

# **HSBC Financial Services (Middle East) Limited**

## **Financial statements**

*For the year ended 31 December 2012*

# **HSBC Financial Services (Middle East) Limited**

## **Financial statements**

*For the year ended 31 December 2012*

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## HSBC Financial Services (Middle East) Limited

### Director's Report

The Directors have pleasure in submitting their annual report and the audited financial statements for the year ended 31 December 2012.

### Activities

HSBC Financial Services (Middle East) Limited ("the Company") completed the sale of its private equity business and continues to focus on equity brokerage activities in the GCC markets.

### Results for the year

The operations for the year 2012 resulted in a net profit of AED 128.5 million (2011: AED 34.03 million). The state of the Company's affairs is set out in the financial statements on pages 3 to 27.

### Dividends

The directors propose a final dividend of AED 129 million for the year ended 31 December 2012 (2011: AED 40 million).

### Directors of the Board

The Directors of the Company during the year and to the date of this report were as follows:

Marcus John Hurry	(Chairman) (appointed on 20 December 2010)
Georges El-Hedery	(appointed on 16 February 2011)
Roger Winfield	(appointed on 16 February 2011)
Angela Calvert	(appointed on 2 June 2011)

### Auditors

KPMG retire and, being eligible, offer themselves for reappointment.



Mr. Marcus J Hurry  
Chairman

18 MAR 2013



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## **Independent Auditors' Report**

The Shareholders  
HSBC Financial Services (Middle East) Limited

### **Report on the Financial Statements**

We have audited the accompanying financial statements of HSBC Financial Services (Middle East) Limited ("the Company"), which comprise the statement of financial position as at 31 December 2012, the statements of comprehensive income (comprising a statement of comprehensive income and a separate statement of income), changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these 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.

#### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

#### *Opinion*

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

### **Report on Other Legal and Regulatory Requirements**

As required by the UAE Federal Law No. 8 of 1984 (as amended), we further confirm that we have obtained all information and explanations necessary for our audit; the financial statements comply, in all material respects, with the applicable requirements of the UAE Federal Law no.8 of 1984 (as amended), Union Law no.10 of 1980 and the Articles of Association of the Company; that proper financial records have been kept by the Company; and the contents of the Directors' report which relate to these financial statements are in agreement with the Company's financial records. We are not aware of any violation of the above mentioned Law and the Articles of Association having occurred during the year ended 31 December 2012, which may have had a material adverse effect on the business of the Company or its financial position.



KPMG

Vijendranath Malhotra  
Registration No: 48 B

18 MAR 2013

## HSBC Financial Services (Middle East) Limited

### Statement of income for the year ended 31 December 2012

	Notes	2012 AED'000	2011 AED'000
Interest income	6	13	32
Dividend income	12.3	154,130	25,711
Fee and commission income	7	37,419	46,478
Cost of sale of subsidiary	12.3	(23,633)	(2,078)
Other income		1,760	-
		-----	-----
Operating income		169,689	70,143
General and administrative expenses	8	(9,046)	(27,606)
		-----	-----
Profit before tax		160,643	42,537
Tax expense	9	(32,129)	(8,507)
		-----	-----
Profit for the year		128,514	34,030
		=====	=====

The accompanying notes on pages 8 to 27 form an integral part of these financial statements.

The independent auditors' report is set out on page 2.

## HSBC Financial Services (Middle East) Limited

### Statement of comprehensive income for the year ended 31 December 2012

	2012 AED'000	2011 AED'000
Net profit for the year	128,514	34,030
Other comprehensive income	-	-
	-----	-----
<b>Total comprehensive income for the year</b>	<b>128,514</b>	<b>34,030</b>
	=====	=====

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# HSBC Financial Services (Middle East) Limited

## Statement of financial position As at 31 December 2012

		2012 AED'000	2011 AED'000
<b>Assets</b>	<i>Notes</i>		
Cash and bank balances	10	180,457	118,788
Receivables	11	4	17
Investments	12	1,243	171,775
Other assets	13	67,365	16,065
<b>Total assets</b>		<b>249,069</b>	<b>306,645</b>
<b>Liabilities</b>			
Other liabilities	14	43,084	189,174
<b>Total liabilities</b>		<b>43,084</b>	<b>189,174</b>
<b>Equity</b>			
Share capital	15	51,000	51,000
Legal reserve	16	25,500	20,018
Retained earnings		129,485	46,453
<b>Total equity</b>		<b>205,985</b>	<b>117,471</b>
<b>Total liabilities and equity</b>		<b>249,069</b>	<b>306,645</b>

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The independent auditors' report is set out on page 2.

These financial statements were approved by the Board of Directors on 18 MAR 2013 and signed on their behalf by:



Marcus J Hurry  
Chairman

# HSBC Financial Services (Middle East) Limited

## Statement of cash flows for the year ended 31 December 2012

	<i>Note</i>	<b>2012</b> <b>AED'000</b>	<b>2011</b> <b>AED'000</b>
<b>Operating activities</b>			
Profit for the year before tax		160,643	34,030
Less: dividend income		(154,130)	(25,711)
Add: cost of sale of subsidiary		5,001	-
<i>Operating profit before working capital change</i>		<u>11,514</u>	<u>8,319</u>
Change in receivables		13	2,560
Change in other assets		(51,300)	16,073
Change in other liabilities		2,059	(39,701)
<i>Net cash used in operations</i>		<u>(37,714)</u>	<u>(12,749)</u>
Income tax paid		(8,507)	(11,271)
<i>Net cash (used in) / generated from operating activities</i>		<u>(46,221)</u>	<u>(24,020)</u>
<b>Investing activities</b>			
Net movement in investments		-	52,198
Dividend income		147,890	25,711
<i>Net cash generated from investing activities</i>		<u>147,890</u>	<u>77,909</u>
<b>Financing activities</b>			
Dividend paid		(40,000)	(40,000)
<i>Net cash used in financing activities</i>		<u>(40,000)</u>	<u>(40,000)</u>
Net increase in cash and cash equivalents		61,669	13,889
Cash and cash equivalents at 1 January		118,788	104,899
<b>Cash and cash equivalents at 31 December</b>	<b>10</b>	<u><u>180,457</u></u>	<u><u>118,788</u></u>

The accompanying notes on pages 8 to 27 form an integral part of these financial statements.

The independent auditors' report is set out on page 2.

## HSBC Financial Services (Middle East) Limited

### Statement of changes in equity for the year ended 31 December 2012

	Share capital AED' 000	Legal reserve AED' 000	Retained earnings AED' 000	Total AED' 000
At 1 January 2011	51,000	16,615	55,826	123,441
Total comprehensive income for the year	-	-	34,030	34,030
<i>Changes in owners' equity</i>				
Dividend paid	-	-	(40,000)	(40,000)
Transfer to statutory reserve	-	3,403	(3,403)	-
At 31 December 2011	51,000	20,018	46,453	117,471
<b>At 1 January 2012</b>	<b>51,000</b>	<b>20,018</b>	<b>46,453</b>	<b>117,471</b>
Total comprehensive income for the year	-	-	128,514	128,514
<i>Changes in owners' equity</i>				
Dividend paid	-	-	(40,000)	(40,000)
Transfer to statutory reserve	-	5,482	(5,482)	-
<b>At 31 December 2012</b>	<b>51,000</b>	<b>25,500</b>	<b>129,485</b>	<b>205,985</b>

The accompanying notes on pages 8 to 27 form an integral part of these financial statements.

The independent auditors' report is set out on page 2.

# HSBC Financial Services (Middle East) Limited

## Notes to the financial statements for the year ended 31 December 2012

### 1. Legal status and principal activities

HSBC Financial Services (Middle East) Limited ("the Company") was incorporated in Dubai, United Arab Emirates, with limited liability on 6 April 1975 under the terms of a decree issued by His Highness Sheikh Rashid Bin Saeed Al Maktoum, The Ruler of Dubai. With effect from 1 July 1995, the name of the Company was changed from Wardley Middle East Limited to HSBC Financial Services (Middle East) Limited ("the Company"). The immediate holding company is HSBC Bank Middle East Limited, Jersey ("the Parent"), and ultimate holding company is HSBC Holdings plc, incorporated in the United Kingdom. The registered address of the Company is 1st Floor, Building No 5, Emaar Square, P. O. Box 502601, Dubai, UAE.

The Company has a Banking license from Central Bank of UAE. The Company is mainly involved in private banking and equity brokerage activities in the GCC Markets.

The Company has two 100% subsidiaries in United Kingdom by the name of Shenfield Nominees Limited & Greenwell Nominees Limited.

Up until 10 December 2012, the Company had a 100% investment in HSBC Private Equity Middle East Limited ("the Subsidiary"), a limited liability company incorporated in British Virgin Islands. The subsidiary in turn owned 100% subsidiaries, HSBC Private Equity Middle East Management Limited and HSBC Private Equity Middle East Management II Limited, limited liability companies incorporated in British Virgin Islands. These companies managed HSBC Private Equity Middle East LP ("LP") and HSBC Private Equity Middle East LP 2 ("LP2") respectively. LP and LP2 owned Sereptah Limited (77.5%) and Ashwood Energy Limited (75%) respectively. The investment in the Subsidiary was sold in year 2012. For further details please refer to note 12.

### 2. Basis of preparation

#### (a) Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") and interpretations adopted by the standing interpretation committee of the International Accounting Standards Board ("IASB").

#### (b) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are issued but not effective for the accounting period starting 1 January 2012, and have not been early adopted in preparing these financial statements:

- IFRS 9 'Financial Instruments' (effective 1 January 2015);
- IFRS 10 'Consolidated Financial Statements' (effective 1 January 2013);
- IFRS 11 'Joint Arrangements' (effective 1 January 2013);
- IFRS 12 'Disclosure of Interests in Other Entities' (effective 1 January 2013);
- IFRS 13 'Fair Value Measurement' (effective 1 January 2013);
- IAS 19 'Employee Benefits (amended 2011)' (effective 1 January 2013);
- IAS 27 Separate Financial Statements (2011) (effective 1 January 2013);
- IAS 28 Investments in Associates & Joint Ventures (2011) (effective 1 January 2013)

## HSBC Financial Services (Middle East) Limited

Notes to the financial statements  
for the year ended 31 December 2012

### 2. Basis of preparation (continued)

#### (b) New standards and interpretations not yet adopted (continued)

Management has assessed the impact of the new standards, amendments to standards and interpretations and amendments to published standards, and concluded that they are either not relevant to the Company or their impact is not material or is limited to the disclosures and presentation requirements in the financial statements.

#### (c) Basis of measurement

These financial statements are prepared under the historical cost convention except for 'Held for trading' financial investments which are revalued at fair value at the reporting date.

#### (d) Functional and presentation currency

Items included in the financial statements of the Company are measured and presented in United Arab Emirates 'Dirhams' ('AED') which is the functional currency of the Company, rounded to the nearest thousand.

#### (e) Accounting for subsidiaries

The Company acts as a holding company of a group of entities (collectively referred to as "Group", refer note 12.2). These financial statements represent the results of operations and financial position of the Company only. In these financial statements the investments in subsidiaries are stated at cost less provision for impairment losses in accordance with International Accounting Standard 27 - Consolidated and Separate Financial Statements. Consolidated financial statements are not prepared on the basis that the ultimate holding company provides consolidated financial statements.

#### (f) Use of estimates and judgments

The preparation of these financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

In particular, considerable management judgment is required in respect of determining impairment losses on receivables.

### 3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

## HSBC Financial Services (Middle East) Limited

Notes to the financial statements  
for the year ended 31 December 2012

### 3. Significant accounting policies (continued)

#### a) Interest income and expense

Interest income and expense for all interest bearing financial instruments are recognised in 'Interest income' and 'Interest expense' in the statement of income using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that discounts estimated future receipts and payments earned or paid on a financial asset or a liability through its expected life or, where appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

When calculating effective interest rates, the Company estimates cash flows considering all contractual terms of the financial instrument, but not future credit losses. The calculation includes all amounts paid or received by the Company that are integral part of the effective interest rate, including transaction costs and all other premiums and discounts.

Interest on impaired financial assets is calculated by applying the original effective interest rate of the financial asset to the carrying amount as reduced by any allowance for impairment.

#### b) Fees and commissions

Fees and commissions which form an integral part of the effective interest rate of a financial instrument are recognised as an adjustment to the effective interest rate and recorded in net interest income.

Fees and commissions includes private banking commissions, murabaha fees and commission income on trading activities on behalf of customers. They are recognised as and when the related services are performed.

#### c) Dividend income

Dividend income is recognised when the right to receive the payment is established.

#### d) Receivables

Receivables arise on unsettled trades and are stated at amortised cost less impairment losses, if any.

#### e) Financial instruments

A financial instrument is any contract that gives rise to both a financial asset for the Company and a financial liability or equity instrument of another party. All assets and liabilities in the statement of financial position are financial instruments, except deferred tax assets, advance receipts and shareholders' equity.

# HSBC Financial Services (Middle East) Limited

## Notes to the financial statements for the year ended 31 December 2012

### 3. Significant accounting policies (continued)

#### e) Financial instruments (continued)

##### *Classification*

Financial instruments are categorised as follows:

*Financial assets at fair value through profit or loss ('FVPL')*: This category has two sub-categories: financial assets held for trading and those designated to be fair valued through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges.

*Loans and advances* are non-derivative financial assets with fixed and determinable payments that are not quoted in an active market. They arise when the Company provides money directly to the borrower with no intention of trading the receivable.

*Held to maturity assets* are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company has the positive intent and ability to hold to maturity. Where the Company sells other than an insignificant amount of held to maturity assets, the entire category would be reclassified as available for sale.

*Available-for-sale assets* are those non-derivative financial assets that are designated as available for sale or not classified as (a) loans and advances, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

##### *Initial recognition*

The Company recognises financial assets and liabilities on its statement for financial position on the date it becomes a party to the contractual provisions of the instrument. From this date, any gains and losses arising from changes in fair value of the assets or liabilities designated as fair value through profit or loss or available for sale assets are recognised.

Loans and advances are recognised on the day the asset is delivered to the counterparty.

##### *Derecognition*

A financial asset is derecognised when the Company loses control over the contractual rights that comprise that asset. This occurs when the rights are realised, expired or surrendered. A financial liability is derecognised when it is extinguished. Loans and receivables are derecognised on the day the cash is received by the Company, or the loans are either sold or written off.

##### *Measurement*

A financial asset or financial liability is initially measured at fair value plus (for an item not subsequently measured at fair value through profit or loss) transaction costs that are directly attributable to its acquisition or issue.

Subsequent to initial recognition all financial instruments to be fair valued through profit or loss and available for sale assets are measured at fair value, except any instrument that does not have a

## HSBC Financial Services (Middle East) Limited

Notes to the financial statements  
for the year ended 31 December 2012

### 3. Significant accounting policies (continued)

#### e) Financial instruments (continued)

##### *Measurement (continued)*

reliably measurable fair value. Such instruments are measured as set out in fair value measurement principles below.

All held to maturity financial instruments and loans and advances for which the fair value has not been hedged are measured at amortised cost less impairment losses. Amortised cost is calculated using the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

##### *Fair value measurement principles*

Fair value is the amount for which an asset could be exchanged, or liabilities settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the fair value of financial instruments is based on quoted market prices in an active market for that instrument, a market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis. If a quoted market price is not available, or if a market for a financial instrument is not active, the fair value is determined by using valuation techniques. Valuation techniques include net present value techniques, discounted cash flow methods, comparison to similar instruments for which market observable prices exist.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market-related rate at the reporting date for an instrument with similar terms and conditions.

##### *Gains and losses on subsequent measurement*

Gains and losses arising from changes in the fair value of the 'financial assets or financial liability at fair value through profit or loss' categories are included in the statement of income in the period in which they arise. Gains and losses arising from changes in the fair value of available for sale financial instruments are recognised in statement of comprehensive income, until the financial instrument is derecognised or impaired at which time the cumulative gain or loss previously recognised in statement of comprehensive income is recognised in the statement of income.

##### *Impairment*

Financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amount is estimated. Impairment loss is the difference between the net carrying value of an asset and its recoverable amount.

## HSBC Financial Services (Middle East) Limited

Notes to the financial statements  
for the year ended 31 December 2012

### 3. Significant accounting policies (continued)

#### e) Financial instruments (continued)

##### *Offsetting*

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position only when the Company has a legally enforceable right to set off the recognised amounts and the transactions are intended to be settled on a net basis.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions such as in the Company's trading activity.

#### f) Cash and cash equivalents

Cash and cash equivalents include cash in hand, unrestricted balances held with central banks and other banks, Bank overdrafts, due to banks and other highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in the fair value, and are used by the Company in the management of its short term commitments.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

#### g) Foreign currencies

Foreign currency transactions are recorded at the rates of exchange ruling at the value dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies are translated into AED at the rates of exchange ruling at the statement of financial position date. Any resultant gains and losses are recognised in the statement of income.

Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities that are stated at fair value are translated into AED at the foreign exchange rates ruling at the dates at which fair values were determined.

#### h) Retirement benefits

The Company contributes to the UAE Nationals Pension and Social Security Scheme for UAE Nationals as per the requirements of the Government of the United Arab Emirates. The Company also makes contributions to the HSBC International Staff Retirement Benefit Scheme for all international staff. For locally recruited employees (non UAE nationals), staff gratuity is calculated in accordance with the UAE Labour Law and is held in the books of HSBC Bank Middle East Limited, UAE Operations ("HBME UAE") and recharged to the Company by HBME UAE on a monthly basis.

## **HSBC Financial Services (Middle East) Limited**

### **Notes to the financial statements** *for the year ended 31 December 2012*

#### **3. Significant accounting policies (continued)**

##### **i) Provisions**

A provision is recognised in the statement of financial position when the Company has a legal or constructive obligation as a result of past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

##### **j) Income tax expense**

Income tax comprises current and deferred tax. Current and deferred tax are recognised in statement of income except to the extent that it relates to items recognised directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority, and when a legal right to offset exists.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences to the extent that it is possible that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

##### **k) Assets held for sale**

Non-current assets and disposal groups (including both the assets and liabilities of the disposal group) are classified as held for sale when their carrying amounts will be recovered principally through sale, they are available for sale in their present condition and their sale is highly probable.

Non-current assets held for sale and disposal groups are measured at the lower of carrying amount and fair value less costs to sell.

# HSBC Financial Services (Middle East) Limited

Notes to the financial statements  
for the year ended 31 December 2012

## 4. Financial risk management

### a) Introduction and overview

The Company has exposure to the following risks from financial instruments:

- Credit risk
- Market risk
- Liquidity risk
- Operational risk

This note presents information about the Company's exposure to each of the above risks and the Company's objective, policies and processes for measuring and managing risk.

#### *Risk management framework*

The risk management framework is established by HSBC Holdings plc ('the Ultimate Holding Company') which sets out the well established risk governance and ownership structure to ensure oversight of, and accountability for, effective management of risk at regional, customer group and operating entity levels. However, the primary responsibility for managing risk rests with the Board of Directors and Managing Director of the Company. The Board of Directors has the responsibility to cascade the Ultimate Holding Company's risk management policies which are designed to support the formulation of risk appetite, guide employees and establish procedures for monitoring and controlling risk with timely and reliable reporting to the Board.

The Ultimate Holding Company regularly reviews and updates its risk management policies and systems to reflect changes in markets, products and emerging best practice which are then cascaded to the Company.

### b) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligation, and arises principally from the Company's loans and advances to customers and investment securities held by the Company. The Company has in place the Ultimate Holding Company standards, policies and procedures dedicated to monitor and manage risk from such activities.

#### *Management of credit risk*

The Ultimate Holding Company formulates the high-level credit policies, the independent review of the Company's large credit exposures and portfolio management of risk concentrations. It also reviews the efficiency of the Company's credit approval process, a key element of which is the Ultimate Holding Company's universal credit grading system.

The Company's local management is responsible for:

- implementing credit policies, procedures and lending guidelines that conform to Ultimate Holding Company standards;
- monitoring the credit process which includes delegated approval authorities and credit procedures;

## HSBC Financial Services (Middle East) Limited

### Notes to the financial statements for the year ended 31 December 2012

#### 4. Financial risk management (*continued*)

##### b) Credit risk (*continued*)

- monitoring quality and performance of the credit portfolio;
- monitoring and controlling all credit risks;
- managing risk concentration by market sector, geography and product;
- managing exposures by customers and retail product segment through local systems; and
- frequent and intensive review and reporting of problem exposures in order to accelerate remedial action.

Periodic risk based audits of credit processes and portfolios are undertaken by Group Audit Middle East. Audit includes consideration of the adequacy and clarity of credit policy/procedure manuals; an in-depth analysis of a representative sample of accounts; the adequacy of impairment calculations and checking that the Ultimate Holding Company and local standards and policies are adhered to in the approval and management of credit facilities.

##### *Debt securities*

Up until March 2012, the Company traded in listed debt securities and the related risks and rewards (including 100% concentration of debt securities in the Indian market), hedged with HSBC Bank Plc by issuing Debt Linked Agreements. The mark to market gain / loss on these listed securities was fully set off against the corresponding mark to market loss / gain on the Debt Linked Agreements. As at 31 December 2012, no debt securities are held by the Company.

Credit risk on balances with banks is managed by placing funds with banks and other institutions with acceptable credit ratings.

##### c) Market risk

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads will affect the Company's income or the value of its holdings of financial instruments. Market risk arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes.

The Company is not currently exposed to any significant market risk.

##### *Interest rate risk*

Interest rate risk is the risk that the value of financial instruments will fluctuate due to changes in market interest rates. The Company defines interest rate risk as the current or prospective risk to earnings and capital arising from adverse movements in interest rates.

The Company manages its interest rate risk by linking the interest rate on borrowings and lending to the relevant market reference rates. The Company was not exposed to any significant interest rate risk as all interest bearing debt securities were covered by issue of back to back debt linked agreements with HSBC Bank plc up until March 2012.

As at the reporting date the Company is not exposed to any interest rate risk.

## HSBC Financial Services (Middle East) Limited

### Notes to the financial statements for the year ended 31 December 2012

#### 4. Financial risk management (continued)

##### d) Liquidity risk

Liquidity risk is the risk that the Bank does not have sufficient financial resources to meet its obligations as they fall due or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows. Funding risk (a form of liquidity risk) arises when the necessary liquidity to fund illiquid asset positions cannot be obtained at the expected terms and when required.

##### *Liquidity and funding management*

The management of liquidity and funding is carried out by the Company in accordance with the Ultimate Holding Company's practices and limits. The Company's liquidity and funding management process includes:

- Monitoring the maturity profile to ensure adequate liquidity is maintained at all times;
- Projecting cash flows;
- Monitoring statement of financial position liquidity ratios against internal requirements;
- Managing contingent liquidity commitments exposures; and
- Maintaining debt financing plans.

The primary source of funding of the Company is through financing arrangements with Ultimate Holding Company entities.

The following table represents the contractual maturity of the financial liabilities of the Company at the reporting date, based on the contractual repayment arrangements determined on the basis of the remaining period at the reporting date to the final maturity dates.

	Carrying value AED'000	Within 3 months AED'000	No fixed maturity AED'000	Total AED'000
At 31 December 2012				
Other liabilities	43,084	43,084	-	43,084
<b>Total</b>	<b>43,084</b>	<b>43,084</b>	<b>-</b>	<b>43,084</b>

	Carrying value AED'000	Within 3 months AED'000	No fixed maturity AED'000	Total AED'000
At 31 December 2011				
Other liabilities	189,174	17,403	171,771	189,174
<b>Total</b>	<b>189,174</b>	<b>17,403</b>	<b>171,771</b>	<b>189,174</b>

# HSBC Financial Services (Middle East) Limited

## Notes to the financial statements for the year ended 31 December 2012

### 4. Financial risk management (continued)

#### e) Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Company's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Company's operations.

The Company's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Company's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

#### *Management of operational risk*

The Ultimate Holding Company has codified its operational risk management process by issuing high level standards. This explains how the Ultimate Holding Company manages operational risk by identifying, assessing, monitoring, controlling and mitigating the risk, rectifying operational risk events, and implementing any additional procedures required for compliance with local regulatory requirements.

The Company is responsible for managing this risk through a controls-based environment in which processes are documented, authorisation is independent and transactions are reconciled and monitored. This is supported by an independent programme of periodic reviews undertaken by Group Audit Middle East, and by monitoring external operational risk events, which ensure that the Company stays in line with best practice and takes account of lessons learned from publicised operational failures within industry.

The Company is responsible for implementing the following Ultimate Holding Company standards:

- Assigning responsibility for operational risk at the Company;
- Use of information systems to record the identification and assessment of operational risks and to generate appropriate, regular operational risk reporting;
- Assessment of risks inherent in the processes, activities and products;
- Reporting of operational risk loss data to the management and the Ultimate Holding Company if it exceeds the materiality thresholds set by the Ultimate Holding Company; and
- Consideration of risk mitigation, including insurance, where considered cost-effective.

### 5. Capital management

The Company's capital management approach is driven by its strategy and organizational requirements, taking into account the regulatory and commercial environment in which it operates. It is the Company's policy, in line with its Ultimate Holding Company requirements, to maintain a strong capital base to support the development of its business and to meet the regulatory capital requirements at all times. It also maintains a strong discipline over its investment decisions and where it allocates its capital, seeking to ensure that returns on investment are appropriate after taking account of capital costs. It is the responsibility of the local

## HSBC Financial Services (Middle East) Limited

### Notes to the financial statements for the year ended 31 December 2012

#### 5. Capital management (continued)

management of the Company to manage its own capital required to support planned business growth and meet local regulatory requirements.

As part of the Ultimate Holding Company's Capital Management Framework, capital generated in excess of planned requirements is generally returned to the Parent, normally by way of dividends.

The Company's lead regulator, the Central Bank of the UAE, sets and monitors regulatory capital requirements.

In implementing current capital requirements, the Company calculates the Capital Adequacy ratio in accordance with the guidelines issued by the Central Bank of the UAE prescribing the ratio of total capital to total risk-weighted assets.

The Company's regulatory Capital Adequacy ratio (BASEL II), set by the Central Bank of the UAE at a minimum level of 12%, is analyzed as follows:

	2012 AED'000	2011 AED'000
<b>Tier 1 capital</b>		
Share capital	51,000	51,000
Legal reserve	20,018	16,615
Retained earnings	6,453	15,826
	<u>77,471</u>	<u>83,441</u>
<b>Tier 2 capital</b>	-	-
	<u>77,471</u>	<u>83,441</u>
<b>Total base capital (a)</b>		
	<u>77,471</u>	<u>83,441</u>
<b>Risk weighted assets:</b>		
Credit risk	62,605	34,756
Market risk	-	-
Operational risk	72,130	48,816
	<u>134,735</u>	<u>83,572</u>
<b>Risk weighted assets (b)</b>		
	<u>134,735</u>	<u>83,572</u>
<b>Capital adequacy ratio (%)</b> <b>[(a)/(b)*100]</b>	<b>57.50%</b>	<b>99.84%</b>

The Company has complied with all externally imposed capital requirements throughout the year.

There have been no material changes in the Company's management of capital during the year.

## HSBC Financial Services (Middle East) Limited

### Notes to the financial statements for the year ended 31 December 2012

#### 6. Interest income

	2012 AED'000	2011 AED'000
Interest income on term deposits with HSBC Bank Middle East Limited	13	32
	<u>13</u>	<u>32</u>

#### 7. Fee and commission income

	2012 AED'000	2011 AED'000
Inter-company income:		
- HSBC Bank plc	35,766	33,303
- HSBC Private Banking Holdings (Suisse)	340	10,524
Third party income	1,313	2,651
	<u>37,419</u>	<u>46,478</u>

Fee and commission income mainly comprises commissions from sales and trading, Murabaha fees, equity broking, private banking and cross border referral fees from HSBC Group entities.

#### 8. General and administrative expenses

	2012 AED'000	2011 AED'000
Inter-company cost recharges - net of reimbursements	101	5,965
Personnel expenses (net)	7,570	19,462
Others (net)	1,375	2,179
	<u>9,046</u>	<u>27,606</u>

## HSBC Financial Services (Middle East) Limited

### Notes to the financial statements for the year ended 31 December 2012

#### 9. Tax expense

Provision for tax expense is made at the rate of 20% of the taxable profit, in accordance with regulations issued in the Emirate of Dubai.

	2012 AED'000	2011 AED'000
Profit before tax	160,643	42,537
Total taxable profit	160,643	42,537
Tax for the year at the applicable tax rate of 20%	32,129	8,507
	32,129	8,507

#### 10. Cash and bank balances

	2012 AED'000	2011 AED'000
Balances at bank		
- Settlement accounts	8	28
- Call accounts	7,362	7,269
- Current account	173,087	81,491
- Term deposit account	-	30,000
	180,457	118,788

#### 11. Receivables

	2012 AED'000	2011 AED'000
Unsettled receivables	4	17

## HSBC Financial Services (Middle East) Limited

### Notes to the financial statements for the year ended 31 December 2012

#### 12. Investments

	2012 AED'000	2011 AED'000
<b>Held for trading</b>		
Debt securities (refer note 12.1)	-	171,771
<b>Available for sale</b>		
Investment in Havenvest Private Equity Middle East Limited (refer note 12.3)	1,242	3
<b>Investment in subsidiaries</b>		
Investment in subsidiaries (refer note 12.2)	1	1
	<u>1,243</u>	<u>171,775</u>

- 12.1** The debt securities held at 31 December 2011 matured during the year and a decision was taken by HSBC Bank plc to cease trading in listed debt securities, including the hedging of these securities by issuing Debt Linked Agreements (refer note 14). In relation to the cessation of such activity the Company cancelled its Foreign Institutional Investor licence with the Securities and Exchange Board of India.

#### 12.2 Investment in subsidiaries

A subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by the other entity (known as the parent). Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The Company's interest, held directly or indirectly, in subsidiaries is as follows:

Name	Status	31 Dec 2011 % holding	31 Dec 2012 % holding	Incorporated in
Shenfield Nominees Limited	Limited liability company	100	100	United Kingdom
Greenwell Nominees Limited	Limited liability company	100	100	United Kingdom

- 12.3** Further to the management buy-out ("MBO") agreement in 2011, on 22 March 2012, the Company entered into a sale and purchase agreement ("SPA") with Havenwest Partners Limited ("HPL") wherein the Company agreed to sell 80.1% of its investment in the fully owned subsidiary HSBC Private Equity Middle East Limited (subsequently renamed to Havenvest Private Equity Middle East Limited on 18 October 2012 and re-domiciled to the Dubai International Financial Centre) ("HPE") should the terms of the SPA be met including those on or before the completion date.

## HSBC Financial Services (Middle East) Limited

### Notes to the financial statements for the year ended 31 December 2012

#### 12 Investments (continued)

On 26 June 2012, the Board members of HPE declared a dividend which was paid in the form of shares which resulted in the share capital of HPE to increase to AED 6,243 thousand (USD 1,700 thousand).

The transaction was completed on 10 December 2012 and 80.1% of shares in HPE, amounting to AED 5,001 thousand (USD 1,362 thousand), were transferred to HPL. Additionally, as per the terms of the SPA, the Company was entitled to procure by way of dividend any cash in excess of the amount required to be maintained by HPE. Therefore, on 10 December 2012, the Company received a final dividend of AED 147,890 thousand as part of the completion of the SPA.

The costs incurred on the sale transaction amounted to AED 23,633 thousand (2011: AED 2,078 thousand).

Subsequent to the completion date of the SPA on 10 December 2012, the residual investment in HPE has been classified as an available for sale investment.

Name	Status	31 Dec 2011 % holding	31 Dec 2012 % holding	Incorporated in Dubai International Financial Centre (previously domiciled in British Virgin Islands)
Havenvest Private Equity Middle East Limited (previously HSBC Private Equity Middle East Limited) ("HPE")	Limited liability company	100	19.9	British Virgin Islands
HSBC Private Equity Middle East Management Limited *	Limited liability company	100	19.9	British Virgin Islands
HSBC Private Equity Middle East Management II Limited *	Limited liability company	100	19.9	British Virgin Islands
HSBC Private Equity Middle East LP 1 *	Limited partnership	1.42	0.28	Bermuda
HSBC Private Equity Middle East LP 2 *	Limited partnership	0.05	0.001	Bermuda
Ashwood Energy Limited (refer note 12.4)	Limited liability company	25.04	-	British Virgin Islands
Sereptah Limited (refer note 12.4)	Limited liability company	18.6	-	British Virgin Islands

\* - Investments in these subsidiaries is held indirectly by the Company through HPE.

- 12.4 As part of the SPA between the Company and HPL, it was agreed that the principal investments held by HPE were to be transferred to HSBC Bank Middle East Limited ("HBME" or "the Parent") for an agreed consideration. As such the investments in Ashwood Energy Limited and Sereptah Limited were sold to HBME on 10 December 2012.

# HSBC Financial Services (Middle East) Limited

## Notes to the financial statements

for the year ended 31 December 2012

### 13. Other assets

	2012 AED'000	2011 AED'000
Inter-company receivables (refer note 17)	66,777	12,855
Others	588	3,210
	<u>67,365</u>	<u>16,065</u>

### 14. Other liabilities

	2012 AED'000	2011 AED'000
Tax liability (refer note 9)	32,129	8,507
Settlement accounts	(421)	169
Debt linked agreements (refer note 12.1)	-	171,771
Others	11,376	8,727
	<u>43,084</u>	<u>189,174</u>

### 15. Share capital

	2012 AED'000	2011 AED'000
<i>Authorised, issued and fully paid up:</i>		
51,000 ordinary shares of AED 1,000 each (2011: 51,000 ordinary shares of AED 1,000 each)	51,000	51,000

As at 31 December 2012, 51,000 (2011: 51,000) ordinary shares of AED 1,000 each were held by the Parent.

### 16. Legal reserve

In accordance with the provisions of Article 82 of Union law No 10 of 1980 and UAE Federal Law No. 8 of 1984 (as amended), a minimum of 10% of the net income for the year is required to be transferred to a statutory reserve until this reserve is equal to 50% of the paid up capital of the Company. A transfer of AED 5.48 million (2011: AED 3.4 million) has been made to the legal reserve in compliance with these laws. This statutory reserve is not currently available for distribution.

### 17. Transactions with related parties

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In the case of the Company, related parties, as defined in International Accounting Standard No 24, include major shareholders of the Company, directors and officers of the Company and companies of whom they are principal owners and key management personnel.

# HSBC Financial Services (Middle East) Limited

Notes to the financial statements  
for the year ended 31 December 2012

## 17. Transactions with related parties (continued)

Banking transactions are entered into with the related parties on agreed terms and conditions approved by the Management.

	2012	2011
Transactions during the year	AED'000	AED'000
Interest income (note 6)	13	32
Fee and commission income (note 7)	36,106	43,827
Dividend income (note 12.3)	154,130	25,711
Charges paid for services received from HPE	1,096	4,884
Expenses recharged to:		
- HSBC Global Asset Management (UK) Ltd	4,797	5,041
- HSBC Group Private Banking	8,717	8,031
- Havenvest Private Equity Middle East Ltd. (previously HSBC Private Equity Middle East Ltd.)	11,736	15,180
Balance as at 31 December	2012	2011
	AED'000	AED'000
Included in cash and bank balances:		
HSBC Bank Middle East Limited – UAE Operations	180,448	107,741
HSBC Private Banking Holdings Limited (Suisse)	-	11,019
	180,448	118,760
	2012	2011
	AED'000	AED'000
Included in other assets recoverable from:		
HSBC Bank Plc – UK operations	673	37
HSBC Private Banking Holdings Limited (Suisse)	859	6,430
HSBC Asset Management	1,597	2,172
Havenvest Private Equity Middle East Ltd. (previously HSBC Private Equity Middle East Ltd.)	6,107	4,216
HSBC Bank Middle East Head office - Jersey	57,541	-
	66,777	12,855
Included in other liabilities:		
Debt Linked Agreements – HSBC Bank Plc	-	171,771
HSBC Bank Plc – UK operations	-	3,205
HSBC Bank Middle East Ltd – UAE Operations	296	600
	296	175,576

# HSBC Financial Services (Middle East) Limited

## Notes to the financial statements for the year ended 31 December 2012

### 17. Transactions with related parties (continued)

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly. All key management personnel expenses are borne by HSBC Bank Middle East Limited – UAE Operations, a related party and are not recharged to the Company.

### 18. Fair value

The management believes that the carrying value of financial assets and liabilities in the statement of financial position represents a reasonable approximate of their fair values.

#### *Fair value hierarchy*

The Company measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

*Level 1:* Quoted market price (unadjusted) in an active market for an identical instrument. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry, group, pricing service or regulatory agency, and those prices represent actual and regularly recurring market transactions on an arm's length basis.

*Level 2:* Valuation techniques based on observable input, either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

*Level 3:* Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

At 31 December 2012	Level 1 AED'000	Level 2 AED'000	Level 3 AED'000	Total AED'000
Investment securities	-	-	1,242	1,242
<b>Total</b>	<b>-</b>	<b>-</b>	<b>1,242</b>	<b>1,242</b>
At 31 December 2011	Level 1 AED'000	Level 2 AED'000	Level 3 AED'000	Total AED'000
Investment securities	171,771	-	-	171,771
Debt linked agreements	-	(171,771)	-	(171,771)
<b>Total</b>	<b>171,771</b>	<b>(171,771)</b>	<b>-</b>	<b>-</b>

## **HSBC Financial Services (Middle East) Limited**

### **Notes to the financial statements** *for the year ended 31 December 2012*

#### **18. Fair value (continued)**

The residual investment in HPE has been classified as an Available for Sale investment in the Level 3 category. For further details please refer note 12.3.

#### **19. Contingent liabilities and commitments**

##### *Contingent liabilities*

As at 31 December 2012, there are no known legal proceedings or other contingent liabilities against the Company (2011: Nil).

##### *Commitments*

The Company had no significant capital commitments as at 31 December 2012 (2011: Nil).

#### **20. Events after the reporting date**

The Board of Directors of the Company proposed a dividend of AED 129 million for the year ended 31 December 2012 which is subject to approval at the annual general meeting.

#### **21. Comparative figures**

Certain comparative figures have been reclassified to conform to the presentation adopted in these financial statements.