidence of impairment. Impairment losses are recognised in the income statement within 'Loan impairment charges and other credit risk provisions' for debt instruments.

Available-for-sale debt securities

In assessing objective evidence of impairment at the reporting date, the Bank considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in the recovery of future cash flows. A subsequent decline in the fair value of the instrument is recognised in the income statement when there is objective evidence of impairment as a result of decreases in the estimated future cash flows. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, or the instrument is no longer impaired, the impairment loss is reversed through the income statement.

Financial instruments designated at fair value

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated irrevocably at inception:

– the use of the designation removes or significantly reduces an accounting mismatch;
– when a group of financial assets, liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; and
– where financial instruments contain one or more non-closely related embedded derivatives.

Under this criterion, the main classes of financial instruments designated by the Bank are:

Long-term debt issues

The interest and/or foreign exchange exposure on certain fixed rate debt securities issued has been matched with the interest and/or foreign exchange exposure on certain swaps as part of a documented risk management strategy.

Financial assets and financial liabilities under unit-linked and non-linked investment contracts

A contract under which the Bank does not accept significant insurance risk from another party is not classified as an insurance contract, but is accounted for as a financial liability. Liabilities are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices. Premiums receivable and amounts withdrawn are accounted for as increases or decreases in the liability recorded in respect of investment contracts. The incremental costs directly related to the acquisition of new investment contracts or renewing existing investment contracts are deferred and amortised over the period during which the investment management services are provided.

Notes to the Financial Statements (continued)

Designated financial assets are recognised when the Bank enters into contracts with counterparties, which are generally on trade date, and are normally derecognised when the rights to the cash flows expire or are transferred. Designated financial liabilities are recognised when the Bank enters into contracts with counterparties, which is generally on settlement date, and are normally derecognised when extinguished. Subsequent changes in fair values are recognised in the income statement in 'Net income from financial instruments designated at fair value'.

Derivatives

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, interest rates or other indices. Derivatives are recognised initially and are subsequently measured at fair value. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative, this includes embedded derivatives which are bifurcated from the host contract when they meet the definition of a derivative on a standalone basis.

Gains and losses from changes in the fair value of derivatives that do not qualify for hedge accounting are reported in 'Net trading income'. Gains and losses on derivatives managed in conjunction with financial instruments designated at fair value are reported in 'Net income from financial instruments designated at fair value' together with the gains and losses on the economically hedged items. Where the derivatives are managed with debt securities issued by the Bank that are designated at fair value, the contractual interest is shown in 'Interest expense' together with the interest payable on the issued debt.

Hedge accounting

When derivatives are held for risk management purposes they are designated in hedge relationships where the required criteria for documentation and hedge effectiveness are met. The Bank enters into fair value hedges or cash flow hedges as appropriate to the risk being hedged.

Fair value hedge

Changes in the fair value of derivatives are recorded in the income statement, along with changes in the fair value of the hedged assets or liabilities attributable to the hedged risk. If a hedge relationship no longer meets the criteria for hedge accounting, hedge accounting is discontinued; the cumulative adjustment to the carrying amount of the hedged item is amortised to the income statement on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised, in which case it is recognised in the income statement immediately.

Cash flow hedge

The effective portion of changes in the fair value of derivatives is recognised in other comprehensive income; the ineffective portion of the change in fair value is recognised immediately in the income statement within 'Net trading income'. The accumulated gains and losses recognised in other comprehensive income are reclassified to the income statement in the same periods in which the hedged item affects profit or loss. In hedges of forecast transactions that result in recognition of a non-financial asset or liability, previous gains and losses recognised in other comprehensive income are included in the initial measurement of the asset or liability. When a hedge relationship is discontinued, any cumulative gain or loss recognised in other comprehensive income remains in equity until the forecast transaction is recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss previously recognised in other comprehensive income is immediately reclassified to the income statement.

Derivatives that do not qualify for hedge accounting

Non-qualifying hedges are derivatives entered into as economic hedges of assets and liabilities for which hedge accounting was not applied.

(g) Employee compensation and benefits

Share-based payments

Shares in HSBC Holdings plc are awarded to employees in certain cases. Equity-settled share-based payment arrangements entitle employees to receive equity instruments of HSBC.

The vesting period for these schemes may commence before the grant date if the employees have started to render services in respect of the award before the grant date. Expenses are recognised when the employee starts to render service to which the award relates.

Notes to the Financial Statements (continued)

Cancellations result from the failure to meet a non-vesting condition during the vesting period, and are treated as an acceleration of vesting recognised immediately in the income statement. Failure to meet a vesting condition by the employee is not treated as a cancellation, and the amount of expense recognised for the award is adjusted to reflect the number of awards expected to vest.

Pension and post-employment benefit plans

The Bank contributes to the UAE Nationals Pension and Social Security Scheme as per the requirements of the Government of the United Arab Emirates.

For locally recruited employees (non UAE Nationals), end of service benefits are calculated and paid in accordance with the UAE Federal Labour Law. The Bank's net obligation in respect of such end of service benefits is the amount of future benefits that employees have earned in return for their service in current and prior periods.

Defined benefit pension obligations are calculated using the projected unit credit method. The net charge to the income statement mainly comprises the service cost and the net interest on the net defined benefit asset or liability, and is presented in operating expenses.

Re-measurements of the net defined benefit asset or liability, which comprise actuarial gains and losses, return on plan assets excluding interest and the effect of the asset ceiling (if any, excluding interest), are recognised immediately in other comprehensive income. The net defined benefit asset or liability represents the present value of defined benefit obligations reduced by the fair value of plan assets, after applying the asset ceiling test, where the net defined benefit surplus is limited to the present value of available refunds and reductions in future contributions to the plan.

The cost of obligations arising from other post-employment plans are accounted for on the same basis as defined benefit pension plans.

The Bank also makes contributions to the HSBC International Staff Retirement Benefit Scheme in respect of a small number of International Managers being seconded to the Bank by the HSBC Group. The Bank accounts for contributions to this scheme as if it is a defined contribution scheme on the basis that any actuarial gains and losses would not be material.

(h) Tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in the same statement in which the related item appears.

Current tax is the tax expected to be payable on the taxable profit for the year and any adjustment to tax payable in respect of previous years. The Bank provides for potential current tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled.

Current and deferred tax is calculated based on tax rates and laws enacted, or substantively enacted, by the balance sheet date.

Critical accounting estimates and judgements

The recognition of a deferred tax asset relies on an assessment of the probability and sufficiency of future taxable profits, future reversals of existing taxable temporary differences and ongoing tax planning strategies. In the absence of a history of taxable profits, the most significant judgements relate to expected future profitability and to the applicability of tax planning strategies.

(i) Debt securities issued

Financial liabilities for debt securities issued are recognised when the Bank enters into contractual arrangements with counterparties and are initially measured at fair value, which is normally the consideration received, net of directly attributable transaction costs incurred. Subsequent measurement of financial liabilities, other than those measured at fair value through profit or loss and financial guarantees, is at amortised cost, using the effective interest method to amortise the difference between proceeds received, net of directly attributable transaction costs incurred, and the redemption amount over the expected life.

Notes to the Financial Statements (continued)

(j) Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation which has arisen as a result of past events and for which a reliable estimate can be made.

Critical accounting estimates and judgements

Judgement is involved in determining whether a present obligation exists and in estimating the probability, timing and amount of any outflows. Professional expert advice is taken on the assessment of litigation, property (including onerous contracts) and similar obligations. Provisions for legal proceedings and regulatory matters typically require a higher degree of judgement than other types of provisions. When matters are at an early stage, accounting judgements can be difficult because of the high degree of uncertainty associated with determining whether a present obligation exists, and estimating the probability and amount of any outflows that may arise. As matters progress, management and legal advisers evaluate on an ongoing basis whether provisions should be recognised, revising previous judgements and estimates as appropriate. At more advanced stages, it is typically easier to make judgements and estimates around a better defined set of possible outcomes. However, the amount provisioned can remain very sensitive to the assumptions used. There could be a wide range of possible outcomes for any pending legal proceedings, investigations or inquiries. As a result, it is often not practicable to quantify a range of possible outcomes for individual matters. It is also not practicable to meaningfully quantify ranges of potential outcomes in aggregate for these types of provisions because of the diverse nature and circumstances of such matters and the wide range of uncertainties involved. Provisions for customer remediation also require significant levels of estimation and judgement. The amounts of provisions recognised depend on a number of different assumptions, such as the volume of inbound complaints, the projected period of inbound complaint volumes, the decay rate of complaint volumes, the population identified as systemically mis-sold and the number of policies per customer complaint.

(k) Contingent liabilities, contractual commitments and guarantees

Contingent liabilities

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security and contingent liabilities related to legal proceedings or regulatory matters, are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

Financial guarantee contracts

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received or receivable.

(l) Acceptances and endorsements

Acceptances arise when the Bank is under an obligation to make payments against documents drawn under letters of credit. Acceptances specify the amount of money, the date, and the person to which the payment is due. After acceptance, the instrument becomes an unconditional liability (time draft) of the Bank and is therefore recognised as a financial liability with a corresponding contractual right of reimbursement from the customer recognised as a financial asset.

4 Net income/(expense) from financial instruments designated at fair value

Net income/(expense) from financial instruments designated at fair value includes all gains and losses from changes in the fair value of financial assets and liabilities designated at fair value through profit or loss, including derivatives that are managed in conjunction with those financial assets and liabilities, and liabilities under investment contracts. Interest income, interest expense and dividend income in respect of those financial instruments are also included, except for interest arising from debt securities issued by the Bank and derivatives managed in conjunction with those debt securities, which is recognised in 'Interest expense'.

	2017	2016
	AED000	AED000
Net income/(expense) arising on:		
changes in own credit spread on long-term debt	**-**	(185)
other changes in fair value	**18,321**	(582)
Net income/(expense) from instruments designated at fair value	**18,321**	(767)

Notes to the Financial Statements (continued)

5 Interest income and expense

	2017 AED000	2016 AED000
Interest income		
Loans and advances to banks	**218,203**	198,953
Loans and advances to customers	**2,611,994**	2,643,128
Investments	**95,361**	88,811
Others	**141,078**	74,736
Total interest income	**3,066,636**	3,005,628

	2017 AED000	2016 AED000
Interest expense		
Deposits by banks	**(290,557)**	(292,161)
Customer accounts	**(118,091)**	(70,641)
Debt issued	**(103,209)**	(124,893)
Total interest expense	**(511,857)**	(487,695)
Net interest income	**2,554,779**	2,517,933

6 Fee income and expense

	2017 AED000	2016 AED000
Fee income		
Personal banking fees	**529,762**	471,979
Corporate banking fees	**338,517**	446,598
Investment banking fees	**613,315**	529,291
Total	**1,481,594**	1,447,868
Fee expense		
Personal banking fees	**(202,916)**	(106,055)
Corporate banking fees	**(18,972)**	(21,852)
Investment banking fees	**(82,648)**	(57,919)
Total	**(304,536)**	(185,826)
Net fee income	**1,177,058**	1,262,042

7 Other operating income

	2017 AED000	2016 AED000
Recovery of operational/support cost from other HSBC Group entities (refer Note 40)	**309,970**	287,827
Gain/(loss) on disposal of property plant and equipment	**65,362**	(375)
Others	**2,531**	(3,116)
Total	**377,863**	284,336

8 Loan impairment charges and other credit risk provisions

	2017 AED000	2016 AED000
Net impairment charge on loans and advances to customers	**(387,362)**	(423,099)
Net impairment (charge)/release in respect of other credit risk	**(26,964)**	(12,306)
Total	**(414,326)**	(435,405)

Notes to the Financial Statements (continued)

9 Employee compensation and benefits

	2017	2016
	AED000	AED000
Wages and salaries	**(1,046,978)**	(1,037,408)
Social security costs	**(11,106)**	(10,748)
Post-employment benefits	**(75,455)**	(81,818)
Others	**(396,023)**	(392,501)
Total	**(1,529,562)**	(1,522,475)

Post-employment benefit plans

Income statement charge in respect of defined benefit plans

	2017	2016
	AED000	AED000
Defined benefit pension plans	**(73,572)**	(78,772)

Net liabilities recognised on balance sheet in respect of defined benefit plans

	2017	2016
	AED000	AED000
Defined benefit pension plans	**592,535**	488,402

Defined benefit pension plans

Arrangements for staff retirement benefits are made in accordance with local regulations and custom. The staff indemnity schemes for local staff include gratuity schemes.

The schemes are reviewed at least annually or in accordance with local practice and regulations by qualified actuaries. The actuarial assumptions used to calculate the scheme obligations vary according to the economic conditions.

	2017	2016
Present value of defined benefit obligations	**AED000**	AED000
At 1 January	**488,402**	457,008
Current service cost	**64,482**	70,144
Other movements	**7,320**	1,923
Interest cost	**9,090**	8,628
Actuarial losses	**60,021**	315
Benefits paid	**(36,780)**	(49,616)
Net liability	**592,535**	488,402

Total expense recognised in the income statement in 'Employee compensation and benefits'

	2017	2016
	AED000	AED000
Current service cost	**(64,482)**	(70,144)
Interest cost	**(9,090)**	(8,628)
Total expense	**(73,572)**	(78,772)

Notes to the Financial Statements (continued)

Post-employment defined benefit plans' principal actuarial assumptions

The principal actuarial financial assumptions used to calculate the Bank's obligations under its defined benefit pension plans at 31 December for each year, and used as the basis for measuring periodic costs under the plans in the following years, were as follows:

Principal actuarial assumptions

	Discount rate %	Rate of pay increase %	Combined rate of resignation and employment termination %
At 31 December 2017			
United Arab Emirates	**2.2**	**6.4**	**9.3**
At 31 December 2016			
United Arab Emirates	1.8	5.0	12.3

The Bank determines discount rates to be applied to its obligations in consultation with the plans' local actuaries, on the basis of current average yields of long term, high quality corporate bonds.

The effect of changes in key assumptions on the principal plan

	2017 AED000	2016 AED000
Discount rate		
Change in scheme obligation at year end from a 25bps increase	**(14,924)**	(8,336)
Change in scheme obligation at year end from a 25bps decrease	**9,706**	8,607
Change in following year scheme cost from a 25bps increase	**(633)**	(266)
Change in following year scheme cost from a 25bps decrease	**648**	269
Rate of pay increase		
Change in scheme obligation at year end from a 25bps increase	**(15,019)**	(8,608)
Change in scheme obligation at year end from a 25bps decrease	**9,865**	8,842
Change in following year scheme cost from a 25bps increase	**(2,391)**	(1,636)
Change in following year scheme cost from a 25bps decrease	**2,317**	1,591

10 Share-based payments

Income statement charge

This charge, which was computed from the fair values of the share-based payment transaction when contracted, arose under employee share awards made in accordance with HSBC's reward structures (discussed further below).

The share-based payments charge is recognised in 'Others' within the Employee compensation and benefits (Note 9).

Deferred share awards

These awards are granted to employees after the performance year. These awards confer the right to the employees concerned to own shares of HSBC Holdings plc upon completion of minimum number of years of service from the date of award. Should the employee not satisfy this condition, subject to certain exceptions, the award would lapse.

The following table identifies the charge recognised in the current year, or expected to be recognised in future years, and the performance year to which the deferred awards relate.

Notes to the Financial Statements (continued)

Income statement impact of deferred share awards on current and future years

	Charge recognised in 2017 in respect of performance year:		**Charge expected to be recognised in 2018 or later in respect of performance year:**	
	2017 AED000	**Pre-2017 AED000**	**2017 AED000**	**Pre-2017 AED000**
HSBC deferred share awards	**(6,790)**	**(15,987)**	**(15,440)**	**(12,784)**
	Charge recognised in 2016 in respect of performance year:		Charge expected to be recognised in 2017 or later in respect of performance year:	
	2016 AED000	Pre-2016 AED000	2016 AED000	Pre-2016 AED000
HSBC deferred share awards	(9,155)	(28,665)	(14,408)	(21,672)

'Wages and salaries' include the effect of share-based payments arrangements, all equity settled, as follows:

	2017 AED000	2016 AED000
Restricted share awards	**(32,949)**	(40,357)
Savings-related and other share award option plans	**(66)**	(44)
Year ended 31 Dec	**(33,015)**	(40,401)

HSBC share awards

Award	**Policy**
Restricted share awards (including annual incentive awards delivered in shares) and GPSP	– An assessment of performance over the relevant period ending on 31 December is used to determine the amount of the award to be granted. – Deferred awards generally require employees to remain in employment over the vesting period and are not subject to performance conditions after the grant date. – Deferred share awards generally vest over a period of three years and GPSP awards vest after five years. – Vested shares may be subject to a retention requirement post-vesting. GPSP awards are retained until cessation of employment. – Awards granted from 2010 onwards are subject to a malus provision prior to vesting.

Movement on HSBC share awards

	2017 Number (000's)	2016 Number (000's)
Restricted share awards outstanding at 1 Jan	**2,308**	2,155
Additions during the year	**1,278**	2,529
Released and forfeited in the year	**(1,664)**	(2,376)
Restricted share awards outstanding at 31 Dec	**1,922**	2,308
Weighted average fair value of awards granted (USD)	**6.96**	7.15

Notes to the Financial Statements (continued)

HSBC share option plans

Award	Policy
Savings-related share option plans (‘Sharesave’)	– Exercisable within six months following either the third or fifth anniversaries of the commencement of a three-year or five-year contract, respectively. – The exercise price is set at a 20% (2016: 20%) discount to the market value immediately preceding the date of invitation.

Calculation of fair values

The fair values of share options are calculated using a Black-Scholes model. The fair value of a share award is based on the share price at the date of the grant.

Movement on HSBC share option plans

	Savings-related share option plans	
	Number (000’s)	Weighted average exercise price (USD)
Outstanding at 1 Jan 2017	**80**	**7.21**
Granted during the year	**11**	**7.91**
Exercised during the year	**(21)**	**7.72**
Transferred during the year	**1**	**6.31**
Forfeited, expired and cancelled during the year	**(9)**	**5.93**
Outstanding at 31 Dec 2017	**62**	**7.12**
Weighted average remaining contractual life (years)	**1.86**	
Outstanding at 1 Jan 2016	192	7.41
Granted during the year	2	5.38
Exercised during the year	(34)	7.35
Transferred during the year	22	7.31
Forfeited, expired and cancelled during the year	(102)	5.70
Outstanding at 31 Dec 2016	80	7.21
Weighted average remaining contractual life (years)	1.93	

Notes to the Financial Statements (continued)

11 Tax expense

Current tax	2017 AED000	2016 AED000
Tax – on current year profit	**(249,670)**	(250,087)
Tax – adjustments in respect of prior years	**7,245**	1,356
Deferred tax	**(18,137)**	(87,089)
Other	**(7,654)**	(7,564)
Tax expense	**(268,216)**	(343,384)

Analysis of tax expense

	2017		2016	
	AED000	**%**	AED000	%
Accounting profit	**1,688,315**		1,905,248	
Taxation at UAE corporate tax rate of 20% (2016: 20%)	**(337,663)**	**(20.0)**	(381,049)	(20.0)
Exempt income in respect of Jebel Ali and Ras Al Khaimah branches	**71,816**	**4.3**	48,177	2.5
Expenses not deductible for tax purposes	**(1,960)**	**(0.1)**	(4,304)	(0.2)
Adjustment in respect of prior period liabilities	**7,245**	**0.4**	1,356	0.1
Other	**(7,654)**	**(0.5)**	(7,564)	(0.4)
Overall tax expense	**(268,216)**	**(15.9)**	(343,384)	(18.0)

The tax charge is determined by applying the official tax rate of 20% to the taxable profits arising in the Emirates of Abu Dhabi, Dubai, Sharjah and Fujairah.

Movement of deferred tax assets

	Loan impairment allowances AED000	Other AED000	Total AED000
Assets	**697,518**	**23,321**	**720,839**
At 1 Jan 2017	**697,518**	**23,321**	**720,839**
Income statement	**(19,875)**	**1,738**	**(18,137)**
Foreign exchange and other adjustments	**-**	**-**	**-**
At 31 Dec 2017	**677,643**	**25,059**	**702,702**
Assets			
Assets	755,649	26,568	782,217
At 1 Jan 2016	755,649	26,568	782,217
Income statement	(58,131)	(3,247)	(61,378)
Foreign exchange and other adjustments	-	-	-
At 31 Dec 2016	697,518	23,321	720,839
Assets			

Notes to the Financial Statements (continued)

12 Analysis of financial assets and liabilities by measurement basis

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting policies in Note 3 describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognized. The following table analyses the carrying amounts of the financial assets and liabilities by category as defined in IAS 39 and by balance sheet heading.

	At 31 December 2017					
	Held for trading AED000	Designated at fair value AED000	Available-for-sale securities AED000	Financial assets and liabilities at amortised cost AED000	Derivatives designated as hedging instruments AED000	Total AED000
Financial assets						
Cash and balances at central bank	-	-	-	7,098,868	-	7,098,868
Trading assets	1,618,520	-	-	-	-	1,618,520
Derivatives	3,175,145	-	-	-	102,858	3,278,003
Loans and advances to banks	-	-	-	14,023,961	-	14,023,961
Loans and advances to customers	-	-	-	54,824,297	-	54,824,297
Reverse repurchase agreements – non-trading	-	-	-	5,095,730	-	5,095,730
Financial investments	-	-	16,428,916	-	-	16,428,916
Other assets	-	-	-	1,472,818	-	1,472,818
Total financial assets	4,793,665	-	16,428,916	82,515,674	102,858	103,841,113
Total non-financial assets						912,857
Total assets						104,753,970
Financial liabilities						
Deposits by banks	-	-	-	8,498,803	-	8,498,803
Customer accounts	-	-	-	61,334,342	-	61,334,342
Trading liabilities	4,811,443	-	-	-	-	4,811,443
Financial liabilities designated at fair value	-	2,716,091	-	-	-	2,716,091
Derivatives	3,207,658	-	-	-	27,838	3,235,496
Debt securities in issue	-	-	-	3,825,214	-	3,825,214
Subordinated Liabilities	-	-	-	2,756,823	-	2,756,823
Other liabilities	-	-	-	3,819,778	-	3,819,778
Total financial liabilities	8,019,101	2,716,091	-	80,234,960	27,838	90,997,990
Total non-financial liabilities						1,563,321
Total liabilities						92,561,311

Notes on the Financial Statements (continued)

	At 31 December 2016					
	Held for trading AED000	Designated at fair value AED000	Available-for-sale securities AED000	Financial assets and liabilities at amortised cost AED000	Derivatives designated as hedging instruments AED000	Total AED000
Financial assets						
Cash and balances at central bank	-	-	-	8,109,427	-	8,109,427
Trading assets	624,212	-	-	-	-	624,212
Derivatives	4,415,988	-	-	-	142,751	4,558,739
Loans and advances to banks	-	-	-	15,472,758	-	15,472,758
Loans and advances to customers	-	-	-	62,933,189	-	62,933,189
Reverse repurchase agreements – non-trading	-	-	-	3,859,692	-	3,859,692
Financial investments	-	-	16,110,930	-	-	16,110,930
Other assets	-	-	-	1,389,784	-	1,389,784
Total financial assets	5,040,200	-	16,110,930	91,764,850	142,751	113,058,731
Total non-financial assets						914,294
Total assets						113,973,025
Financial liabilities						
Deposits by banks	-	-	-	14,591,570	-	14,591,570
Customer accounts	-	-	-	60,867,651	-	60,867,651
Trading liabilities	5,496,794	-	-	-	-	5,496,794
Financial liabilities designated at fair value	-	1,475,028	-	-	-	1,475,028
Derivatives	4,326,162	-	-	-	570,704	4,896,866
Subordinated liabilities	-	-	-	2,757,742	-	2,757,742
Debt securities in issue	-	-	-	5,139,667	-	5,139,667
Other liabilities	-	-	-	3,878,369	-	3,878,369
Total financial liabilities	9,822,956	1,475,028	-	87,234,999	570,704	99,103,687
Total non-financial liabilities						1,386,159
Total liabilities						100,489,846

13 Cash and balances at central bank

	2017 AED000	2016 AED000
Cash in hand	**706,313**	636,835
Statutory reserves with central bank	**6,392,555**	7,472,592
	7,098,868	8,109,427

14 Loans and advances to banks

	2017 AED000	2016 AED000
Loans and advances to banks	**14,023,961**	15,472,758

As at 31 December 2017, there were no allowances for impairment losses (2016: Nil).

15 Loans and advances to customers

	2017 AED000	2016 AED000
Overdrafts	**4,841,058**	5,203,616
Credit cards	**2,247,676**	2,326,775
Term lending	**41,849,147**	48,994,554
Bills discounted	**1,789,331**	1,836,157
Mortgages	**6,910,840**	7,281,294
Others	**796,834**	1,260,033
	58,434,886	66,902,429
Less: Allowance for impairment losses	**(3,610,589)**	(3,969,240)
	54,824,297	62,933,189

Notes on the Financial Statements (continued)

16 Trading assets

	2017 AED000	2016 AED000
Trading assets:		
– not subject to re-pledge or resale by counterparties	**1,618,520**	624,212
Treasury and other eligible bills	**170,051**	-
Debt securities	**1,031,255**	335,451
Loans and advances	**220,939**	169,845
Others	**196,275**	118,916
	1,618,520	624,212

17 Derivatives

Fair values of derivatives by product contract type held by the Bank

	Assets			**Liabilities**		
At 31 December 2017	**Trading AED000**	**Hedging AED000**	**Total AED000**	**Trading AED000**	**Hedging AED000**	**Total AED000**
Foreign exchange	**1,521,235**	**16,252**	**1,537,487**	**1,569,908**	**89**	**1,569,997**
Interest rate	**1,522,050**	**86,606**	**1,608,656**	**1,508,975**	**27,749**	**1,536,724**
Equity	**2,519**	**-**	**2,519**	**2,518**	**-**	**2,518**
Credit	**3,149**	**-**	**3,149**	**861**	**-**	**861**
Commodity and other	**126,192**	**-**	**126,192**	**125,396**	**-**	**125,396**
Total	**3,175,145**	**102,858**	**3,278,003**	**3,207,658**	**27,838**	**3,235,496**

	Assets			Liabilities		
At 31 December 2016	Trading AED000	Hedging AED000	Total AED000	Trading AED000	Hedging AED000	Total AED000
Foreign exchange	2,640,873	45,641	2,686,514	2,646,987	549,038	3,196,025
Interest rate	1,579,228	97,110	1,676,338	1,478,373	21,666	1,500,039
Equity	5,050	-	5,050	5,050	-	5,050
Credit	3,198	-	3,198	8,118	-	8,118
Commodity and other	187,639	-	187,639	187,635	-	187,635
Total	4,415,988	142,751	4,558,739	4,326,163	570,704	4,896,867

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

	2017 AED000	2016 AED000
Foreign exchange	**250,394,022**	238,562,278
Interest rate	**186,786,737**	182,003,764
Equity	**191,140**	272,548
Credit	**799,423**	865,800
Commodity and other	**4,292,592**	238,035
	442,463,914	421,942,425

The notional contract amounts of derivatives held for trading purposes and derivatives designated in qualifying hedge accounting indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Use of derivatives

The Bank transacts derivatives for three primary purposes: to create risk management solutions for clients, to manage the portfolio risks arising from client business and to manage and hedge the Bank's own risks. The Bank's derivative activities give rise to significant open positions in portfolios of derivatives. These positions are managed constantly to ensure that they remain within acceptable risk levels. When entering into derivative transactions, the Bank employs the same credit risk management framework to assess and approve potential credit exposures that it uses for traditional lending.

Notes on the Financial Statements (continued)

Trading derivatives

Most of the Bank's derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities include market-making and risk management. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume. Risk management activity is undertaken to manage the risk arising from client transactions, with the principal purpose of retaining client margin. Other derivatives classified as held for trading include non-qualifying hedging derivatives.

Derivatives valued using models with unobservable inputs

The difference between the fair value at initial recognition (the transaction price) and the value that would have been derived had valuation techniques used for subsequent measurement been applied at initial recognition, less subsequent releases, is AED Nil (2016: AED Nil).

Hedge accounting derivatives

Notional contract amounts of derivatives held for hedge accounting purposes by product type

	2017	**2017**	2016	2016
	Fair value hedge	**Cash flow hedge**	Fair value hedge	Cash flow hedge
	AED000	**AED000**	AED000	AED000
Foreign exchange	**-**	**4,946,508**	-	6,537,753
Interest rate	**4,568,329**	**11,427,644**	3,973,018	10,741,141
	4,568,329	**16,374,152**	3,973,018	17,278,894

Fair value hedges

The Bank's fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates.

Fair value of derivatives designated as fair value hedges

	At 31 December 2017		At 31 December 2016	
	Assets	**Liabilities**	Assets	Liabilities
	AED000	**AED000**	AED000	AED000
Interest rate	**58,847**	**10,512**	49,291	13,194

Gains or losses arising from fair value hedges

	2017	2016
	AED000	AED000
Gains/(losses):		
– on hedging instruments	**14,408**	35,316
– on the hedged items attributable to the hedged risk	**(15,917)**	(34,915)
	(1,509)	401

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

During the year ended 31 December 2017, a loss of (AED 1.54m) (2016: AED 1.54m gain) was recognised due to hedge ineffectiveness in relation to fair value hedges.

Cash flow hedges

The Bank's cash flow hedges consist principally of interest rate swaps, futures and cross-currency swaps that are used to protect against exposures to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio of financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedges of forecast transactions.

Notes on the Financial Statements (continued)

Fair value of derivatives designated as cash flow hedges

	At 31 December 2017		At 31 December 2016	
	Assets	**Liabilities**	Assets	Liabilities
	AED000	**AED000**	AED000	AED000
Foreign Exchange	**16,252**	**89**	45,641	549,038
Interest rate	**27,759**	**17,237**	47,819	8,472

During the year ended 31 December 2017 a loss of (AED 0.57m) (2016: AED Nil) was recognised due to cashflow hedge ineffectiveness.

Forecast principal balances on which interest cash flows are expected to arise

	3 months or less AED000	**More than 3 months but less than 1 year AED000**	**5 years or less but more than 1 year AED000**	**More than 5 years AED000**
At 31 December 2017				
Assets	**12,880,000**	**14,543,801**	**7,082,806**	**-**
Liabilities	**-**	**-**	**-**	**-**
Net cash inflow exposure	**12,880,000**	**14,543,801**	**7,082,806**	**-**

	3 months or less AED000	More than 3 months but less than 1 year AED000	5 years or less but more than 1 year AED000	More than 5 years AED000
At 31 December 2016				
Assets	16,357,381	8,718,265	3,349,790	-
Liabilities	(919,939)	(919,902)	-	-
Net cash inflow exposure	15,437,442	7,798,363	3,349,790	-

This table reflects the interest rate repricing profile of the underlying hedged items.

18 Financial investments

	2017 AED000	2016 AED000
Financial investments:		
– not subject to repledge or resale by counterparties	**16,428,916**	16,110,930

	2017 AED000	2016 AED000
Treasury and other eligible bills		
– available-for-sale	**913,230**	548,473
Debt securities		
– available-for-sale	**15,515,686**	15,562,457
Total financial investments	**16,428,916**	16,110,930

Notes on the Financial Statements (continued)

19 Intangible assets

Movement of intangible assets

	Internally generated software AED000	Purchased software AED000	Customer relationship AED000	Core deposits AED000	Preferential lease payment AED000	Total AED000
Cost						
At 1 January 2017	**102,882**	**28,159**	**13,100**	**41,798**	**5,315**	**191,254**
Additions[1]	**18,150**	**1,594**	**-**	**-**	**-**	**19,744**
Disposals	**(11,804)**	**-**	**-**	**-**	**-**	**(11,804)**
At 31 December 2017	**109,228**	**29,753**	**13,100**	**41,798**	**5,315**	**199,194**
Accumulated amortisation						
At 1 January 2017	**(82,245)**	**(27,724)**	**(7,798)**	**(24,879)**	**(2,767)**	**(145,413)**
Charge for the year[2]	**(10,543)**	**(500)**	**(1,871)**	**(5,972)**	**(664)**	**(19,550)**
Impairment	**-**	**-**	**-**	**-**	**-**	**-**
Disposals	**1,050**	**-**	**-**	**-**	**-**	**1,050**
Other changes	**2**	**-**	**-**	**-**	**-**	**2**
At 31 December 2017	**(91,736)**	**(28,224)**	**(9,669)**	**(30,851)**	**(3,431)**	**(163,911)**
Net carrying amount at 31 December 2017[3]	**17,492**	**1,529**	**3,431**	**10,947**	**1,884**	**35,283**
Cost						
At 1 January 2016	93,241	30,016	13,100	41,798	5,315	183,470
Additions[1]	9,641	1,063	-	-	-	10,704
Disposals	-	(2,920)	-	-	-	(2,920)
Other changes	-	-	-	-	-	-
At 31 December 2016	102,882	28,159	13,100	41,798	5,315	191,254
Accumulated amortisation						
At 1 January 2016	(71,201)	(29,535)	(5,926)	(18,908)	(2,102)	(127,672)
Charge for the year[2]	(10,467)	(1,075)	(1,872)	(5,971)	(664)	(20,049)
Impairment	-	-	-	-	-	-
Disposals	-	2,886	-	-	-	2,886
Other changes	(577)	-	-	-	-	(577)
At 31 December 2016	(82,245)	(27,724)	(7,798)	(24,879)	(2,766)	(145,412)
Net carrying amount at 31 December 2016[3]	20,637	435	5,302	16,919	2,549	45,842

1 *At 31 December 2017, the Bank did not have any contractual commitments to acquire intangible assets (2016: nil).*
2 *The amortisation and impairment charges for the year are recognised within the income statement under 'Amortisation and impairment of intangible assets'.*
3 *There are no intangible assets whose title is restricted and/or pledged as security for liabilities.*

Notes on the Financial Statements (continued)

20 Property, plant and equipment

Movement of property & equipment

	Short leasehold land and buildings AED000	Equipment, fixtures and fittings AED000	Total AED000
Cost or fair value			
At 1 January 2017	**252,330**	**194,917**	**447,247**
Additions at cost	**13,843**	**11,913**	**25,756**
Disposals	**(62,007)**	**(370)**	**(62,377)**
Other changes	**-**	**-**	**-**
At 31 December 2017	**204,166**	**206,460**	**410,626**
Accumulated depreciation			
At 1 January 2017	**(142,027)**	**(157,607)**	**(299,634)**
Depreciation charge for the year	**(18,794)**	**(14,478)**	**(33,272)**
Disposals	**32,161**	**639**	**32,800**
Impairment losses recognised	**-**	**-**	**-**
Other changes	**694**	**(489)**	**205**
At 31 December 2017	**(127,966)**	**(171,935)**	**(299,901)**
Net carrying amount at 31 December 2017	**76,200**	**34,525**	**110,725**
Cost or fair value			
At 1 January 2016	219,873	193,032	412,905
Additions at cost	37,868	7,360	45,228
Disposals	(5,411)	(5,475)	(10,886)
Other changes	-	-	-
At 31 December 2016	252,330	194,917	447,247
Accumulated depreciation			
At 1 January 2016	(129,236)	(150,909)	(280,145)
Depreciation charge for the year	(17,388)	(12,084)	(29,472)
Disposals	4,784	5,161	9,945
Impairment losses recognised	-	-	-
Other changes	(187)	225	38
At 31 December 2016	(142,027)	(157,607)	(299,634)
Net carrying amount at 31 December 2016	110,303	37,310	147,613

21 Other assets

	2017 AED000	2016 AED000
Interest receivable	**113,986**	94,611
Prepaid expenses	**64,147**	49,627
Endorsements and acceptances	**1,129,052**	1,070,093
Items in course of collection from other banks	**5**	-
Other accounts	**229,775**	175,453
	1,536,965	1,389,784

Notes on the Financial Statements (continued)

22 Deferred tax assets

	2017 AED000	2016 AED000
Deferred tax is applicable to the following		
Recognised in income statement		
Other liabilities	**25,059**	23,321
Allowance for impairment losses	**677,643**	697,518
	702,702	720,839

23 Customer accounts

	2017 AED000	2016 AED000
Current accounts	**37,302,473**	38,641,620
Savings accounts	**7,411,977**	7,651,952
Call deposits	**5,254,806**	4,363,365
Term deposits	**11,348,425**	10,193,273
Money market term deposits	**16,661**	17,375
Others	**-**	66
	61,334,342	60,867,651

24 Trading liabilities

The sale of borrowed securities is classified as trading liabilities.

	2017 AED000	2016 AED000
Debt securities in issue (Note 26)	**4,656,947**	5,360,689
Others	**154,496**	136,105
	4,811,443	5,496,794

25 Financial liabilities designated at fair value

	2017 AED000	2016 AED000
Debt securities in issue (Note 26)	**2,716,091**	1,475,028

At 31 December 2017, the accumulated amount of change in fair value attributable to changes in credit risk was a loss of (AED 10.37m) (2016: AED 2.76m gain).

26 Debt securities in issue

	2017		2016	
	Carrying amount AED000	**Fair value AED000**	Carrying amount AED000	Fair value AED000
Medium term notes	**11,198,252**	**11,198,057**	11,975,384	11,972,458
Of which debt securities in issue reported as				
- trading liabilities	**(4,656,947)**	**(4,656,947)**	(5,360,689)	(5,360,689)
- financial liabilities designated at fair value	**(2,716,091)**	**(2,716,091)**	(1,475,028)	(1,475,028)
	3,825,214	**3,825,019**	5,139,667	5,136,741

Certain debt securities in issue are managed on a fair value basis as part of the group's interest rate risk management policies. The hedged portion of these debt securities is presented within the balance sheet caption 'Financial liabilities designated at fair value', with the remaining portion included within 'Trading liabilities'.

Notes on the Financial Statements (continued)

27 Other liabilities

	2017	2016
	AED000	AED000
Items in course of transmission to other banks	**174,430**	122,470
Marginal deposits	**767,140**	933,994
Banker's drafts	**34,083**	22,715
Endorsements and acceptances	**1,129,052**	1,070,093
Other liabilities	**1,715,073**	1,729,097
	3,819,778	3,878,369

28 Provisions for liabilities and charges

	2017	2016
	AED000	AED000
At 1 January	**573,915**	501,151
Charge for the year	**230,849**	130,909
Provisions utilised	**(59,945)**	(76,077)
Exchange differences and other movements	**45,598**	17,932
At 31 December	**790,417**	573,915

AED 173m (2016: AED 67m) relates to costs arising from contingent liabilities and contractual commitments, AED 593m (2016: AED 488m) relates to provisions for pension and post retirement obligations (see Note 9) and AED 25m (2016: AED 19m) relates to restructuring provisions.

29 Fair value of financial instruments

Control framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk taker.

Where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is used. For inactive markets, the Bank sources alternative market information, with greater weight given to information that is considered to be more relevant and reliable. Examples of the factors considered are price observability, instrument comparability, consistency of data sources, underlying data accuracy and timing of prices.

For fair values using valuation models, the control framework includes development or validation by independent support functions of the model logic, inputs, model outputs and adjustments. Valuation models are subject to a process of due diligence before becoming operational and are calibrated against external market data on an ongoing basis.

Financial liabilities measured at fair value

In certain circumstances, the Bank records its own debt in issue at fair value, based on quoted prices in an active market for the specific instrument concerned, where available. An example of this is where own debt in issue is hedged with interest rate derivatives. When quoted market prices are unavailable, the own debt in issue is valued using valuation techniques, the inputs for which are either based upon quoted prices in an inactive market for the instrument, or are estimated by comparison with quoted prices in an active market for similar instruments. In both cases, the fair value includes the effect of applying the credit spread which is appropriate to the Bank's liabilities. The change in fair value of issued debt securities attributable to the Bank's own credit spread is computed as follows: for each security at each reporting date, an externally verifiable price is obtained or a price is derived using credit spreads for similar securities for the same issuer. Then, using discounted cash flow, each security is valued using a Libor-based discount curve. The difference in the valuations is attributable to the Bank's own credit spread. This methodology is applied consistently across all securities.

Structured notes issued and certain other hybrid instrument liabilities are included within trading liabilities and are measured at fair value. The credit spread applied to these instruments is derived from the spreads at which the Bank issues structured notes.

Gains and losses arising from changes in the credit spread of liabilities issued by the Bank reverse over the contractual life of the debt, provided that the debt is not repaid at a premium or a discount.

Notes on the Financial Statements (continued)

Fair value hierarchy

Fair values of financial assets and liabilities are determined according to the following hierarchy:

• Level 1 – valuation technique using quoted market price: financial instruments with quoted prices for identical instruments in active markets that the Bank can access at the measurement date.

• Level 2 – valuation technique using observable inputs: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

• Level 3 – valuation technique with significant unobservable inputs: financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

Financial instruments carried at fair value and bases of valuation

		Valuation techniques:		
	Quoted market price Level 1 AED000	Using observable inputs Level 2 AED000	With significant non-observable inputs Level 3 AED000	Total AED000
At 31 December 2017				
Assets				
Trading assets	**-**	**1,618,520**	**-**	**1,618,520**
Derivatives	**-**	**3,266,966**	**11,037**	**3,278,003**
Financial investments: available-for-sale	**-**	**16,428,916**	**-**	**16,428,916**
Liabilities	**-**			
Trading liabilities	**-**	**4,811,443**	**-**	**4,811,443**
Financial liabilities designated at fair value	**-**	**2,716,091**	**-**	**2,716,091**
Derivatives	**-**	**3,224,459**	**11,037**	**3,235,496**
At 31 December 2016				
Assets				
Trading assets	-	624,212	-	624,212
Derivatives	-	4,532,187	26,552	4,558,739
Financial investments: available-for-sale	-	16,110,930	-	16,110,930
Liabilities	-			
Trading liabilities	-	5,496,794	-	5,496,794
Financial liabilities designated at fair value	-	1,475,028	-	1,475,028
Derivatives	-	4,870,315	26,552	4,896,867

Fair value adjustments

Fair value adjustments are adopted when the Bank considers that there are additional factors that would be considered by a market participant which are not incorporated within the valuation model. The Bank classifies fair value adjustments as either 'risk-related' or 'model-related'.

Movements in the level of fair value adjustments do not necessarily result in the recognition of profits or losses within the income statement. For example, as models are enhanced, fair value adjustments may no longer be required. Similarly, fair value adjustments will decrease when the related positions are unwound, but this may not result in profit or loss.

Risk-related adjustments

Bid-offer

IFRS 13 requires use of the price within the bid-offer spread that is most representative of fair value. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the extent to which bid-offer cost would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the position.

Notes on the Financial Statements (continued)

Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, there exists a range of possible values that the financial instrument or market parameter may assume and an adjustment may be necessary to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model.

Credit and debit valuation adjustment

The credit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the counterparty may default and that the Bank may not receive the full market value of the transactions.

The debit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the Bank may default, and that the Bank may not pay the full market value of the transactions.

The Bank calculates a separate credit valuation adjustment ('CVA') and debit valuation adjustment ('DVA') for each counterparty to which the entity has exposure.

The Bank calculates the CVA by applying the probability of default ('PD') of the counterparty conditional on the non-default of the Bank to the expected positive exposure to the counterparty and multiplying the result by the loss expected in the event of default. Conversely, the Bank calculates the DVA by applying the PD of the Bank, conditional on the non-default of the counterparty, to the expected positive exposure of the counterparty to the Bank and multiplying by the loss expected in the event of default. Both calculations are performed over the life of the potential exposure.

Funding fair value adjustment

The funding fair value adjustment is calculated by applying future market funding spreads to the expected future funding exposure of any uncollateralised component of the OTC derivative portfolio. This includes the uncollateralised component of collateralised derivatives in addition to derivatives that are fully uncollateralised. The expected future funding exposure is calculated by a simulation methodology, where available. The expected future funding exposure is adjusted for events that may terminate the exposure such as the default of the Bank or the counterparty.

Model-related adjustments

Model limitation

Models used for portfolio valuation purposes may be based upon a simplified set of assumptions that do not capture all current and future material market characteristics. In these circumstances, model limitation adjustments are adopted.

Inception profit (Day 1 P&L reserves)

Inception profit adjustments are adopted where the fair value estimated by a valuation model is based on one or more significant unobservable inputs.

Fair value valuation bases

Financial instruments measured at fair value using a valuation technique with significant unobservable inputs – Level 3

	Assets AED000	Liabilities AED000
At 31 December 2017		
Other derivatives	**11,037**	**11,037**
At 31 December 2016		
Other derivatives	26,552	26,552

Notes on the Financial Statements (continued)

Derivatives

OTC (i.e. non-exchange traded) derivatives are valued using valuation models. Valuation models calculate the present value of expected future cash flows, based upon 'no-arbitrage' principles. For many vanilla derivative products, such as interest rate swaps and European options, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some differences in market practice. Inputs to valuation models are determined from observable market data wherever possible, including prices available from exchanges, dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices via model calibration procedures or estimated from historical data or other sources.

Movement in Level 3 financial instruments

	Assets	Liabilities
	Derivatives AED000	**Derivatives AED000**
At 1 January 2017	**26,552**	**26,552**
Total gains recognised in profit or loss	**218,826**	**218,826**
Total gains recognised in other comprehensive income	-	-
Purchases	-	-
Sales	-	-
Transfers out	**(234,341)**	**(234,341)**
Transfers in	-	-
At 31 December 2017	**11,037**	**11,037**
Total unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held on 31 December 2017	**11,037**	**(11,037)**
At 1 January 2016	8,160	77,129
Total gains/(losses) recognised in profit or loss	5,912	(64,640)
Total gains recognised in other comprehensive income	-	-
Purchases	-	-
Sales	-	-
Transfers out	-	-
Transfers in	12,480	14,063
At 31 December 2016	26,552	26,552
Total unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held on 31 December 2016	26,552	(26,552)

Transfers between levels of the fair value hierarchy are deemed to occur at the end of each semi-annual reporting period.

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

Sensitivity of Level 3 fair values to reasonably possible alternative assumptions

	2017		2016	
	Reflected in profit or loss		Reflected in profit or loss	
	Favourable changes	**Unfavourable changes**	Favourable changes	Unfavourable changes
	AED000	**AED000**	AED000	AED000
Derivatives, trading assets and trading liabilities[1]	**1,104**	**(1,104)**	**2,655**	**(2,655)**

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

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

	2017		2016	
	Reflected in profit or loss		Reflected in profit or loss	
	Favourable changes	**Unfavourable changes**	Favourable changes	Unfavourable changes
	AED000	**AED000**	AED000	AED000
Other Derivatives	**1,104**	**(1,104)**	2,655	(2,655)

Notes on the Financial Statements (continued)

Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable parameters using statistical techniques. The statistical techniques aim to apply a 95% confidence interval. When parameters are not amenable to statistical analysis, the quantification of uncertainty is judgemental, but is also guided by the 95% confidence interval.

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

Key unobservable inputs to Level 3 financial instruments

	Fair Value		**2017**				2016			
	Assets	**Liabilities**	**Full range of inputs**		**Core range of inputs[1]**		Full range of inputs		Core range of inputs[1]	
	AED000	**AED000**	**Lower**	**Higher**	**Lower**	**Higher**	Lower	Higher	Lower	Higher
Interest rate derivatives	**-**	**-**	**-**	**-**	**-**	**-**	45.3%	98.5%	57.1%	98.0%
FX derivatives	**11,037**	**11,037**	**0.4%**	**5.0%**	**0.4%**	**5.0%**	0.6%	3.6%	0.6%	3.6%

[1] *The core range of inputs is the estimated range within which 90% of the inputs fall.*

A description of the categories of key unobservable inputs is given below.

Prepayment rates

Prepayment rates are a measure of the anticipated future speed at which a loan portfolio will be repaid in advance of the due date.

They vary according to the nature of the loan portfolio and expectations of future market conditions, and may be estimated using a variety of evidence, such as prepayment rates implied from proxy observable security prices, current or historical prepayment rates and macroeconomic modelling.

Market proxy

Market proxy pricing may be used for an instrument for which specific market pricing is not available, but evidence is available in respect of instruments that have common characteristics. In some cases it might be possible to identify a specific proxy, but more generally evidence across a wider range of instruments will be used to understand the factors that influence current market pricing and the manner of that influence.

Volatility

Volatility is a measure of the anticipated future variability of a market price. It varies by underlying reference market price, and by strike and maturity of the option.

Certain volatilities, typically those of a longer-dated nature, are unobservable and are estimated from observable data. The range of unobservable volatilities reflects the wide variation in volatility inputs by reference market price. The core range is significantly narrower than the full range because these examples with extreme volatilities occur relatively rarely within the Bank portfolio.

Correlation

Correlation is a measure of the inter-relationship between two market prices and is expressed as a number between minus one and one. It is used to value more complex instruments where the payout is dependent upon more than one market price. There is a wide range of instruments for which correlation is an input, and consequently a wide range of both same-asset correlations and cross-asset correlations is used. In general, the range of same-asset correlations will be narrower than the range of cross-asset correlations.

Unobservable correlations may be estimated based upon a range of evidence, including consensus pricing services, group trade prices, proxy correlations and examination of historical price relationships. The range of unobservable correlations quoted in the table reflects the wide variation in correlation inputs by market price pair.

Credit spread

Credit spread is the premium over a benchmark interest rate required by the market to accept a lower credit quality. In a discounted cash flow model, the credit spread increases the discount factors applied to future cash flows, thereby reducing the value of an asset. Credit spreads may be implied from market prices. Credit spreads may not be observable in more illiquid markets.

Inter-relationships between key unobservable inputs

Key unobservable inputs to Level 3 financial instruments may not be independent of each other. As described above, market variables may be correlated. This correlation typically reflects the manner in which different markets tend to react to macro-economic or other events. Furthermore, the impact of changing market variables upon the Bank portfolio will depend upon the Bank's net risk position in respect of each variable.

Notes on the Financial Statements (continued)

Fair values of financial instruments not carried at fair value

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

	At 31 December 2017				
		Fair value Valuation techniques			
	Carrying amount AED000	Quoted market price Level 1 AED000	Using observable inputs Level 2 AED000	With significant unobservable inputs Level 3 AED000	Total AED000
Assets and liabilities not held for sale					
Assets					
Loans and advances to banks	**14,023,961**	**-**	**13,992,198**	**-**	**13,992,198**
Loans and advances to customers	**54,824,297**	**-**	**-**	**54,242,115**	**54,242,115**
Reverse repurchase agreements- non-trading	**5,095,730**	**-**	**5,095,729**	**-**	**5,095,729**
Liabilities					
Deposits by banks	**8,498,803**	**-**	**8,494,217**	**-**	**8,494,217**
Customer accounts	**61,334,342**	**-**	**61,970,067**	**-**	**61,970,067**
Debt securities in issue	**3,825,214**	**-**	**3,825,019**	**-**	**3,825,019**

	At 31 December 2016				
		Fair value Valuation techniques			
	Carrying amount AED000	Quoted market price Level 1 AED000	Using observable inputs Level 2 AED000	With significant unobservable inputs Level 3 AED000	Total AED000
Assets and liabilities not held for sale					
Assets					
Loans and advances to banks	15,472,758	-	15,553,377	-	15,553,377
Loans and advances to customers	62,933,189	-	-	62,630,809	62,630,809
Reverse repurchase agreements- non-trading	3,859,692	-	3,859,692	-	3,859,692
Liabilities					
Deposits by banks	14,591,570	-	14,590,281	-	14,590,281
Customer accounts	60,867,651	-	61,519,484	-	61,519,484
Debt securities in issue	5,139,667	-	5,136,741	-	5,136,741

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

Valuation

The fair value measurement is the Bank's estimate of the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It does not reflect the economic benefits and costs that the Bank expects to flow from the instruments' cash flows over their expected future lives. Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available.

Loans and advances to banks and customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using valuation models that incorporate a range of input assumptions. These assumptions may include value estimates from third party brokers which reflect over-the-counter trading activity; forward looking discounted cash flow models using assumptions which the Bank believes are consistent with those which would be used by market participants in valuing such loans; and trading inputs from other market participants which includes observed primary and secondary trades.

Notes on the Financial Statements (continued)

Loans are grouped, as far as possible, into homogeneous groups and stratified by loans with similar characteristics to improve the accuracy of estimated valuation outputs. The stratification of a loan book considers all material factors, including vintage, origination period, estimates of future interest rates, prepayment speeds, delinquency rates, loan-to-value ratios, the quality of collateral, default probability, and internal credit risk ratings.

The fair value of a loan reflects both loan impairments at the balance sheet date and estimates of market participants' expectations of credit losses over the life of the loans, and the fair value effect of repricing between origination and the balance sheet date.

Financial investments

The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that take into consideration the prices and future earnings streams of equivalent quoted securities.

Deposits by banks and customer accounts

Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is approximated by its carrying value.

Debt securities in issue and subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments.

Repurchase and reverse repurchase agreements – non-trading

Fair values approximate carrying amounts as their balances are generally short dated.

30 Maturity analysis of assets and liabilities

The following is an analysis by remaining contractual maturities at the balance sheet date, of assets and liability line items that combine amounts expected to be recovered or settled within one year and after more than one year.

Trading assets and liabilities are excluded because they are not held for collection or settlement over the period of contractual maturity.

Maturity analysis of assets and liabilities

	At 31 December 2017			At 31 December 2016		
	Due within one year AED000	**Due after more than one year AED000**	**Total AED000**	Due within one year AED000	Due after more than one year AED000	Total AED000
Assets						
Loans and advances to banks	**11,162,063**	**2,861,898**	**14,023,961**	13,452,322	2,020,436	15,472,758
Loans and advances to customers	**28,779,229**	**26,045,068**	**54,824,297**	37,166,098	25,767,091	62,933,189
Reverse repurchase agreements- non-trading	**5,095,730**	**-**	**5,095,730**	3,859,692	-	3,859,692
Financial investments	**10,988,893**	**5,440,023**	**16,428,916**	12,191,261	3,919,669	16,110,930
Other assets	**1,528,784**	**8,181**	**1,536,965**	1,389,362	422	1,389,784
	57,554,699	**34,355,170**	**91,909,869**	68,058,735	31,707,618	99,766,353
Liabilities						
Deposits by banks	**3,285,064**	**5,213,739**	**8,498,803**	9,370,785	5,220,785	14,591,570
Customer accounts	**61,334,342**	**-**	**61,334,342**	60,850,276	17,375	60,867,651
Financial liabilities designated at fair value	**-**	**2,716,091**	**2,716,091**	-	1,475,028	1,475,028
Debt securities in issue	**1,358,308**	**2,466,906**	**3,825,214**	3,131,794	2,007,873	5,139,667
Other liabilities	**3,720,036**	**99,742**	**3,819,778**	3,733,241	145,128	3,878,369
	69,697,750	**10,496,478**	**80,194,228**	77,086,096	8,866,189	85,952,285

Notes on the Financial Statements (continued)

The following is an analysis, by remaining contractual maturities at the balance sheet date, of undiscounted cash flows payable under financial liabilities.

	On demand AED000	Due within 3 months AED000	Due between 3 and 12 months AED000	Due between 1 and 5 years AED000	Due after 5 years AED000
At 31 December 2017					
Deposits by banks	**961,107**	**1,070,651**	**1,253,306**	**5,213,739**	**-**
Customer accounts	**53,277,177**	**4,528,552**	**3,528,613**	**-**	**-**
Trading liabilities	**4,811,443**	**-**	**-**	**-**	**-**
Financial liabilities designated at fair value	**-**	**23,130**	**111,815**	**2,806,465**	**-**
Derivatives	**3,225,028**	**867**	**3,103**	**6,498**	**-**
Debt securities in issue	**-**	**1,284,925**	**73,383**	**2,466,906**	**-**
Subordinated loan from Head Office	**-**	**-**	**-**	**2,756,823**	**-**
Other liabilities	**3,028,692**	**313,850**	**377,494**	**99,742**	**-**
	65,303,447	**7,221,975**	**5,347,714**	**13,350,173**	**-**
Guarantees and off balance sheet commitments	**72,069,796**	**-**	**-**	**-**	**-**
	137,373,243	**7,221,975**	**5,347,714**	**13,350,173**	**-**
At 31 December 2016					
Deposits by banks	1,081,137	3,441,057	4,848,591	5,220,786	-
Customer accounts	54,126,857	4,513,995	2,209,424	17,375	-
Trading liabilities	5,496,794	-	-	-	-
Financial liabilities designated at fair value	-	-	40,346	1,549,696	-
Derivatives	4,326,156	555	550,546	19,610	-
Debt securities in issue	-	1,006,146	2,125,648	1,857,571	150,301
Subordinated loan from Head Office	-	-	-	2,757,742	
Other liabilities	3,093,347	388,117	251,778	145,128	-
	68,124,291	9,349,870	10,026,333	11,567,908	150,301
Guarantees and off balance sheet commitments	70,736,577	-	-	-	-
	138,860,868	9,349,870	10,026,333	11,567,908	150,301

Trading liabilities and trading derivatives have been included in the 'On demand' time bucket, and not by contractual maturity, because trading liabilities are typically held for short periods of time. The undiscounted cash flows on hedging derivative liabilities are classified according to their contractual maturity. The undiscounted cash flows potentially payable under financial guarantee contracts are classified on the basis of the earliest date they can be drawn down.

Further discussion of the Bank's liquidity and funding management can be found in Note 35 'Risk management'.

31 Offsetting of financial assets and financial liabilities

The 'Amounts not set off in the balance sheet' in the following table for derivatives and loans and advances to customers and similar agreements include transactions where:

- the counterparty has an offsetting exposure with the Bank and a master netting or similar arrangement is in place with a right of set off only in the event of default, insolvency or bankruptcy, or the offset criteria are otherwise not satisfied; and
- cash and non-cash collateral has been received/pledged in respect of the transactions described above.

For risk management purposes, the net amounts of such exposures are subject to limits which are monitored and the relevant customer agreements are subject to review and updated, as necessary, to ensure that the legal right of offset remains appropriate.

Notes on the Financial Statements (continued)

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements

	Gross amounts of recognised financial assets AED000	Gross amounts offset in the balance sheet AED000	Net amounts presented in the balance sheet AED000	Amounts not set off in the balance sheet Cash collateral received AED000	Net Amount AED000
At 31 December 2017					
Derivatives	**3,278,003**	-	**3,278,003**	-	**3,278,003**
Reverse repurchase, securities borrowing and similar agreements classified as:	**5,095,730**	-	**5,095,730**	-	**5,095,730**
– loans and advances to banks at amortised cost	**4,180,161**	-	**4,180,161**	-	**4,180,161**
– loans and advances to customers at amortised cost	**915,569**	-	**915,569**	-	**915,569**
Loans and advances to customers excluding reverse repos at amortised cost	**1,784,763**	-	**1,784,763**	**(372,616)**	**1,412,147**
	10,158,496	-	**10,158,496**	**(372,616)**	**9,785,880**
At 31 December 2016					
Derivatives	4,558,739	-	4,558,739	-	4,558,739
Reverse repurchase, securities borrowing and similar agreements classified as:	3,859,692	-	3,859,692	-	3,859,692
– loans and advances to banks at amortised cost	3,771,279	-	3,771,279	-	3,771,279
– loans and advances to customers at amortised cost	88,413	-	88,413	-	88,413
Loans and advances to customers excluding reverse repos at amortised cost	2,452,206	-	2,452,206	(565,472)	1,886,734
	10,870,637	-	10,870,637	(565,472)	10,305,165

32 Assets charged as security for liabilities and collateral accepted as security for assets

Collateral accepted as security for assets

The fair value of financial assets accepted as collateral that the Bank is permitted to sell or repledge in the absence of default is AED 5,096m (2016: AED 3,860m). The fair value of any such collateral that have been sold or repledged is AED Nil (2016: AED Nil). The Bank is obliged to return these assets. These transactions are conducted under terms that are usual and customary to standard securities borrowing and reverse repurchase agreements.

33 Subordinated liabilities

On 23 December 2009, a sub-ordinated loan of AED 2,754m was provided by the Bank's Head Office. The loan carries an interest rate of Libor plus 366bps (2016: Libor plus 366bps) payable quarterly and full principal amount of the facility is to be repaid in December 2019. The Bank has the option to repay the loan, all or part only (together with accrued interest thereon), on any interest payment date falling in or after December 2017. The Central Bank of the UAE has approved the loan to be considered as Tier 2 capital for regulatory purposes. The balance includes accrued interest payable of AED 2m (2016: AED 3m).

Notes on the Financial Statements (continued)

34 Cash and cash equivalents

	2017 AED000	2016 AED000
Cash and balances at central bank	**7,098,868**	8,109,427
Loans and advances to banks maturing within 3 months	**7,943,065**	11,326,177
Central Bank certificates of deposit and other financial investments maturing within three months	**5,696,619**	6,687,458
	20,738,552	26,123,062

35 Risk management

All the Bank's activities involve, to varying degrees, the analysis, evaluation, acceptance and active management of risks or combinations of risks. The key financial risks that the Bank is exposed to are credit risk (including cross-border country risk), market risk (predominantly foreign exchange and interest rate risks) and liquidity risk. The Bank is also exposed to operational risk in various forms (including technology, projects, process, people, security and fraud risks). The Bank continues to enhance its capabilities and coverage of financial crime control. Other risks that the Bank is actively managing include legal risk, reputational risk, pensions risk, strategic risk (direction and execution) and ensuring the Bank complies with various regulatory requirements or takes necessary actions where it is not yet doing so.

Risk governance and ownership

An established risk governance and ownership structure ensures oversight of, and accountability for, the effective management of risk at the HSBC Group, regional and global business level. The risk management framework fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions. Integral to the Bank's risk management framework are the enterprise tools of Risk Appetite, Top and Emerging ('T&E') Risks, Risk Map and Stress Testing.

The HBME Board approves HBME's risk appetite framework, plans and performance targets for its principal operating subsidiaries, the appointment of senior officers, the delegation of authorities for credit and other risks and the establishment of effective control procedures. The Audit and Risk Committees are responsible for advising the HBME Board on material risk matters and providing non-executive oversight of risks. Under authority delegated by the HBME Board, the separately convened Risk Management Meeting ('RMM') chaired by the UAE CRO (who reports to MENAT CRO) defines risk appetite and oversees the implementation of risk appetite and controls. The RMM together with the Asset and Liability Committee ('ALCO') monitors all categories of risk, receives reports on actual performance and emerging issues, determines action to be taken and reviews the efficacy of the Bank's risk management framework.

Risk management tools

The Bank uses a range of tools to identify, monitor and manage risk. The key tools are summarised below.

Risk appetite
Risk appetite, a key component of the Bank's risk management framework, is approved by the RMM and describes the types and levels of risk that the Bank is prepared to accept in executing the Bank's strategy. The Bank's risk appetite is set out in the RMM's Risk Appetite Statement and is central to the annual planning process. Global businesses as well as countries are required to articulate their Risk Appetite Statements which are aligned with the Bank strategy.

Quantitative and qualitative metrics are organized under; returns, costs, capital, liquidity and funding, loan impairments, market risk, operational and credit risk.

Measurements against the metrics serve to:
- guide underlying business activity, ensuring it is aligned to risk appetite statements;
- determine risk-adjusted remuneration;
- enable the key underlying assumptions to be monitored and, where necessary, adjusted through subsequent business planning cycles; and
- promptly identify business decisions needed to mitigate risk.

Notes on the Financial Statements (continued)

Risk map

The Bank uses a risk map to provide a point-in-time view of its risk profile across a suite of risk categories. This highlights the potential for these risks to materially affect our financial results, reputation or business sustainability on current and projected bases.

The risks presented on the risk map are regularly assessed against risk appetite, are stress tested and, where longer-term thematic issues arise, are considered for inclusion as top or emerging risks.

Top and emerging risks

The Bank uses a top and emerging risks process to provide a forward-looking view of issues that have the potential to threaten the execution of the Bank's strategy or operations over the medium to long term.

The Bank defines a 'top risk' as a thematic issue that may form and crystallise in between six months and one year, and that has the potential to materially affect the Bank's financial results, reputation or business model. It may arise across any combination of risk types, regions or global businesses. The impact may be well understood by senior management and some mitigating actions may already be in place. Stress tests of varying granularity may also have been carried out to assess the impact.

An 'emerging risk' is a thematic issue with large unknown components that may form and crystallise beyond a one-year time horizon. If it were to materialise, it could have a material effect on the Bank's long-term strategy, profitability and reputation. Existing mitigation plans are likely to be minimal, reflecting the uncertain nature of these risks at this stage. Some high-level analysis and/or stress testing may have been carried out to assess the potential impact.

Stress testing

Stress Testing is a critical component of the HSBC Group's strategic, risk and capital management governance as the regulatory expectations and demands in this area continue to expand significantly. It is an important tool used to evaluate the potential financial impact of plausible scenarios in the event of an economic downturn or a geopolitical duress. The stress testing and scenario analysis programme examines the sensitivities of our capital plans and unplanned demand for regulatory capital under a number of scenarios and ensures that top and emerging risks are appropriately considered. These scenarios include, but are not limited to, adverse macroeconomic events, failures at country, sector and counterparty levels, geopolitical occurrences and a variety of projected major operational risk events. The Bank is included in the annual Group stress test submitted to the Bank of England.

In addition to the HSBC Group-wide risk scenarios, the Bank conducts regular macroeconomic and event-driven scenario analyses specific to the region. The bank is subject to regulatory stress testing in many jurisdictions within the region. These have increased both in frequency and in the granularity of information required by supervisors. Assessment by regulators is on both quantitative and qualitative bases, the latter focusing on portfolio quality, data provision, stress testing capability, forward-looking capital management processes and internal management processes.

Apart from the aforementioned Enterprise Wide Stress Tests the Bank also undertakes Reverse Stress Testing, which is conducted to examine a set of potential scenarios that may render the bank's business model non-viable. Non-viability might occur before the bank's capital is depleted, and could result from a variety of events, including idiosyncratic or systemic events or combinations thereof. Reverse stress testing is used to strengthen our resilience by helping to inform early-warning triggers, management actions and contingency plans designed to mitigate the potential stresses and vulnerabilities which we might face.

The results of aforementioned stress tests feed into the regional recovery plan and forms a part of the Bank's Internal Capital Adequacy Assessment Process ('ICAAP') submission to the regulator.

Risk culture

The Bank's strong risk governance reflects the importance placed by the Board on managing risks effectively. It is supported by a clear policy framework of risk ownership and by the accountability of all staff for identifying, assessing and managing risks within the scope of their assigned responsibilities. This personal accountability, reinforced by the governance structure, experience and mandatory learning, helps to foster a disciplined and constructive culture of risk management and control throughout the Bank. Personal accountability is also reinforced by the Bank's values, with staff expected to be:
- dependable, doing the right thing;
- open to different ideas and culture; and
- connected to our customers, regulators and each other.

Notes on the Financial Statements (continued)

Credit risk

Credit risk management

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from direct lending, trade finance and leasing business, but also from off-balance sheet products such as guarantees and derivatives, and from the Bank's holdings of debt and other securities. Credit risk generates the largest regulatory capital requirement of the risks the Bank incurs.

HSBC Holdings plc is responsible for the formulation of high-level credit risk policies and provides high-level centralised oversight and management of credit risk for the HSBC Group worldwide. In addition its responsibilities include:

- Controlling exposures to sovereign entities, banks and other financial institutions, as well as debt securities which are not held solely for the purpose of trading.
- Monitoring intra-HSBC Group exposures to ensure they are maintained within regulatory limits.
- Controlling cross-border exposures, through the imposition of country limits with sub-limits by maturity and type of business. Country limits are determined by taking into account economic and political factors, and applying local business knowledge. Transactions with countries deemed to be higher risk are considered case by case.

Within the Bank, the Credit Risk function is headed by the Regional Heads of Credit & Market Risk (for wholesale) and Retail Banking & Wealth Management Risk (for retail) who report to the MENAT CRO.

The Bank's local management is responsible for:

- Formulating and recording detailed credit policies and procedures, consistent with HSBC Group policy.
- Issuing policy guidelines to subsidiaries and offices on appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain high-risk sectors.
- Undertaking independent review and objective assessment of risk. Credit Risk assesses all commercial non-bank credit facilities and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken.
- Monitoring the performance and management of portfolios.
- Maintaining policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to the Bank's capital base and remain within internal and regulatory limits.
- Maintaining and developing the governance and operation of HSBC Group's risk rating framework and systems, to classify exposures.
- Reporting on retail portfolio performance, high risk portfolios, risk concentrations, country limits and cross-border exposures, large impaired accounts, impairment allowances and stress testing results and recommendations to the RMM, the Audit and Risk Committee and the HBME Board of Directors.
- Acting on behalf of the Bank as the primary interface, for credit-related issues, with external parties including the rating agencies, corporate analysts, trade associations etc.

The Bank is required to implement credit policies, procedures and lending guidelines that meet local requirements while conforming to the HSBC Group standards.

Credit quality

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

The Bank's risk rating system facilitates the Internal Ratings Based ('IRB') approach for portfolio management purposes. Special attention is paid to problem exposures in order to accelerate remedial action. Where appropriate, the Bank uses specialist units to provide customers with support in order to help them avoid default wherever possible.

Periodic risk-based audits of the Bank's credit processes and portfolios are also undertaken by an independent function.

Impairment assessment

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

Notes on the Financial Statements (continued)

When impairment losses occur, the Bank reduces the carrying amount of loans and advances through the use of an allowance account. When impairment of available-for-sale financial assets and held-to-maturity financial investments occurs, the carrying amount of the asset is reduced directly.

Write-off of loans and advances

Loans are normally written off, either partially or in full, when there is no realistic prospect of further recovery. For secured loans, write-off generally occurs after receipt of any proceeds from the realisation of security.

Unsecured personal facilities, including credit cards, are generally written off at between 150 and 210 days past due, the standard period being the end of the month in which the account becomes 180 days contractually delinquent. Write-off periods may be extended, generally to no more than 360 days past due but in very exceptional circumstances exceeding that figure, where local regulation or legislation constrain earlier writeoff, or where the realisation of collateral for secured real estate lending extends to this time.

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

Refinance risk

Many types of lending require the repayment of a significant proportion of the principal at maturity. Typically, the mechanism of repayment for the customer is through the acquisition of a new loan to settle the existing debt. Refinance risk arises where a customer is unable to repay such term debt on maturity, or to refinance debt at commercial rates. When there is evidence that this risk may apply to a specific contract, the Bank may need to refinance the loan on concessionary terms that it would not otherwise have considered, in order to recoup the maximum possible cash flows from the contract and potentially avoid the customer defaulting on the repayment of principal. When there is sufficient evidence that borrowers, based on their current financial capabilities, may fail at maturity to repay or refinance their loans, these loans are disclosed as impaired with recognition of a corresponding impairment allowance where appropriate.

Credit exposure

Maximum exposure to credit risk

The Bank's exposure to credit risk is spread across a broad range of asset classes, including derivatives, trading assets, loans and advances to customers, loans and advances to banks, and financial investments.

The following table presents our maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments before taking account of any collateral held or other credit enhancements (unless such enhancements meet accounting offsetting requirements). For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees and similar contracts granted, it is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments, it is generally the full amount of the committed facilities.

The offset in the table relate to amounts where there is a legally enforceable right of offset in the event of counterparty default and where, as a result, there is a net exposure for credit risk purposes. However, as there is no intention to settle these balances on a net basis under normal circumstances, they do not qualify for net presentation for accounting purposes.

Notes on the Financial Statements (continued)

In the case of derivatives and reverse repos the offset column also includes collateral received in cash and other financial assets.

	At 31 December 2017			At 31 December 2016		
	Maximum exposure AED000	Offset AED000	Exposure to credit risk (net) AED000	Maximum exposure AED000	Offset AED000	Exposure to credit risk (net) AED000
Cash and balances at central bank....	7,098,868	-	7,098,868	8,109,427	-	8,109,427
Trading assets	1,618,520	-	1,618,520	624,212	-	624,212
debt securities	1,201,306	-	1,201,306	335,451	-	335,451
loans and advances to customers ..	417,214	-	417,214	288,761	-	288,761
Derivatives	3,278,003	-	3,278,003	4,558,739	-	4,558,739
Loans and advances held at amortised cost...	68,848,258	(372,616)	68,475,642	78,405,947	(565,472)	77,840,475
loans and advances to banks..........	14,023,961	-	14,023,961	15,472,758	-	15,472,758
loans and advances to customers...	54,824,297	(372,616)	54,451,681	62,933,189	(565,472)	62,367,717
Reverse repurchase agreements- non-trading	5,095,730	-	5,095,730	3,859,692	-	3,859,692
Financial investments	16,428,916	-	16,428,916	16,110,930	-	16,110,930
other investments	-	-	-	-	-	-
debt securities	16,428,916	-	16,428,916	16,110,930	-	16,110,930
Other assets......................................	1,536,965		1,536,965	1,389,784		1,389,784
endorsements and acceptances	1,129,052	-	1,129,052	1,070,093	-	1,070,093
accrued income and other	407,913	-	407,913	319,691	-	319,691
Financial guarantees and similar contracts	27,950,946	-	27,950,946	27,800,491	-	27,800,491
Loan commitments and other credit-related commitments........................	44,118,850	-	44,118,850	42,936,085	-	42,936,085
	175,975,056	(372,616)	175,602,440	183,795,307	(565,472)	183,229,835

Collateral and other credit enhancements held

Loans and advances held at amortised cost

Although collateral can be an important mitigant of credit risk, it is the Bank's practice to lend on the basis of the customer's ability to meet their obligations out of cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided without security. However, for other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of default, the bank may utilise the collateral as a source of repayment. Depending on its form, collateral can have a significant financial effect in mitigating the Bank's exposure to credit risk.

The tables below provide a quantification of the value of fixed charges the Bank holds over a borrower's specific asset (or assets) where the Bank has a history of enforcing, and are able to enforce, the collateral in satisfying a debt in the event of the borrower failing to meet its contractual obligations, and where the collateral is cash or can be realised by sale in an established market. The collateral valuation in the tables below excludes any adjustments for obtaining and selling the collateral.

The Bank may also manage its risk by employing other types of collateral and credit risk enhancements, such as second charges, other liens and unsupported guarantees, but the valuation of such mitigants is less certain and therefore the level of collateral on the remaining balance of loans and advances to customers has not been quantified. In particular, loans shown in the tables below as not collateralised or partially collateralised may benefit from such credit mitigants.

Notes on the Financial Statements (continued)

Personal lending – Residential mortgages by level of collateral

	2017 AED000	2016 AED000
Non-impaired loans and advances		
Uncollateralised	**35,429**	23,956
Fully collateralised	**6,280,534**	6,580,682
Less than 50% loan to value ('LTV')	**1,499,395**	1,709,790
51% to 60% LTV	**869,980**	1,015,790
61% to 70% LTV	**1,323,681**	1,448,567
71% to 80% LTV	**2,028,500**	1,855,770
81% to 90% LTV	**444,441**	467,488
91% to 100% LTV	**114,537**	83,277
Partially collaterised		
Greater than 100% LTV (A)	**256,377**	242,442
101% to 110% LTV	**53,380**	54,454
111% to 120% LTV	**25,970**	39,887
Greater than 120% LTV	**177,027**	148,101
Collateral value on A	**173,134**	140,713
Total	**6,572,340**	6,847,080
Impaired loans and advances		
Fully collateralised	**132,513**	174,042
Less than 50% loan to value ('LTV')	**23,141**	59,580
51% to 60% LTV	**8,668**	1,791
61% to 70% LTV	**32,190**	38,837
71% to 80% LTV	**19,690**	10,046
81% to 90% LTV	**18,918**	32,058
91% to 100% LTV	**29,906**	31,730
Partially collaterised		
Greater than 100% LTV (A)	**203,194**	266,163
101% to 110% LTV	**31,565**	36,357
111% to 120% LTV	**44,878**	44,123
Greater than 120% LTV	**126,751**	185,683
Collateral value on A	**173,717**	232,114
Total	**335,707**	440,205
Total residential mortgages	**6,908,047**	7,287,285

The above table shows residential mortgage lending including off-balance sheet loan commitments by level of collateral. The collateral included in the table above consists of fixed first charges on real estate.

The LTV ratio is calculated as the gross on-balance sheet carrying amount of the loan and any off-balance sheet loan commitment at the balance sheet date divided by the value of collateral. The methodologies for obtaining residential property collateral values are typically determined through a combination of professional appraisals, house price indices or statistical analysis. The collateral valuation excludes any adjustments for obtaining and selling the collateral. Annual professional appraisals are conducted when a loan is identified and assessed as impaired.

Other personal lending

The other personal lending consists primarily of credit cards and second lien portfolios. Credit cards and overdrafts are generally unsecured. Second lien lending is supported by collateral but the claim on the collateral is subordinate to the first lien charge.

Corporate and commercial and financial (non-banking) lending

Commercial real estate loans and advances

Collateral held is analysed below for commercial real estate and other corporate, and commercial and financial (non-bank) lending. This reflects the difference in collateral held on the portfolios.

Notes on the Financial Statements (continued)

The following table shows commercial real estate lending including off-balance sheet loan commitments by level of collateral.

	2017 AED000	2016 AED000
Rated CRR/EL 1 to 7	**1,018,282**	1,189,420
Uncollateralised	**827,969**	1,079,609
Fully collateralised	**190,313**	109,811
Partially collateralised	**-**	-
- collateral value	**-**	-
Rated CRR/EL 8 to 10	**721,374**	726,497
Uncollateralised	**9,212**	14,335
Fully collateralised	**712,161**	712,161
Partially collateralised	**1**	1
- collateral value	**-**	-

The collateral included in the table above consists of fixed first charges on real estate and charges over cash for commercial real estate. These facilities are disclosed as not collateralised if they are unsecured or benefit from credit risk mitigation from guarantees, which are not quantified for the purposes of this disclosure.

The value of commercial real estate collateral is determined through a combination of professional and internal valuations and physical inspection. Due to the complexity of valuing collateral for commercial real estate, local valuation policies determine the frequency of review based on local market conditions. Revaluations are sought with greater frequency when, as part of the regular credit assessment of the obligor, material concerns arise in relation to the transaction which may reflect on the underlying performance of the collateral, or in circumstances where an obligor's credit quality has declined sufficiently to cause concern that the principal payment source may not fully meet the obligation (i.e. the obligor's credit quality classification indicates it is at the lower end, that is sub-standard, or approaching impaired). Where such concerns exist the revaluation method selected will depend upon the loan-to-value relationship, the direction in which the local commercial real estate market has moved since the last valuation and, most importantly, the specific characteristics of the underlying commercial real estate which is of concern.

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

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

The following table shows corporate and commercial and financial (non-bank) lending including off-balance sheet loan commitments by level of collateral.

	2017 AED000	2016 AED000
Rated CRR/EL 8 to 10	**4,201,986**	4,326,732
Uncollateralised	**2,305,043**	2,275,798
Fully collateralised	**350,463**	479,642
Partially collateralised	**1,546,480**	1,571,292
- collateral value	**217,581**	243,949

Other credit risk exposures

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

Securities issued by governments, banks and other financial institutions may benefit from additional credit enhancement, notably through government guarantees that reference these assets.

Trading assets include loans and advances held with trading intent, the majority of which consist of reverse repos and stock borrowing which, by their nature, are collateralised.

The Bank's maximum exposure to credit risk includes financial guarantees and similar arrangements that the Bank issues or enters into, and loan commitments that the Bank are irrevocably committed to. Depending on the terms of the arrangement, the Bank may have recourse to additional credit mitigation in the event that a guarantee is called upon or a loan commitment is drawn and subsequently defaults.

Notes on the Financial Statements (continued)

Derivatives

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

Concentration of exposure

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

The Bank provides a diverse range of financial services in the UAE. As a result, its portfolio of financial instruments with credit risk is diversified, with no exposures to individual industries or economic groupings totalling more than 10% of total assets, except as follows:

- the majority of the Bank's exposure to credit risk is concentrated in the UAE. Within the UAE, the Bank's credit risk is diversified over a wide range of industrial and economic groupings; and
- the Bank's position as part of a major international banking group means, that it has a significant concentration of exposure to banking counterparties. The majority of credit risk to the banking industry at 31 December 2017 and 31 December 2016 was concentrated in the Middle East and Europe.

Wrong-way risk is an aggravated form of concentration risk and arises when there is a strong correlation between the counterparty's probability of default and the mark-to-market value of the underlying transaction. The group uses a range of procedures to monitor and control wrong-way risk, including requiring entities to obtain prior approval before undertaking wrong-way risk transactions outside preagreed guidelines.

Loans and advances

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

Gross loans and advances to customers by industry sector

	Gross loans and advances to customers	
	2017	2016
	AED000	AED000
Personal		
Residential mortgages	**6,905,157**	7,275,423
Other personal	**6,178,373**	5,694,163
	13,083,530	12,969,586
Corporate and commercial		
Commercial, industrial and international trade	**24,016,091**	20,711,962
Commercial real estate	**1,677,259**	1,851,988
Other property-related	**4,667,033**	5,064,023
Government	**4,497,151**	4,537,431
Other commercial	**7,642,099**	12,087,733
	42,499,633	44,253,137
Financial		
Non-bank financial institutions	**2,851,723**	9,679,706
	2,851,723	9,679,706
Total gross loans and advances to customers	**58,434,886**	66,902,429
Impaired loans	**4,514,192**	5,019,662
- as a percentage of gross loans and advances to customers	**7.73%**	7.50%

Notes on the Financial Statements (continued)

Credit quality of financial instruments

Credit Review and Risk Identification teams regularly review exposures and processes in order to provide an independent, rigorous assessment of the credit risk management framework across the HSBC Group, reinforce secondary risk management controls and share best practice. Internal audit, as a tertiary control function, focuses on risks with a global perspective and on the design and effectiveness of primary and secondary controls, carrying out oversight audits via the sampling of global/regional control frameworks, themed audits of key or emerging risks and project audits to assess major change initiatives.

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

There is no direct correlation between the internal and external ratings at granular level, except to the extent each falls within a single quality classification.

Credit quality classification

	Wholesale	Retail lending	Debt securities/other
Quality classification	**Internal credit rating**	**Internal credit rating[3]**	**External credit rating**
Strong	CRR[1] 1 to CRR 2	EL[2] 1 to EL 2	A- and above
Good	CRR 3	EL 3	BBB+ to BBB-
Satisfactory	CRR 4 to CRR 5	EL 4 to EL 5	BB+ to B and unrated
Sub – standard	CRR 6 to CRR 8	EL 6 to EL 8	B- to C
Impaired	CRR 9 to CRR 10	EL 9 to EL 10	Default

1 *Customer risk rating ('CRR').*
2 *Expected loss ('EL').*
3 *The Bank observes the disclosure convention that, in addition to those classified as EL9 to EL10, retail accounts classified EL1 to EL8 that are delinquent by 90 days or more are considered impaired, unless individually they have been assessed as not impaired (see 'Past due but not impaired gross financial instruments').*

Quality classification definitions

'Strong': exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss.

'Good': exposures require closer monitoring and 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.

'Impaired': exposures have been assessed as impaired. These also include retail accounts classified as EL1 to EL8 that are delinquent by more than 90 days, unless individually they have been assessed as not impaired; and renegotiated loans that have met the requirements to be disclosed as impaired and have not yet met the criteria to be returned to the unimpaired portfolio.

Risk rating scales

The Customer Risk Rating ('CRR') 10-grade scale above summarises a more granular underlying 23-grade scale of obligor probability of default ('PD'). All distinct Bank customers use the 10 or 23-grade scale, depending on the degree of sophistication of the Basel II approach adopted for the exposure.

The Expected Loss ('EL') 10-grade scale for retail business summarises a more granular underlying EL scale for these customer segments; this combines obligor and facility/product risk factors in a composite measure.

For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications. The ratings of Standard and Poor's are cited, with those of other agencies being treated equivalently. Debt securities with short-term issue ratings are reported against the long-term rating of the issuer of those securities. If major rating agencies have different ratings for the same debt securities, a prudent rating selection is made in line with regulatory requirements.

For the purpose of the following disclosure, retail loans which are past due up to 89 days and are not otherwise classified as EL9 or EL10, are not disclosed within the EL grade to which they relate but are separately classified as past due but not impaired.

Notes on the Financial Statements (continued)

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

Distribution of financial instruments by credit quality

	31 December 2017							
	Neither past due nor impaired							
	Strong AED000	Good AED000	Satisfactory AED000	Sub-Standard AED000	Past due not impaired AED000	Impaired AED000	Impairment allowances AED000	Total AED000
Cash and balances at central bank	7,098,868	-	-	-	-	-	-	7,098,868
Trading assets	450,670	192,751	954,997	20,102	-	-	-	1,618,520
– treasury and other eligible bills…………...	-	-	170,051	-	-	-	-	170,051
– debt securities .	229,731	192,751	588,673	20,102	-	-	-	1,031,257
– loans and advances to banks	-	-	195,526	-	-	-	-	195,526
– loans and advances to customers	220,939	-	747	-	-	-	-	221,686
Derivatives	346,117	209,497	2,711,637	10,752	-	-	-	3,278,003
Loans and advances held at amortised cost	27,925,363	16,974,401	19,146,607	1,967,683	1,930,601	4,514,192	(3,610,589)	68,848,258
– loans and advances to banks	2,811,121	2,978,266	8,234,574	-	-	-	-	14,023,961
– loans and advances to customers	25,114,242	13,996,135	10,912,033	1,967,683	1,930,601	4,514,192	(3,610,589)	54,824,297
Reverse repurchase agreements - non-trading………………	3,339,108	137,536	1,619,086	-	-	-	-	5,095,730
Financial investments	6,531,377	-	9,897,539	-	-	-	-	16,428,916
– treasury and other eligible bills	913,230	-	-	-	-	-	-	913,230
– debt securities .	5,618,147	-	9,897,539	-	-	-	-	15,515,686
Other assets.............	58,152	422,455	953,973	12,846	9,053	16,339	-	1,472,818
– endorsements and acceptances	52,745	421,989	616,080	12,846	9,053	16,339	-	1,129,052
– accrued income and other	5,407	466	337,893	-	-	-	-	343,766
Total	45,749,655	17,936,640	35,283,839	2,011,383	1,939,654	4,530,531	(3,610,589)	103,841,113

Notes on the Financial Statements (continued)

	31 December 2016							
	Neither past due nor impaired							
	Strong AED000	Good AED000	Satisfactory AED000	Sub-Standard AED000	Past due not impaired AED000	Impaired AED000	Impairment allowances AED000	Total AED000
Cash and balances at central bank	8,109,427	-	-	-	-	-	-	8,109,427
Trading assets	251,627	91,868	275,012	5,705	-	-	-	624,212
– treasury and other eligible bills……………	-	-	-	-	-	-	-	-
– debt securities ...	208,893	91,868	28,985	5,705	-	-	-	335,451
– loans and advances to banks	-	-	164,649	-	-	-	-	164,649
– loans and advances to customers	42,734	-	81,378	-	-	-	-	124,112
Derivatives	684,779	1,150,283	2,713,556	10,121	-	-	-	4,558,739
Loans and advances held at amortised cost	35,031,916	16,794,586	21,146,583	1,549,910	2,681,218	5,170,976	(3,969,242)	78,405,947
– loans and advances to banks	5,763,422	1,161,979	8,494,886	52,471	-	-	-	15,472,758
– loans and advances to customers	29,268,494	15,632,607	12,651,697	1,497,439	2,681,218	5,170,976	(3,969,242)	62,933,189
Reverse repurchase agreements - non-trading…………..	2,042,940	1,816,752	-	-	-	-	-	3,859,692
Financial investments	6,061,588	-	10,049,342	-	-	-	-	16,110,930
– treasury and other eligible bills	-	-	548,473	-	-	-	-	548,473
– debt securities ...	6,061,588	-	9,500,869	-	-	-	-	15,562,457
Other assets	41,157	395,716	821,186	53,482	16,368	61,875	-	1,389,784
– endorsements and acceptances	38,541	395,694	504,133	53,482	16,368	61,875	-	1,070,093
– accrued income and other	2,616	22	317,053	-	-	-	-	319,691
Total	52,223,434	20,249,205	35,005,679	1,619,218	2,697,586	5,232,851	(3,969,242)	113,058,731

Past due but not impaired gross financial instruments

Past due but not impaired loans are those for which the customer is in the early stages of delinquency and has failed to make a payment, or a partial payment, in accordance with the contractual terms of the loan agreement. This is typically where a loan is less than 90 days past due and there are no other indicators of impairment.

Further examples of exposures past due but not impaired include overdue loans fully secured by cash collateral; mortgages that are individually assessed for impairment, and that are in arrears more than 90 days, but where the value of collateral is sufficient to repay both the principal debt and all potential interest for at least one year; and short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty. When groups of loans are collectively assessed for impairment, collective impairment allowances are recognised for loans classified as past due but not impaired.

Notes on the Financial Statements (continued)

The following table provides an analysis of gross loans and advances to customers held at amortised cost which are past due but not considered impaired. There are no other significant balance sheet items where past due balances are not considered impaired.

	Up to 29 days AED000	30-59 days AED000	60-89 days AED000	90-179 days AED000	Over 180 days AED000	Total AED000
At 31 December 2017 ……………………..	**1,631,903**	**113,235**	**106,189**	**34,781**	**44,492**	**1,930,600**
At 31 December 2016 …………………...	2,229,208	178,354	220,751	24,290	28,616	2,681,219

Renegotiated loans and forbearance

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

Identifying renegotiated loans

Loans are identified as renegotiated loans when the Bank modifies the contractual payment terms due to significant credit distress of the borrower. 'Forbearance' describes concessions made on the contractual terms of a loan in response to an obligor's financial difficulties. The Bank classifies and report loans on which concessions have been granted under conditions of credit distress as 'renegotiated loans' when their contractual payment terms have been modified because the Bank has significant concerns about the borrowers' ability to meet contractual payments when due.

When considering modification terms, the borrower's continued ability to repay is assessed and where they are unrelated to payment arrangements, whilst potential indicators of impairment, these loans are not considered as renegotiated loans. Loans that have been identified as renegotiated retain this designation until maturity or derecognition. A loan that is renegotiated is derecognised if the existing agreement is cancelled 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 substantially a different financial instrument. Any new loans that arise following derecognition events will continue to be disclosed as renegotiated loans.

Credit quality classification of renegotiated loans

Under IFRS, an entity is required to assess whether there is objective evidence that financial assets are impaired at the end of each reporting period. A loan is impaired when there is objective evidence of a loss event that has an effect on the cash flows of the loan which can be reliably estimated.

When the Bank grants a concession to a customer that the Bank would not otherwise consider, as a result of its financial difficulty, this is objective evidence of impairment and impairment losses are measured accordingly.

A renegotiated loan is presented as impaired when:

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

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

The renegotiated loan will continue to be disclosed as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

Renegotiated loans are classified as unimpaired where the renegotiation has resulted from significant concern about a borrower's ability to meet their contractual payment terms but the renegotiated terms are based on current market rates and contractual cash flows are expected to be collected in full following the renegotiation. Unimpaired renegotiated loans also include previously impaired renegotiated loans that have demonstrated satisfactory performance over a period of time or have been assessed based on all available evidence as having no remaining indicators of impairment.

Loans that have been identified as renegotiated retain this designation until maturity or derecognition. When a loan is restructured as part of a forbearance strategy and the restructuring results in derecognition of the existing loan, such as in some debt consolidations, the new loan is disclosed as renegotiated.

When determining whether a loan that is restructured should be derecognised and a new loan recognised, we consider the extent to which the changes to the original contractual terms result in the renegotiated loan, considered as a whole, being a substantially different financial instrument.

Notes on the Financial Statements (continued)

Renegotiated loans and advances to customers

	At 31 December 2017				At 31 December 2016			
	Neither past due nor impaired AED000	**Past due but not impaired AED000**	**Impaired AED000**	**Total AED000**	Neither past due nor impaired AED000	Past due but not impaired AED000	Impaired AED000	Total AED000
Retail	**131,365**	**17,277**	**364,698**	**513,340**	48,391	4,972	151,792	205,155
− Residential mortgages	**115,215**	**15,302**	**313,119**	**443,636**	38,340	435	101,946	140,721
− Other personal	**16,150**	**1,975**	**51,579**	**69,704**	10,051	4,537	49,846	64,434
Commercial real estate	**191,827**	**-**	**1,115,374**	**1,307,201**	-	586,201	1,426,963	2,013,164
Corporate and commercial	**15,965**	**59,127**	**1,085,282**	**1,160,374**	1,350	111,941	1,287,496	1,400,787
Financial	**911,979**	**-**	**-**	**911,979**	951,567	-	-	951,567
Total renegotiated loans and advances to customers	**1,251,136**	**76,404**	**2,565,354**	**3,892,894**	1,001,308	703,114	2,866,251	4,570,673
Total impairment allowance on renegotiated loans				**1,650,717**				1,582,834

For retail lending, renegotiated loans are segregated from other parts of the loan portfolio for collective impairment assessment to reflect the higher rates of losses often encountered in these segments. When empirical evidence indicates an increased propensity to default and higher losses on such accounts, the use of roll-rate methodology ensures these factors are taken into account when calculating impairment allowances by applying roll rates specifically calculated on the pool of loans subject to forbearance. When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, a basic formulaic approach based on historical loss rate experience is used. As a result of our roll-rate methodology, we recognise collective impairment allowances on homogeneous groups of loans, including renegotiated loans, where there is historical evidence that there is a likelihood that loans in these groups will progress through the various stages of delinquency, and ultimately prove irrecoverable as a result of events occurring before the balance sheet date. This treatment applies irrespective of whether or not those loans are presented as impaired in accordance with our impaired loans disclosure convention. When the Bank considers that there are additional risk factors inherent in the portfolios that may not be fully reflected in the statistical roll rates or historical experience, these risk factors are taken into account by adjusting the impairment allowances derived solely from statistical or historical experience.

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

Impaired loans

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

- loans and advances classified as CRR 9, CRR 10, EL 9 or EL 10 (a description of our internal credit rating grades is provided above;
- retail exposures 90 days or more past due, unless individually they have been assessed as not impaired; or
- renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet its contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

Notes on the Financial Statements (continued)

Movement in impairment allowances on loans and advances to customers

	Total AED000
At 1 January 2017	**3,969,240**
Amounts written off	**(835,729)**
Charge to income statement	**450,361**
Exchange and other movements	**26,717**
At 31 December 2017	**3,610,589**
At 1 January 2016	4,183,477
Amounts written off	(748,161)
Charge to income statement	500,006
Exchange and other movements	33,918
At 31 December 2016	3,969,240

Liquidity and funding risk management framework

The Bank has an internal liquidity and funding risk management framework ('LFRF') which aims to allow it to withstand very severe liquidity stresses. It is designed to be adaptable to changing business models, markets and regulations. 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. The risk arises from mismatches in the timing of cash flows. Funding risk (a form of liquidity risk) arises when the liquidity needed to fund illiquid asset positions cannot be obtained on the expected terms and when required.

Structure and organisation of the liquidity risk management function

The Bank's management of liquidity and funding is in compliance with the HSBC Group's LFRF, and with practices and limits set by the HSBC Group Management Board ('GMB') through the Risk Management Meeting ('RMM') and approved by the HSBC Holdings Board for 'RMM operating entities'.

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

- Group, regional and entity level asset and liability management committees ('ALCOs'); and
- Annual individual liquidity adequacy assessment process ('ILAAP') for the UAE branch, which is used to validate local risk tolerance and set risk appetite.

The primary responsibility for managing liquidity and funding within the Bank's framework and risk appetite resides with the UAE ALCO and UAE RMM, and overseen by HBME ALCO, HSBC Group ALCO and the HSBC Group Risk Management Meeting.

Liquidity coverage ratio ('LCR')

The LCR metric is designed to promote the short-term resilience of a Bank's liquidity profile

Unaudited	Liquidity coverage ratio during:	
	2017	2016
	%	%
Year-end	**197.5**	241.0

Net Stable Funding Ratio

The Bank calculates NSFR in line with Basel Committee on Banking Supervision's publication number 295 (BCBS295). This calculation requires various interpretations of the text, and therefore the bank's NSFR may not be directly comparable with the ratios of other institutions.

Unaudited	Net Stable Funding Ratio during:	
	2017	2016
	%	%
Year-end	**142.9**	140.7

Notes on the Financial Statements (continued)

Depositor concentration and term funding maturity concentration

The LCR and NSFR metrics assume a stressed outflow based on a portfolio of depositors within each deposit segment. The validity of these assumptions is challenged if the portfolio of depositors is not large enough to avoid depositor concentration. Operating entities are exposed to term re-financing concentration risk if the current maturity profile results in future maturities being overly concentrated in any defined period.

At 31 December 2017, the Bank was within the risk tolerance levels set for depositor concentration and term funding maturity concentration.

Primary sources of funding

Customer deposits in the form of current accounts and savings deposits payable on demand or at short notice form a significant part of our funding, and the Bank places considerable importance on maintaining their stability. For deposits, stability depends upon maintaining depositor confidence in our capital strength and liquidity, and on competitive and transparent pricing. Of total liabilities of AED 92,561m at 31 December 2017, funding from customers amounted to AED 61,344m, of which AED 61,344m was contractually repayable within one year.

An analysis of cash flows payable by the Bank under financial liabilities by remaining contractual maturities at the balance sheet date is included in Note 30.

Assets available to meet these liabilities, and to cover outstanding commitments to lend (AED 135,578m), included cash, central bank balances, items in the course of collection and treasury and other bills (AED 1,083m); loans to banks (AED 14,024m, including AED 11,162m repayable within one year); and loans to customers (AED 54,824 m, including AED 28,779m repayable within one year). In the normal course of business, a proportion of customer loans contractually repayable within one year will be extended.

The Bank also accesses wholesale funding markets by issuing senior secured and unsecured debt securities (publicly and privately) and borrowing from the secured repo markets against high quality collateral to align asset and liability maturities and currencies and to maintain a presence in local wholesale markets.

Ordinary share capital and retained reserves, non-core capital instruments and intergroup borrowings are also a source of stable funding.

Market risk management

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 will reduce the Bank's income or the value of its portfolios.

The Bank's exposure to market risk is separated into trading or non-trading portfolios. Trading portfolios include those positions arising from market-making, position-taking and others designated as marked-to-market positions. Non-trading portfolios include positions that primarily arise from the interest rate management of the Bank's retail and commercial banking assets and liabilities, financial investments designated as available-for-sale and held-to-maturity.

Market risk measures

Monitoring and limiting market risk exposures

The Bank's objective is to manage and control market risk exposures while maintaining a market profile consistent with the Bank's risk appetite. The Bank uses a range of tools to monitor and limit market risk exposures, including:

- sensitivity measures include sensitivity of net interest income and sensitivity for structural foreign exchange, which are used to monitor the market risk positions within each risk type;
- value at risk ('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; and
- in recognition of VaR's limitations the Bank augments VaR with stress testing to evaluate the potential impact on portfolio values of more extreme, though plausible, events or movements in a set of financial variables.

Market risk is managed and controlled through limits approved by the Risk Management Meeting of the GMB for HSBC Holdings and our various global businesses. These limits are allocated across business lines and to the HSBC Group's legal entities.

The management of market risk is principally undertaken in Global Markets. VaR limits are set for portfolios, products and risk types, with market liquidity being a primary factor in determining the level of limits set.

Notes on the Financial Statements (continued)

VaR limits are set for portfolios, products and risk types, with market liquidity being a primary factor in determining the level of limits set. HSBC Group Risk, an independent unit within HSBC Group, is responsible for our market risk management policies and measurement techniques. The Bank has an independent market risk management and control function that is responsible for measuring market risk exposures in accordance with the policies defined by HSBC Group Risk, and monitoring and reporting these exposures against the prescribed limits on a daily basis.

The Bank assesses the market risks arising on each product in its business and to transfer them to either its Global Markets unit for management, or to separate books managed under the supervision of the local ALCO. Our aim is to ensure that all market risks are consolidated within operations that have the necessary skills, tools, management and governance to manage them professionally. In certain cases where the market risks cannot be fully transferred, the Bank identifies the impact of varying scenarios on valuations or on net interest income resulting from any residual risk positions.

Sensitivity analysis

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

Value at risk ('VAR')

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.

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

The historical simulation models assess potential market movements with reference to data from the past two years and calculate VAR to a 99% confidence level and for a one-day holding period.

The Bank routinely validates the accuracy of its VAR models by back-testing the actual daily profit and loss results, adjusted to remove non-modelled items such as fees and commissions, against the corresponding VAR numbers. Statistically, the Bank would expect to see losses in excess of VAR only 1% of the time over a one-year period. The actual number of excesses over this period can therefore be used to gauge how well the models are performing.

Although a valuable guide to risk, VAR should always be viewed in the context of its limitations:

– the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;

– the use of a one-day holding period assumes that all positions can be liquidated or the risks offset in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;

– the use of a 99% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;

– VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and

– VAR is unlikely to reflect loss potential on exposures that only arise under significant market moves.

Trading and non-trading portfolios

The following table provides an overview of the reporting of risks within this section:

	Portfolio	
	Trading	**Non-trading**
Risk type		
Foreign exchange and commodity	VAR	VAR[1]
Interest rate	VAR	VAR
Credit spread	VAR	VAR

[1]The reporting of commodity risk is with foreign exchange risk and is not applicable to non-trading portfolios.

Notes on the Financial Statements (continued)

Value at risk of the trading and non-trading portfolios

The Bank VAR, both trading and non-trading, is below:

Value at risk

	2017	2016
	AED000	AED000
At 31 December	**37,042**	14,038
Average	**20,798**	13,184
Minimum	**10,614**	3,884
Maximum	**37,872**	21,929

Trading portfolios

The Bank's control of market risk in the trading portfolios is based on a policy of restricting individual operations to trading within a list of permissible instruments authorised for each site by HSBC Group Risk, of enforcing rigorous new product and approval procedures, and of restricting trading in the more complex derivative products only to offices with appropriate levels of product expertise and robust control systems.

Market-making and position-taking is undertaken within Global Markets. The VAR for such trading intent activity at 31 December 2017 was AED 40.1m (2016: AED 5.0m). This is analysed below by risk type:

VAR by risk type for the trading intent activities

	Foreign exchange AED000	**Interest rate AED000**	**Credit AED000**	**Total[1] AED000**
At 31 December 2017	**37,701**	**10,406**	**1,358**	**35,058**
At 31 December 2016	796	5,260	456	4,979
Average				
2017	**12,414**	**10,289**	**2,819**	**16,356**
2016	840	6,044	905	6,203
Minimum				
2017	**752**	**5,212**	**456**	**5,081**
2016	321	854	277	6,165
Maximum				
2017	**37,701**	**15,553**	**3,825**	**35,058**
2016	9,815	12,165	1,872	12,366

1 *The total VAR is non-additive across risk types due to diversification effects.*

Gap risk

Certain products are structured in such a way that they give rise to enhanced gap risk, being the risk that loss is incurred upon occurrence of a gap event. A gap event is a significant and sudden change in market price with no accompanying trading opportunity. Such movements may occur, for example, when, in reaction to an adverse event or unexpected news announcement, some parts of the market move far beyond their normal volatility range and become temporarily illiquid.
Given the characteristics, these transactions, they will make little or no contribution to VaR or to traditional market risk sensitivity measures. The Bank captures the risks for such transactions within the stress testing scenarios and monitor gap risk on an ongoing basis.

The Bank incurred no material losses arising from gap risk movements in the underlying market price on such transactions in the 12 months ended 31 December 2017.

De-peg risk

For currencies such as the AED that are pegged or managed, the spot exchange rate is pegged at a fixed rate (typically to USD), or managed within a predefined band around a pegged rate. De-peg risk is the risk of the peg or managed band changing or being abolished, and moving to a floating regime.

Notes on the Financial Statements (continued)

Using stressed scenarios on spot rates, the Bank is able to analyse how de-peg events would impact the positions held by the Bank. This complements traditional market risk metrics, such as historical VaR, which may not fully capture the risk involved in holding positions in pegged currencies. Historical VaR relies on past events to determine the likelihood of potential profits or losses. However, pegged or managed currencies may not have experienced a de-peg event during the historical timeframe being considered.

Non-trading portfolios

The principal objective of market risk management of non-trading portfolios is to optimise net interest income.
Interest rate risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas, such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts.
The control of market risk in the non-trading portfolios is based on transferring the risks to the books managed by Global Markets or ALCO. The net exposure is typically managed through the use of interest rate swaps within agreed limits. The VAR for these portfolios is included within the Bank VAR.

Sensitivity of net interest income

A principal part of the Bank's management of market risk in non-trading portfolios is monitoring the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). The Bank aims, through our management of market risk in non-trading portfolios, to mitigate the impact of prospective interest rate movements which could reduce future net interest income, while balancing the cost of hedging such activities on the current net revenue stream.

For simulation modelling, businesses use a combination of scenarios relevant to their local businesses and markets and standard scenarios which are required throughout the HSBC Group. The latter are consolidated to illustrate the combined pro forma effect on the Bank's consolidated portfolio valuations and net interest income.

Projected net interest income sensitivity figures represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and the Bank's current interest rate risk profile. This effect, however, does not incorporate actions which would probably be taken by Global Markets or in the business units to mitigate the effect of interest rate risk. In reality, Global Markets seeks proactively to change the interest rate risk profile to minimise losses and optimise net revenues. The projections also assume that interest rates of all maturities move by the same amount (although rates are not assumed to become negative in the falling rates scenario) and, therefore, do not reflect the potential impact on net interest income of some rates changing while others remain unchanged. In addition, the projections take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates linked to other bases (such as Central Bank rates or product rates over which the entity has discretion in terms of the timing and extent of rate changes). The projections make other simplifying assumptions, including that all positions run to maturity.

Defined benefit pension scheme

Market risk also arises within the Bank's defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows.

Operational risk

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

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

The objective of the group's operational risk management is to manage and control operational risk in a cost-effective manner within targeted levels of operational risk consistent with the group's risk appetite, as defined by the Group Management Board.

Operational risk management

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

Notes on the Financial Statements (continued)

Business managers throughout the Bank are responsible for maintaining an acceptable level of internal control commensurate with the scale and nature of operations, and for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The ORMF helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data. A centralised database is used to record the results of the operational risk management process. Operational risk and control self-assessments are inputted and maintained by business units. Business and functional management and business risk and control managers monitor the progress of documented action plans to address shortcomings. To help ensure that operational risk losses are consistently reported and monitored at group level, all group companies are required to report individual losses when the net loss is expected to exceed US$10,000, and to aggregate all other operational risk losses under US$10,000. Losses are entered into the Bank's operational risk database and reported to the group Risk Management Meeting on a monthly basis.

Key developments in 2017

During 2017 the Bank implemented a new ORMF and system of record. The new ORMF provides an end-to-end view of non-financial risks, enhancing focus on the risks that matter the most and associated controls. It provides a platform to drive forward looking risk awareness and assist management focus. It also helps the organisation understand the level of risk it is willing to accept. We also maintained activity to continually strengthen our risk culture. In particular, we focused on the use of the three lines of defence model. It sets our roles and responsibilities for managing operational risk on a daily basis.

Three Lines of Defence

The Bank uses an activity-based three lines of defence model to delineate management accountabilities and responsibilities for risk management and the control environment. This creates a robust control environment to manage risks. The model underpins the approach to risk management by clarifying responsibility, encouraging collaboration, and enabling efficient coordination of risk and control activities.

The three lines of defence are summarised below:

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

Legal risk

The Bank implements processes and procedures in place to manage legal risk that conform to HSBC Group standards.
Legal risk falls within the definition of operational risk and includes:

- contractual risk, which is the risk of a member of the Bank suffering financial loss, legal or regulatory action or reputational damage because its rights and/or obligations under a contract to which it is a party are technically defective;
- dispute adjudication risk, which is the risk of a member of the Bank suffering financial loss or reputational damage due to an adverse dispute environment or a failure to take appropriate steps to defend, prosecute and/or resolve actual or threatened legal claims brought against or by a group member, including for the avoidance of doubt, regulatory matters;
- legislative risk, which is the risk that a group member fails to or is unable to identify, analyse, track, assess or correctly interpret applicable legislation, case law or regulation, or new regulatory, legislative or doctrinal interpretations of existing laws or regulations, or decisions in the Courts or regulatory bodies; and
- non-contractual rights risk, which is the risk that a group member's assets are not properly owned or protected or are infringed by others, or a group member infringes another party's rights.
- non-contractual obligations risk, which is the risk arising due to infringement of third-party rights and/or breach of common law duties.

The Bank has a legal function to assist management in controlling legal risk. The function provides legal advice to manage and control legislative, contractual and non-contractual risks and support in managing litigation claims and significant regulatory enforcement against group companies, as well as in respect of non-routine debt recoveries or other litigation against third parties. The Bank must notify the legal department immediately if any litigation, dispute or material regulatory action is either threatened or commenced against the group or an employee (acting in his capacity as an officer or employee of the Bank). The legal department must be immediately advised of any significant action by a regulatory authority, where the proceedings are criminal, or where the claim might materially affect HSBC Group's reputation.

Notes on the Financial Statements (continued)

The legal department will assess each claim that is threatened or commenced against the Bank or any employee (acting in his capacity as an officer or employee of the Bank) in order to determine the appropriate action, including appointment of external counsel, consideration of the merits of the claim, consideration of any provision, consideration of any document holds or interviews that may be required and consideration of any immediate reporting to senior management or the Bank's regulators as may be necessary.

The legal department must immediately advise the Bank's senior management, the HSBC Group of any threatened or actual litigation claims if such claim exceeds US$5 million or of any significant action by a regulatory authority, where the proceedings are criminal or where a claim might materially affect HSBC Group's reputation. In addition, the legal department submits periodic returns to the Bank's risk management meeting and Board Risk Committee meeting, including updates on ongoing litigation and details of any judgements issued against the Bank. These returns are shared with the Bank's regulators on a periodic basis.
Finally, the Bank is required to submit a quarterly return to HSBC Group detailing outstanding claims where the claim (or group of similar claims) exceeds US$10 million, where the action is by a regulatory authority, where the proceedings are criminal, where the claim might materially affect the Bank's reputation, or, where the HSBC Group has requested returns be completed for a particular claim. These returns are used for reporting to the HSBC Group Audit Committee and the Board of HSBC Holdings plc.

Capital management

The Bank's regulator, the Central Bank of the UAE, sets and monitors regulatory capital requirements. The Bank's objectives when managing capital are to:
- Safeguard the Bank's ability to continue as a going concern; and
- Comply with regulatory capital requirements set by the Central Bank of the UAE.

The Bank's regulatory capital adequacy ratio is set by the Central Bank of the UAE at a minimum level of 11.75% (2016: 12%).

The Bank's regulatory capital is analysed into two tiers:
- Tier 1 capital, which includes allocated capital and retained earnings (excluding current year profit); and
- Tier 2 capital, which includes collective impairment provision and subordinated facilities.

Capital structure as at 31 December

(Unaudited)	**2017 Basel III AED000**	2016 Basel II AED000
Composition of regulatory capital		
Common Equity Tier 1 (CET1) capital	**10,776,451**	11,875,472
Additional Tier 1 (AT1) capital	**486**	-
Total Tier 1 capital	**10,776,937**	11,875,472
Tier 2 Capital	**2,015,924**	2,577,887
Total Eligible Capital	**12,792,861**	14,453,359
Risk weighted assets		
Credit risk counterparty risk	**73,094,999**	74,020,936
Market risk	**4,104,576**	2,872,952
Operational risk	**9,356,135**	9,373,971
	86,555,710	86,267,859
Capital ratios	**%**	%
Capital adequacy ratio	**14.78**	16.75

Notes on the Financial Statements (continued)

36 Contingent liabilities, contractual commitments and guarantees

	2017 AED000	2016 AED000
Guarantees and other contingent liabilities		
Guarantees	**27,950,946**	27,800,492
Commitments		
Documentary credits and short-term trade-related transactions	**620,810**	732,179
Undrawn formal standby facilities, credit lines and other commitments to lend	**43,498,040**	42,203,906
	44,118,850	42,936,085

The table above discloses the nominal principal amounts of commitments, excluding capital commitments, which are separately disclosed below, guarantees and other contingent liabilities; mainly credit-related instruments which include both financial and non-financial guarantees and commitments to extend credit. Nominal principal amounts represent the amounts at risk should contracts be fully drawn upon and clients default. As a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of these nominal principal amounts is not representative of future liquidity requirements.

Other commitments

In addition to the commitments disclosed above, at 31 December 2017 the group had capital commitments to purchase, within one year, land and building and other fixed assets for a value of AED 817m (2016: AED 817m).

37 Lease commitments

Operating lease commitments

At 31 December 2017, the Bank was obligated under a number of non-cancellable operating leases for properties, plant and equipment for which the future minimum lease payments extend over a number of years.

	Land and buildings	
	2017 **AED000**	2016 AED000
Future minimum lease payments under non-cancellable operating leases expiring:		
– no later than one year	**68,322**	70,159
– later than one year and no later than five years	**75,706**	109,936
– later than five years	**6,270**	14,510
	150,298	194,605

Finance lease receivables

The Bank leases a variety of assets to third parties under finance leases. At the end of the lease terms, assets may be sold to third parties or leased for further terms. Lessees may participate in any sales proceeds achieved. Lease rentals arising during the lease terms will either be fixed in quantum or be varied to reflect changes in, for example, tax or interest rates. Rentals are calculated to recover the cost of assets less their residual value, and earn future income.

	Present value of financial lease commitments	
	2017 **AED000**	2016 AED000
Lease receivables:		
- no later than one year	**489,543**	996,226
- later than one year and no later than five years	**35,210**	43,897
- later than five years	**246,169**	219,910
	770,922	1,260,033

Notes on the Financial Statements (continued)

38 Interests in associates and Joint Arrangements

Joint arrangement of the Bank

	At 31 December 2017			
	Country of incorporation	**Principal activity**	**The Bank's interest in equity capital**	**Issued equity capital**
HSBC Middle East Leasing Partnership	**Dubai, UAE**	**Leasing**	**15.00%**	**US$503 million fully paid**

	At 31 December 2016			
	Country of incorporation	Principal activity	The Bank's interest in equity capital	Issued equity capital
HSBC Middle East Leasing Partnership	Dubai, UAE	Leasing	15.00%	US$503 million fully paid

39 Legal proceedings and regulatory matters

The Bank 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. 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 31 December 2017. Where an individual provision is material, the fact that a provision has been made is stated and quantified, except to the extent doing so would be seriously prejudicial. Any provision recognised does not constitute an admission of wrongdoing or legal liability. It is not practicable to provide an aggregate estimate of potential liability for our legal proceedings and regulatory matters as a class of contingent liabilities.

Anti-money laundering and sanctions-related

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

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

In December 2012, HSBC Holdings, HNAH and HSBC Bank USA entered into agreements with US and UK government agencies regarding past inadequate compliance with the BSA, AML and sanctions laws. Among those agreements, HSBC Holdings and HSBC Bank USA entered into a five-year deferred prosecution agreement with, among others, the DoJ (the 'US DPA'); and HSBC Holdings consented to a cease-and-desist order, and HSBC Holdings and HNAH consented to a civil money penalty order with the FRB.

HSBC Holdings also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions, as well as an undertaking with the UK FCA to comply with certain forward-looking AML and sanctions-related obligations. In addition, HSBC Bank USA entered into civil money penalty orders with the Financial Crimes Enforcement Network of the US Treasury Department and the OCC.

Under these agreements, HSBC Holdings and HSBC Bank USA made payments totalling US$1.9 billion 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'). Under the cease and desist order issued by the FRB in 2012, the Monitor also serves as an independent consultant to conduct annual assessments. In February 2018, the Monitor delivered his fourth annual follow-up review report.

Notes on the Financial Statements (continued)

Through his country-level reviews, the Monitor identified potential anti-money laundering and sanctions compliance issues that the DoJ and HSBC are reviewing further with the DoJ, FRB and/or FCA. In December 2017, the US DPA entered into in December 2012 expired. HSBC fulfilled its commitments, and, therefore, under the terms of the DPA, the Department of Justice will file a motion with the US District Court for the Eastern District of New York seeking the dismissal of the charges deferred by the agreement. The Monitor overseeing HSBC's progress under the US DPA has also been serving since July 2013 as HSBC's Skilled Person under a 2012 direction issued by the UK Financial Conduct Authority and will continue in that capacity for a period of time at the discretion of the UK FCA. Additionally, HSBC is the subject of other ongoing investigations and reviews by the DoJ. HSBC Bank plc is also the subject of an investigation by the FCA into its compliance with UK money laundering regulations and financial crime systems and controls requirements.

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

Since November 2014, four lawsuits, the details of which are below, have been filed in federal court in New York and Illinois, against various HSBC companies (including the group) and others, on behalf of plaintiffs who are, or are related to, victims of terrorist attacks in Iraq and Jordan. In each case, it is alleged that the defendants aided and abetted the unlawful conduct of various sanctioned parties in violation of the US Anti-Terrorism Act. These actions are all at early stages.

In November 2014, a complaint was filed in the US District Court for the Eastern District of New York on behalf of representatives of US persons alleged to have been killed or injured in Iraq between April 2004 and November 2011. The complaint was filed against HSBC Holdings, HSBC Bank plc, HSBC Bank USA and HSBC Bank Middle East Limited, as well as other non-HSBC banks and the Islamic Republic of Iran (together, the 'Defendants'). The plaintiffs allege that Defendants violated the US Anti-Terrorism Act ('US ATA') by altering or falsifying payment messages involving Iran, Iranian parties and Iranian banks for transactions processed through the US. The Defendants filed a Motion to Dismiss in May 2015 and an amended Motion to Dismiss in September 2017, following the filing by the Plaintiffs of a Second Amended Complaint in July 2017. In July 2017, the various motions before the Court were referred for review and for the issuance of a judicial report and recommendations prior to being decided.

In November 2015, a complaint was filed in the US District Court for the Northern District of Illinois on behalf of representatives of US persons alleged to have been killed or injured in terrorist attacks on three hotels in Amman, Jordan in 2005. The complaint was filed against HSBC Holdings, HSBC Bank USA, HNAH, HSI, HSBC Finance, HSBC USA Inc. and HSBC Bank Middle East Limited, as well as non-HSBC bank, Al Rajhi Bank (together the 'Defendants'). The plaintiffs allege that the HSBC defendants violated the US ATA by failing to enforce due diligence methods to prevent its financial services from being used to support the terrorist attacks. In early January 2017, the Defendants filed various Motions, including a Motion to Dismiss from the Plaintiffs' Complaint HSBC Bank Middle East Limited and another HSBC defendant. In August 2017, the Court issued a favourable decision by dismissing the claim filed against the group for the lack of personal jurisdiction over it. The proceedings continue against other HSBC defendants.

In November 2016, a complaint was filed in the Southern District of Illinois on behalf of representatives of US soldiers killed or injured whilst serving in Iraq. The complaint was filed against HSBC Holdings plc, HSBC Bank plc, HSBC Bank Middle East Limited, HSBC Bank USA, N.A and other non-HSBC banks, Deutsche Bank AG, Barclays Bank plc, Standard Chartered Bank, Royal Bank of Scotland, N.V., Credit Suisse AG, Bank Saderat plc and Commerzbank AG (together the 'Defendants'). The plaintiffs allege that the HSBC defendants violated the US ATA by altering or falsifying payment messages involving Iran, Iranian parties and Iranian banks for transactions processed through the US. In December 2017, the Defendants filed a Motion to Transfer the action to the Eastern District of New York which was granted in April 2017. In January 2017, the Plaintiffs filed a First Amended Complaint which named an additional HSBC defendant, HSBC North America Holdings Inc. In October 2017 the Plaintiffs voluntarily withdrew the case against all defendants [but remain at liberty to refile].

In November 2017, a complaint was filed in the Southern District of New York on behalf of representatives of US soldiers killed or injured whilst serving in Iraq. The complaint was filed against HSBC Holdings plc, HSBC Bank plc, HSBC Bank Middle East Limited, HSBC Bank USA, N.A, HSBC North America Holdings Inc. and other non-HSBC Banks, Deutsche Bank AG, Barclays Bank plc, Standard Chartered Bank, Royal Bank of Scotland, N.V., Royal Bank of Scotland plc, Credit Suisse AG, Bank Saderat plc and Commerzbank AG, Commerzbank AG, New York Branch, BNP Paribas S.A., Credit Agricole S.A., Credit Agricole Corporate & Investment Bank (together the 'Defendants'). The plaintiffs allege that the HSBC defendants violated the US ATA by altering or falsifying payment messages involving Iran, Iranian parties and Iranian banks for transactions processed through the US and also allege breaches of US Justice Against Sponsors of Terrorism Act ('JASTA'). The proceedings are at the very early stage of service upon the defendants.

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

Notes on the Financial Statements (continued)

Foreign exchange rate investigations and litigation

Various regulators and competition and law enforcement authorities around the world, including in the EU, Switzerland, Brazil, South Korea and South Africa, are conducting civil and criminal investigations and reviews into trading by HSBC and others on the foreign exchange markets. HSBC is cooperating with these investigations and reviews and settlements relevant to the group are detailed below.

In May 2015, the DoJ resolved its investigations with respect to five non-HSBC financial institutions, four of whom agreed to plead guilty to criminal charges of conspiring to manipulate prices in the foreign exchange spot market, and resulting in the imposition of criminal fines in the aggregate of more than US$2.5 billion. Additional penalties were imposed at the same time by the FRB and other banking regulators. HSBC was not a party to these resolutions. In August 2016, the DoJ indicted two now-former HSBC employees and charged them with wire fraud and conspiracy relating to a 2011 foreign exchange transaction. One of the former employees was found guilty in October 2017 of one count of conspiracy to commit wire fraud and eight counts of wire fraud. HSBC was not named as a defendant in the indictment.

In September 2017, HBSC Holdings and HNAH consented to a civil money penalty order with the FRB in connection with its investigation into HSBC's historic foreign exchange activities. Under the terms of the order, HSBC Holdings and HNAH agreed to pay a civil money penalty of US$175 million to the FRB.

In January 2018, HSBC Holdings entered into a three-year deferred prosecution agreement with the Criminal Fraud Division of the DoJ, covering conduct in 2010 and 2011, and received a declination from the Antitrust Division of the DoJ, concluding its investigation into HSBC's historic foreign exchange activities. Under the terms of the deferred prosecution agreement, HSBC agreed to pay a penalty and restitution of US$101.5 million 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.

40 Related party transactions

The ultimate parent company of the Bank is HSBC Holdings plc, which is incorporated in England.

Copies of the HSBC Group financial statements may be obtained from the following address:

HSBC Holdings plc
8 Canada Square
London
E14 5HQ

The Bank's related parties include the parent and its subsidiaries, fellow branches, and associates, post-employment benefit plans for HSBC employees, key management personnel, close family members of key management personnel and entities which are controlled, jointly controlled or significantly influenced by key management personnel or their close family members.

Transactions with related parties

	2017	2016
	Balance at the year end[1] AED000	Balance at the year end[1] AED000
Assets		
Loans and advances to customers	**25,912**	1,131,128
Loans and advances to banks	**8,233,286**	7,571,936
Reverse repurchase agreements – non-trading	**66,857**	32,024
Liabilities		
Deposits by banks	**6,211,269**	12,008,054
Customer accounts	**349,451**	147,118
Subordinated loan from Head Office	**2,756,823**	2,757,742
Irrevocable commitments and contingencies	**2,706,958**	2,012,536

Notes on the Financial Statements (continued)

	For the year ended 31 December 2017 AED000	For the year ended 31 December 2016 AED000
Income Statement		
Interest income	**105,875**	105,763
Interest expense	**(258,006)**	(260,716)
Fee income	**223,532**	197,473
Fee expense	**(78,392)**	(56,558)
Other operating income	**309,970**	287,827
General and administrative expenses	**(338,987)**	(231,092)

[1] *The disclosure of the year-end balance is considered the most meaningful information to represent transactions during the year.*

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

On 22 December 2017, the net assets from HSBC Middle East Finance Company Limited ("the Company"), a subsidiary of HBME, were transferred to the Bank for an initial purchase consideration of AED 63m, based on the carrying value as at 31 October 2017.

As the transfer was made with a member of the HBME group, which falls within the definition of a common control transaction, predecessor accounting has been applied and no gain on the transaction was booked as the consideration was equivalent to the carrying value of net assets.

The carrying value of net assets transferred as at 22 December 2017, AED 49m, comprised of loans and advances to customers (net of impairment allowances amounting to AED 15m) AED 989m, accrued interest receivable AED 3m, loans from related party (AED 943m) and accrued expenses (AED 0.6m).

The reduction in the carrying value of AED 15m was recognised as a payable to the Bank, which was subsequently settled on 28 January 2018.

41 Events after the balance sheet date

These accounts were approved by management on _________________ and authorised for issue.

HSBC Bank Middle East Limited - UAE Operations

Pillar III disclosures under Basel II

31 December 2017

CONSOLIDATED CAPITAL STRUCTURE UNDER BASEL II

	AED'000
Tier 1 Capital	
Paid up share capital/common stock	4,495,255
Reserves	6,277,304
Statutory reserve	1,908,118
Special reserve	-
General reserve	4,369,186
Minority interests in the equity of subsidiaries	-
Innovative capital instruments	-
Other capital instruments	-
Surplus capital from insurance companies	-
	10,772,559
Less: Deductions for regulatory calculation	-
Less: Deductions from Tier 1 capital	(3,892)
Tier 1 Capital	**10,776,451**
Tier 2 capital	**2,015,924**
Less: Other deductions from capitals	(486)
Tier 3 capital	-
Total eligible capital after deductions	**12,792,861**

CONSOLIDATED CAPITAL STRUCTURE UNDER BASEL III

	AED'000
Capital Base	
Common Equity Tier 1 (CET1) Capital	
Share Capital	4,495,255
Share Premium	-
Eligible Reserves	1,589,488
Retained Earnings / (Accumulated Losses)	4,687,816
Eligible amount of minority interest	-
Capital shortfall if any	-
CET1 capital Before the regulatory adjustments and threshold deduction	**10,772,559**
Less: Regulatory deductions	(3,892)
Less: Threshold deductions	-
Total CET1 capital after the regulatory adjustments and threshold deduction	**10,776,451**
Total CET1 capital after transitional arrangement for deductions (CET1)	**10,776,451**
Additional Tier 1 (AT1) Capital	
Eligible AT1 capital (After grandfathering)	-
Other AT1 Capital e.g. (Share premium, minority interest)	-
Total AT1 capital	**-**
Total AT1 capital after transitional arrangements (AT1)	**-**
Tier 2 (T2) Capital	
Tier 2 Instruments e.g. subordinated loan (After grandfathering and/or amortization)	1,101,750
Other Tier 2 capital (including General Provisions, etc.)	913,687
Total T2 Capital	**2,015,437**
Total T2 capital after transitional arrangements (T2)	**2,015,437**
Total Capital (CET1+AT1+T2)	**12,791,888**

INFORMATION ON SUBSIDIARIES AND SIGNIFICANT INVESTMENTS

Basis of Consolidation:

	Country of Incorporation	% Ownership	Description	Accounting Treatment	Surplus Capital	Capital Deficiencies	Total Interests
Subsidiaries……………………	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Significant Investments……….	N/A	N/A	N/A	N/A	N/A	N/A	N/A

HSBC Bank Middle East Limited - UAE Operations
Basel III - Pillar III Disclosures
for the year ended 31 December 2017

CAPITAL ADEQUACY

	Capital Charge AED'000	Capital Ratio %
Capital Requirements		
Credit Risk		
Standardised Approach……	7,674,975	
Foundation IRB……	-	
Advanced IRB……	-	
Market Risk		
Standardised Approach……	430,981	
Models Approach……	-	
Operational Risk		
Basic Indicator Approach……	-	
Standardised Approach/ASA……	982,394	
Advanced Measurement Approach……	-	
Total Capital requirements	**9,088,350**	
Capital Ratio		
Total Capital Ratio for the Bank		**14.78%**
Tier 1 ratio for the Bank		**12.45%**
Total for each significant bank subsidiary		**N/A**

CAPITAL ADEQUACY

Qualitative Disclosures

The Bank's policies around the management of Credit, Market and Operational risk are disclosed in the Financial Statements for the year ended 31 December 2017 as a part of Note 35.

Quantitative Disclosures

Capital Requirements	**RWA** **AED'000**	**Capital Charge** **AED'000**	**Capital Ratio (%)** **%**
Credit Risk - Standardized Approach……………………………	73,094,999	7,674,975	
Market Risk - Standardized Approach……………………………	4,104,576	430,981	
Operation Risk			
Basic Indicator Approach…………………………………	-	-	
Standardised Approach/ASA………………………………	9,356,135	982,394	
Advanced Measurement Approach………………………	-	-	
Total Capital requirements		**9,088,350**	
Capital Ratio			
Total Capital Ratio for the Bank…………………………………			**14.78%**
Tier 1 ratio for the Bank…………………………………………			**12.45%**
Total for each significant bank subsidiary………………………			**N/A**

Qualitative Disclosures

Definition of past due and impaired (for accounting purposes)

Impaired loans

Impaired loans and advances are those that meet any of the following criteria:
- loans and advances classified as CRR 9, CRR 10, EL 9 or EL 10 (a description of our internal credit rating grades is provided below;
- retail exposures 90 days or more past due, unless individually they have been assessed as not impaired; or
- renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet its contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

Risk rating scales

The Customer Risk Rating (‘CRR’) 10-grade scale above summarises a more granular underlying 23 grade scale of obligor probability of default (‘PD’). All distinct Bank customers use the 10 or 23-grade scale, depending on the degree of sophistication of the Basel II approach adopted for the exposure.

The Expected Loss (‘EL’) 10-grade scale for retail business summarises a more granular underlying EL scale for these customer segments; this combines obligor and facility/product risk factors in a composite measure.

Retail loans which are past due up to 89 days and are not otherwise classified as EL9 or EL10, are not disclosed within the EL grade to which they relate but are separately classified as past due but not impaired.

Further details around the Bank's accounting policies can be found the in the audit Financial Statements for the year ended 31 December 2017.

Description of approaches followed for specific and general allowances and statistical methods

Specific allowances
of loans in the portfolio, the importance of the individual loan relationship, and how this is managed. Loans that are determined to be individually significant based on the above and other relevant factors will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective methodology.

Loans considered as individually significant are typically to corporate and commercial customers, are for larger amounts and are managed on an individual basis. For these loans, the Bank considers on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired.

The determination of the realisable value of security is based on the current market value at the time the impairment assessment is performed. The value is not adjusted for anticipated increases in future market prices though; adjustments are made to reflect local conditions, such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest at the loan’s original effective interest rate, or an approximation thereof, and comparing the resultant present value with the loan’s current carrying amount. The impairment allowances on individually significant accounts are reviewed at least semi-annually, and more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

General allowances

Impairment is assessed collectively to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment or for homogeneous groups of loans that are not considered individually significant, generally retail lending portfolios.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for a collective impairment assessment. This assessment captures impairment losses that the Bank has incurred as a result of events occurring before the balance sheet date which the Bank is not able to identify on an individual loan basis, and that can be reliably estimated. When information becomes available which identifies losses on individual loans within a group, those loans are removed from the Bank and assessed individually.

Homogeneous groups of loans and advances
because individual loan assessment is impracticable. The methods that are used to calculate collective allowances are:

- When appropriate empirical information is available, the Bank utilises roll-rate methodology. This methodology employs statistical analyses of historical data and experience of delinquency and default to estimate the amount of loans that will eventually be written off as a result of the events occurring before the balance sheet date which the Bank is not able to identify on an individual loan basis, and that can be reliably estimated. Under this methodology, loans are grouped into ranges according to the number of days past due and statistical analysis is used to estimate the likelihood that loans in each range will progress through the various stages of delinquency, and ultimately prove irrecoverable. In addition to the delinquency groupings, loans are segmented according to their credit characteristics as described above. Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio, and the carrying amount of the portfolio.

- When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, the Bank adopts a basic formulaic approach based on historical loss rate experience, or a discounted cash flow model. Where a basic formulaic approach is undertaken, the period between a loss event occurring and its identification is explicitly estimated by local management, and is typically between six and twelve months.

Further details around the Bank's impairment policies can be found the in the audited Financial Statements for the year ended 31 December 2017.

External Ratings

Qualitative information

Currently, the Bank has used the following three external rating agencies for determining risk weighted assets for all its exposures (which utilise external ratings): a) Moody's Investors Service; b) Standard & Poor's; and c) Fitch ratings.

Quantitative information

Loan portfolio as per the standardised approach

	AED'000									
	Gross credit exposures					Exposures subject to deduction				
Loan Portfolio	**Rated**	**Unrated**	**Total**	**Post CRM**	**RWA post CRM**	**Rated**	**Unrated**	**Total**	**Post CRM**	**RWA post CRM**
Claims on sovereigns……	26,709,363	-	26,709,363	26,709,363	182,646	26,709,363	-	26,709,363	26,709,363	182,646
Claims on public sector entities……	-	725,341	725,341	725,341	55,704	-	725,341	725,341	725,341	55,704
Claims on multilateral development banks……	1,202,654	-	1,202,654	1,202,654	-	1,202,654	-	1,202,654	1,202,654	-
Claims on securities firms……	-	-	-	-	-	-	-	-	-	-
Claims on banks……	14,925,839	17,313,580	32,239,419	29,989,778	8,877,964	14,925,839	17,313,580	32,239,419	29,989,778	8,877,964
Claims on corporate……	56,365	96,160,036	96,216,401	65,734,210	51,678,583	56,365	96,160,036	96,216,401	65,734,210	51,678,583
Regulatory and other retail exposure……	-	13,352,573	13,352,573	13,352,573	4,219,836	-	13,352,573	13,352,573	13,352,573	4,219,836
Residential retail exposure……	-	6,946,637	6,946,637	6,946,637	2,742,041	-	6,946,637	6,946,637	6,946,637	2,742,041
Commercial real estate……	-	-	-	-	-	-	-	-	-	-
Past due loans……	-	3,718,666	3,718,666	3,718,666	1,803,823	-	3,718,666	3,718,666	3,718,666	1,803,823
Other assets……	688,244	8,224,500	8,912,744	8,912,744	3,534,165	688,244	8,224,500	8,912,744	8,912,744	3,534,165
Claims on securitised assets……	-	-	-	-	-	-	-	-	-	-
Credit derivatives (Banks selling protection)……	-	-	-	-	-	-	-	-	-	-
Total	**43,582,465**	**146,441,333**	**190,023,798**	**157,291,966**	**73,094,762**	**43,582,465**	**146,441,333**	**190,023,798**	**157,291,966**	**73,094,762**

Equity risk

Market risk as per the standardised approach

	AED'000
Interest rate risk	3,801,001
Equity position risk	-
Foreign exchange risk	269,930
Commodity risk	33,646
Total market risk capital charge	**4,104,576**

Interest rate risk in the banking book (IRRBB)

	AED'000	
Shift in yield curves	**Net interest income**	**Regulatory capital**
+200 basis point…………………………………………………………	440,700	10,776,451
- 200 basis point…………………………………………………………	(683,085)	10,776,451

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Gross credit exposures by residual contractual maturity

	AED'000								
Contractual maturity	**Loans**	**Debt securities**	**Other assets**	**Total funded**	**Commitments***	**OTC derivatives***	**Other off-balance sheet exposures***	**Total non funded***	**Total**
Less than 3 months…………………………………………	31,835,817	1,246,715	17,739,786	50,822,318	6,611,528	1,347,830	-	7,959,358	**58,781,676**
3 months to one year………………………………………	10,507,508	172,698	377,494	11,057,700	3,653,317	1,549,408	-	5,202,725	**16,260,425**
One to five years……………………………………………	12,340,910	1,354,253	8,181	13,703,344	10,651,269	4,712,620	-	15,363,889	**29,067,233**
Over five years………………………………………………	23,525,236	4,959,014	5,911,357	34,395,607	-	808,926	-	808,926	**35,204,533**
Total	**78,209,471**	**7,732,680**	**24,036,818**	**109,978,969**	**20,916,114**	**8,418,784**	**-**	**29,334,898**	**139,313,867**

Note:
* these are converted to on balance sheet equivalent amounts

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Gross credit exposures by currency type

	AED'000								
Currency type	**Loans**	**Debt securities**	**Other assets**	**Total funded**	**Commitments***	**OTC derivatives***	**Other off-balance sheet exposures***	**Total non funded***	**Total**
Foreign Currency………………………………	44,315,979	7,732,680	6,382,951	58,431,610	8,379,084	7,659,285	-	16,038,368	**74,469,978**
AED……………………………………………	33,893,492	-	17,653,867	51,547,359	12,537,030	759,499	-	13,296,529	**64,843,888**
Total	**78,209,471**	**7,732,680**	**24,036,818**	**109,978,969**	**20,916,114**	**8,418,784**	**-**	**29,334,898**	**139,313,867**

Note:
* these are converted to on balance sheet equivalent amounts

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Gross credit exposures by geographic region

	AED'000								
	Loans	**Debt securities**	**Other assets**	**Total funded**	**Commitments***	**OTC derivatives***	**Other off-balance sheet exposures***	**Total non funded***	**Total**
Geographic Region	51,337,568	990,635	21,405,699	73,733,902	17,276,576	1,343,207	-	18,619,783	**92,353,685**
GCC Excluding UAE	9,239,270	445,151	63,216	9,747,637	827,591	615,583	-	1,443,174	**11,190,811**
Arab League (excluding GCC)	1,788,950	492,918	12,951	2,294,819	80,670	17,332	-	98,002	**2,392,821**
Asia	1,795,331	1,273,174	14,654	3,083,159	194,908	115,051	-	309,959	**3,393,118**
Africa	14,052	-	-	14,052	147	-	-	147	**14,199**
North America	983,892	2,385,194	9,081	3,378,167	187,824	33,690	-	221,514	**3,599,681**
South America	1,183,805	-	10,308	1,194,113	-	-	-	-	**1,194,113**
Caribbean	-	-	-	-	-	-	-	-	**-**
Europe	7,510,789	1,655,994	2,468,596	11,635,379	1,861,379	6,207,796	-	8,069,175	**19,704,554**
Australia	34,190	-	7,748	41,938	18,625	38,607	-	57,232	**99,170**
Others	4,321,624	489,614	44,566	4,855,804	468,394	47,516	-	515,910	**5,371,715**
Total	**78,209,471**	**7,732,680**	**24,036,818**	**109,978,969**	**20,916,114**	**8,418,784**	**-**	**29,334,898**	**139,313,867**

Note:
* these are converted to on balance sheet equivalent amounts

Impaired exposures by geographic region

	AED'000							
	Pastdue			Provisions		Adjustments		Total Impaired Assets
Geographic Region	Less than 90 days	90 days and above	Total	Specific	General	Write-offs	Writebacks	
United Arab Emirates ("UAE")……	527,127	3,958,305	4,485,432	2,353,608	1,167,950	809,012	-	4,607,814
GCC Excluding UAE……	-	204	204	204	-	-	-	11,100
Arab League (excluding GCC)……	-	-	-	-	-	-	-	-
Asia……	-	-	-	-	-	-	-	5,620
Africa……	-	-	-	-	-	-	-	-
North America……	-	-	-	-	-	-	-	11,871
South America……	-	-	-	-	-	-	-	-
Caribbean……	-	18,363	18,363	18,363	-	-	-	18,363
Europe……	-	-	-	-	-	-	-	100,023
Australia……	-	-	-	-	-	-	-	11,476
Others……	-	-	-	-	-	-	-	-
Total	**527,127**	**3,976,872**	**4,503,999**	**2,372,175**	**1,167,950**	**809,012**	**-**	**4,766,267**

Note: Jurisdictions should not be included more than once under the geographic region

Gross credit exposures by industry segment

	AED'000								
Industry segment	**Loans**	**Debt securities**	**Other assets**	**Total funded**	**Commitments***	**OTC derivatives***	**Other off-balance sheet exposures***	**Total non funded***	**Total**
Agriculture, Fishing & related activities………..	3	-	-	3	9	3	-	12	**15**
Crude Oil, Gas, Mining & Quarrying……………	561	-	-	561	2,636	2	-	2,638	**3,199**
Manufacturing……………………………………	8,270	-	-	8,270	1,374	80	-	1,454	**9,723**
Electricity& Water………………………………	2,410	-	-	2,410	-	213	-	213	**2,623**
Construction………………………………………	6,519	-	-	6,519	3,330	0	-	3,330	**9,849**
Trade………………………………………………	10,043	-	-	10,043	-	731	-	731	**10,775**
Transport, Storage & Communication………….	6,431	-	-	6,431	854	281	-	1,135	**7,566**
Financial Institutions……………………………	27,582	484	-	28,066	1,735	7,114	-	8,849	**36,915**
Services……………………………………………	5,231	-	-	5,231	1,568	58	-	1,626	**6,856**
Government………………………………………	4,537	13,703	-	18,241	56	167	-	222	**18,463**
Retail/Consumer banking………………………	13,662	-	-	13,662	3,669	-	-	3,669	**17,331**
All Others………………………………………	1,538.16	2,259	16,234	20,032	4,550	26	-	4,576	**24,608**
Total	**86,788**	**16,446**	**16,234**	**119,468**	**19,780**	**8,675**	**-**	**28,455**	**147,923**

Note:
* these are converted to on balance sheet equivalent amounts

Impaired loans by industry segment

	AED'000							
	Pastdue			Provisions		Adjustments		Total
Industry Segement	**Less than 90 days**	**90 days and above**	**Total**	**Specific**	**General**	**Write-offs**	**Writebacks**	**Impaired Assets**
Agriculture, Fishing & related activities…………………….	-	-	-	-	2	24	-	-
Crude Oil, Gas, Mining & Quarrying……………………….	-	15,782	15,782	4,366	9,034	-	-	15,782
Manufacturing………………………………………………	85,211	497,970	583,181	348,241	65,814	5,691	-	653,863
Electricity& Water………………………………………….	-	-	-	-	-	-	-	-
Construction………………………………………………..	3	1,526,079	1,526,082	516,595	569,784	123,057	-	1,540,979
Trade……………………………………………………….	35,397	802,087	837,484	694,305	258,931	163,306	-	950,617
Transport, Storage & Communication………………………	1	75,965	75,966	58,321	3,680	3,451	-	75,966
Financial Institutions………………………………………..	-	-	-	-	6	288	-	-
Services……………………………………………………..	140,290	158,334	298,624	121,872	63,482	24,136	-	332,638
Government…………………………………………………	-	-	-	-	-	-	-	-
Retail/Consumer banking……………………………………	266,124	625,135	891,259	484,337	118,833	479,274	-	891,259
All Others……………………………………………………	101	275,520	275,621	144,138	78,385	9,784	-	305,163
Total	**527,127**	**3,976,872**	**4,503,999**	**2,372,175**	**1,167,950**	**809,012**	**-**	**4,766,267**

Reconciliation of changes in provisions for impaired loans

	AED'000
Opening Balance of Provisions for Impaired Loans	2,704,659
Add: Charge for the year	
- Specific provisions	713,999
- General provisions	-
	3,418,658
Less: Write-off of impaired loans	(791,572)
Less: Write-back of provisions for loans	(226,339)
Less: Adjustments of loan loss provisions	(28,572)
Closing Balance of Provisions for Impaired Loans	**2,372,175**

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Credit risk as per the standardised approach

	AED'000					
	On balance sheet	**Off balance sheet**	**Total**			
Asset classes	**Gross outstanding**	**Net exposure after Credit Converison Factors (CCF)**	**Gross exposure before CRM**	**CRM**	**After CRM**	**Risk weighted assets**
Claims on sovereigns…………………………………………………………………………	25,475,932	1,233,431	26,709,363	-	26,709,363	182,646
Claims on non-central Government public sector entities (PSEs)………………………	589,458	135,883	725,341	-	725,341	55,704
Claims on multilateral development banks…………………………………………………	1,202,654	-	1,202,654	-	1,202,654	-
Claims on banks…………………………………………………………………………	19,068,804	13,170,615	32,239,419	(2,249,642)	29,989,778	8,877,964
Claims on securities firms…………………………………………………………………	-	-	-	-	-	-
Claims on corporates………………………………………………………………………	38,333,042	57,883,359	96,216,401	(30,482,191)	65,734,210	51,678,583
Claims included in the regulatory retail portfolio…………………………………………	5,698,421	7,654,151	13,352,573	-	13,352,573	4,219,836
Claims secured by residential property……………………………………………………	6,943,965	2,672	6,946,637	-	6,946,637	2,742,041
Claims secured by commercial real estate…………………………………………………	-	-	-	-	-	-
Past due loans………………………………………………………………………………	3,718,666	-	3,718,666	-	3,718,666	1,803,823
Higher-risk categories………………………………………………………………………	-	-	-	-	-	-
Other assets…………………………………………………………………………………	8,912,744	-	8,912,744	-	8,912,744	3,534,165
Claims on securitised assets………………………………………………………………	-	-	-	-	-	-
Credit derivatives (banks selling protection)………………………………………………	-	-	-	-	-	-
Total claims	**109,943,686**	**80,080,112**	**190,023,798**	**(32,731,832)**	**157,291,966**	**73,094,762**

Credit risk mitigation: Disclosures for standardised approach

	AED'000	
	Exposures	**Risk weighted assets**
Gross Exposures prior to credit risk mitigation	190,023,798	73,544,800
Less: Exposures covered by on-balance sheet netting	-	-
Less: Exposures covered by eligible financial collateral	(3,533,018)	(279,594)
Less: Exposures covered by guarantees	(29,198,814)	(170,444)
Less: Exposures covered by credit derivatives	-	-
Net exposures after credit risk mitigation	**157,291,966**	**73,715,244**

EQUITY POSITION IN THE BANKING BOOK

a) Qualitative Disclosures

As at 31 December 2017 , the bank's total equity investment portfolio in the banking book amounted to AED Nil , which represents quoted investments. For details of the accounting policies and valuation methodology, please refer to Note 3 of the financial statements under 'Significant Accounting Policies'. Details of cost, market and fair value are reported in Note 18 of the financial statements under the heading of "Financial Investments".

b) Quantitative Disclosures

QUANTITATIVE DETAILS OF EQUITY POSITION:

	Current Year		Previous Year	
Type	**Publicly Traded**	**Privately Held**	**Publicly Traded**	**Privately Held**
Equities	-	-	-	-
Collective investment schemes	-	-	-	-
Any other investment	-	-	-	-
Total	-	-	-	-

REALISED, UNREALISED AND LATENT REVALUATION GAINS (LOSES) DURING THE YEAR:

Gains (Losses)	**AED'000**
Realised gains (losses) from sales and liquidations	-
Unrealised gains (losses) recognised in the balance sheet but not through profit and loss account	(1,664)
Latent revaluation gains (losses) for investment recorded at cost but not recognised in balance sheet or profit and loss account	-
Total	**(1,664)**

ITEMS ABOVE INCLUDED IN TIER 1/TIER 2 CAPITAL:

Tier Capital	**AED'000**
Amount included in Tier I capital	(1,664)
Amount included in Tier II capital	-
Total	**(1,664)**

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EQUITY POSITION IN THE BANKING BOOK

CAPITAL REQUIREMENTS BY EQUITY GROUPINGS

Grouping	AED'000
Strategic investments……	-
Available for sale……	-
Held for trading……	-
Total capital requirement	**-**