HSBC Middle East Finance Company Limited

Financial statements

for the year ended 31 December 2013

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Financial statements

for the year ended 31 December 2013

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HSBC

DIRECTOR'S REPORT

The Directors have pleasure in submitting their annual report and the audited financial statements for the year ended 31 December 2013.

	2013	2012
	AED '000	AED '000
Profit for the year after provisions	**30,990**	37,416
Add: retained earnings brought forward	**38,244**	46,828
Less: dividends paid during the year	**(38,000)**	(46,000)
Retained earnings carried forward	**31,234**	38,244

The Directors propose a dividend payout of AED 31 million for the year ended 31 December 2013.

Directors

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

1.	Abdulfattah Sharaf	Chairman
2.	Nabeel A Rahim	
3.	Robert R Crossman	Resigned as a Director on 7 November 2013
4.	Marcus John Hurry	Resigned as a Director on 16 April 2013
5.	Marwan Mohd Hadi	
6.	Abdullah Bin Habtoor	Representative of Investment Corporation of Dubai

Auditors

The Auditors, M/s KPMG retire and have expressed their willingness for reappointment. A resolution will be proposed at the Annual General Meeting to reappoint them as auditors and to fix their remuneration from the conclusion of the meeting until the next Annual General Meeting.

By Order of the Board

Hamed Amshan
Managing Director

Abdulfattah Sharaf
Chairman

HSBC Middle East Finance Company Limited

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Independent Auditors' Report

The Shareholders
HSBC Middle East Finance Company Limited

Report on the Financial Statements

We have audited the accompanying financial statements of HSBC Middle East Finance Company Limited ("the Company"), which comprise the statement of financial position as at 31 December 2013, the statement of income and statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes to the financial statements, 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 2013, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG Lower Gulf Limited
Vijendra Nath Malhotra
Registration No: 48B

HSBC Middle East Finance Company Limited
Statement of income
for the year ended 31 December 2013

	Notes	2013 AED '000	2012 AED '000
Interest income		**85,898**	89,208
Interest expense		**(33,682)**	(35,502)
Net interest income		**52,216**	53,706
Fee and commission income		**13,724**	19,573
Fee and commission expense		**(8,339)**	(8,113)
Net fee income		**5,385**	11,460
Other income	*7*	**5,692**	-
Operating income		**63,293**	65,166
Administrative expenses	*8*	**(29,056)**	(29,938)
Depreciation	*11*	**(261)**	(381)
Operating profit before impairment losses		**33,976**	34,847
Allowance for impairment losses	*10.1*	**(12,460)**	(18,221)
Recoveries against bad debts written off previously		**9,474**	20,790
Profit for the year		**30,990**	37,416

The accompanying notes on pages 8 to 40 form an integral part of these financial statements.

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

HSBC Middle East Finance Company Limited
Statement of comprehensive income
for the year ended 31 December 2013

	2013 AED '000	2012 AED '000
Net profit for the year	**30,990**	37,416
Other comprehensive income	-	-
Total comprehensive income for the year	**30,990**	37,416

The accompanying notes on pages 8 to 40 form an integral part of these financial statements.

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

HSBC Middle East Finance Company Limited

Statement of financial position

as at 31 December 2013

	Notes	2013	2012
		AED '000	AED '000
ASSETS			
Cash and bank balances	*9*	**20,210**	19,748
Loans and advances to customers	*10*	**1,431,191**	1,359,508
Property and equipment	*11*	**179**	437
Other assets	*12*	**5,970**	10,647
Total assets		**1,457,550**	1,390,340
LIABILITIES & SHAREHOLDERS' FUNDS			
Loans from related parties	*13*	**1,365,000**	1,282,500
Other liabilities	*14*	**26,316**	34,596
Total liabilities		**1,391,316**	1,317,096
Shareholders' funds			
Share capital	*15*	**35,000**	35,000
Retained earnings		**31,234**	38,244
Total shareholders' funds		**66,234**	73,244
Total liabilities and shareholders' funds		**1,457,550**	1,390,340

The accompanying notes on pages 8 to 40 form an integral part of these financial statements.

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

Hamed Amshan
Managing Director

Abdulfattah Sharaf
Chairman

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

HSBC Middle East Finance Company Limited

Statement of cash flows

for the year ended 31 December 2013

	Notes	2013 AED '000	2012 AED '000
Operating activities			
Profit for the year		**30,990**	37,416
Adjustments for:			
Depreciation and amortisation		**261**	381
Allowance for impairment losses		**12,460**	18,221
Net cash generated from operations		**43,711**	56,018
Change in loans and advances to customers		**(84,143)**	(136,964)
Change in other assets		**4,677**	9,839
Change in other liabilities		**(8,280)**	(12,286)
Net cash used in operating activities		**(44,035)**	(83,393)
Investing activities			
Purchase of property and equipment		**(3)**	(17)
Net cash used in investing activities		**(3)**	(17)
Financing activities			
Change in term loans from related parties		**82,500**	102,500
Dividends paid		**(38,000)**	(46,000)
Net cash generated from financing activities		**44,500**	56,500
Net increase/(decrease) in cash and cash equivalents		**462**	(26,910)
Cash and cash equivalents at the beginning of the year		**19,748**	46,658
Cash and cash equivalents at the end of the year	*9*	**20,210**	19,748

The accompanying notes on pages 8 to 40 form an integral part of these financial statements.

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HSBC Middle East Finance Company Limited
Statement of changes in equity
for the year ended 31 December 2013

	Share capital AED '000	Retained earnings AED '000	Total AED '000
Balance at 1 January 2012	35,000	46,828	81,828
Total comprehensive income for the year			
Profit for the year	-	37,416	37,416
Transactions with owners, recorded directly in			
Dividends paid	-	(46,000)	(46,000)
Balance at 31 December 2012	35,000	38,244	73,244
Balance at 1 January 2013	35,000	38,244	73,244
Total comprehensive income for the year			
Profit for the year	-	30,990	30,990
Transactions with owners, recorded directly in			
Dividends paid	-	(38,000)	(38,000)
Balance at 31 December 2013	**35,000**	**31,234**	**66,234**

The accompanying notes on pages 8 to 40 form an integral part of these financial statements.

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

1. Legal status and activities

HSBC Middle East Finance Company Limited (the "Company") was incorporated as a private limited liability company in 1969 under a decree issued by the Ruler of Dubai, United Arab Emirates (the "UAE"). The Company is a subsidiary of HSBC Bank Middle East Limited (the "Holding Company") which is incorporated in Jersey (Channel Islands) and its ultimate holding company is HSBC Holdings plc which is registered in England.

The Company is principally engaged in providing hire purchase finance in the UAE for the purchase of motor vehicles.

The registered address of the Company is Shop No. 4&5, Ground Floor & Mezzanine, Hilal Salim Bin Tarraf Building, Al Wasl Area, Sheikh Zayed Road, Dubai - UAE.

2. Basis of preparation

(a) Statement of compliance

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

(b) Standards adopted during the year ended 31 December 2013

On 1 January 2013, the Company adopted IFRS 13 'Fair Value Measurement' which establishes a single framework for measuring fair value and introduces new requirements for disclosure of fair value measurements. IFRS 13 is required to be applied prospectively from the beginning of the first annual period in which it is applied. The disclosure requirements of IFRS 13 do not require comparative information to be provided for periods prior to initial application. The financial effect is insignificant to these financial statements.

(c) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations effective for the accounting period starting 1 January 2013 have not been early adopted in preparing these financial statements:

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.

2. Basis of preparation *(continued)*

(d) Basis of measurement

These financial statements are prepared under the historical cost convention. The financial statements are presented in United Arab Emirates Dirham ("AED") which is the functional currency of the Company, rounded to the nearest thousand.

(e) 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.

The 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's judgment is required in respect of determining impairment losses on loans and advances to customers.

3. Significant accounting policies

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

(a) Interest income and expense

Interest income and expense for all interest bearing financial instruments except for those classified as held for trading or designated as fair value through profit or loss 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 cash 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.

3. Significant accounting policies *(continued)*

(a) Interest income and expense *(continued)*

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

(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 commission income including cheque clearing charges, cheque return charges and loan default charges are recognised as the related services are rendered.

Fees and commission expense relates mainly to commission to dealers and external sales representatives which are expensed as and when the services are received.

(c) Loans and advances to customers

Loans and advances to customers include loans and advances originated by the Company which are not intended to be sold in the short term and have not been classified either as held for trading or designated at fair value. They 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 intially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised costs using the effective interest method, less any reduction for impairment or uncollectability.

(d) Property and equipment

Property and equipment is measured at cost less accumulated depreciation and impairment losses. Depreciation is calculated on a straight-line basis to write off the assets over their accumulated useful lives as follows:

3. Significant accounting policies *(continued)*

(d) Property and equipment *(continued)*

Lease improvements	over the unexpired term of the lease
Motor vehicles, furniture, fixtures & equipment	3 – 5 years

Property and equipment is subject to an impairment review if there are events or changes in circumstances which indicate that the carrying amount may not be recoverable. Depreciation method and useful lives are reassessed at each reporting date.

(e) Intangible assets

Intangible assets that are acquired by the Company are stated at cost less accumulated amortisation and accumulated impairment losses, if any. Costs of the intangible asset represent the costs incurred to acquire and bring to use the specific intangible asset. Amortisation is charged to the statement of income on a straight line basis over the estimated useful lives of intangible assets from the date that they are available for use. The Company's intangible assets normally comprise of software costs which are amortised over a period of 3 years. There are intangible assets of AED 4.2 mn held at cost which are fully amortised as at 31 December 2013 (2012: AED 4.2 mn).

(f) 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"), a related party, and recharged to the Company by HBME UAE on a monthly basis.

(g) Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation as a result of past events, and a reliable estimate can be made of the amount of the obligation.

(h) Cash and cash equivalents

For the purposes of cash flow statement, cash and cash equivalents comprise cash in hand, bank overdrafts and balances with banks maturing within three months of the reporting date.

3. Significant accounting policies *(continued)*

(i) 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 property and equipment and shareholders' equity.

Classification

Financial instruments are categorised as follows:

Financial assets at fair value through profit or loss ("FVTPL"): 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 of 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 income statement or available for sale assets are recognised.

Loans and advances are recognised when the cash is advanced to the counterparty.

3. Significant accounting policies *(continued)*

(i) Financial instruments *(continued)*

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 advances are derecognised when borrowers repay their obligations, 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 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 price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Company has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Company measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

3. Significant accounting policies *(continued)*

(i) Financial instruments *(continued)*

Fair value measurement principles *(continued)*

If there is no quoted price in an active market, then the Company uses valuation techniques that maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price - i.e. the fair value of the consideration given or received. If the Branch determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognized in the consolidated income statement on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Company on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio. This indicates adjustments to take account of credit risk of the Company and the counterparty, where applicable.

Policy applicable before 1 January 2013

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

The determination of fair value of financial assets and financial liabilities is based on quoted market prices or dealer price quotations for financial instruments traded in active markets. For all other financial instruments, fair value is determined by using valuation techniques. Valuation techniques include net present value techniques, the discounted cash flow method and other valuation models.

3. Significant accounting policies *(continued)*

(i) Financial instruments *(continued)*

Fair value measurement principles *(continued)*

Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Company and the counterparty, where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties, to the extent that the Company believes a third-party market participant would take them into account in pricing a transaction.

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, bank, 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 inputs, 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 unobservable 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.

3. Significant accounting policies *(continued)*

(i) Financial instruments *(continued)*

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.

The impairment of loans and advances is further explained in note 4.

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 group of similar transactions such as in the Company's trading activity.

(k) Impairment of non-financial assets

The carrying amounts of the Company's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the assets recoverable amount is estimated and any reduction in value is recognised in the statement of income.

4. Financial risk management

(a) Introduction and overview

All the Company's activities involve analysis, evaluation, acceptance and management of some degree of risk or combination of risks. The Company's significant exposure can be broadly categorized into the following risks:

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

This note represents broad information about the Company's objectives, policies and processes for identifying, measuring, reporting and mitigating the above mentioned risks.

Risk management framework

The risk management framework is established by the HSBC Holdings plc (the "Group") 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 rest with the Board of Directors and Managing Director of the Company. The Board of Directors has the responsibility to cascade the Group'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 Group 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 the financial instrument fails to meet an obligation under a contract. It arises principally from the loans and advances to the customers. The Company has in place HSBC Group standards, policies and procedures dedicated to monitor and manage risk from such activities.

4. Financial risk management *(continued)*

(b) Credit risk *(continued)*

Management of credit risk

The Group 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 Group's universal facility grading system.

The Company's local management is responsible for:

- implementing credit policies, procedures and lending guidelines that conform to Group standards;
- monitoring credit process which includes delegated approval authorities and credit procedures;
- monitoring quality and performance of credit portfolio;
- monitoring and controlling all credit risks;
- managing risk concentrations by market sector, geography and product;
- managing exposures by customer and retail product segments 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; an overview of homogeneous portfolios of similar assets to assess the quality of the loan book and other exposures; the adequacy of impairment calculations and checking that the Group and local standards and policies are adhered to in the approval and management of credit facilities.

Credit quality

The credit quality of the portfolio of loans and advances at 31 December 2013 can be assessed by reference to the Company's standard credit grading system. The Company's rating process for credit facilities is designed to highlight exposures requiring greater management attention based on a higher probability of default and potential loss. Management particularly focuses on facilities to those borrowers and portfolio segments classified below satisfactory grades. Amendments to risk grades, where necessary, are required to be undertaken promptly. Management also regularly evaluates the adequacy of the established allowances for impaired loans by conducting a detailed review of the loan portfolio, comparing performance and delinquency statistics with historical trends and assessing the impact of current economic conditions.

4. Financial risk management *(continued)*

(b) Credit risk *(continued)*

Credit quality *(continued)*

The credit rating with reference to the standard credit rating system is assessed as follows:

Quality classification	Wholesale lending and derivatives	Retail lending
Strong	CRR1 to CRR2	E1 to EL2
Good	CRR3	EL3
Medium	CRR4 to CRR5	EL4 to EL5
Sub-Standard	CRR6 to CRR8	EL6
Impaired	CRR9 to CRR10	EL7 to EL10

Strong:
These exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and / or low levels of expected loss. Retail accounts operate within product parameters and only exceptionally show any period of delinquency.

Good:
These exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.

Medium:
These exposures require closer monitoring, with low to moderate default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.

Sub-standard:

These exposures require varying degrees of special attention and default risk of greater concern. Retail portfolio segments show longer delinquency periods of generally up to 90 days past due and / or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes.

4. Financial risk management *(continued)*

(b) Credit risk *(continued)*

***Credit quality** (continued)*

Impaired:

These exposures have been assessed, individually or collectively, as impaired.

The credit quality of loans and advances balances at year end is set out below:

Loans and advances to customers	**2013**	2012
	AED '000	AED '000
Strong	**1,412,777**	1,352,365
Good	**11,734**	9,682
Medium	**16,616**	2,906
Sub-standard	**1,571**	1,406
Impaired	**1,615**	3,925
Loans and advances to customers - gross	**1,444,313**	1,370,284
Less:		
- collective allowance for impairment	**(12,582)**	(8,870)
- uncleared cheques	**(540)**	(1,906)
	1,431,191	1,359,508

Collateral

It is the Company's policy, when lending, to do so within the customer's capacity to repay, rather than rely excessively on security. Motor vehicles financed to the customers forms the principal collateral type held by the Company.

Repossessed motor vehicles amounting to AED 3.99 million as at 31 December 2013 (2012: AED 3.96 million) are made available for sale, with the proceeds used to reduce or repay the outstanding indebtedness. These vehicles are accounted for in the statement of financial position at fair value or outstanding loan amount, whichever is lower.

4. Financial risk management *(continued)*

(b) Credit risk *(continued)*

Credit quality *(continued)*

The following table provides a detailed analysis of loans and advances outstanding at the reporting date:

	Loans and advances to customers 2013 AED '000	Loans and advances to customers 2012 AED '000
Gross loans and advances		
- neither past due nor impaired	**1,433,183**	1,353,125
- past due but not impaired	**9,515**	13,234
- impaired	**1,615**	3,925
	1,444,313	1,370,284

Loans and advances which were past due but not impaired

Loans and advances which were past due at reporting date but not impaired were as follows:

	2013 AED '000	2012 AED '000
Past due up to 29 days	**7,169**	9,406
Past due 30-59 days	**1,303**	2,520
Past due 60-89 days	**1,043**	1,308
	9,515	13,234

4. Financial risk management *(continued)*

(b) Credit risk *(continued)*

Impairment assessment

Losses on impaired loans are recognised promptly when there is objective evidence that an impairment of a loan or a portfolio of loans has occurred. The Company provides allowance for impaired loans promptly when required and on a consistent basis in accordance with established HSBC Group guidelines.

Impairment losses are calculated on individual and collectively assessed loans.

Individually assessed loans

Loans and advances are impaired if their carrying amount is greater than their recoverable amount. The Company assesses on a case-by-case basis whether there is objective evidence that a loan is impaired. This procedure is applied to all loans that are considered individually significant.

Impairment losses are calculated by discounting the expected future cash flows of a loan at its original effective interest rate, and comparing the resultant present value with the loan's current carrying amount. The loss recognised in the statement of income is the difference between the carrying amount and the recoverable amount. The carrying amount of impaired loans on the reporting date is reduced through the use of an allowance account.

Collectively assessed loans

The Company assesses the impairment on a collective basis in two different scenarios:

- for loans subject to individual assessment, to cover losses which have been incurred but have not yet been identified; and

- for the homogeneous group of loans that are not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been identified are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss. This arises from impairment at the reporting date which will only be individually identified in the future.

4. Financial risk management *(continued)*

(b) Credit risk *(continued)*

Incurred but not yet identified impairment (continued)

The collective impairment allowance is determined after taking into account:

• historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, loan grade or product);

• the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and

• management's experienced judgment as to whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by management for each identified portfolio.

Homogeneous groups of loans

For homogeneous groups of loans that are not considered individually significant the Company utilizes roll rate methodology to calculate allowances on a portfolio basis. This methodology employs a statistical analysis of historical trends of the probability of default and the amount of consequential loss, assessed at each time period for which the customer's contractual payments are overdue.

Reversal of impairment losses

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 reversal is recognised in the statement of income.

Loan write-offs

Loans and advances (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from realising the security have been received.

4. Financial risk management *(continued)*

(b) Credit risk *(continued)*

Maximum exposure to credit

	Maximum exposure 2013 AED '000	Maximum exposure 2012 AED '000
Cash and bank balances	**20,210**	19,748
Loans and advances to customers	**1,431,191**	1,359,508
Other assets	**5,970**	10,647
	1,457,371	1,389,903
Off-balance sheet:		
Loan commitments	**8,501**	14,658

Concentration of exposure

Concentrations of credit risk exist when a number of counterparties are engaged in similar activities or operate in the same geographical areas or industry sectors and have comparable economic characteristics, so that their ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. The Company monitors concentration of credit risk relating to gross loans and advances primarily through economic and customer group sector as follows:

Economic sector concentration

	2013 AED '000	2012 AED '000
Personal	**1,423,822**	1,349,581
Commercial and industrial	**11,652**	11,156
Commercial real estate	**973**	1,304
Others	**7,866**	8,243
Total	**1,444,313**	1,370,284

4. Financial risk management *(continued)*

(b) Credit risk *(continued)*

Customer concentration

	2013 AED '000	2012 AED '000
Personal	**1,423,822**	1,349,581
Corporate	**20,491**	20,703
Total	**1,444,313**	1,370,284

(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.

Foreign exchange risk

The Company does not have significant currency risk as it does not deal in foreign currencies during the normal course of business and all significant financial instruments of the Company are classified under loans and advances.

Interest rate risk

Interest rate risk is the risk that the value of financial instruments will fluctuate due to changes in market interest rates.

4. Financial risk management *(continued)*

(c) Market risk *(continued)*

Interest rate risk *(continued)*

Interest rate sensitivity gap

Sensitivity to interest rates arises from mismatches in the period to re-pricing of assets and that of the corresponding liability funding. Significant changes in gap positions can be made to adjust the profile as market outlooks change. Additionally, whilst mismatches exist, liabilities maturing are to a great extent historically rolled over rather than withdrawn.

The following table represents the Company's interest rate sensitivity for its interest bearing assets, liabilities and off-balance sheet instruments based on the maturity dates in the periods shown below:

2013	Up to 3 months AED '000	3 to 12 Months AED '000	Over 1 to 5 Years AED '000	Over 5 years AED '000	Total AED'000
Financial assets					
Cash and bank balances	20,210	-	-	-	**20,210**
Loans and advances to customers	163,037	470,379	797,775	-	**1,431,191**
Total	**183,247**	**470,379**	**797,775**	**-**	**1,451,401**
Financial liabilities					
Loans from related parties	268,800	432,000	664,200	-	**1,365,000**
Total	**268,800**	**432,000**	**664,200**	**-**	**1,365,000**
Interest sensitivity gap:					
- net	**(85,553)**	**38,379**	**133,575**	**-**	**-**
- cumulative	**(85,553)**	**(47,174)**	**86,401**	**-**	**86,401**

4. Financial risk management *(continued)*

(c) Market risk *(continued)*

Interest rate sensitivity gap *(continued)*

2012	Up to 3 months AED '000	3 to 12 Months AED '000	Over 1 to 5 Years AED '000	Over 5 years AED '000	Total AED'000
Financial assets					
Cash and bank balances	19,748	-	-	-	19,748
Loans and advances to customers	129,052	384,843	845,613	-	1,359,508
Total	148,800	384,843	845,613	-	1,379,256
Financial liabilities					
Loans from related parties	165,000	345,000	772,500	-	1,282,500
Total	165,000	345,000	772,500	-	1,282,500
Interest sensitivity gap:					
- net	(16,200)	39,843	73,113	-	-
- cumulative	(16,200)	23,643	96,756	-	96,756

Interest rate risk is also assessed by estimating the impact of a possible change in interest rate. Assuming the fluctuation of 25 basis points in the interest rates the impact on the profit or loss and equity will be AED 0.216 mn (2012: AED 0.242 mn) based on the net cumulative interest bearing assets of AED 86.4 mn (2012: AED 96.8 mn).

(d) Liquidity and funding management

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivery of cash or another financial asset.

4. Financial risk management *(continued)*

(d) Liquidity and funding management *(continued)*

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

- Monitoring maturity profile to ensure adequate liquidity is maintained at all times;
- Projecting cash flows;
- Monitoring balance sheet 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 the Group entities.

2013	Up to 3 months AED '000	3 to 12 Months AED '000	Over 1 to 5 Years AED '000	Over 5 years AED '000	No fixed maturity AED '000	Total AED'000
Financial assets						
Cash and bank balances	20,210	-	-	-	-	**20,210**
Loans and advances to customers	163,037	470,379	797,775	-	-	**1,431,191**
Other receivables	5,970	-	-	-	-	**5,970**
Total	**189,217**	**470,379**	**797,775**	-	-	**1,457,371**
Financial liabilities						
Loans from related parties	268,800	432,000	664,200	-	-	**1,365,000**
Other liabilities	-	-	-	-	26,316	**26,316**
Total	**268,800**	**432,000**	**664,200**	-	**26,316**	**1,391,316**

4. Financial risk management *(continued)*

(d) Liquidity and funding management *(continued)*

2012	Up to 3 months AED '000	3 to 12 Months AED '000	Over 1 to 5 Years AED '000	Over 5 years AED '000	No fixed maturity AED '000	Total AED'000
Financial assets						
Cash and bank balances	19,748	-	-	-	-	19,748
Loans and advances to customers	129,052	384,843	845,613	-	-	1,359,508
Other receivables	10,647	-	-	-	-	10,647
Total	159,447	384,843	845,613	-	-	1,389,903
Financial liabilities						
Loans from related parties	165,000	345,000	772,500	-	-	1,282,500
Other liabilities	-	-	-	-	34,596	34,596
Total	165,000	345,000	772,500	-	34,596	1,317,096

The following table provides the contractual cash flows for financial liabilities.

2013	Up to 3 months AED '000	3 to 12 months AED '000	Over 1 to 5 years AED '000	No fixed maturity AED '000	Total AED '000	Carrying value AED '000
Loans from related parties	275,493	475,689	688,606	-	1,439,788	1,365,000
Other liabilities	-	3,553	-	22,763	26,316	26,316
Undrawn loan commitments	8,501	-	-	-	8,501	8,501
	283,994	**479,242**	**688,606**	**22,763**	**1,474,605**	**1,399,817**

4. Financial risk management *(continued)*

(d) Liquidity and funding management *(continued)*

2012	Up to 3 months AED '000	3 to 12 months AED '000	Over 1 to 5 years AED '000	No fixed maturity AED '000	Total AED '000	Carrying value AED '000
Loans from related parties	168,614	397,640	796,968	-	1,363,222	1,282,500
Other liabilities	-	4,224	-	30,372	34,596	34,596
Undrawn loan commitments	14,658	-	-	-	14,658	14,658
	183,272	401,864	796,968	30,372	1,412,476	1,331,754

(e) Operational risk

Operational risk is the risk of loss arising from fraud, unauthorised activities, error, omission, inefficiency, systems failure or external events. It is inherent to every business organisation and covers a wide spectrum of issues.

Management of operational risk

The Group operational risk management process is codified by issuing a high level standard supplemented by more detailed formal guidance issued. This explains how the Group 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 control-based environment in which processes are documented, authorisation is independent and transactions are reconciled and monitored. This is supported by an independent program 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 the industry.

4. Financial risk management *(continued)*

(e) Operational risk *(continued)*

Management of operational risk

The Company is responsible for implementing the following Group standards:

- Assigning responsibility for the 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 the operational risk loss data to the management and the Group if it exceeds the materiality thresholds set by the Group; and
- Consideration of risk mitigation, including insurance where it is cost-effective.

5. Capital management

The Company's regulator, the Central Bank of the UAE, sets and monitors capital requirements for the Company. In implementing current capital requirements, the Central Bank of the UAE normally requires the capital funds to be maintained at a minimum of 15% of the total available funds. However, this minimum capital requirement for the Company has been waived by the Central Bank of the UAE since the Company has provided a letter of comfort from its parent company confirming capital support as and when required.

The Company's capital management approach is driven by its strategy and organisational requirements taking into account the commercial environment in which it operates. The Company's capital management takes into account assets growth and the optimal amount and mix of capital required to support planned business growth.

The Company has complied with all externally imposed capital requirements throughout the year and there have been no material changes in the Company's management of capital during the year.

6. Analysis of financial assets and liabilities by measurement basis

The table below sets out the Company's classification of each class of financial assets and liabilities and their fair values:

2013	Loans and Advances AED '000	Other amortised cost AED '000	Total carrying amount AED '000	Fair value AED'000
Cash and bank balances	-	20,210	20,210	20,210
Loans and advances to customers	1,431,191	-	1,431,191	1,453,731
Other receivables	-	5,970	5,970	5,970
Total	**1,431,191**	**26,180**	**1,457,371**	**1,479,911**
Loans from related parties	-	1,365,000	1,365,000	1,365,000
Other liabilities	-	26,316	26,316	26,316
Total	-	**1,391,316**	**1,391,316**	**1,391,316**

6. Analysis of financial assets and liabilities by measurement basis *(continued)*

2012	Loans and Advances AED '000	Other amortised cost AED '000	Total carrying amount AED '000	Fair value AED'000
Cash and bank balances	-	19,748	19,748	19,748
Loans and advances to customers	1,359,508	-	1,359,508	1,361,414
Other receivables	-	10,647	10,647	10,647
Total	1,359,508	30,395	1,389,903	1,391,809
Loans from related parties	-	1,282,500	1,282,500	1,282,500
Other liabilities	-	34,596	34,596	34,596
Total	-	1,317,096	1,317,096	1,317,096

7. Other income

Until 2009, the Company recorded vehicle loans on Hire Purchase Lending System ("HPLS"). An exercise was initiated during the year to migrate the legacy customer accounts on HPLS to the existing loan system. Management reconciled and rectified all unreconciled accounts within HPLS resulting in a release to the income statement of AED 5.69 million for the year ended 31 December 2013.

8. Administrative expenses

	2013 AED '000	2012 AED '000
Staff costs:		
- wages and salaries	**12,104**	13,966
- pension costs	**1,080**	935
- other costs	**5,061**	3,409
	18,245	18,310
Premises and equipment	**37**	93
IT charges and other support costs recharged by HSBC Bank Middle East Limited - UAE Operations	**8,308**	9,168
Communication and other sundry expenses	**2,466**	2,367
Total	**29,056**	29,938

9. Cash and bank balances

	2013 AED '000	2012 AED '000
Balances with HSBC Bank Middle East Limited - UAE Operations, a related party		
- Current account	**20,210**	19,748
Total	**20,210**	19,748

10. Loans and advances to customers

	2013 AED '000	2012 AED '000
Receivables	**1,444,313**	1,370,284
Less: Allowance for impairment losses (note 10.1)	**(12,582)**	(8,870)
	1,431,731	1,361,414
Un-cleared cheques lodged with banks for collection	**(540)**	(1,906)
Total	**1,431,191**	1,359,508

The above advances are in local currency and are concentrated entirely in the UAE.

10.1 Allowance for impairment losses

	2013 AED '000	2012 AED '000
At 1 January	**8,870**	10,950
Charge for the year	**12,633**	18,221
	21,503	29,171
Amounts written off	**(8,921)**	(20,301)
	12,582	8,870

11. Property and equipment

	Leasehold improvements AED '000	Motor vehicles, equipment, furniture & fixtures AED '000	Total AED '000
Cost			
At 1 January 2012	4,584	3,416	8,000
Additions	-	17	17
Disposals	(832)	(2,746)	(3,578)
At 31 December 2012	3,752	687	4,439
At 1 January 2013	3,752	687	4,439
Additions	-	3	3
At 31 December 2013	3,752	690	4,442
Accumulated depreciation			
At 1 January 2012	3,948	3,251	7,199
Charge for the year	326	55	381
On disposals	(832)	(2,746)	(3,578)
General Ledger Transfers	(65)	65	-
At 31 December 2012	3,377	625	4,002
At 1 January 2013	3,377	625	4,002
Charge for the year	238	23	261
At 31 December 2013	3,615	648	4,263
Net book value			
At 31 December 2013	**137**	**42**	**179**
At 31 December 2012	375	62	437

12. Other assets

	2013 AED '000	2012 AED '000
Accrued interest receivable from		
- Loans and advances to customers	4,413	10,538
Accrued Fee Income	1,454	-
Others	103	109
Total	5,970	10,647

13. Loans from related parties

	2013 AED '000	2012 AED '000
Loans (note 13.1)	1,365,000	1,282,500
Less: repayment due after one year	(664,200)	(772,500)
Loans due for repayment within one year	700,800	510,000

13.1 The loans include AED 1,365 mn (2012: AED 1,250.5 mn) from HSBC Bank Middle East Limited – UAE Branch. The Company does not have any loans from HSBC Bank Middle East Limited – Bahrain Offshore Banking Unit (2012: AED 32 mn). These facilities are unsecured and carry interest rates ranging from 0.7981% to 4.0100% (2012: 1.2775% to 5.2370%). The loans due for repayment within one year are repayable on various dates by 31 December 2014 whereas long-term loans are repayable on various dates by 11 December 2017.

13.2 The Company has overdraft facility of AED 50 mn from HSBC Bank Middle East Limited – UAE Branch at the interest rate of 0.165% p.a. (2012: 0.30% p.a.). However, there is no overdrawn balance at the balance sheet date (2012: Nil).

14. Other liabilities

	2013 AED '000	2012 AED '000
HSBC Group entities		
- Accrued interest	**3,553**	4,224
- Others	**591**	4,336
Accrued expenses	**1,773**	6,740
Payable to dealers	**20,042**	18,538
Sundry creditors	**357**	758
	26,316	34,596

15. Share capital

	2013 AED '000	2012 AED '000
Authorised:		
50,000 ordinary shares of AED 1,000 each	**50,000**	50,000
Issued and fully paid up:		
35,000 ordinary shares of AED 1,000 each	**35,000**	35,000

As at 31 December 2013, 28,000 (2012: 28,000) ordinary shares of AED 1,000 each were held by HSBC Bank Middle East Limited, Jersey ("the Holding Company").

16. Related party transactions

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

The balances and transactions other than those disclosed in the respective notes to these financial statements are as follows:

Transactions during the year	2013 AED '000	2012 AED '000
HSBC Bank Middle East Limited		
- Interest income	10	7
- Interest expense	33,682	35,502
- Fee and commission expense	545	456
- Remuneration to key management person	608	1,014

17. Contingent liabilities and commitments

(a) Contingencies

As at 31 December 2013 there were no known legal proceedings or other contingent liabilities against the Company (2012: Nil).

(b) Commitments

	2013 AED '000	2012 AED '000
Un-drawn loan commitments	8,501	14,658

18. Fair value of financial instruments not carried at fair value

The financial instruments not measured at fair value through profit or loss are short-term financial assets and financial liabilities whose carrying amounts approximate fair value.

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:

18. Fair value of financial instruments not carried at fair value *(continued)*

At 31 December 2013	Level 1 AED'000	Level 2 AED'000	Level 3 AED'000	Total AED'000
Financial assets				
Cash and bank balances	-	20,210	-	20,210
Loans and advances to customers	-	-	1,431,191	1,431,191
Other assets	-	-	5,970	5,970
Total as at 31 December 2013	-	20,210	1,437,161	1,457,371

At 31 December 2013	Level 1 AED'000	Level 2 AED'000	Level 3 AED'000	Total AED'000
Financial liabilities				
Loans from related parties	-	-	1,365,000	1,365,000
Other liabilities	-	-	26,316	26,316
Total as at 31 December 2013	-	-	1,391,316	1,391,316

19. Proposed dividend

The Board of Directors of the Company have proposed a dividend of AED 31 mn (2012: AED 38 mn). This dividend has not been accounted for in these financial statements.

20. Comparative figures

Certain comparative figures have been rearranged and reclassified, where necessary, to conform to the presentation adopted in these financial statements.