THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED - SRI LANKA BRANCH

FINANCIAL STATEMENTS 31 DECEMBER 2018

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED SRI LANKA BRANCH

FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

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THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH

FOR THE YEAR ENDED 31 DECEMBER 2018

CONTENTS

Independent auditor's report

To the head office management of Hongkong and Shanghai Banking Corporation Limited Sri Lanka Branch

Report on the audit of the financial statements

Our opinion

In our opinion, the accompanying financial statements give a true and fair view of the financial position of Hongkong and Shanghai Banking Corporation Limited Sri Lanka Branch ("the Branch") as at December 31, 2018, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

What we have audited

The financial statements of the Branch, which comprise:

- the statement of financial position as at December 31, 2018;
- income statement and the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Basis for opinion

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

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

Independence

We are independent of the Branch in accordance with the Code of Ethics issued by CA Sri Lanka (Code of Ethics), and we have fulfilled our other ethical responsibilities in accordance with the Code of Ethics.

Other information

Management is responsible for the other information. The other information comprises the supplemental Basel III disclosures but does not include the financial statements and our auditor's report thereon.

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Partners D.T.S.H. Mudalige FCA, C.S. Manoharan FCA, S. Gajendran FCA, Ms. S. Hadgie FCA, N.R. Gunasekera FCA, Ms. S. Perera ACA, T.U. Jayasinghe FCA

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

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- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Branch's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

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

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

CHARTERED ACCOUNTANTS
COLOMBO
28 March 2019

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH
INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER	Note	2018 Rs.'000	2017 Rs.'000
Interest income		29,657,388	28,445,719
Interest expenses		(11,211,749)	(10,303,277)
Net interest income	5	18,445,639	18,142,442
Fee and commission income		4,046,719	3,680,452
Fee and commission expenses		(1,006,278)	(882,970)
Net fee and commission income	6	3,040,441	2,797,482
Net gain from trading	7	1,776,387	1,889,193
Net gain / (loss) from financial investments	8	312,260	307,951
Other operating income (net)	9	60,244	51,583
Total operating income		23,634,971	23,188,651
Impairment charge for loans and other losses	10	(168,847)	(248,563)
Net operating income		23,466,124	22,940,088
Personnel expenses	11	(3,852,704)	(3,492,303)
Depreciation and amortisation expenses	12	(300,142)	(304,936)
Other expenses	12	(7,136,236)	(6,239,284)
Operating profit before Value Added Tax and Nation Building Tax		12,177,042	12,903,565
Value Added Tax and Nation Building Tax		(2,120,039)	(2,194,557)
Profit before tax		10,057,003	10,709,008
Income tax expense	13	(3,935,439)	(4,300,974)
Profit for the year		6,121,564	6,408,034

Figures in brackets indicate deductions.

The financial statements are to be read in conjunction with the related notes as set out on pages 9 to 80, which form an integral part of the financial statements of the Branch. The Report of the Auditors is given on page 1 to 3.

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH
STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER	Note	2018 Rs.'000	2017 Rs.'000
Profit for the year		**6,121,564**	6,408,034
Other comprehensive income / (expenses)			
Items that may be reclassified to profit or loss in subsequent periods			
Net gains / (losses) on investments in debt instruments measured at fair value through other comprehensive income		**(1,655,322)**	2,409,308
Gain from the financial statements of foreign currency operation		**3,921,085**	626,846
Tax relating to components of other comprehensive income	13.d	**463,490**	(676,693)
Net other comprehensive income that may be reclassified to profit or loss in subsequent periods		**2,729,253**	**2,359,461**
Items that may not be reclassified to profit or loss in subsequent periods			
Remeasurement of post-employment benefit obligations		**33,677**	(218,746)
Gain on revaluation of property plant and equipment		**872,949**	462,482
Tax relating to components of other comprehensive income	13.d	**(852,087)**	35,114
Net other comprehensive income that may not be reclassified to profit or loss in subsequent periods		**54,539**	**278,850**
Total comprehensive income for the year		**8,905,356**	**9,046,345**

Figures in brackets indicate deductions.

The financial statements are to be read in conjunction with the related notes as set out on pages 9 to 80, which form an integral part of the financial statements of the Branch. The Report of the Auditors is given on page 1 to 3.

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH
STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER	**Note**	**2018 Rs.'000**	2017 Rs.'000
ASSETS			
Cash and cash equivalents	15	23,502,316	7,721,011
Balances with the Central Bank of Sri Lanka	16	7,332,880	7,765,246
Placements with banks	17	49,385,700	41,214,750
Derivative financial instruments	18	4,466,754	1,265,432
Financial assets measured at fair value through profit or loss	19	11,516,593	4,762,430
Financial Assets at Amortised Cost – Loans and Advances	20	255,830,603	202,739,049
Financial assets measured at fair value through other comprehensive income	21	100,949,137	150,869,348
Financial assets at amortised cost - debt instruments	22	5,308,259	-
Property, plant and equipment	23	4,789,830	3,940,743
Other assets	25	14,357,782	14,627,602
Total Assets		477,439,854	434,905,611
LIABILITIES			
Due to banks	26	184,786,888	175,400,730
Derivative financial instruments	27	3,875,848	1,032,710
Financial liabilities at amortised cost - due to depositors	28	205,873,323	180,725,041
Retirement benefit obligations deficit	29	23,005	125,358
Current tax liabilities		1,925,367	1,923,018
Deferred tax liabilities	24	132,730	106,271
Other liabilities	30	21,146,952	18,744,753
Total Liabilities		417,764,113	378,057,881
EQUITY			
Assigned capital	30	3,152,358	3,152,358
Statutory reserve fund	31	2,473,286	2,350,855
Other reserves	32	16,739,084	14,171,169
Retained earnings		37,311,013	37,173,348
Total Equity		59,675,741	56,847,730
Total equity and liabilities		477,439,854	434,905,611
Contingent liabilities and commitments	35	612,582,703	533,264,306

The financial statements are to be read in connection with the related notes as set out on pages 9 to 80, which form an integral part of the financial statements of the Branch. The Report of the Auditors is given on page 1 to 3.

The Management is responsible for the preparation of the Financial Statements. The Financial Statements have been prepared in compliance with Sri Lanka Financial Reporting Standards and the requirements of the Central Bank of Sri Lanka regulations and guidelines.

Approved and signed for and on behalf of the Management

Patrick J Gallagher
(Signed) Chief Executive Officer

Kanchana Hewavitharana
(Signed) Chief Financial Officer

28th March 2019
Colombo

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH
STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2018

	Assigned Capital	Exchange Equalisation of Reserve	IFA Reserve	OCI Reserve	SBP Reserve	Statutory Reserve Fund	Revaluation Reserve	Retained Earnings	Total Equity
	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000
Balance as at 1 January 2017	3,152,358	5,002,336	5,108,459	(988,971)	171,369	2,222,693	2,099,531	37,475,748	54,243,523
Total comprehensive income for the year									
Profit for the year	-	-	-	-	-	-	-	6,408,034	6,408,034
Other comprehensive income (net of tax)	-	626,846	-	1,732,616	-	-	425,803	(146,954)	2,638,311
Total comprehensive income for the year	-	626,846	-	1,732,616	-	-	425,803	6,261,080	9,046,345
Transactions with non equity holders, recognised directly in equity									
Depreciation on revaluation reserve	-	-		-	-	-	(5,119)	5,119	-
Deferred tax on revaluation							1,435	(1,435)	-
Transactions with equity holders, recognised directly in equity									
Transfers to reserves during the year	-	-	-	-	(3,135)	128,162	-	(128,162)	(3,135)
Restricted shares	-	-	-	-	-	-	-	(13,826)	(13,826)
Cost of share options granted during the year	-	-	-	-	-	-	-	-	-
Change in fair value of restricted share awards	-	-	-	-	-	-	-	-	-
Profit transferred to head office	-	-	-	-	-	-	-	(6,425,177)	(6,425,177)
Total transactions with equity holders	-	-	-	-	(3,135)	128,162	(3,684)	(6,563,481)	(6,442,138)
Balance as at 31 December 2017	3,152,358	5,629,182	5,108,459	743,645	168,234	2,350,855	2,521,649	37,173,348	56,847,730
Balance as at 1 January 2018	**3,152,358**	**5,629,182**	**5,108,459**	**743,645**	**168,234**	**2,350,855**	**2,521,649**	**37,173,348**	**56,847,730**
SLFRS 9 Provisions - Day 1 impact								(1,234,205)	(1,234,205)
Restated balance as at 1 January 2018	**3,152,358**	**5,629,182**	**5,108,459**	**743,645**	**168,234**	**2,350,855**	**2,521,649**	**35,939,143**	**55,613,525**
Total comprehensive income for the year									
Profit for the year	-	-	-	-	-	-	-	**6,121,564**	**6,121,564**
Other comprehensive income (net of tax)	-	**3,921,085**	-	**(1,191,832)**	-	-	**40,354**	**14,185**	**2,783,792**
Total comprehensive income for the year	-	**3,921,085**	-	**(1,191,832)**	-	-	**40,354**	**6,135,749**	**8,905,356**
Transactions recognised directly in equity									
Deferred tax on revaluation reserve	-	-	-	-	-	-	**1,544**	**(1,544)**	-
Depreciation on revaluation reserve	-	-	-	-	-	-	**(5,514)**	**5,514**	-
Impairment of Financial assets fair value through other comprehensive income	-	-	-	**184,810**	-	-	-	-	**184,810**
Transactions with equity holders, recognised directly in equity									
Transfers to reserves during the year	-	-	-	-	**219**	**122,431**	-	**(122,431)**	**219**
Restricted shares	-	-	-	-	-	-	-	**6,822**	**6,822**
Transfer from IFA reserve	-	-	**(382,751)**	-	-	-	-	**382,751**	-
Profit transferred to head office	-	-	-	-	-	-	-	**(5,034,991)**	**(5,034,991)**
Total transactions with equity holders	-	-	**(382,751)**	**184,810**	**219**	**122,431**	**(3,970)**	**(4,763,879)**	**(4,843,140)**
Balance as at 31 December 2018	**3,152,358**	**9,550,267**	**4,725,708**	**(263,377)**	**168,453**	**2,473,286**	**2,558,033**	**37,311,013**	**59,675,741**

Figures in brackets indicate deductions.

The financial statements are to be read in conjunction with the related notes as set out on pages 9 to 80, which form an integral part of the financial statements of the Branch. The Report of the Auditors is given on page 1 to 3.

PricewaterhouseCoopers
Colombo

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH
CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER	Note	2018 Rs.'000	2017 Rs.'000
Cash flow from operating activities			
Interest received		30,308,851	27,603,791
Interest paid		(10,275,415)	(12,981,530)
Fees and commission received		3,040,441	2,797,482
Net receipts from trading activities		1,776,386	1,889,192
Payments to employees		(3,832,331)	(3,492,303)
VAT and NBT on financial services		(2,432,312)	(2,149,889)
Receipts from other operating activities		697,031	724,718
Payments to other operating activities		(6,547,354)	(6,054,776)
Operating profit before changes in operating assets and liabilities		12,735,297	8,336,685
(Increase) / decrease in operating assets			
Balances with Central Bank of Sri Lanka		432,365	1,324,781
Financial assets at amortised cost - loans and advances		(63,293,388)	9,050,064
Treasury bills nd bonds		36,239,862	(29,937,534)
Other assets		(2,983,835)	(1,929,073)
		(29,604,996)	(21,491,762)
(Increase) / decrease in operating liabilities			
Financial liabilities at amortised cost - due to depositors		25,148,283	(2,618,171)
Financial liabilities at amortised cost - due to other borrowers		9,386,158	23,815,596
Other liabilities		3,793,065	2,612,630
		38,327,506	23,810,055
Net cash generated from operating activities before income tax		21,457,807	10,654,978
Income tax paid		(4,376,214)	(4,482,963)
Net cash (used in) / from operating activities		17,081,593	6,172,015
Cash flow from investing activities			
Proceeds from disposal of property, plant and equipment		22,714	25,933
Acquisition of property, plant and equipment		(281,376)	(52,838)
Net cash (used in) / from investing activities		(258,662)	(26,905)
Cash flow from financing activities			
Profit transferred to Head Office		(5,034,991)	(6,425,177)
Net cash (used in) / from financing activities		(5,034,991)	(6,425,177)
Net (decrease)/increase in cash and cash equivalents		11,787,940	(280,067)
Cash and cash equivalents at the beginning of period	15	7,721,011	7,388,308
Exchange difference in respect of cash and cash equivalents		3,993,365	612,770
Cash and cash equivalents at the end of the period	15	23,502,316	7,721,011

Figures in brackets indicate deductions.

The financial statements are to be read in conjunction with the related notes as set out on pages 9 to 80, which form an integral part of the financial statements of the Branch. The Report of the Auditors is given on page 1.

1. CORPORATE INFORMATION

1.1 Domicile and legal form

The Hongkong and Shanghai Banking Corporation Limited is a public limited liability company incorporated in Hong Kong SAR. It carries out banking activities in Sri Lanka through HSBC Sri Lanka Branch ("the Branch"/"HSBC") a licensed commercial bank registered under the Banking Act No 30 of 1988 as amended by the Banking Amendment Act No 33 of 1995. The registered office of HSBC Sri Lanka Branch is located at No. 24, Sir Baron Jayatilaka Mawatha, Colombo 1.

1.2 Principal activities and nature of operations

The principal activities of the Branch, which is carrying out banking activities through its branches remained unchanged during the year. The primary banking services include corporate and retail banking including credit cards and global trade finance.

1.3 Parent company and ultimate parent company

The immediate parent entity is the Hongkong and Shanghai Banking Corporation Limited incorporated in Hongkong and the ultimate parent entity is HSBC Holding plc. (Incorporated in Great Britain and registered in England and Wales). The ultimate parent is listed on the Hong Kong and London Stock Exchanges.

2. BASIS OF PREPARATION

2.1 Statement of compliance

The financial statements of the Branch which comprise the statement of financial position, income statement, statement of changes in equity, statement of cash flows and notes thereto have been prepared in accordance with relevant Sri Lanka Accounting Standards (SLFRSs and LKASs) laid down by the Institute of Chartered Accountants of Sri Lanka, relevant interpretations of the Standard Interpretations Committee ("SIC"), International Financial Reporting Interpretations Committee ("IFRIC") and comply with the requirements of the Banking Act No. 30 of 1988 and subsequent amendments thereto.

2.2 Basis of measurement

The financial statements have been prepared on the historical cost basis and applied consistently with no adjustments being made for inflationary factors affecting the financial statements, except for the following;

- Assets and liabilities held for trading are measured at fair value;
- Derivative financial instruments are measured at fair value;
- Assets fair value through other comprehensive income are measured at fair value;
- Plan asset of the defined benefit obligations that are measured at fair value.
- Freehold land and buildings are measured at fair value.

2.3 Functional and presentation currency

The financial statements are presented in Sri Lankan Rupees, which is the Branch's presentation and functional currency. The items in the financial statements are measured using the currency of the primary economic environment in which the Branch operates (the functional currency).

2. BASIS OF PREPARATION (CONTINUED)

2.4 Use of estimates and judgement

The preparation of financial statements require management to make judgement estimates and assumptions that effects the application of accounting policies and the 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 of which the estimate is revised and in any future period affected. The significant estimates and judgements are disclosed in Note 4.

2.5 Changes in accounting standards

(a) New accounting standards, amendments and interpretations adopted in 2018

The following standards and interpretations apply for the first time to financial reporting periods commencing on or after 1 January 2018:

(i) SLFRS 9 Financial Instruments and associated amendments to various other standards

SLFRS 9 replaces the multiple classification and measurement models in LKAS 39 Financial instruments: Recognition and measurement with a single model that has initially only two classification categories: amortised cost and fair value.

Classification of debt assets will be driven by the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. A debt instrument is measured at amortised cost if: a) the objective of the business model is to hold the financial asset for the collection of the contractual cash flows, and b) the contractual cash flows under the instrument solely represent payments of principal and interest.

All other debt and equity instruments, including investments in complex debt instruments and equity investments, must be recognised at fair value.

All fair value movements on financial assets are taken through the statement of profit or loss, except for equity investments that are not held for trading, which may be recorded in the statement of profit or loss or in reserves (without subsequent recycling to profit or loss).

For financial liabilities that are measured under the fair value option entities will need to recognise the part of the fair value change that is due to changes in the their own credit risk in other comprehensive income rather than profit or loss.

Further changes introduced to the classification and measurement rules and also introduced a new impairment model to SLFRS 9. The changes introduce:

I. a third measurement category (FVOCI) for certain financial assets that are debt instruments.
II. a new expected credit loss (ECL) model which involves a three-stage approach whereby financial assets move through the three stages as their credit quality changes. The stage dictates how an entity measures impairment losses and applies the effective interest rate method. A simplified approach is permitted for financial assets that do not have a significant financing component (eg trade receivables). On initial recognition, entities will record a day-1 loss equal to the 12 month ECL (or lifetime ECL for trade receivables), unless the assets are considered credit impaired.

The standard is effective for the annual periods beginning on or after 1 January 2018.

2. BASIS OF PREPARATION (CONTINUED)

2.5 Changes in accounting standards (contd)

Statement of financial position on transition

Following table presents balances in the statement of financial position as reported under LKAS 39 principals as at 31 December 2017, and the same balances represented under the SLFRS 9 principals as at 1 January 2018. The movement between the balances represent the transition impact.

In LKR'000	1 January 2018	31 December 2017	1 January 2017
Assets			
Cash and cash equivalents	7,721,011	7,721,011	7,388,309
Balances with Central Bank	7,765,246	7,765,246	9,090,026
Placements with banks	41,214,750	41,214,750	40,524,300
Derivative financial instruments	1,265,432	1,265,432	471,757
Financial assets measured at fair value through profit or loss	4,762,430	4,762,430	756,106
Financial assets at amortised cost - loans and advances	201,375,632	202,739,049	212,875,084
Financial assets measured at fair value through other comprehensive income	145,131,295	150,869,348	122,514,575
Financial assets at amortised cost - debt instruments	5,604,235	-	-
Property, plant and equipment	3,940,743	3,940,743	3,737,377
Deferred tax assets	373,698	-	545,073
Other assets	14,585,338	14,627,602	13,400,066
Total assets	**433,739,810**	**434,905,610**	**411,302,673**
Liabilities			
Due to banks	175,400,730	175,400,730	151,585,134
Derivative financial instruments	1,032,710	1,032,710	383,472
Due to other customers	180,725,041	180,725,041	183,343,212
Retirement benefit obligations	125,358	125,358	-
Current tax liabilities	1,923,018	1,923,018	1,720,293
Deferred tax liabilities	-	106,271	-
Other liabilities	18,744,754	18,744,754	20,027,040
Total liabilities	**377,951,611**	**378,057,881**	**357,059,151**
Equity			
Assigned capital	3,152,358	3,152,358	3,152,358
Statutory reserve fund	2,350,855	2,350,855	2,222,693
Retained earnings	36,682,790	37,916,995	11,392,723
Other reserves	13,602,196	13,427,523	37,475,748
Total Equity	**55,788,199**	**56,847,730**	**54,243,522**
Total equity and liabilities	**433,739,810**	**434,905,611**	**411,302,673**
Commitments and contingencies	533,264,306	533,264,306	540,191,605

2. BASIS OF PREPARATION (CONTINUED)

2.5 Changes in accounting standards (contd)

Reconciliation of impairment allowances balance from IAS39 to IFRS9

Measurement Category	IAS39	Reclassification	Measurement	IFRS9
Loans and advances to banks			662,927	662,927
Loans and advances to customers	766,513,573		1,362,754,022	2,129,267,596
Financial assets at fair value through other comprehensive income		(15,035,554)	308,492,750	293,457,196
Other financial assets at amortised cost		15,035,554		15,035,554
Acceptances & endorsements and other			8,550,405	8,550,405
Loan commitments and financial guarantees			33,713,345	33,713,345
Total	**766,513,573**	-	**1,714,173,449**	**2,480,687,022**

Impairment on day 1

Stage wise break up of impairment as at 01January 2018	Stage 1	Stage 2	Stage 3	Total
Loans and advances to banks	662,927			662,927
Loans and advances to customers	718,835,034	847,631,133	562,801,429	2,129,267,596
Financial assets at fair value through other comprehensive income	293,457,196			293,457,196
Other financial assets at amortised cost	15,035,554			15,035,554
Acceptances & endorsements and other	7,580,980	969,425		8,550,405
Loan commitments and financial guarantees	27,382,535	5,991,347	339,462	33,713,345
Total	**1,062,954,227**	**854,591,905**	**563,140,890**	**2,480,687,022**

As permitted by the transitional provisions of SLFRS 9, the Branch elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities, at the date of transition were recognised in the retained earnings as at 1 April 2018. Accordingly, the information presented for year 2017/2018 does not reflect the requirements of SLFRS 9 and therefore not comparable to the information presented for the year 2018 under SLFRS 9.

2. BASIS OF PREPARATION (CONTINUED)

2.5 Changes in accounting standards (contd)

(ii) SLFRS 15 Revenue from contracts with customers and associated amendments to various other standards

SLFRS 15 will replace LKAS 18 which covers contracts for goods and services and LKAS 11 which covers construction contracts.
The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer – so the notion of control replaces the existing notion of risks and rewards.

A new five-step process must be applied before revenue can be recognised:

I. identify contracts with customers
II. identify the separate performance obligation
III. determine the transaction price of the contract
IV. allocate the transaction price to each of the separate performance obligations, and
V. recognise the revenue as each performance obligation is satisfied.

Key changes to current practice are:

I. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements.
II. Revenue may be recognised earlier than under current standards if the consideration varies for any reasons (such as for incentives, rebates, performance fees, royalties, success of an outcome etc) – minimum amounts must be recognised if they are not at significant risk of reversal.
III. The point at which revenue is able to be recognised may shift: some revenue which is currently recognised at a point in time at the end of a contract may have to be recognised over the contract term and vice versa.
IV. There are new specific rules on licenses, warranties, non-refundable upfront fees and, consignment arrangements, to name a few.
V. There are also increased disclosures.

These accounting changes may have flow-on effects on the entity's business practices regarding systems, processes and controls, compensation and bonus plans, contracts, tax planning and investor communications.

Entities will have a choice of full retrospective application, or prospective application with additional disclosures. The branch adopted the full retrospective application, however the adoption did not have a notable impact on the financial statements of the Branch.

Amendments to SLFRS 15, 'Revenue from contracts with customers'

These amendments comprise clarifications of the guidance on identifying performance obligations, accounting for licenses of intellectual property and the principal versus agent assessment (gross versus net revenue presentation permitted).

This standard and the amendment is effective for the annual periods beginning on or after 1 January 2018.

2. BASIS OF PREPARATION (CONTINUED)

2.5 Changes in accounting standards (contd)

(b) New accounting standards, amendments and interpretations issued but not yet adopted (contd)

The following standards and interpretations had been issued but not mandatory for annual reporting periods ending 31 December 2018.

(i) SLFRS 16 Leases

SLFRS 16 will affect primarily the accounting by lessees and will result in the recognition of almost all leases on balance sheet. The standard removes the current distinction between operating and financing leases and requires recognition of an asset (the right to use the leased item) and a financial liability to pay rentals for virtually all lease contracts. An optional exemption exists for short-term and low-value leases.

The income statement will also be affected because the total expense is typically higher in the earlier years of a lease and lower in later years. Additionally, operating expense will be replaced with interest and depreciation, so key metrics like EBITDA will change.

Operating cash flows will be higher as cash payments for the principal portion of the lease liability are classified within financing activities. Only the part of the payments that reflects interest can continue to be presented as operating cash flows.

The accounting by lessors will not significantly change. Some differences may arise as a result of the new guidance on the definition of a lease. Under SLFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The standard is effective for annual periods beginning on or after 1 January 2019 with earlier application permitted if SLFRS 15, 'Revenue from Contracts with Customers', is also applied.

(ii) Amendments to LKAS 28, 'Investments in associates and joint ventures', Long-term Interests in Associates and Joint Ventures

These amendments clarify that company's account for long-term interests in an associate or joint venture to which the equity method is not applied using SLFRS 9.

This amendment is effective for the annual periods beginning on or after 1 January 2019.

(iii) Amendments to LKAS 19, 'Employee benefits' on plan amendment, curtailment or settlement'

These amendments require an entity to:
use updated assumptions to determine current service cost and net interest for the reminder of the period after a plan amendment, curtailment or settlement; and
recognise in profit or loss as part of past service cost, or a gain or loss on settlement, any reduction in a surplus, even if that surplus was not previously recognised because of the impact of the asset ceiling.

2. BASIS OF PREPARATION (CONTINUED)

2.5 Changes in accounting standards (contd)

(b) New accounting standards, amendments and interpretations issued but not yet adopted (contd)

This amendment is effective for the annual periods beginning on or after 1 January 2019.

(iv) Amendments to LKAS 1 and LKAS 8 on the definition of material

These amendments to LKAS 1, 'Presentation of financial statements', and LKAS 8, 'Accounting policies, changes in accounting estimates and errors', and consequential amendments to other SLFRSs:

a) use a consistent definition of materiality throughout SLFRSs and the Conceptual Framework for Financial Reporting;
b) clarify the explanation of the definition of material; and
c) incorporate some of the guidance in LKAS 1 about immaterial information.

These amendments are effective for the annual periods beginning on or after 1 January 2020.

(v) IFRIC 23, 'Uncertainty over income tax treatments'

This IFRIC clarifies how the recognition and measurement requirements of LKAS 12 'Income taxes', are applied where there is uncertainty over income tax treatments.

An uncertain tax treatment is any tax treatment applied by an entity where there is uncertainty over whether that treatment will be accepted by the tax authority. For example, a decision to claim a deduction for a specific expense or not to include a specific item of income in a tax return is an uncertain tax treatment if its acceptability is uncertain under tax law. IFRIC 23 applies to all aspects of income tax accounting where there is an uncertainty regarding the treatment of an item, including taxable profit or loss, the tax bases of assets and liabilities, tax losses and credits and tax rates. This amendment is effective for the annual period beginning on or after 1 January 2019.

2.6 Rounding of amounts

All amounts disclosed in the financial statements and notes have been rounded off to the nearest thousand Sri Lankan Rupees unless otherwise stated.

3. SIGNIFICANT ACCOUNTING POLICIES

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

3.1 Foreign currency translation

Transactions and balances: Foreign currency transactions are translated into the functional currency using the exchange rates at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies at year end exchange rates are generally recognised in profit or loss.

Foreign exchange gains and losses are presented in the income statement under net gains from trading with customers and others.

The results and financial position of foreign currency operation (Foreign Currency Banking Unit) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position;
- income and expenses for each statement of income statement and statement of comprehensive income are translated at spot exchange rates; and
- all resulting exchange differences are recognised in other comprehensive income.

Forward exchange contracts are valued at the forward market rates ruling on the reporting date. Both unrealised losses and gains are reflected in the income statement.

3.2 Interest

Interest income and expense is recognised in income statement using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Branch estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

When a receivable is impaired, the Branch reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised using the original effective interest rate.

The calculation of the effective interest rate includes all transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

Interest income and expense presented in the income statement include interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.3 Fees and commissions

The fees and commission income and expense that are integral to the effective interest rate on financial asset or liability are included in the measurement of the effective interest rate. Other fees and commissions are recognised in the period in which the services are rendered. The fees and commissions for services relating to periods after the reporting date is deferred in the statement of financial position.

Other fees and commission income, including account servicing fees, trade fees are recognised as the related services are performed. Other fees and commission expense relate mainly to transaction and service fees, which are expensed as the services are received.

3.4 Taxation

Income taxation

The provision for income tax is based on the element of the income and expenditure as reported in the financial statements and computed in accordance with the provisions of the Inland Revenue Act No.24 of 2017 and subsequent amendments thereto. The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at end of the reporting period. Management periodically evaluate positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It established provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Relevant details are disclosed in the notes to the financial statements.

Deferred tax

Deferred tax is provided using the liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets and liabilities are recognised in full for all temporary differences. Deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit nor loss.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.4 Taxation (contd)

Deferred tax (contd)

Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax credits and unused tax losses can be utilised. The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Current and deferred tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

3.5 Financial assets and financial liabilities

3.5.1 Valuation of financial instruments

All financial instruments are initially recognised at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, if there is a difference between the transaction price and the fair value of financial instruments whose fair value is based on a quoted price in an active market or a valuation technique that uses only data from observable markets, the branch recognises the difference as a trading gain or loss at inception (a 'day 1 gain or loss'). In all other cases, the entire day 1 gain or loss is deferred and recognised in the income statement over the life of the transaction until the transaction matures, is closed out, the valuation inputs become observable or the branch enters into an offsetting transaction.

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5 Financial assets and financial liabilities (contd)

3.5.2 Critical accounting estimates and judgements

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

3.5.3 Financial instruments measured at amortised cost

Financial assets that are held to collect the contractual cash flows and which contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest are measured at amortised cost. Such financial assets include most loans and advances to branches and customers and some debt securities. In addition, most financial liabilities are measured at amortised cost.

The branch accounts for regular way amortised cost financial instruments using trade date accounting. The carrying value of these financial assets at initial recognition includes any directly attributable transactions costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some leveraged finance and syndicated lending activities, the difference is deferred and recognised over the life of the loan through the recognition of interest income.

The branch may commit to underwriting loans on fixed contractual terms for specified periods of time. When the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative. When the branch intends to hold the loan, the loan commitment is included in the impairment calculations set out below.

Non-trading reverse repurchase, repurchase and similar agreements

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

Contracts that are economically equivalent to reverse repo or repo agreements (such as sales or purchases of debt securities entered into together with total return swaps with the same counterparty) are accounted for similarly to, and presented together with, reverse repo or repo agreements.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5 Financial assets and financial liabilities (contd)

3.5.4 Financial assets measured at fair value through other comprehensive income

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

3.5.5 Financial instruments designated at fair value through profit or loss

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

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

Designated financial assets are recognised when the branch enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when the rights to the cash flows expire or are transferred. Designated financial liabilities are recognised when the branch enters into contracts with counterparties, which is generally on settlement date, and are normally derecognised when extinguished. Subsequent changes in fair values are recognised in the income statement in 'Net income from financial instruments held for trading or managed on a fair value basis' or 'Net income/(expense) from assets and liabilities of insurance businesses, including related derivatives, measured at fair value through profit or loss'.

Under the above criterion, the main classes of financial instruments designated by the branch are:

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5 Financial assets and financial liabilities (contd)

3.5.6 Financial instruments designated at fair value through profit or loss (contd)

3.5.6 Derivatives

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, interest rates or other indices. Derivatives are recognised initially and are subsequently measured at fair value through profit or loss. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative. This includes embedded derivatives in financial liabilities, which are bifurcated from the host contract when they meet the definition of a derivative on a stand-alone basis. Where the derivatives are managed with debt securities issued by HSBC that are designated at fair value, the contractual interest is shown in 'Interest expense' together with the interest payable on the issued debt.

3.5.7 Impairment of amortised cost and FVOCI financial assets

Expected credit losses ('ECL') are recognised for loans and advances to branchs and customers, non-trading reverse repurchase agreements, other financial assets held at amortised cost, debt instruments measured at FVOCI, and certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is required for ECL resulting from default events that are possible within the next 12 months, or less, where the remaining life is less than 12 months ('12-month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12- month ECL is recognised are considered to be 'stage 1'; financial assets that are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in 'stage 3'. Purchased or originated credit-impaired financial assets ('POCI') are treated differently, as set out below.

3.5.8 De-recognition of financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when the rights to receive cash flows from the financial asset have expired. The Company also derecognises the financial asset if it has both transferred the financial asset and the transfer qualifies for derecognition.

3.5.9 Derecognition - financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in profit or loss.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5 Financial assets and financial liabilities (contd)

3.5.10 Finance and operating lease

The determination of whether an arrangement is a lease, or contains a lease, is based on the substance of the arrangement at the inception date and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

3.5.11 Operating leases - company as a lessee

Leases that do not transfer to the Branch substantially all risks and benefits incidental to ownership of the leased assets are operating leases. Operating lease payments are recognized as an expense in the profit or loss on a straight-line basis over the lease term and leased assets are not recognised on the statement of financial position. Contingent rental payable is recognized as an expense in the period in which they are incurred.

3.5.12 Assigned capital

Assigned capital of the bank represent the capital contributions made to the Branch by the Head office. The increase in equity on the receipt of capital contributions is normally recorded as the residual after recording the recognition or de-recognition of assets or liabilities arising on the share issue (the proceeds of issue) and after deducting directly attributable transaction costs.

Distributions to holders of equity, which include profits transferred to head office are debited directly to equity at the date of payment.

3.5.13 Accounting policies applied to financial instruments prior to 1 January 2018

Financial instruments measured at amortised cost

Loans and advances to branch's and customers, held-to-maturity investments and most financial liabilities are measured at amortised cost. The carrying value of these financial assets at initial recognition includes any directly attributable transactions costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some leveraged finance and syndicated lending activities, the difference is deferred and recognised over the life of the loan (as described in sub-section (c) above) through the recognition of interest income, unless the loan becomes impaired.

HSBC may commit to underwriting loans on fixed contractual terms for specified periods of time. When the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative. When HSBC intends to hold the loan, a provision on the loan commitment is only recorded where it is probable that HSBC will incur a loss.

Impairment of loans and advances

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

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3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5.13 Accounting policies applied to financial instruments prior to 1 January 2018 (contd.)

Individually assessed loans and advances

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

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

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

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

Collectively assessed loans and advances

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

Write-off of loans and advances

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

Reversals of impairment

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

PricewaterhouseCoopers
Colombo

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5 Financial assets and financial liabilities (contd)

3.5.13 Accounting policies applied to financial instruments prior to 1 January 2018 (contd)

Renegotiated loans

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

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

Non-trading reverse repurchase, repurchase and similar agreements

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

Contracts that are economically equivalent to reverse repurchase or repurchase agreements (such as sales or purchases of debt securities entered into together with total return swaps with the same counterparty) are accounted for similarly to, and presented together with, reverse repurchase or repurchase agreements.

Financial instruments measured at fair value

Available-for-sale financial assets

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5 Financial assets and financial liabilities (contd)

3.5.13 Accounting policies applied to financial instruments prior to 1 January 2018 (contd)

Impairment of available-for-sale financial assets

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

Available-for-sale debt securities

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

Financial instruments designated at fair value

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

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

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.6 Events occurring after reporting date

All material events occurring after the reporting date are considered and disclosed and where necessary, adjustments are made in the financial statements.

3.7 Cash flow statements

The cash flow has been prepared and presented using the "direct method" of preparing cash flow statements in accordance with LKAS 7, Statements of Cash Flows.

Cash and cash equivalent comprise mainly of cash in hand, short-term placements with other Branches and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value and are used by the Branch in the management of its short term commitments.

3.8 Comparative figures

The comparative figures and phrases have been re-arranged wherever necessary to conform to the current year's presentation. The accounting policies have been consistently applied by the Branch and are consistent with those of previous year.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.9 Assets and bases of their valuation

3.9.8 Property, plant and equipment

Initial measurement

The property, plant and equipment are recorded at cost or revaluation. The cost of property, plant and equipment is the cost of purchase or construction together with any incidental expenses thereon and valuation is carried out once a year for land and building by an independent valuer. The property, plant and equipment are stated at cost or valuation (land, freehold buildings and improvements to buildings are carried at revalued amounts) less accumulated depreciation, which is provided for on the bases specified below and impairment losses. All property and equipment costing less than USD 400 and maintenance and repairs to machinery are charged to the income statement. All major renovations and renewals are capitalised.

Depreciation

The provision for depreciation is calculated on the cost or valuation of property, plant and equipment has been provided on straight line basis over the periods appropriate to estimated useful lives of the different types of Property, plant and equipment as shown below. The Freehold land is not depreciated.

Assets	No of Years
Freehold buildings and improvements to buildings	over 50 years
Fixed assets relating to Head Office refurbishment project	over 10 years/over 20 years
Office machinery	over 5 years
Furniture and equipment	over 5 years
ATM machines	over 7 years
Motor vehicles	over 4 years
Computer equipment including AS 400 system	over 5 years
Computer terminals	over 5 years
Personal computers and local area networks	over 4 years

In addition to the above, refurbishments on office furniture and equipment carried out for lease hold properties will be depreciated based on the remaining lease term.

Depreciation is charged on monthly basis from the date of acquisition and no depreciation is charged on the month of disposal of the asset.

Disposals

Gain or loss on disposal of property, plant and equipment have been accounted for in the income statement by considering sales proceeds, cost and accumulated depreciation of such disposed item of property, plant and equipment.

Impairment of assets

An impairment loss is recognised if the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. A cash generating unit is the smallest identifiable asset group that generates cash flows that are largely independent from other assets and groups. Impairment losses are recognised in income statement.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.9 Assets and bases of their valuation (contd.)

3.9.9 Export bills negotiated and discounted

The export bills are shown in the books at their face values. Export bills in foreign currencies are converted at the year-end exchange rates. The resulting gain or loss is dealt with in the income statement.

3.9.10 Cash and cash equivalents

Cash and short term funds are regarded as cash and cash equivalents as these are funds held for the purpose of meeting short term cash commitments. Further, these funds have a short maturity of less than three months.

3.9.11 Statutory deposits with the Central Bank of Sri Lanka

The Monetary Law Act requires that all commercial banks operating in Sri Lanka to maintain a reserve against all deposit liabilities denominated in Sri Lankan Rupees. The reserve should be maintained for an amount equal to 6.0% of the total of such rupee deposit liabilities.

3.10 Employee share plans

Discretionary awards of shares granted under HSBC Group share plans align the interests of employees with those of shareholders. The Branch employee share plans are also aligned to group policy.

3.10.8 Discretionary awards

In line with the HSBC Group share awards system, the Branch has entered into equity-settled share-based payment arrangements with its employees as compensation for services provided by employees. Equity-settled share-based payment arrangements entitle employees to receive equity instruments of HSBC Holdings plc.

The cost of equity-settled share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted and recognised as an expense on a straight-line basis over the vesting period, with a corresponding credit to 'Liability to HSBC Holdings'. The vesting period is the period during which all the specified vesting conditions of the arrangement are to be satisfied. The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately.

Fair value is determined by using appropriate valuation models, taking into account the terms and conditions of the award. Vesting conditions include service conditions and performance conditions; any other features of the arrangement are non-vesting conditions. Market performance conditions and non-vesting conditions are taken into account when estimating the fair value of the award at the date of grant, so that an award is treated as vesting irrespective of whether these conditions are satisfied, provided all other vesting conditions are satisfied.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11 Liabilities and provisions

3.11.8 Employee retirement benefit obligation

Pension fund

All the employees of the Branch are eligible for the pension Fund. The Fund has been established under Trust Deed dated 7 December 1992 to fund the retirement benefits accruing to employees.

Up to 31 December 2008, the Branch operated the Pension Fund outside the financial statements of the Branch. Accordingly, no asset or liability was recognised in the financial statements of the Branch.

Up to 2012, the Pension Fund was a funded, non-contributory, defined benefit plan. In 2012, the Branch introduced an optional pension scheme which is defined contribution scheme. Therefore, currently the Branch operates two separate pension funds. Namely, the defined benefit plan and defined contributory plan.

The net of present value of defined benefit obligation, net of fair value of plan assets has been recognised in the statement of financial position. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using a discount rate based on the interest rates of Government bonds that are denominated in the currency in which the benefits will be paid, and that have terms approximating to the terms of the related obligation. Current service cost, interest cost, expected return on plan assets are charged / credited to income statement and the actuarial gains/losses are recognised through other comprehensive income statement. Re-measurement gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised in the period in which they occur, directly in other comprehensive income.

The Branch carries out an actuarial valuation of the fund annually. The actuarial valuation is carried out by Towers Watson India Private Limited. The actuary has used the "Projected Unit Credit (PUC) Method" in determining the present value of defined benefit obligation and the contribution rate required to fund or provide for the promised benefits under the Pension Fund.

In 2012, the Branch introduced an optional pension scheme which is a defined contribution scheme. Employees who opt for defined contribution scheme will be credited with an "opening balance" on the date of commencement of the new scheme, which is calculated taking factors such as service period, current pensionable salary, etc. The Branch contributes 10% of the gross salary thereon, on a monthly basis. The lump sum accrued (Branch's contribution plus interest) will be payable at the time of staff retirement or leaving service.

Provident fund

The Branch contributes to the approved Provident Fund, which is maintained outside the financial statements of the Branch. This is a defined contribution plan. The Branch contributes 12% of the employees' gross salary to this fund whilst the employees contributes 8% of the gross salary. The Branch has no further payment obligations once the contributions have been paid.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11 Liabilities and provisions (contd.)

3.11.1 Employee retirement benefit obligation (contd.)

Trust fund

The Branch contributes 3% of the gross salary of employees to the Employees Trust Fund, which is a defined contribution plan. The Branch has no further payment obligations once the contributions have been paid.

3.11.9 Borrowings

Borrowings are initially recognised at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in income statement over the period of the borrowings using the effective interest method. Borrowings are removed from the statement of financial position when the obligation specified in the contract is discharged, cancelled or expired.

3.11.10 Other payables

These amounts represent liabilities for goods and services provided to the Branch prior to the end of financial year which are unpaid. The amounts are unsecured. Other payables are presented as other liabilities.

3.11.11 Provisions

Provisions are recognised when the Branch has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognised for future operating losses. Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

3.11.12 Commitment and contingencies

All discernible risks are accounted for in determining the amount of other liabilities and all capital commitments and contingent liabilities are disclosed in the financial statements. Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is not probable or cannot reliably measured. To meet the financial needs of customers, the Branch enters into various irrevocable commitments and contingent liabilities. These consist of guarantees, letters of credit, and other undrawn commitments. These instruments commit the Branch to make payments on behalf of customers in the event of a specific act, generally related to import and export. They carry credit risk similar to loans and receivables. These contingent liabilities are disclosed in the financial statements as Off Balance Sheet transactions.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11 Liabilities and provisions (contd.)

3.11.6 Other off-balance sheet transactions

The Branch enters into off- balance sheet transactions such as forward exchange contracts, currency swaps, interest rate swaps and options, the principle amounts of which are recorded as Off Balance Sheet transactions. The financial derivatives in connection with these transactions are recorded in the trading position at fair value. The movement in fair value is recognised in the Income Statement.

4 SIGNIFICANT MANAGEMENT ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Critical accounting estimates and assumptions

The Branch makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

Income and other taxes

The Branch is subject to income tax and other tax such as Value Added Tax, Nation Building Tax, Crop Levy and Debt Repayment Levy specifically levied on the banking and financial sector. The calculations are based on the provisions enacted as per the relevant Acts and guidelines published by Inland Revenue Department. The Branch recognises liabilities for any pending tax matters with the tax authorities based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made.

The recognition of a deferred tax asset relies on an assessment of the probability and sufficiency of future taxable profits, future reversals of existing taxable temporary differences and ongoing tax planning strategies.

4. SIGNIFICANT MANAGEMENT ESTIMATES AND JUDGEMENTS (CONTINUED)

Valuation of financial instruments

The best evidence of fair value is a quoted price in an actively traded principal market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. When a financial instrument has a quoted price in an active market, the fair value of the total holding of the financial instrument is calculated as the product of the number of units and the quoted price. The judgement as to whether a market is active may include, but is not restricted to, consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. Valuation techniques may incorporate assumptions about factors that other market participants would use in their valuations, including:

- the likelihood and expected timing of future cash flows on the instrument. Judgement may be required to assess the counterparty's ability to service the instrument in accordance with its contractual terms. Future cash flows may be sensitive to changes in market rates;
- selecting an appropriate discount rate for the instrument. Judgement is required to assess what a market participant would regard as the appropriate spread of the rate for an instrument over the appropriate risk-free rate; and
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing derivative products.

A range of valuation techniques is employed, dependent on the instrument type and available market data. Most valuation techniques are based upon discounted cash flow analyses, in which expected future cash flows are calculated and discounted to present value using a discounting curve. Prior to considering credit risk, the expected future cash flows may be known, as would be the case for the fixed leg of an interest rate swap, or may be uncertain and require projection, as would be the case for the floating leg of an interest rate swap. 'Projection' utilises market forward curves, if available. In option models, the probability of different potential future outcomes must be considered. In addition, the value of some products is dependent on more than one market factor, and in these cases it will typically be necessary to consider how movements in one market factor may affect the other market factors. The model inputs necessary to perform such calculations include interest rate yield curves, exchange rates, volatilities, correlations and prepayment and default rates. For interest rate derivatives with collateralised counterparties and in significant currencies, the Branch uses a discounting curve that reflects the overnight interest rate. The majority of valuation techniques employ only observable market data.

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4. SIGNIFICANT MANAGEMENT ESTIMATES AND JUDGEMENTS (CONTINUED)

Pension benefits

The present value of the pension obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the discount rate. Any changes in these assumptions will impact the carrying amount of pension obligations. The Branch determines the appropriate discount rate at the end of each year. This is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. In determining the appropriate discount rate, the Branch considers the interest rates of Government bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating the terms of the related pension obligation. Other key assumptions for pension obligations are based in part on current market conditions.

Impairment

Credit impaired (stage 3)

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

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

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due. Therefore stage 3 represents all loans that are considered defaulted or otherwise credit impaired.

Write-off

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

Renegotiation

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

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement is made on substantially different terms, or if the terms of an existing agreement are modified such that the renegotiated loan is a substantially different financial instrument. Any new loans that arise following de-recognition events in these circumstances are considered to be POCI and will continue to be disclosed as renegotiated loans.

4. SIGNIFICANT MANAGEMENT ESTIMATES AND JUDGEMENTS (CONTINUED)

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

Loan modifications that are not credit impaired

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

Significant increase in credit risk (stage 2)

An assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. The assessment explicitly or implicitly compares the risk of default occurring at the reporting date compared with that at initial recognition, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. The assessment is unbiased, probability-weighted, and to the extent relevant, uses forward-looking information consistent with that used in the measurement of ECL. The analysis of credit risk is multifactor. The determination of whether a specific factor is relevant and its weight compared with other factors depends on the type of product, the characteristics of the financial instrument and the borrower, and the geographical region. Therefore, it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk, and these criteria will differ for different types of lending, particularly between retail and wholesale.

However, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when 30 days past due. In addition, wholesale loans that are individually assessed, typically corporate and commercial customers, and included on a watch or worry list, are included in stage 2.

For wholesale portfolios, the quantitative comparison assesses default risk using a lifetime probability of default ('PD') which encompasses a wide range of information including the obligor's customer risk rating ('CRR'), macroeconomic condition forecasts and credit transition probabilities.

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

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

FOR THE YEAR ENDED 31 DECEMBER

5 Net interest income	2018 Rs.'000	2017 Rs.'000
Interest income		
Cash and cash equivalents	**667,065**	294,606
Balances with central banks	**5,082**	11,813
Placements with banks	**154,612**	99,312
Derivative financial instruments	-	-
Financial assets recognized through profit or loss	-	-
- measured at fair value	**947,720**	414,885
- designated fair value	-	-
Financial assets at amortised cost	-	-
- loans and advances	**17,860,315**	14,751,967
- debt and other instruments	**598,830**	-
Financial assets measured at fair value through other comprehensive income	**9,423,764**	12,873,136
Others	-	-
Total interest income	**29,657,388**	28,445,719
Interest expenses		
Due to banks	**(414,783)**	(445,001)
Financial liabilities at amortised cost	-	-
- due to depositors	**(6,801,803)**	(7,644,283)
- due to debt securities holders	**(376,263)**	(24,410)
- due to other borrowers	-	-
Others	**(3,618,900)**	(2,189,583)
Total interest expenses	**(11,211,749)**	(10,303,277)
	18,445,639	18,142,442

5.1 Net interest income from Sri Lanka Government Securities		
Interest income	**10,970,314**	13,288,021

FOR THE YEAR ENDED 31 DECEMBER

6 Net fee and commission income

	2018 Rs.'000	2017 Rs.'000
Fee and commission income	**4,046,719**	3,680,452
Fee and commission expenses	**(1,006,278)**	(882,970)
	3,040,441	2,797,482

6.1 Comprising

Loans and advances	**117,496**	215,994
Credit cards	**1,694,345**	1,418,833
Trade and remittance transactions	**1,054,389**	1,010,107
Deposits accounts	**109,332**	110,541
Trustee and fiduciary services	**196,222**	190,761
Others	**(131,343)**	(148,754)
Net fee and commission income	**3,040,441**	2,797,482

7 Net gain from trading

	2018 Rs.'000	2017 Rs.'000
Foreign exchange (excluding derivatives)		
- Gains from transaction with customers	**2,356,793**	2,571,587
- Losses from transaction with others	**(594,227)**	(963,406)
Fixed income securities	**18,130**	279,010
Derivative financial instruments	**(4,309)**	2,002
	1,776,387	1,889,193

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FOR THE YEAR ENDED 31 DECEMBER

8 Net gain / (loss) from financial investments	2018 Rs.'000	2017 Rs.'000
Net gain from financial investments	312,260	307,951
	312,260	307,951

9 Other operating income (net)	2018 Rs.'000	2017 Rs.'000
Profit on sale of property, plant and equipment	17,614	25,935
Others	42,630	25,648
	60,244	51,583

10 Impairment charges for loans and other losses	2018 Rs.'000	2017 Rs.'000
Presented under SLFRS 9		
Financial assets at amortised cost - loans and advances (Note 10.1)	(259,579)	
(Note 10.2)	(11,971)	
income (Note 10.3)	138,635	
Contingent liabilities & commitments (Note 10.4)	(37,897)	
Others	1,965	
Presented under LKAS 39		
Individual significant impairment charge (Note 10.5)		(22,165)
Collective impairment charge (Note 10.6)		(226,398)
	(168,847)	(248,563)

10.1 Financial assets at amortised cost - loans and advances (Note 21(b)	
Stage 1	(15,822)
Stage 2	283,440
Stage 3	(527,197)
	(259,579)

10.2 Financial assets at amortised cost – debt instruments	
Stage 1	(11,971)
Stage 2	-
Stage 3	-
	(11,971)

10.3 Financial assets measured at fair value through other	
Stage 1	138,635
Stage 2	-
Stage 3	-
	138,635

FOR THE YEAR ENDED 31 DECEMBER

10 Impairment charges for loans and other losses (contd)

	2018 Rs.'000	2017 Rs.'000
10.4 Contingent liabilities and commitments (Note 45(a))		
Stage 1	(30,786)	
Stage 2	(751)	
Stage 3	(6,360)	
	(37,897)	
Others	1,965	
	(168,847)	
10.5 Individual impairment charge		
Impairment reversal /(provision) for the year		
- For customer balances		377,213
Direct write-offs for the year		(425,981)
Recoveries during the year		26,603
		(22,165)
10.6 Collective impairment charge		
Impairment reversal for the year		26,525
Direct write-offs for the year		(617,439)
Recoveries during the year		364,516
		(226,398)

11 Personnel expenses

	2018 Rs.'000	2017 Rs.'000
Salary and bonus	(2,650,559)	(2,375,155)
Contributions to defined contribution/benefit plans	(338,193)	(186,337)
Provision for defined benefit obligations (Note 29)	(23,005)	(125,358)
Others	(840,947)	(805,453)
	(3,852,704)	(3,492,303)

The defined contribution expense for the year ended 31 March 2019 is not expected to deviate significantly from the current year expense.

FOR THE YEAR ENDED 31 DECEMBER

12 Other expenses

	2018 Rs.'000	2017 Rs.'000
Auditors' remunerations	(4,306)	(2,802)
Non-audit fees to auditors	(5,726)	(1,162)
Professional and legal expenses	(56,642)	(30,708)
Depreciation of property, plant and equipment	(300,142)	(304,936)
Office administration and establishment expenses	(2,451,969)	(2,215,548)
Others	(4,617,593)	(3,989,063)
	(7,436,378)	(6,544,219)

Main component of expenses classified as 'Others' is regionally allocated charges (RAC), which is remittable to regional Head Office.

13 Tax expense

	2018 Rs.'000	2017 Rs.'000
13.a Current tax expense		
Current tax on profit for the year (**Note 13.c**)	(3,989,625)	(4,062,178)
(Over)/under provision for the previous year	484,959	(1,945)
Tax of prior years paid in current year	(99,942)	-
Remittance tax	(213,000)	(227,086)
	(3,817,608)	(4,291,209)
13.b Deferred tax expenses		
- Provision for employee benefit	-	-
- Owned assets	(62,016)	(16,234)
- Allowance for loans losses	(61,078)	-
Deferred tax assets reversed during the year	(123,094)	(16,234)
- Provision for employee benefit	3,719	518
- Depreciation on revaluation of land & building	1,544	1,433
- Allowance for loans losses		4,518
Deferred tax liabilities recognized during the year	5,263	6,469
	(117,831)	(9,765)
Total tax charge to income statement	(3,935,439)	(4,300,974)
13.c Reconciliation between tax expense and accounting profit		
Accounting profit before taxation	10,057,003	10,709,008
Income tax for the period at 28%	2,815,944	2,998,521
Add: Tax effect of expenses that are not deductable for tax purposes	1,729,962	2,195,832
Less: Tax effect of expenses that are deductable for tax purposes	(555,361)	(579,807)
Exempt Income	(920)	(552,368)
Taxable income	3,989,625	4,062,178
13.d Tax charge to the statement of other comprehensive income		
-Provision for employee benefit	(19,492)	71,793
-OCI reserve	463,490	(676,693)
-Revaluation of buildings	(832,594)	(36,679)
	(388,596)	(641,579)

Deferred tax on loan losses attributed to SLFRS 9 adoption amounting to LKR 479,968,566 was adjusted to day 1 impact in equity statement.

AS AT 31 DECEMBER

14 Analysis of financial instruments by measurement basis

14.1 As at 31 December 2018

	Fair value through profit or loss	Amortized cost	Fair value through other comprehensive income	Total
	Rs.'000	Rs.'000	Rs.'000	Rs.'000
ASSETS				
Cash and cash equivalents	-	23,502,316	-	23,502,316
Balances with the Central Bank of Sri Lanka	-	7,332,880	-	7,332,880
Placements with banks	-	49,385,700	-	49,385,700
Derivative financial instruments	4,466,754	-	-	4,466,754
Financial assets measured at fair valu	11,516,593	-	-	11,516,593
Financial Assets at Amortised Cost – Loans and Advances	-	255,830,603	-	255,830,603
Financial assets measured at fair value through other comprehensive	-	-	100,949,137	100,949,137
Financial assets at amortised cost - debt instruments	-	5,308,259	-	5,308,259
Acceptances and endorsements	-	6,843,206	-	6,843,206
Total financial assets	**15,983,347**	**348,202,964**	**100,949,137**	**465,135,448**
LIABILITIES				
Due to banks	-	184,786,888	-	184,786,888
Derivative financial instruments	3,875,848	-	-	3,875,848
Financial liabilities at amortised cost	-	205,873,323	-	205,873,323
Acceptances and endorsements	-	6,843,206	-	6,843,206
Total financial liabilities	**3,875,848**	**397,503,417**	**-**	**401,379,265**

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THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

AS AT 31 DECEMBER

14 Analysis of financial instruments by measurement basis (contd)

14.2 As At 31 December 2017

	Held for trading Rs.'000	Amortized cost Rs.'000	Available for sale Rs.'000	Total Rs.'000
ASSETS				
Cash and cash equivalents	-	7,721,011	-	7,721,011
Balances with Central Bank	-	7,765,246	-	7,765,246
Placements with banks	-	41,214,750	-	41,214,750
Derivative financial instruments	1,265,432	-	-	1,265,432
Financial assets measured at fair value through profit or loss	4,762,430	-	-	4,762,430
Financial Assets at Amortised Cost – Loans and Advances	-	202,739,049	-	202,739,049
Financial assets measured at fair value through other comprehensive	-	-	150,869,348	150,869,348
Acceptances and endorsements	-	6,239,553	-	6,239,553
Total financial assets	**6,027,862**	**265,679,609**	**150,869,348**	**422,576,819**
LIABILITIES				
Due to banks	-	175,400,730	-	175,400,730
Derivative financial instruments	1,032,710	-	-	1,032,710
Financial liabilities at amortised cost	-	180,725,041	-	180,725,041
Acceptances and endorsements	-	6,239,553	-	6,239,553
Total financial liabilities	**1,032,710**	**362,365,324**	**-**	**363,398,034**

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AS AT 31 DECEMBER

15 Cash and cash equivalents	2018 Rs.'000	2017 Rs.'000
Cash in hand	1,543,232	1,287,738
Balances with other banks	21,959,084	6,433,273
	23,502,316	7,721,011

16 Balances with the Central Bank of Sri Lanka	2018 Rs.'000	2017 Rs.'000
Balances with Central Bank	7,332,880	7,765,246
	7,332,880	7,765,246

As required by the provisions of Section 93 of the Monetary Law Act, a cash balance is maintained with the Central Bank of Sri Lanka. The minimum cash reserve requirement on Rupee deposit liabilities was 6.0% as at 31st December 2018 (2017 : 7.5%).

17 Placements with banks	2018 Rs.'000	2017 Rs.'000
Placements	49,385,700	41,214,750
	49,385,700	41,214,750

18 Derivative financial instruments	2018 Rs.'000	2017 Rs.'000
Interest rate derivatives		
Interest rate swaps	13,693	35,901
Currency options	-	-
Forward foreign exchange contracts	4,453,061	1,229,531
	4,466,754	1,265,432

19 Financial assets measured at fair value through profit or loss	2018 Rs.'000	2017 Rs.'000
Treasury bills	950,871	277,771
Treasury bonds	10,565,722	4,484,659
	11,516,593	4,762,430

19.a Analysis		
By collateralisation		
- Unencumbered	11,516,593	4,762,430
By currency		
- Sri Lankan rupee	11,516,593	4,762,430

AS AT 31 DECEMBER

20 Financial Assets at Amortised Cost – Loans and Advances	2018 Rs.'000	2017 Rs.'000
Gross loans and advances (Note 20.1)	257,982,789	203,505,562
Stage 1	237,628,433	
Stage 2	19,584,012	
Stage 3	770,344	
Less: Accumulated impairment under (Note 20.2)	(2,152,186)	(766,513)
Stage 1	(817,352)	
Stage 2	(610,453)	
Stage 3	(724,381)	
Individual impairment charges		(356,936)
Collective impairment charges		(409,577)
Net loans and receivables	255,830,603	202,739,049

20.1 Analysis

a. By product

	2018 Rs.'000	2017 Rs.'000
Overdrafts	35,859,299	16,932,499
Trade finance	51,733,563	38,269,262
Credit cards	24,428,098	21,266,957
Staff loans	1,869,720	1,836,986
Term loans - short term	22,687,007	16,168,700
Term loans - long term	120,494,378	107,995,151
Mortgages	910,724	1,036,007
Gross Total	257,982,789	203,505,562

b. By currency

	2018 Rs.'000	2017 Rs.'000
Sri Lankan Rupee	86,853,321	66,607,542
United States Dollar	166,876,051	129,413,712
Great Britain Pound	-	17,521
Others	4,253,417	7,466,787
Gross Total	257,982,789	203,505,562

c. By industry

	2018 Rs.'000	2017 Rs.'000
Agriculture and fishing	4,515,815	8,818,473
Manufacturing	80,759,461	52,771,003
Tourism	37,999,229	32,001,371
Transport	15,830,302	6,741,996
Construction	5,724,129	4,083,982
Traders	30,151,021	25,559,244
New economy	10,728,457	15,198,806
Others	72,274,375	58,330,687
Gross Total	257,982,789	203,505,562

AS AT 31 DECEMBER

20 Financial Assets at Amortised Cost – Loans and Advances (contd)

20.2 Provision for impairment loss	**2018 Rs.'000**	2017 Rs.'000
a. Stage 1		
Opening balance	719,498	
Impairment classification	15,822	
Write-off during the year	-	
Exchange fluctuations and other movements	82,032	
Closing balance	817,352	
b. Stage 2		
Opening balance	847,631	
Impairment classification	(283,440)	
Write-off during the year	-	
Exchange fluctuations and other movements	46,262	
Closing balance	610,453	
c. Stage 3		
Opening balance	766,513	
Impairment classification	190,799	
Write-off during the year	-	
Exchange fluctuations and other movements	(232,931)	
Closing balance	724,381	
c.1 Individual impairment charges		
Opening balance		727,608
(Reversal) / charge for the year		(377,213)
Exchange fluctuations and other movements		6,541
Closing balance		356,936
c.2 Collective impairment charges		
Opening balance		393,442
Reversal for the year		(26,525)
Exchange fluctuations and other movements		42,660
Closing balance		409,577
Total	2,152,186	766,513

21 Financial assets measured at fair value through other comprehensive income	**2018 Rs.'000**	2017 Rs.'000
Treasury bills	1,859,948	5,570,425
Treasury bonds	99,089,189	145,298,923
	100,949,137	150,869,348

PricewaterhouseCoopers
Colombo

AS AT 31 DECEMBER

		2018	2017
21	**Financial assets measured at fair value through other comprehensive income (contd)**	**Rs.'000**	Rs.'000
21.1	**Securities pledged against repurchase agreements**		
	Repo value	**8,686,934**	227,989
	Fair value of securities held	**8,697,504**	229,957

As of the financial year 2018, there were nil reverse repurchase agreements transactions.

		2018
22	**Financial assets at amortised cost - debt instruments**	**Rs.'000**
	Treasury bills	-
	Treasury bonds	**5,308,259**
		5,308,259
22.a	**Financial assets at amortised cost - debt instruments**	
	By collateralisation	
	- Unencumbered	**5,320,230**
	By currency	
	- Sri Lankan Rupee	**5,320,230**
	Movements in impairment during the year	
	Stage 1	
	Opening balance	-
	Impairment classification	**(11,971)**
	Write-off during the year	-
	Exchange fluctuations and other movements	-
	Closing balance	**(11,971)**

AS AT 31 DECEMBER

23 Property, plant and equipment

	Land	Freehold buildings and improvements	Office equipment, furniture and fittings	Household equipment, furniture and fittings	Office machines	Computer hardware and software	Motor vehicle	Total
Cost/revalued Amount								
Balance as at 1 January 2017	1,774,147	1,348,379	735,263	16,681	178,801	644,717	222,220	4,920,208
Additions during the year	-	-	20,954	611	4,018	27,255	-	52,838
Disposals during the year	-	-	(2,021)	(385)	(2,002)	(5,889)	(57,976)	(68,273)
Transfers during the year								-
Revaluation gain	331,486	19,737	-	-	-	-	-	351,223
Balance as at 31 December 2017	2,105,633	1,368,116	754,196	16,907	180,817	666,083	164,244	5,255,996
Balance as at 1 January 2018	**2,105,633**	**1,368,116**	**754,196**	**16,907**	**180,817**	**666,083**	**164,244**	**5,255,996**
Additions during the year	**11,441**	-	**89,984**	-	**117,347**	**62,604**	-	**281,376**
Disposals during the year	-	-	**(5,437)**	-	-	**(646)**	**(45,703)**	**(51,786)**
Transfers during the year	-	-	-	-	-	-	-	-
Revaluation gain	**694,032**	**66,785**	-	-	-	-	-	**760,817**
Balance as at 31 December 2018	**2,811,106**	**1,434,901**	**838,743**	**16,907**	**298,164**	**728,041**	**118,541**	**6,246,403**
Accumulated depreciation								
Balance as at 1 January 2017	-	-	381,414	15,696	161,385	442,539	181,797	1,182,831
Charge for the year	-	111,259	93,795	296	6,099	70,073	23,414	304,936
Disposals during the year	-	-	(2,022)	(385)	(1,977)	(5,107)	(51,764)	(61,255)
Reclassified during the year	-	-	-	-	-	-	-	-
Revaluation adjustment	-	(111,259)	-	-	-	-	-	(111,259)
Balance as at 31 December 2017	-	-	473,187	15,607	165,507	507,505	153,447	1,315,253
Balance as at 1 January 2018	-	-	**473,187**	**15,607**	**165,507**	**507,505**	**153,447**	**1,315,253**
Charge for the year	-	**112,466**	**103,678**	**346**	**12,187**	**65,785**	**5,680**	**300,142**
Reclassified during the year	-	-	-	-	-	-	-	-
Revaluation adjustment	-	**(112,466)**	-	-	-	-	-	**(112,466)**
Disposals during the year	-	-	**(6)**	-	-	**(646)**	**(45,704)**	**(46,356)**
Balance as at 31 December 2018	-	-	**576,859**	**15,953**	**177,694**	**572,644**	**113,423**	**1,456,573**
Carrying value								
As at 31 December 2017	2,105,633	1,368,116	281,009	1,300	15,310	158,578	10,797	3,940,743
As at 31 December 2018	**2,811,106**	**1,434,901**	**261,884**	**954**	**120,470**	**155,397**	**5,118**	**4,789,830**

a) As at 31 December 2018, property plant and equipment include fully depreciated assets of amounting to Rs 938,763,591 (2017 - Rs 906,425,880) which are still in use.

b) Carrying amounts that would have been recognised if land and buildings were stated at cost.

	Land		Buildings	
	2018	**2017**	**2018**	**2017**
	Rs.	**Rs.**	**Rs.**	**Rs.**
Cost	4,970,000	4,970,000	1,103,848,410	1,092,427,363
Accumulated depreciation	-	-	(405,766,603)	(290,304,254)
Net book amount as at 31 December	**4,970,000**	**4,970,000**	**698,081,807**	**802,123,109**

PricewaterhouseCoopers Colombo

AS AT 31 DECEMBER

23 Property, plant and equipment (contd)

23.1 Methods and assumptions used in the fair valuation of property, plant and equipment

The land and buildings of the Branch as at 31 December 2018 have been revalued and the revalued amounts have been incorporated in the financial statements for the year. This is considered as a level 3 valuation and the details of the valuation are given below.

Property	Name and Qualifications of the independent valuer	Valuation Technique	Significant unobservable inputs	Inter-relationship between key unobservable inputs and fair value measurement
Sir Baron Jayatilaka Mawatha, Colombo 01	1. Ashwin Thenappan MBA Finance 4 years experience 2. Anuradha Vijay M.Arch 12 years experience 3. Somy Thomas MBA 14 years experience	Summation approach of "Income capitalisation" and "Depreciated Replacement Cost" approach	Rate per square foot	Direct correlation - higher the rate per square foot, higher the market value
Independence Avenue, Colombo 07	1. Ashwin Thenappan MBA Finance 4 years experience 2. Anuradha Vijay M.Arch 12 years experience 3. Somy Thomas MBA 14 years experience	Land Sales Comparable Method plus Cost Spent approach	Sale price per perch Cost spent	Direct correlation - higher the cost spent, higher the market value

AS AT 31 DECEMBER

24 Deferred tax (liabilities) / assets

	2018 Rs.'000	2017 Rs.'000
Deferred tax assets	932,387	354,973
Deferred tax liabilities	(1,065,117)	(461,244)
	(132,730)	(106,271)

24.1 Reconciliation of deferred tax

Deferred tax assets and liabilities are attributable to the following:

	2018		2017	
	Temporary difference Rs. '000	Tax effects Rs.'000	Temporary difference Rs.'000	Tax effects Rs.'000
Deferred tax assets on ;				
Provision for retirement benefit obligation	801,854	224,519	858,185	240,292
Allowance for loan losses	1,905,616	533,573	409,578	114,681
Available for sale reserve	622,482	174,295	-	-
	3,329,952	932,387	1,267,763	354,973
Deferred tax liabilities on ;				
Property revaluation reserve	(3,552,819)	(994,789)	(584,779)	(163,738)
Accelerated Depreciation for tax: - Owned assets	(251,167)	(70,328)	(29,681)	(8,311)
Available for sale reserve			(1,032,840)	(289,195)
	(3,803,986)	(1,065,117)	(1,647,300)	(461,244)
Net (liabilities) / assets as at 31 December	(474,034)	(132,730)	(379,537)	(106,271)

Deferred tax is computed using the effective tax rate of 28%.

25 Other assets

	2018 Rs.'000	2017 Rs.'000
Receivables	4,340,536	4,374,967
Deposits and prepayments	242,967	375,061
Sundry debtors	1,308	
Acceptances and endorsements	6,843,206	6,239,553
Others	2,929,765	3,638,021
	14,357,782	14,627,602

26 Due to banks

	2018 Rs.'000	2017 Rs.'000
Borrowings	157,185,930	166,455,097
Securities sold under repurchase (repo) agreements	8,686,934	227,989
Others	18,914,024	8,717,644
	184,786,888	175,400,730

PricewaterhouseCoopers Colombo

AS AT 31 DECEMBER

		2018 Rs.'000	2017 Rs.'000
27	**Derivative financial instruments**		
	Interest rate derivatives	**36,663**	35,893
	Forward foreign exchange contracts	**3,839,185**	996,817
		3,875,848	1,032,710
28	**Financial liabilities at amortised cost - due to depositors**		
	Total amount due to other customers **(Note 28.1)**	**205,873,323**	180,725,041
		205,873,323	180,725,041
28.1	**Analysis**		
	a. By product		
	Demand deposits (current accounts)	**70,067,868**	41,716,995
	Savings deposits	**40,303,962**	41,530,878
	Fixed deposits	**90,006,030**	92,649,756
	Other deposits	**5,495,463**	4,827,412
	Total	**205,873,323**	180,725,041
	b. By currency		
	Sri Lankan Rupees	**102,614,349**	111,311,044
	United States Dollar	**88,008,708**	53,700,387
	Great Britain Pound	**6,244,241**	6,051,823
	Others	**9,006,025**	9,661,787
	Total	**205,873,323**	180,725,041
29	**Defined benefit liability - net**		
	Present value of defined benefit obligations **(Note 29.1.a)**	**801,853**	858,185
	Fair value of plan assets **(Note 29.2)**	**(778,848)**	(732,827)
		23,005	125,358
29.1	**Movement in the present value of defined benefit obligations**		
	Opening balance	**858,185**	599,933
	Current service cost	**6,189**	2,188
	Interest cost	**85,288**	74,905
	Benefits paid during the year	**(78,196)**	(75,243)
	Actuarial gain or loss for the year	**(69,613)**	256,402
	Closing balance	**801,853**	858,185
29.2	**Movement in fair value of plan assets**		
	Opening balance	**732,827**	610,719
	Expected return on plan assets	**76,620**	75,695
	Contribution by employers	**84,000**	84,000
	Benefits paid during the year	**(78,196)**	(75,243)
	Actuarial gain or loss for the year	**(36,403)**	37,656
	Closing balance	**778,848**	732,827

Plan assets are invested in government treasury securities, that are measured at fair value through profit or loss.

29 Defined benefit liability - net (contd)

29.3 Sensitivity analysis of the defined benefit obligation

	2018 Rs.'000	2017 Rs.'000
a. Discount rate		
Discount rate	**11.90%**	10.40%
1. Effect due to the increase in the discount rate by 1.00% (Rs '000)	**(61,951)**	(75,719)
1. Effect due to the decrease in the discount rate by 1.00% (Rs '000)	**73,431**	92,258
b. Increase in salary escalation rate and post retirement pension		
Salary escalation rate		
- Union members	**5%**	10%
- Non-union members	**5%**	5%
Post retirement pension	**4.0%**	3.1%
1. Effect on DBO due to an increase in the salary escalation and post retirement pension rate by 1% p.a. (Rs '000)	**67,070**	79,257
2. Effect on DBO due to a decrease in the salary escalation and post retirement pension rate by 1% p.a. (Rs '000)	**(58,576)**	(68,608)
Weighted average duration of defined benefit obligation	**10.6 years**	16.7 years

30 Other liabilities

	2018 Rs.'000	2017 Rs.'000
Sundry creditors	**955,143**	499,691
Interest payable	**5,628,882**	4,885,657
Acceptances and endorsements	**6,843,206**	6,239,553
Impairment in respect of off-balance sheet credit exposures	**77,348**	-
Other payables	**7,642,373**	7,119,852
	21,146,952	18,744,753

31 Assigned capital

	2018 Rs.'000	2017 Rs.'000
Assigned Capital	**3,152,358**	3,152,358
	3,152,358	3,152,358

32 Statutory reserve fund

	2018 Rs.'000	2017 Rs.'000
Opening balance	**2,350,855**	2,222,694
Transferred during the year	**122,431**	128,161
Closing balance	**2,473,286**	2,350,855

The statutory reserve fund is maintained as required by the section 20 (1) of the Banking Act No. 30 of 1988. The Bank appropriated 2% of the profit after tax to attain the minimum requirement under section 20(1) and the balance in the statutory reserve fund will be used only for the purposes specified in the section 20(2) of the Banking Act No 30 of 1988.

PricewaterhouseCoopers
Colombo

AS AT 31 DECEMBER

33	**Other reserves**	**2018**	2017
		Rs.'000	Rs.'000
	Exchange equalisation of reserve (Note 33.1)	**9,550,267**	5,629,182
	Other comprehensive income reserve (Note 33.2)	**(263,377)**	743,645
	Revaluation reserve (Note 33.3)	**2,558,033**	2,521,649
	IFA reserve (Note 33.4)	**4,725,708**	5,108,459
	SBP reserve (Note 33.5)	**168,453**	168,234
		16,739,084	14,171,169

33.1	**Exchange equalisation of reserve**	**2018**	2017
		Rs.'000	Rs.'000
	Opening balance	**5,629,182**	5,002,336
	Fluctuation of foreign exchange reserves	**3,921,085**	626,846
	Closing balance	**9,550,267**	5,629,182

33.2	**Other comprehensive income reserve**	**2018**	2017
		Rs.'000	Rs.'000
	Opening balance	**743,645**	(988,971)
	Net gain on revaluation	**(1,191,832)**	1,732,616
	Impairment of financial assets fair value through other comprehensive income	**184,810**	-
	Closing balance	**(263,377)**	743,645

33.3	**Revaluation reserve**	**2018**	2017
		Rs.'000	Rs.'000
	Opening balance	**2,521,649**	2,099,530
	Revaluation surplus for the year	**36,384**	422,119
	Closing balance	**2,558,033**	2,521,649

33.4	**IFA reserve**	**2018**	2017
		Rs.'000	Rs.'000
	Opening balance	**5,108,459**	5,108,459
	Transferred during the year	**(382,751)**	-
	Closing balance	**4,725,708**	5,108,459

According to the guidelines issued by the Central Bank of Sri Lanka, Banks are required to transfer 8% of the profit calculated for the payment of Value Added Tax (VAT) on financial services and 5% profit before tax calculated for payment of income tax to Investment Fund Account. Operations of IFA ceased with effect from 1 October 2014 and the above indicates the balance accrued up to that date. Movement for the financial year came as a result of maturities of several bonds in the portfoio.

33.5	**Share based payment reserve**	**2018**	2017
		Rs.'000	Rs.'000
	Opening balance	**168,234**	171,369
	Transferred during the year	**219**	(3,135)
	Closing balance	**168,453**	168,234

AS AT 31 DECEMBER

33.5 Share based payment reserve

HSBC Sri Lanka has a share option plan referred to as "HSBC Restricted Shares". Under this share option plan, HSBC Group defers part of the annual discretionary variable pay of a few senior managers into shares according to a vesting schedule. The shares are granted to the employees within a span of three years' vesting period. The cost of the shares are initially borne by the HSBC Group Head Office in UK and subsequently recharged to the local office (i.e. in the case of Sri Lankan employees, HSBC UK recharges the cost from HSBC Sri Lanka).

		2018	2017
33.6	**Share based payments and share option**		
33.6.1	**Restricted share awards - No of shares**		
	Outstanding at the beginning	**23,002**	27,922
	Awards during the year	**17,757**	18,903
	Vested during the year	**(18,212)**	(13,140)
	Outstanding at the end	**22,547**	33,685
33.6.2	**Share-based payments income statement charge**	**Rs.'000**	Rs.'000
	Restricted and performance share awards	**20,373**	19,780
	Share award option plans	**-**	(410)
		20,373	19,370

34 Events occurring after the reporting date

Subsequent to the reporting date, no circumstances have arisen which would require adjustment to or disclosure in the financial statements.

35 Comparative figures

The comparative figures and phrases have been re-arranged wherever necessary to conform to the current year's presentation.

36 Commitments and contingencies

a. In the normal course of business, the Branch makes various commitments and incurs certain contingent liabilities with legal recourse to its customers. No material losses are anticipated as a result of these transactions.

	2018 Rs.'000	2017 Rs.'000
Performance bonds	**9,000,541**	6,136,407
Letters of credit	**6,420,366**	8,012,482
Other contingent items	**63,441,836**	46,175,651
Undrawn loan commitments	**183,240,708**	181,836,466
Foreign exchange contracts *	**325,991,347**	251,218,496
Derivatives- principal amount	**4,572,750**	21,885,007
Other contra accounts	**19,915,155**	17,999,797
Total	**612,582,703**	533,264,306

* Foreign exchange contracts include sales and purchases elements of booked transactions.

AS AT 31 DECEMBER

36 Commitments and contingencies (contd)

b. Pending litigations against the Branch as at 31 December 2018

1. Court action has been taken under case no.HC/CIVIL/338/12 where case filed by the plaintiff against other three defendants for alleged malicious prosecution. The bank has been enlisted as the 4th defendant for giving evidence on certain transactions of the plaintiff.

2. Four Labour Tribunal actions have been taken under case numbers LT 8/648/12 , LT 01/32/2016, LT 01/AD/51/2016 and LT 24/478/2016 by former staff members for alleged unfair termination.

3. Case no. 254/2014/DSP filed in District Court of Colombo where the plaintiff Cargills PLC alleges that the recent installation of air condition cooling towers by the Branch in the space between two buildings has caused them inconveniences and nuisance.

4. Court action has been initiated by H Abeywickrema ; a customer in proceedings case no:DMR 1384/2016; suing the Bank for professional negligence and breach of duty of care as a result of the incorrect overseas travel details been updated and for subsequent collection related activities.

5. Case no. DMR 02342/16 filed in District Court of Colombo where the plaintiff Litro Gas Lanka Limited alleges that the bank has not effected the requested transfer and has hold payment without assigning a reason , due to this additional cost and loss of interest was incurred by the Plaintiff as they had to facilitate the payment through another Bank.

6 Law suit instituted by a former staff (Plaintiff) case no: 2369/2016/MR , demanding for compensation for causing him the pain of mind further to his termination from the services of the Bank.

7. Case No: DMR 00285/17, has been instituted by M S A Shipping (Pvt) Ltd (The Plaintiff) has filed the action against Mr Asela Tennnakoon - the First Defendant, who has credited 12 cheques, drawn by OPPO Lanka (Pvt) Ltd in favour of "MSA Shipping (Pvt) Ltd or Bearer", into his personal account with HSBC and also joined HSBC as the Second Defendant on grounds of negligence and breach of duty of care.

8. High Court - Appeal Case No : HCALT 23/2018 Former staff member instituted legal action for alleged unfair termination at the Labour Tribunal (LT) .The Order of the LT was delivered on 28 February 2018 and the LT upheld the position of the Bank accordingly the Applicants case was dismissed. The Applicant has now appealed to the High court to squash the Order given by the LT President.

9. The Honourable Minister of Labour has referred two disputes (A/34/2017 and A/25/2017) pertaining to the payment of Pension for two former staff, which is currently pending with the Commissioner of Labour , for compulsory Arbitration.

10. District Court of Colombo - Case No: DSP/228/18 -The Director-Department of Supervision of Non-Bank Financial Institutions- Central Bank of Sri Lanka (Petitioner) has instituted action against ETI Finance Limited, its four Directors and 10 other Financial Institutions, as the Respondents. HSBC Sri Lanka has been named as the 7th Respondent. It is noteworthy that there is no claim or allegation levelled in this case against HSBC, even though the case has named HSBC the 7th Respondent. HSBC can make use of the hearings of the case (by being a party to the case) to make its objections and present its claims against the Directors based on the dues of each Director to the Bank.

11. Civil High Court of the Western Province/ Commercial High Court of Colombo case no- 734/18/MR - Prince Shirley Rodrigo Sathianathen (Plaintiff) as instituted litigation against HSBC claiming that HSBC Sri Lanka has wrongfully disbursed the estate of the late Mr. Philip Rodrigo Sathianathen (the deceased customer) to the survivor of the joint accounts held with the deceased customer.

There are no material contingent liabilities outstanding as at the reporting date other than those disclosed above. The management believes matters relating to these litigations will resolve in favour of the Bank and therefore no provisions have been made against these contingent liabilities.

FOR THE YEAR ENDED 31 DECEMBER

37 Related party disclosures

The Branch carries out transactions in the ordinary course of its business with parties who are defined as related parties in Sri Lanka Accounting Standard (LKAS 24) "Related Party Disclosures", the details of which are reported below.

37 Transactions with related parties

(a) Interest paid to other HSBC Branches and Group companies	2018 Rs.'000	2017 Rs.'000
Other HSBC Branches		
HSBC Hongkong	3,300,950	2,003,716
HSBC New Zealand	43	-
HSBC Singapore	1	-
	3,300,994	2,003,716
Group companies		
HSBC London	212	-
HSBC Canada	1	-
HSBC Data Processing Ltd	126,895	10,957
HSBC Middle East	7	-
	127,115	10,957

(b) Interest received from other HSBC Branches and Group companies	2018 Rs.'000	2017 Rs.'000
Other HSBC Branches		
HSBC Hongkong	667,024	294,624
	667,024	294,624
Group companies		
HSBC USA	6	-
HSBC Data Processing Ltd	35	13
	41	13

(c) Commission paid to other HSBC Branches and Group companies	2018 Rs.'000	2017 Rs.'000
Other HSBC Branches		
HSBC Hongkong	33,645	40,861
HSBC New Zealand	233	157
HSBC Japan	89	93
HSBC Singapore	236	226
HSBC India	-	14
HSBC Thailand	324	192
HSBC Malaysia	-	11
	34,527	41,554
Group companies		
HSBC London	1,429	174
HSBC Canada	-	577
HSBC China	2	-
HSBC Australia	1,421	1,307
HSBC USA	43,777	40,219
HSBC Trinkaus and Burkhardt	-	644
HSBC United Arab Emirates	-	5
	46,629	42,926

37 Related Party Disclosures (contd)

37.1 Transactions with related parties (contd)

(d) Commission Received from Other HSBC Branches and Group Companies

	2018	2017
	Rs.'000	Rs.'000
Other HSBC branches		
HSBC Hongkong	68,166	18,328
HSBC New Zealand	-	-
HSBC Japan	4,277	2,298
HSBC Singapore	3,091	2,074
HSBC India	2,278	1,773
HSBC Indonesia	-	45
HSBC Vietnam	420	375
HSBC Malaysia	1,643	16
	79,875	24,909
Group companies		
HSBC London	11,357	12,060
HSBC Canada	75	12
HSBC France	132	52
HSBC China	7,695	9,080
HSBC Australia	170	295
HSBC Zurich	1,246	134
HSBC Poland	-	38
HSBC USA	1,870	2,391
HSBC Turkey	56	118
HSBC Data processing Ltd	820	708
HSBC Trinkaus and Burkhardt	76	-
HSBC United Arab Emirates	1,052	1,005
	24,549	25,893

(e) Receivable from other HSBC Branches and Group companies

	2018	2017
	Rs.'000	Rs.'000
Other HSBC Branches		
HSBC Hongkong	50,386,583	41,519,361
HSBC New Zealand	92,981	259,296
HSBC Japan	79,729	44,880
HSBC Singapore	318,245	55,023
HSBC India	4,601,652	1,617,299
HSBC Thailand	-	838
HSBC Maldives	40,785	24,031
	55,519,975	43,520,728
Group companies		
HSBC London	3,281,679	1,296,388
HSBC China (Bank) Co. Ltd	31,279	1,152
HSBC Canada	9,489	22,561
HSBC USA	12,012,065	2,503,184
HSBC Data processing Ltd	319,100	658
HSBC UAE	241	4,109
HSBC Credit Comml De France SA	181,915	
HSBC Australia	26,894	59,656
	15,862,662	3,887,708

FOR THE YEAR ENDED 31 DECEMBER

37 Related party disclosure (contd)

(f) Payable to other HSBC Branches and Group companies	**2018**	2017
	Rs.'000	Rs.'000
Other HSBC Branches		
HSBC Hongkong (Branch)	**160,041,761**	153,316,972
HSBC Hongkong (Head Office)	**-**	202,369
HSBC Japan	**7,582**	6,168
HSBC Singapore	**3,074**	7,310
HSBC India	**2,348,871**	403,791
HSBC Bangladesh	**454,647**	249,859
HSBC Maldives	**1,205**	350
	162,857,140	154,186,819
Group companies		
HSBC London	**2,613,165**	426,995
HSBC Trustee (Hong Kong) Ltd	**-**	70
HSBC Baharain	**629**	580
HSBC Canada	**36**	64
HSBC China (Bank) Co. Ltd	**10,718**	4,527
HSBC USA	**319,551**	518,888
HSBC Securities (New York)	**2,247**	5,596
HSBC Data processing Ltd - Sri Lanka	**1,931,546**	1,457,973
HSBC Data processing Ltd - India	**-**	10,445
HSBC Bank Malaysia Berhad	**2,559**	1,213
HSBC Bank (Singapore) Limited	**27,016**	21,242
HSBC Kuwait	**436**	436
HSBC France	**2,107,012**	41
HSBC Qatar	**2,050**	484
HSBC Vietnam	**185**	59
HSBC Trinkaus & Burkhardt	**66**	21
HSBC UAE	**2,243**	3,811
HSBC Global Services Limited	**864**	-
HSBC Australia	**805**	4,783
	7,021,128	2,457,228

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER

37 Related party disclosure (contd)

37.2 Transactions with Key Management Personnel (KMP)

According to Sri Lanka Accounting Standard No. 24 - "Related Party Disclosures", Key Management Personnel are those having authority and responsibility for planning, directing and controlling the activities of the Branch. The Branch has identified Chief Executive Officer, Chief Operating Officer, Chief Risk Officer, Chief Financial Officer, Financial Controller, Senior Internal Audit Manager, Head of Financial Crime Compliance, Head of Regulatory Compliance, Director /Head of Global Markets, General Legal Counsel, Head of Information Technology, Head of Wholesale Banking, Head of Retail Banking and Wealth Management, Head of Human Resources and Senior Marketing & Communications Manager as its key management personnel based on the above requirements.

37.2.a Compensation of KMPs	2018 Rs.'000	2017 Rs.'000
Aggregate remuneration paid for the year	291,548	251,609
	291,548	251,609

37.2.b Transactions with KMPs and their close relations	2018 Rs.'000	2017 Rs.'000
Total deposits	46,982	72,371
Total accommodation granted	241,804	270,310
	288,786	342,681

38 Financial risk management

38.1 Risk management framework

All of the Branch's activities involve, to varying degrees, the analysis, evaluation, acceptance and management of risks or combinations of risks. An established risk governance framework and ownership structure ensures oversight of and accountability for the effective management of risk at Group, regional and global business levels. It also provides for the compliance with the Banking Act No 30 of 1988 as amended by the Banking Amendment Act No 33 of 1995, Directions, Determinations, and Circulars issued to Licensed Commercial Banks by the Central Bank of Sri Lanka. The Branch's Risk Function consists of Wholesale and Market Risk and Retail Banking and Wealth Management (RBWM) Risk, Security and Fraud Risk, Chief Risk Officer (CRO) and Administration which encapsulate Risk Strategy, Enterprise Wide Stress Testing and Operational Risk. The HSBC Group provides overall written policies and procedures on risk management covering specific areas such as credit risk, liquidity risk, market risk and operational risks. The local management through Executive Committee and Risk Management Committee monitor the execution of risk management policies and procedures.

Risk appetite and tolerance limits for key types of risks

Bank's risk appetite defines its desired forward-looking risk profile, and informs the strategic and financial planning process. Furthermore, it is integrated with other key risk management tools, such as stress testing and our top and emerging risk reports, to help ensure consistency in risk management practices. The bank sets out the aggregated level and risk types it accepts in order to achieve its business objectives in a risk appetite statement ('RAS'). This is reviewed on an ongoing basis, and formally approved by Risk Management Committee every six months and regional Risk Appetite and Governance team provides oversight. The bank's actual performance is reported monthly against the approved RAS to the Risk Management Meeting ('RMM'), enabling senior management to monitor the risk profile and guide business activity to balance risk and return. This reporting allows risks to be promptly identified, mitigated and drive a strong risk culture. Risk Appetite and tolerance thresholds are decided by respective risk stewards in collaboration with respective business lines.

Stress testing

Enterprise Wide Stress Testing ("EWST") evaluates the potential vulnerabilities in the Bank's overall profitability, asset portfolio, liquidity, operations and capital strength under remote, yet plausible, stressed environments by assessing a variety of risks that the Bank is exposed to. Equally, it assists in the formulation of possible mitigating actions that could be considered in such circumstances.

The EWST is one of the requested stress tests in guideline for commercial banks. The EWST is developed on the basis of local regulatory reporting requirements. Local capital rules, provision rules, and financial reporting rules are followed and it is an integral part of the bank's annual ICAAP submission.

Stress tests that can be applied to a bank are broadly in two categories: sensitivity tests and scenario tests. HSBC Sri Lanka follows scenario based methodologies to assess the impact of various risks on bank's capital. Scenario tests include simultaneous moves in a number of variables based on a single event experienced in the past or a plausible market event that has not yet happened and the assessment of their impact on the bank's financial position.

HSBC Sri Lanka perform EWST under three stress scenarios with ascending levels of severity, i.e. minor, medium and major, with reference to the normal situation. Accordingly we have used Global economy slow-down into three scenarios (severe crisis, moderate and mild scenarios) which are developed by applying shocks of varying severity.

38 Financial risk management (contd)

38.1 Risk management framework (contd)

The EWST exercise covers Wholesale Credit Risk (including concentration risk), Retail Credit Risk, Traded Credit Risk and Market Risk and Funding Risk (including IRRBB) and Operational Risk (including compliance risk).

Stress test results are reviewed by both local and regional subject matter experts before presenting for Chief Financial Officer (CFO) and CRO approval. Subsequently, CFO and CRO present the EWST results to the Regional team seeking their approval. As the final step, Sri Lanka HSBC EWST gross results are shared with local Risk Management Committee.

Internal stress tests are used in our enterprise-wide risk management and capital management frameworks. Risks to our capital plan are assessed through a range of scenarios which explore risks that management needs to consider under stress. They include potential adverse macroeconomic, geopolitical and operational risk events, and potential events that are specific to HSBC. Stress testing analysis helps management understand the nature and extent of any vulnerability. Using this information, management decides whether risks can or should be mitigated through management actions or, if they were to crystallise, should be absorbed through capital. This in turn informs decisions about preferred capital levels.

38.2 Credit risk

Credit risk is defined as the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. Credit risk arises principally from cash and cash equivalents, direct lending, trade finance and also from certain other products such as derivative instruments and off balance sheet transactions such as letters of credit and guarantees.

* Credit risk:
  Is measured as the amount which could be lost if a customer or counterparty fails to make repayments. In the case of derivatives, the measurement of exposure takes into account the current mark to market value to the Branch of the contract and the expected potential change in that value over time caused by movements in market rates;
* Is monitored within limits, approved by individuals within a framework of delegated authorities. These limits represent the peak exposure or loss to which the Branch could be subjected should the customer or counterparty fail to perform its contractual obligations;
* Is managed through a robust risk control framework which outlines clear and consistent policies, principles and guidance for risk managers.

38.2.1 Credit risk management

The role of the independent credit control unit is fulfilled by the local Risk team which is a part of the Asia Pacific Risk function. Credit approval authorities are delegated by Regional Office (ASP) to Chief Executive Officer (CEO) who in turn delegates limit to local risk executives.

The principle objectives of our credit risk management are;

* To maintain across the Branch a strong culture of responsible lending and a robust risk policy and control framework.
* To both partner and challenge Branch's businesses in defining, implementing and continually re-evaluating our risk appetite under actual and scenario conditions; and
* To ensure there is independent, expert scrutiny of credit risks, their costs and their mitigation.

38 Financial risk management (contd)

38.2 Credit risk (contd)

38.2.1 Credit risk management (contd)

Credit quality of financial instruments

Branch's credit risk rating systems and processes are designed to differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. In the case of individually significant accounts that are predominantly within the wholesale businesses, the risk ratings are reviewed regularly and any amendments are implemented promptly. Within Branch's retail businesses, risk is assessed and managed using a wide range of risk models to maintain risk reward balance.

Branch's risk rating system facilitates the internal ratings-based ('IRB') approach under Basel II adopted by the HSBC Group to support calculation of our minimum credit regulatory capital requirement. Credit quality of customers are assessed taking into account their financial position, past experience and other factors. Special attention is paid to problem exposures in order to accelerate remedial action.

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

Impairment assessment

The Branch computes Expected Credit Losses (ECLs) appropriately.

Impairment and credit risk mitigation

The existence of collateral has an impact when calculating ECLs on stage 3 assests. (credit impaired assets) When an account is classified as default or when the Branch no longer expect to recover the principal or interest due on a loan in full or in accordance with the original terms and conditions, it is assessed for ECLs individually, where recovery is projected for each loan using a discounted cash flow method. If exposures are secured, the current net realizable value of the collateral will be taken into account when assessing the need for individually assessed ECLs.

Personal lending portfolios are generally assessed for impairment on a collective basis as the portfolios typically consist of large groups of homogeneous loans.

The impairment requirements under IFRS 9 are based on an Expected Credit Losses ('ECL') concept that requires the recognition of ECL in a timely and forward-looking manner.

The assessment of credit risk, and the estimation of ECL, are unbiased and probability-weighted, and incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money.

ECL is determined via a two-step approach, where the financial instruments are first assessed for their relative credit deterioration, followed by the measurement of the ECL (which depends on the credit deterioration categories).

38 Financial risk management (contd)

38.2 Credit risk (contd)

38.2.1 Credit risk management (contd)

Impairment and credit risk mitigation (contd)

Financial instruments that are performing are considered to be 'Stage 1'. Financial instruments which are considered to have experienced a significant increase in credit risk are in 'Stage 2'. Financial instruments for which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in 'Stage 3'.

Financial instruments that are credit-impaired upon initial recognition are POCI (Purchase or originated credit impaired).

In the absence of a significant increase in credit risk, 12-month ECL should be recognized from initial recognition (except POCI) .Therefore, performing financial instruments in Stage 1 will recognize 12-month ECL. The underlying principle of the ECL model is that lifetime ECL is recognized when there has been a significant increase in credit risk since initial recognition.

The transfers between the stages are symmetrical, i.e. a financial instrument could deteriorate from Stage 1 to 2 or 3, but it can also recover from stage 3 to 2 or 1 .The only exception being POCI financial assets, where it will always remain in this category until de recognition.

Write off of loans and receivables

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

Credit cards, personal loans and auto loans are generally written off at 180 days. It is done on the billing date of the month, the account reaches 180 days and non performing home loans are written off once it's in non-performing loan status for 60 months. The process is done manually and any exception is tracked completed the next day. However early write off could be triggered by the circumstance of the account for example on death, bankruptcy, early settlement etc.

Usually Collections / Recovery activities may continue after charge off and Legal action would be taken if the parties are unable to reach an amicable settlement.

38 Financial risk management (contd)

38.2 Credit risk (contd)

38.2.1 Credit risk management (contd)

Collateral management and valuation

It is the Branch's practice to lend on the basis of the customer's ability to meet their obligations out of cash flow resources rather than rely on the value of collateral which is an important credit risk mitigation mechanism. Depending on the customer's standing and the type of product, facilities may be provided unsecured. However, for other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of default, the Branch may utilize the collateral as a source of repayment. Some of the collateral types that are used in order to mitigate credit risk of the Wholesale segment includes deposits under lien, property mortgages, machinery mortgages and Corporate and Bank guarantees. The main types of guarantees are the parental corporate guarantees issued by a parent company on behalf of a subsidiary, where the creditworthiness of the corporate guarantee is assessed based on the financial strength of the parent company. Guarantees issued by a third party to secure borrowings of a company is also accepted , however is not common and will be accommodated only on an exceptional basis post establishing the financial strength of the guarantor. Valuation of tangible collateral is periodically done according to bank's collateral policy.

The secured facilities extended to retail customers consist of Home Loans, Vehicle Loans (at present both of these products are limited only to Bank's staff), facilities against shares and cash back facilities. Accordingly the nature of collateral relating to Retail facilities consist of property, vehicles, shares (Colombo Stock Exchange) and cash for respective facilities.

Depending on its form, collateral can have a significant financial effect in mitigating our exposure to credit risk.

38.2.2 Quantitative disclosures

Gross loans and receivables
Gross loans and receivables, impairment and net loans and receivables from customers are disclosed in Note 20 in the financial statements

Movements in individual and collective impairment during the period are disclosed in Note 20.2 in the financial statements.

Gross loans and receivables - by product

	Loans and receivables to other customers			
	Gross exposure	Average gross exposure	Gross exposure	Average gross exposure
	2018	2018	2017	2017
	Rs.000	Rs.000	Rs.000	Rs.000
By product - local currency				
Overdrafts	21,199,830	19,750,792	12,627,843	14,647,990
Term loans	41,094,094	38,762,837	32,691,908	31,526,922
Credit cards	24,428,098	22,594,078	21,266,957	20,647,741
Other loans	131,298	65,055	20,834	51,990
Sub total	86,853,320	81,172,762	66,607,542	66,874,643
By product - foreign currency				
Overdrafts	14,659,470	9,680,743	4,304,702	4,847,997
Term loans	155,341,713	142,045,719	131,552,074	133,369,747
Other loans	1,128,286	919,453	1,041,244	948,233
Sub total	171,129,469	152,645,915	136,898,020	139,165,977
Total	257,982,789	233,818,677	203,505,562	206,040,619

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.2 Quantitative disclosures (contd)

Gross loans and receivables - by currency

Loans and receivables to other customers

	2018 Rs.000	2017 Rs.000
By product - currency		
Sri Lankan Rupee	86,853,321	66,607,542
United States Dollar	166,876,116	129,413,712
Great Britain Pound	-	17,521
Others	4,253,352	7,466,787
Total	257,982,789	203,505,562

Individual impairment - sector wise analysis

	2018 Rs.000	2017 Rs.000
By product - local currency		
Manufacturing	300,795	260,356
Traders	-	17,465
Transport	-	6,579
Construction	-	-
Financial and business services	-	36,072
Tourism	-	6,421
Other services	46,683	-
Others	-	30,043
Total	347,478	356,936

Collective impairment - counterparty wise analysis

	2018 Rs.000	2017 Rs.000
By product - local currency		
Retail	872,024	319,020
Corporate	932,684	90,558
	1,804,708	409,577

2018 figures represent on SLFRS 9 basis whilst comparatives are on IAS 39. Collective impairment for 2018 represents stage 1, 2 and 3 on portfolio basis.

Individual impairment charge/(reversal) during the year - counterparty wise analysis

	2018 Rs.000	2017 Rs.000
By product - local currency		
Personal - mortgages	18,180	14,401
Personal - other loans	128,189	2,759
Corporate	(313,919)	(394,373)
	(167,550)	(377,213)

The above note consists movement in impairment as a result of SLFRS 9 where as comparatives are on IAS 39. Further, recoveries and write offs from income statement are excluded from 2018 figures for an accurate comparison.

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THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.2 Quantitative disclosures (contd)

Gross loans and receivables - sector wise analysis

Sector	Import bills Rs.000	Export bills Rs.000	Overdrafts Rs.000	Credit cards Rs.000	Short term loans Rs.000	Medium and long term loans Rs.000	Mortgages Rs.000	2018 Total Rs. 000	2017 Total Rs. 000
Agriculture & Fishing	-	483,157	2,138,006	-	-	1,894,652	-	**4,515,815**	8,818,473
Manufacturing	2,418,416	26,062,172	11,742,011	-	12,991,187	27,545,675	-	**80,759,461**	52,771,003
Tourism	-	-	2,695,608	-	-	35,303,621	-	**37,999,229**	32,001,371
Transport	-	-	4,197,575	-	4,158,547	7,474,180	-	**15,830,302**	6,741,996
Construction	-	-	1,137,073	-	-	4,587,056	-	**5,724,129**	4,083,982
Traders	21,774,191	943,855	2,832,590	-	3,579,409	1,020,976	-	**30,151,021**	25,559,244
New Economy	51,772	-	192,440	-	842,081	9,642,164	-	**10,728,457**	15,198,807
Financial and Business Services	-	-	1,343,592	-	758,213	5,424,343	-	**7,526,148**	2,811,785
Infrastructure	-	-	-	-	-	-	-	-	6,595
Other Services	-	-	4,952,406	-	357,570	8,723,013	-	**14,032,989**	12,382,025
Credit card	-	-	-	24,428,098	-	-	-	**24,428,098**	21,266,957
Other	-	-	4,627,999	-	-	19,743,724	1,915,417	**26,287,140**	21,863,324
Total	**24,244,379**	**27,489,184**	**35,859,300**	**24,428,098**	**22,687,007**	**121,359,404**	**1,915,417**	**257,982,789**	203,505,562

PricewaterhouseCoopers
Colombo

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.2 Quantitative disclosures (contd)

Total Gross Loans and receivables including acceptances - residual contractual maturity based on discounted cash flows

Sector	Less than 7 days Rs.000	7-30 days Rs.000	1-3 months Rs.000	3-6 months Rs.000	6-12 months Rs.000	1-3 years Rs.000	3-5 years Rs.000	Over 5 years Rs.000	2018 Total Rs. 000	2017 Total Rs. 000
Overdrafts	35,859,300	-	-	-	-	-	-	-	**35,859,300**	16,932,545
Term lending	9,488,262	18,405,511	45,312,922	10,473,715	4,657,985	39,438,432	55,278,053	8,198,083	**191,252,963**	159,573,280
Non-eligible bills	452,526	363,052	444,006	-	-	-	-	-	**1,259,584**	1,062,079
Money market placements	1,826,100	728,000	460,000	-	-	-	-	-	**3,014,100**	2,282,892
Credit card advances	24,428,098	-	-	-	-	-	-	-	**24,428,098**	21,266,957
Mortgages	301,475	50	482	1,670	5,870	72,615	101,246	1,685,336	**2,168,744**	2,387,810
Total gross loans and receivables	**72,355,761**	**19,496,613**	**46,217,410**	**10,475,385**	**4,663,855**	**39,511,047**	**55,379,299**	**9,883,419**	**257,982,789**	203,505,562
Acceptances	321,798	1,746,164	2,482,398	1,705,854	469,196	117,796	-	-	**6,843,206**	6,239,553
Total	**72,677,559**	**21,242,777**	**48,699,808**	**12,181,239**	**5,133,051**	**39,628,843**	**55,379,299**	**9,883,419**	**264,825,995**	209,745,115

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.2 Quantitative disclosures (contd)

Distribution of financial instruments by credit quality

Sector	Strong Rs.000	Good Rs.000	Satisfactory Rs.000	Sub Standard Rs.000	Past due but not impaired Rs.000	Impaired Rs.000	Impairment allowance Rs.000	2018 Total Rs. 000	2017 Total Rs. 000
Cash and cash equivalents	1,543,232	21,959,084	-	-	-	-	-	**23,502,316**	7,721,011
Balances with central banks	7,332,880	-	-	-	-	-	-	**7,332,880**	7,765,246
Placements with banks	-	49,385,700	-	-	-	-	-	**49,385,700**	41,214,750
Derivative financial instruments	453,901	1,435,616	2,577,237	-	-	-	-	**4,466,754**	1,265,432
Financial assets measured at fair value through profit or loss	11,516,593	-	-	-	-	-	-	**11,516,593**	4,762,430
Loans and receivables to customers	1,839,801	12,019,231	234,906,898	2,056,827	5,281,545	1,878,487	(2,152,186)	**255,830,603**	202,739,049
Financial assets measured at fair value through other comprehensive income	100,949,137	-	-	-	-	-	-	**100,949,137**	150,869,348
Financial assets at amortised cost - debt instruments	5,320,230	-	-	-	-	-	(11,971)	**5,308,259**	-
Acceptances	-	-	6,568,494	274,712	-	-	-	**6,843,206**	6,239,553
Total	**128,955,774**	**84,799,631**	**244,052,629**	**2,331,539**	**5,281,545**	**1,878,487**	**(2,164,157)**	**465,135,448**	422,576,819

The Bank classifies its financial assets according to the above grading based on its internal rating systems measuring a customer's credit worthiness, industry, macro economic factors and external credit ratings issued to counterparties.

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Colombo

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.2 Quantitative disclosures (contd)

Collateral held and other credit enhancements and their financial effect

	2018		2017	
	Carrying amount LKR'000	Carrying amount LKR'000	Carrying amount LKR'000	Carrying amount LKR'000
Loans and receivables to banks	255,830,603	99,733,162	202,739,049	70,735,207

The note aims to provide carrying value of collaterals held by the Bank of its customers where, they can be liquidated at market value with reasonable certainty. Collaterals such as cash, guarantees from corporates, banks, property and fixed assets pledged are considered as eligible for consideration. Collateral relating to past due but not impaired and impaired loans as at 31 December 2018 amounts to LKR 3,117,404,744/-

39.3 Liquidity risk

Liquidity and funding risk is the risk that the Branch does not have sufficient financial resources to meet its obligations as they fall due or that it can only do so at excessive cost. Liquidity risk arises from mismatches in the timing of cash flows. Funding risk arises when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.

Liquidity and funding risk is:

- Measured using the European Banking Authority - Delegated Act - Liquidity Coverage Ratio (EBA DA LCR) and Net Stable Funding Ratio (NSFR)
- Monitored against the Group's liquidity and funding risk framework and overseen by Regional and local Asset and Liability Management Committees ('ALCO's); and
- Managed on a stand-alone basis with no reliance on any related party (unless pre-committed) or the Central Bank of Sri Lanka, unless this

represents routine established business as usual market practice.

39.3.1 Management of liquidity and funding risk

The Branch uses the HSBC's liquidity and funding risk management framework ('LFRF') that employs two key measures to define, monitor and control the liquidity and funding risk of each of its operating entities. The **Net Stable Funding Ratio ("NSFR")** is used to monitor the structural long-term funding position, and the **Liquidity Coverage Ratio ("LCR")** is used to monitor the resilience to severe liquidity stresses. The NSFR and LCR are monitored on a daily basis by the local management team, with monthly monitoring carried out by the Regional Office.

NSFR

of the balance sheet is considered to "provide" stable funding while on and off balance sheet assets are considered to be "requiring" stable funding. Proportion of stable funding provided/required by each balance sheet item is predetermined based on EBA regulations.

LCR

liquidity stress, the bank is expected to maintain a sufficient stock of High Quality Liquid Assets ("HQLA") which will allow the bank to honour the net cash outflow due within the next 30 days from the start of the stress period. Outflows are assumed to originate from the liabilities of the bank while inflows within the next 30 days are assumed to originate from the assets held by the bank. The outflow and inflow rates are determined based on EBA regulations.

39 Financial risk management (contd)

39.3 Liquidity risk (contd)

39.3.1 Management of liquidity and funding risk (contd)

Maturity analysis of financial liabilities based on undiscounted cash flows

Sector	Less than 7 days Rs.000	7-30 days Rs.000	1-3 months Rs.000	3-6 months Rs.000	6-12 months Rs.000	1-3 years Rs.000	3-5 years Rs.000	Over 5 years Rs.000	2018 Total Rs. 000	2017 Total Rs. 000
Due to banks	29,076,756	12,307,996	7,559,057	22,010,949	28,130,034	74,784,930	12,911,155	1,829,100	**188,609,977**	175,400,730
Derivative financial instruments	3,875,848	-	-	-	-	-	-	-	**3,875,848**	1,032,732
Due to other customers	126,275,403	16,312,108	17,287,889	16,591,237	17,004,874	9,249,932	8,312,725	-	**211,034,168**	193,298,294
Acceptances	322,022	1,746,209	2,482,462	1,705,771	469,157	117,585	-	-	**6,843,206**	6,239,530
Total	**159,550,029**	**30,366,313**	**27,329,408**	**40,307,957**	**45,604,065**	**84,152,447**	**21,223,880**	**1,829,100**	**410,363,199**	379,453,277

Note : Maturity analysis for 2017 is based on undiscounted cash flows whereas comparatives are discounted.

39.3.2 Indicators

	2018	**2017**
Net loans to total assets	54%	47%
Loans to customer deposits	124%	112%
Liquid assets to short term liabilities*	275%	380%
Commitments to total loans	72%	90%

* *Liquidity Coverage ratio is indicated under 'Liquid Assets to Short Term Liabilities Ratio*

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39 Financial risk management (contd)

39.4 Market risk

The risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, which will reduce the income or the value of Branch's portfolio is considered as market risk.

Exposure to market risk is separated into two portfolios:

- Trading portfolios comprise positions arising from market-making and warehousing of customer derived positions.
- Non-trading portfolios comprise positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, financial investments designated as available for sale.

39.4.1 Monitoring and limiting market risk exposures

Branch's objective is to manage and control market risk exposures while maintaining a market profile consistent with our risk appetite.

Branch uses a range of tools to monitor and limit market risk exposures, including:

- Sensitivity analysis, the sensitivities of the net present values of assets and expected liability cash flows, in total and by currency, to a one basis point parallel shift in the discount curves used to calculate the net present values.
- Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.
- For foreign exchange risk, the total net short foreign exchange position and the net foreign exchange positions by currency.
- Value at risk ('VAR') which is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence and.
- In recognition of VAR's limitations the Branch augment VAR with stress testing to evaluate the potential impact on portfolio values of more extreme, though plausible, events or movements in a set of financial variables.

39.4.2 Risk management

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

39 Financial risk management (contd)

39.4 Market risk (contd)

39.4.2 Risk management (contd)

Both the VAR and Stressed VAR models the Branch uses are based predominantly on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking into account interrelationships between different markets and rates such as interest rates and foreign exchange rates.

The historical simulation models used incorporate the following features:

• Historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities;
• Potential market movements utilized for VAR are calculated with reference to data from the past two years,
• Potential market movements employed for stressed VAR calculations are based on a continuous one year period of stress for the trading portfolio

Branch routinely validates the accuracy of the VAR models by back-testing the actual daily profit and loss results, adjusted to remove non-modelled items such as fees and commissions, against the corresponding VAR numbers.

39 Financial risk management (contd)

39.4 Market risk (contd)

39.4.2 Risk management (contd)

Foreign exchange position

Currency in LKR Million	Spot			Forward			Net open position	Net position in other exchange contracts	Overall exposure in other respective foreign currency	Overall exposure in Sri Lankan Rupees
	Assets	Liabilities	Net	Assets	Liabilities	Net				
USD	187,313.64	(184,124.99)	3,188.65	79,247.02	(82,347.32)	(3,100.30)	154.14	-	0.84	154.14
GBP	21,659.70	(27,791.12)	(6,131.42)	6,387.91	(255.34)	6,132.57	13.31	-	0.06	13.31
EUR	6,145.79	(8,381.98)	(2,236.19)	2,892.00	(649.73)	2,242.27	57.21	-	0.27	57.21
JPY	8,334.65	(8,347.88)	(13.23)	470.32	(461.99)	8.32	1.30	-	0.01	1.30
INR								-		
AUD	15,035.82	(20,079.53)	(5,043.71)	5,675.30	(620.33)	5,054.96	17.30	-	0.07	17.30
CAD	6,926.60	(7,328.65)	(402.05)	401.99	-	401.99	(1.01)	-	(0.01)	(1.01)
Other	126,022.43	(115,384.44)	10,638.00	66,519.81	(77,259.62)	(10,739.81)	234.23	-	1.37	234.23
Total	371,438.62	(371,438.58)	0.04	161,594.34	(161,594.34)	-	476.46	-	2.61	476.46

39 Financial risk management (contd)

39.4 Market risk (contd)

39.4.2 Risk management (contd)

Maturities of assets and liabilities

Figures in LKR'000	Upto 1 month	Between 1 - 3 months	Between 3 - 6 months	Between 6 - 12 months	1 - 3 years	3 - 5 years	5 years and above	Non financial assets and liabilities	Total
Cash and cash equivalent	23,502,316	-	-	-	-	-	-	-	23,502,316
Balances with Central Bank	7,332,880	-	-	-	-	-	-	-	7,332,880
Placements with banks	49,385,700	-	-	-	-	-	-	-	49,385,700
Derivative financial instruments	4,466,754	-	-	-	-	-	-	-	4,466,754
Financial assets measured at fair value through profit or loss	1,324,577	-	7,977	3,229,023	4,927,560	2,027,456	-	-	11,516,593
Financial assets at amortised cost - loans and advances	93,397,236	47,863,983	13,330,187	4,156,995	42,189,108	50,008,980	4,884,114	-	255,830,603
Financial assets measured at fair value through other comprehensive income	17,940,029	18,291,000	2,992,964	16,652,199	31,669,510	13,403,435	-	-	100,949,137
Financial assets at amortised cost - debt instruments	644,553	-	53,740	1,565,134	2,508,859	535,973	-	-	5,308,259
Property,plant and equipment	-	-	-	-	-	-	-	4,789,830	4,789,830
Other assets	1,576,632	1,746,164	2,482,398	1,705,854	469,196	117,796	-	6,259,742	14,357,782
Total assets	**199,570,677**	**67,901,147**	**18,867,266**	**27,309,205**	**81,764,233**	**66,093,640**	**4,884,114**	**11,049,572**	**477,439,854**
Due to banks	41,255,928	7,403,583	21,430,955	27,436,500	72,798,880	12,631,943	1,829,099	-	184,786,888
Derivative financial instruments	3,875,848	-	-	-	-	-	-	-	3,875,848
Financial liablities at amortised cost - due to depositors	140,161,480	16,593,216	15,940,849	16,322,145	8,877,556	7,978,077	-	-	205,873,323
Retirement benefit obligations	-	-	23,005	-	-	-	-	-	23,005
Deferred tax liability	-	-	132,730	-	-	-	-	-	132,730
Current tax liability	-	641,862	641,862	641,643	-	-	-	-	1,925,367
Other liabilities	2,158,298	1,671,062	1,705,854	285,522	117,794	-	-	15,208,422	21,146,952
Equity	-	-	-	-	-	-	-	59,675,741	59,675,741
Total liabilities	**187,451,554**	**26,309,723**	**39,875,255**	**44,685,810**	**81,794,230**	**20,610,020**	**1,829,099**	**74,884,163**	**477,439,854**
Cumulative gap	**12,119,123**	**41,591,424**	**(21,007,989)**	**(17,376,605)**	**(29,997)**	**45,483,620**	**3,055,015**	**(63,834,591)**	**-**

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments. The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

	Upto 1 month	Between 1 - 3 months	Between 3 - 6 months	Between 6 - 12 months	1 - 3 years	3 - 5 years	5 years and above	Total
Performance bonds	39,372	254,468	1,712,616	1,806,672	1,849,314	3,338,099	-	9,000,541
Letters of credit	1,778,921	3,150,261	686,629	804,555	-	-	-	6,420,366
Other contingent items	3,254,852	7,127,171	3,707,533	14,166,780	15,006,482	20,179,018	-	63,441,836
Undrawn loan commitments	183,240,708	-	-	-	-	-	-	183,240,708
Foreign exchange contracts	121,055,949	119,142,760	34,788,343	49,176,459	1,827,836	-	-	325,991,347
Derivatives- principal amount	-	4,572,750	-	-	-	-	-	4,572,750
Other contra accounts	19,915,155	-	-	-	-	-	-	19,915,155
	329,284,957	**134,247,410**	**40,895,121**	**65,954,466**	**18,683,632**	**23,517,117**	**-**	**612,582,703**

39 Financial risk management (contd)

39.4 Market risk (contd)

39.4.2 Risk management (contd)

Interest rate sensitivity analysis of assets and liabilities

Figures in LKR'000	Upto 1 month	Between 1 - 3 months	Between 3 - 6 months	Between 6 - 12 months	1 - 3 years	3 - 5 years	5 years and above	Non-Sensitive	Total
Cash and cash equivalent	-	-	-	-	-	-	-	23,502,316	23,502,316
Balances with Central Bank	-	-	-	-	-	-	-	7,332,880	7,332,880
Placements with banks	49,385,700	-	-	-	-	-	-	-	49,385,700
Derivative financial instruments	4,466,754	-	-	-	-	-	-	-	4,466,754
Financial assets measured at fair value through profit or loss	1,324,577	-	7,977	3,229,023	4,927,560	2,027,456	-	-	11,516,593
Financial assets at amortised cost - loans and advances	133,383,481	75,833,066	19,561,611	1,209,149	7,349,026	14,449,615	3,100,285	944,970	255,830,603
Financial assets measured at fair value through other comprehensive income	17,940,029	18,291,000	2,992,964	16,652,199	31,669,510	13,403,435	-	-	100,949,137
Financial assets at amortised cost - debt instruments	644,553	-	53,740	1,565,134	2,508,859	535,973	-	-	5,308,259
Property,plant and equipment	-	-	-	-	-	-	-	4,789,830	4,789,830
Other assets	321,798	1,746,164	2,482,398	1,705,854	469,196	117,796	-	7,514,576	14,357,782
Total assets	**207,466,892**	**95,870,230**	**25,098,690**	**24,361,359**	**46,924,151**	**30,533,675**	**3,100,285**	**44,084,572**	**477,439,854**
Due to banks	67,328,143	69,161,925	11,366,550	14,632,800	-	3,806,537	1,829,100	16,661,833	184,786,888
Derivative financial instruments	3,875,848	-	-	-	-	-	-	-	3,875,848
Financial liablities at amortised cost - due to depositors	56,396,378	16,593,216	15,940,849	16,322,145	8,877,556	7,978,077	-	83,765,102	205,873,323
Retirement benefit obligations	-	-	-	-	-	-	-	23,005	23,005
Deferred tax liability	-	-	-	-	-	-	-	132,730	132,730
Current tax liability	-	-	-	-	-	-	-	1,925,367	1,925,367
Other liabilities	321,798	1,746,164	2,482,398	1,705,854	469,196	117,797	-	14,303,745	21,146,952
Equity	-	-	-	-	-	-	-	59,675,741	59,675,741
Total liabilities	**127,922,167**	**87,501,305**	**29,789,797**	**32,660,799**	**9,346,752**	**11,902,411**	**1,829,100**	**176,487,523**	**477,439,854**
Cumulative gap	**79,544,725**	**8,368,925**	**(4,691,107)**	**(8,299,440)**	**37,577,399**	**18,631,264**	**1,271,185**	**(132,402,951)**	**-**

39 Financial risk management (contd)

39.5 Operational risk

The objective of our operational risk management is to manage and control operational risk in a cost effective manner within targeted levels of operational risk consistent with our risk appetite.

A formal governance structure provides oversight over the management of operational risk. A country level Risk Management Meeting is held on a monthly basis to discuss key risk issues and review the effective implementation of our operational risk management framework.

Business managers are responsible for maintaining an acceptable level of internal control, commensurate with the scale and nature of operations. They are responsible for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The operational risk management framework helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

Some of the key action taken to mitigate operational risk include the following :
- A Risk and Control Assessment process is in place that facilitates the assessment of risk and the associated control environment for all operational risks faced by the bank
- Classification of all information based on the potential risk to HSBC, HSBC's customers and related parties. This classification is used to invoke policies and procedures to protect the confidentiality and integrity of HSBC information.
- A vendor management process is in place where due diligence performed by business departments forms part of the Risk Assessment process of the vendor. Selecting a financially viable vendor with appropriate capability, skills and experience is essential part of the HSBC Vendor due diligence process in managing risk.
- HSBC has also undertaken steps to mitigate the risk of continuation of business through comprehensive Business Continuity Planning, taking into account the risks to the business, impact analysis, resource requirements etc. The Business Continuity Plans are updated regularly, tested and approved. The plans describes how normal business can be resumed following an adverse event or business interruption ensuring minimum impact to the business and customers.
- With regard to outsourcing of activities, HSBC Group policy is to outsource activities either internally to Global Service Centre's (GSCs) or externally, to third party service providers, where this enables the work to be performed more efficiently and at a lower cost than can be achieved within the business, due to economies of scale, specialist knowledge or resource constraints. Guidance on the outsourcing of work is contained in the Group policies & procedures and the outsource direction issued by the Central Bank of Sri Lanka.

A centralized database is used to record the results of the operational risk management process. Operational risk self-assessments are input and maintained by business units. To ensure that operational risk losses are consistently reported and monitored at HSBC Group level, all branches are required to report individual losses in excess of a particular threshold.
Total operational losses for 2017 for HSBC Sri Lanka was USD125,671/-.

39 Financial risk management (contd)

39.5 Operational risk (contd)

39.5.1 Capital management

Qualitative disclosures

The Branch's capital is segregated into Tier 1 and Tier 2 Capital:

Tier 1 Capital – Core Capital
This includes assigned capital, statutory reserve fund, published retained profits, accumulated other comphrehensive income, general and other reserves. The assigned capital is the amount provided by HSBC Asia Pacific to conduct its operation in Sri Lanka.

Tier 2 Capital – Supplementary capital
Revaluation reserves is the main constituent of supplementary capital for the Branch. As per the CBSL regulations a prudential revaluation is done reflecting the full possibility of price fluctuations and forced sale, with prior approval from CBSL, which is then subject to a discount of 50%.

Upon the introduction of LKAS 32/39, general provision/collective impairment is not included in the accounts, hence Tier 2 will reflect NIL provision amounts from 2012 onwards.

Composition of regulatory capital (audited)	**2018**	2017
	Rs'000	Rs'000
Equity capital or stated capital/assigned capital	**3,152,358**	3,152,358
Reserve fund	**2,473,285**	2,350,854
Published retained earnings/(Accumulated retained losses)	**36,882,472**	31,040,434
Accumulated other comprehensive income (OCI)	**4,476,850**	-
General and other disclosed reserves	**4,894,161**	9,100,389
Total qualifying tier 1 capital prior to deductions	**51,879,126**	45,644,036
Deductions to tier 1 capital	**(24,443)**	(218,198)
Net deferred tax assets	**-**	-
Amounts due to head office and branches outside Sri Lanka in Sri Lanka Rupees (-)	**(24,443)**	(218,198)
Amounts due from head office and branches outside Sri Lanka in foreign currency (Net)		-
Tier 1 capital	**51,903,569**	45,862,234
Components of tier 2 capital		
Revaluation reserves (as approved by CBSL)	**1,049,765**	356,917
General provisions*	**-**	-
Total qualifying tier 2 capital prior to deductions	**1,049,765**	356,917
Tier 3 capital	**-**	-
Total capital	**52,953,334**	46,219,151

39 Financial risk management (contd)

39.5 Operational risk (contd)

39.5.1 Capital management(contd)

Capital adequacy

HSBC Sri Lanka follows the Capital Planning and Guidance as set out by its Group Office, while ensuring that all requirements as set out by the local regulator are complied with.

All growth measures as targeted in the Annual Operating Plan (AOP) are reviewed in line with impact to Capital Adequacy Ratio (CAR) limits set by CBSL. Any remittance of profit to Regional offices is evaluated in terms of impact to CAR. Further, exchange rate fluctuations to a maximum of 20% are taken into account when forecasting CAR, which is carried out on a monthly basis. HSBC Sri Lanka will ensure that all business growth and profit remittances are carried out in full compliance with the prudential limits set by CBSL, while ensuring sufficient capital to absorb the impact of a 20% movement in foreign exchange rates. The minimum expected CAR will ensure optimal Single Borrower Limits, optimal Deposit Insurance fee levels and also ensure ability to continue Derivative Trading activity.

Risk-weighted assets (un-audited)	**2018**	2017
	Rs.'000	Rs.'000
Credit risk	**296,029,229**	213,931,330
Market risk	**17,506,057**	21,840,907
Operational risk	**28,819,376**	29,399,910
Total risk-weighted assets	**342,354,662**	265,172,147
Capital ratios (Audited)		
Tier 1 ratio	**15.16%**	17.30%
Total capital ratio	**15.47%**	17.43%

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AS AT 31 DECEMBER

40 Fair value of financial assets and liabilities

40.1 Fair value of financial instruments not carried at fair value

Assets	Carrying value Rs'000	Fair value Rs'000
Cash and cash equivalents	23,502,316	23,502,316
Balances with Central Bank	7,332,880	7,332,880
Placements with banks	49,385,700	49,385,700
Financial assets at amortised cost - loans and advances	255,830,603	257,276,343
Acceptances and endorsements	6,843,206	6,843,206
Liabilities		
Due to banks	184,786,888	184,786,888
Financial liablities at amortised cost - due to depositors	205,873,323	205,873,323
Acceptances and endorsements	6,843,206	6,843,206

Note:
For financial instruments other than "Loans and receivables to other customers", carrying amount is a reasonable approximation of fair value because, for example, they are short term in nature or re-price to current market rates frequently.

AS AT 31 DECEMBER

40 Fair value of financial assets and liabilities (contd)

40.2 Fair value of financial instruments carried at fair value

40.2.1 Fair value hierarchy

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

- Level 1 – valuation technique using quoted market price: financial instruments with quoted prices for identical instruments in active markets that the Branch can access at the measurement date.
- Level 2 – valuation technique using observable inputs: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or valued using models where all significant inputs are observable. Similar instruments in inactive markets and financial instruments.
- Level 3 – valuation technique with significant unobservable inputs: financial instruments valued using valuation.

Financial instruments carried at fair value and bases of valuation

As at 31 December 2018	**Level 1 Rs'000**	**Level 2 Rs'000**	**Level 3 Rs'000**
Assets			
Financial assets measured at fair value through	-	11,516,593	-
Derivative financial instruments	3,226	4,463,528	-
Financial assets measured at fair value through other comprehensive income	-	100,949,137	-
	3,226	116,929,258	-
Liabilities			
Derivatives	1,207	3,874,641	-
	1,207	3,874,641	-
As at 31 December 2017			
Assets			
Financial assets measured at fair value through profit or loss	-	4,762,430	-
Derivative financial instruments	7,682	1,257,749	-
Financial assets measured at fair value through other comprehensive income	-	150,869,348	-
	7,682	156,889,527	-
Liabilities			
Derivative financial instruments	4,123	1,028,587	-
	4,123	1,028,587	-

40 Fair value of financial assets and liabilities (contd)

40.2 Fair value of financial instruments carried at fair value

40.2.2 Valuation of financial instruments

The best evidence of fair value is a quoted price in an actively traded principal market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. Where a financial instrument has a quoted price in an active market, the fair value of the total holding of the financial instrument is calculated as the product of the number of units and quoted price. The judgment as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. Valuation techniques may incorporate assumptions about factors that other market participants would use in their valuations, including:

- the likelihood and expected timing of future cash flows on the instrument. Judgement may be required to assess the counterparty's ability to service the instrument in accordance with its contractual terms. Future cash flows may be sensitive to changes in market rates;

- selecting an appropriate discount rate for the instrument. Judgement is required to assess what a market participant would regard as the appropriate spread of the rate for an instrument over the appropriate risk-free rate;

- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products. A range of valuation techniques is employed, dependent on the instrument type and available market data. Most valuation techniques are based upon discounted cash flow analyses, in which expected future cash flows are calculated and discounted to present value using a discounting curve. Prior to considering credit risk, the expected future cash flows may be known, as would be the case for the fixed leg of an interest rate swap, or may be uncertain and require projection, as would be the case for the floating leg of an interest rate swap.

The majority of valuation techniques employ only observable market data. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them the measurement of fair value is more judgemental. In developing unobservable inputs, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop unobservable inputs shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions.

40 Fair value of financial assets and liabilities (contd)

40.2 Fair value of financial instruments carried at fair value (contd)

40.2.2 Valuation of financial instruments (contd)

Control framework

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

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets branch will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors that are considered in this regard are, inter alia:

• the extent to which prices may be expected to represent genuine traded or tradable prices;
• the degree of similarity between financial instruments;
• the degree of consistency between different sources;
• the process followed by the pricing provider to derive the data;
• the elapsed time between the date to which the market data relates and the balance sheet date;
• the manner in which the data was sourced.

Fair value adjustments

Fair value adjustments are adopted when HSBC considers that there are additional factors that would be considered by a market participant which are not incorporated within the valuation model. HSBC classifies fair value adjustments as either 'risk-related' or 'model-related'. Movements in the level of fair value adjustments do not necessarily result in the recognition of profits or losses within the income statement. For example, as models are enhanced, fair value adjustments may no longer be required. Similarly, fair value adjustments will decrease when the related positions are unwound, but this may not result in profit or loss.

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THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH
SUPPLEMENTARY INFORMATION

AS AT 31 DECEMBER

41 Basel III disclosures

41.1 Key Regulatory Ratios - Capital and Liquidity

	2018 As at 31 December	2017 As at 31 December
Regulatory Capital Adequacy *		
Common Equity Tier 1, Rs. '000	51,903,569	45,862,234
Tier 1 Capital, Rs. '000	51,903,569	45,862,234
Total Capital, Rs. '000	52,953,334	46,219,151
Common Equity Tier 1 Capital Ratio, as % of Risk Weighted Assets (Minimum Requirement, 5.75%)	15.16%	17.30%
Tier 1 Capital Ratio, as % of Risk Weighted Assets (Minimum Requirement, 7.25%)	15.16%	17.30%
Total Capital Ratio, as % of Risk Weighted Assets (Minimum Requirement, 11.25%)	15.47%	17.43%

* With effect from 1 July 2017, Regulatory Capital and Ratios are computed in accordance to Basel III minimum capital requirements whilst comparatives were reported based on Basel II.

	2018 As at 31 December	2017 As at 31 December
Regulatory Liquidity		
Statutory Liquid Assets, Rs.'000		
Domestic Banking unit	115,206,461	103,016,474
Off-Shore Banking Unit	70,115,622	82,536,029
Statutory Liquid Assets Ratio,% (Minimum Requirement, 20%)		
Domestic Banking Unit	54.33%	55.67%
Off-Shore Banking Unit	39.38%	47.49%
Liquidity Coverage Ratio (%) - Rupee (Minimum Requirement, 2017 - 80%; 2016 - 70%)	150.18%	216.40%
Liquidity Coverage Ratio (%) - All currency (Minimum Requirement, 2017 - 80%; 2016 - 70%)	275.03%	379.95%

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AS AT 31 DECEMBER

41 Basel III disclosures (contd)

41.2 Computation of capital adequacy ratio

Item	Amount as at Dec 2018 (LKR '000)
Common Equity Tier I (CETI) Capital after Adjustments	**51,903,569**
Total Common Equity Tier I (CET1) Capital	**51,879,126**
Equity capital or stated capital/assigned capital	3,152,358
Reserve fund	2,473,285
Published retained earnings/(accumulated retained losses)	36,882,472
Accumulated other comprehensive income (OCI)	4,476,850
General and other disclosed reserves	4,894,160
Total Adjustments to CET1 Capital	**(24,443)**
Amount due to head office & branches outside Sri Lanka in Sri Lanka Rupees	(24,443)
Tier 2 Capital after Adjustments	**1,049,765**
Total Tier 2 Capital	**1,049,765**
Revaluation gains	1,049,765
Total Adjustments to Tier 2 Capital	-
Total Tier 1 Capital	**51,903,569**
Total Capital	**52,953,334**
Total Risk Weighted Assets (RWA)	**342,354,662**
RWAs for Credit Risk	296,029,229
RWAs for Market Risk	17,506,057
RWAs for Operational Risk	28,819,376
CET1 Capital Ratio (including Capital Conservation Buffer,	
Countercyclical Capital Buffer & Surcharge on D-SIBs) (%)	**15.16%**
of which: Capital Conservation Buffer (%)	1.25%
of which: Countercyclical Buffer (%)	
of which: Capital Surcharge on D-SIBs (%)	
Total Tier 1 Capital Ratio (%)	**15.16%**
Total Capital Ratio (including Capital Conservation Buffer, Countercyclical	**15.47%**
Capital Buffer & Surcharge on D-SIBs) (%)	
of which: Capital Conservation Buffer (%)	1.25%
of which: Countercyclical Buffer (%)	
of which: Capital Surcharge on D-SIBs (%)	

AS AT 31 DECEMBER

41 Basel III disclosures (contd)

41.3 Computation of Liquidity Coverage Ratio

Item	Amount (LKR'000) 31-Dec-18		Amount (LKR'000) 31-Dec-17	
	Un-weighted	Weighted	Un-weighted	Weighted
Total Stock of High-Quality Liquid Assets (HQLA)	**57,360,923**	**57,360,923**	**89,368,940**	**89,368,940**
Total Adjusted Level 1A Assets	**57,307,146**	**57,307,146**	**89,370,909**	**89,370,909**
Level 1 Assets	**57,360,923**	**57,360,923**	**89,368,940**	**89,368,940**
Total Adjusted Level 2A Assets	-	-	-	-
Level 2A Assets	-	-	-	-
Total Adjusted Level 2B Assets	-	-	-	-
Level 2B Assets	-	-	-	-
Total Cash Outflows	**537,749,918**	**83,424,510**	**467,488,187**	**77,314,888**
Deposits	104,820,995	10,482,100	107,930,534	10,793,053
Unsecured Wholesale Funding	140,386,559	54,754,820	97,777,035	48,135,091
Secured Funding Transactions	8,686,934	-	227,989	-
Undrawn Portion of Committed (Irrevocable) Facilities and Other Contingent Funding Obligations	268,946,657	3,278,817	248,400,559	5,234,674
Additional Requirements	14,908,773	14,908,773	13,152,069	13,152,069
Total Cash Inflows	**121,215,816**	**74,219,611**	**74,024,597**	**53,793,385**
Maturing Secured Lending Transactions Backed by Collateral	-	-	-	-
Committed Facilities	-	-	-	-
Other Inflows by Counterparty which are Maturing within 30 Days	82,923,001	66,154,351	65,815,850	53,515,300
Operational Deposits	22,970,952	-	7,915,352	-
Other Cash Inflows	15,321,863	8,065,260	293,394	278,085
Liquidity Coverage Ratio (%) (Stock of High Quality Liquid Assets/Total Net Cash Outflows over the Next 30 Calendar Days) * 100		**275.03%**		**379.95%**

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH
SUPPLEMENTARY INFORMATION (CONTINUED)

AS AT 31 DECEMBER

41 Basel III disclosures (contd)

41.4 Credit Risk under standardised approach - credit risk exposures and credit risk mitigation (CRM) effects

Asset Class	Amount (LKR'000) as at 31December2018					
	Exposures before Credit Conversion Factor (CCF) and CRM		Exposures post CCF and CRM		RWA and RWA Density (%)	
	On-Balance Sheet Amount	Off-Balance Sheet Amount	On-Balance Sheet Amount	Off-Balance Sheet Amount	RWA	RWA Density(ii)
Claims on Central Government and CBSL	127,364,729	19,205,550	127,364,729	548,730	9,713,781	7.59%
Claims on Foreign Sovereigns and their Central Banks	-	-	-	-	-	-
Claims on Public Sector Entities	-	-	-	-	-	-
Claims on Official Entities and Multilateral Development Banks	-	-	-	-	-	-
Claims on Banks Exposures	21,116,120	142,549,805	21,116,120	21,324,714	18,787,693	44.27%
Claims on Financial Institutions	-	11,584,612	-	500,000	500,000	100.00%
Claims on Corporates	206,209,012	213,991,180	205,844,608	27,590,761	223,006,928	95.53%
Retail Claims	45,430,540	47,408,969	38,058,412	94,234	29,054,666	76.15%
Claims Secured by Residential Property	2,904,662	-	2,904,662	-	2,904,662	100.00%
Claims Secured by Commercial Real Estate	-	-	-	-	-	-
Non-Performing Assets (NPAs)	1,377,606	-	1,377,606	-	1,979,899	143.72%
Higher-risk Categories	-	-	-	-	-	-
Cash Items and Other Assets	12,441,925	-	12,441,925	-	10,081,599	81.03%
Total	**416,844,594**	**434,740,116**	**409,108,062**	**50,058,439**	**296,029,228**	

Note : RWA Density – Total RWA/Exposures post CCF and CRM.

PricewaterhouseCoopers
Colombo

AS AT 31 DECEMBER

41 Basel III disclosures (contd)

41.5 Credit risk under standardised approach: exposures by asset classes and risk weights

Description	Amount (LKR'000) as at 31December2017 (Post CCF & CRM)							
Risk Weight / Asset classes	0%	20%	50%	75%	100%	150%	>150%	Total Credit Exposures Amount
Claims on Central Government and Central Bank of Sri Lanka	127,913,459	-	-	-	-	-	-	127,913,459
Claims on Foreign Sovereigns and their Central Banks	-	-	-	-	-	-	-	-
Claims on Public Sector Entities	-	-	-	-	-	-	-	-
Claims on Official Entities and Multilateral Development Banks	-	-	-	-	-	-	-	-
Claims on Banks Exposures	-	19,402,120	16,262,889	-	6,775,825	-	-	42,440,834
Claims on Financial Institutions	-	-	-	-	500,000	-	-	500,000
Claims on Corporates	-	11,643,080	2,227,954	-	219,564,335	-	-	233,435,369
Retail Claims	-	-	-	36,391,920	1,760,726	-	-	38,152,646
Claims Secured by Residential Property	-	-	-	-	2,904,662	-	-	2,904,662
Claims Secured by Commercial Real Estate	-	-	-	-	-	-	-	-
Non-Performing Assets (NPAs)	-	-	-	-	173,019	1,204,587	-	1,377,606
Higher-risk Categories	-	-	-	-	-	-	-	-
Cash Items and Other Assets	1,543,232	1,021,369	-	-	9,877,324	-	-	12,441,925
Total	**129,456,691**	**32,066,569**	**18,490,843**	**36,391,920**	**241,555,891**	**1,204,587**	**-**	**459,166,501**

AS AT 31 DECEMBER

41 Basel III disclosures (contd)

41.6 Market risk under standardised measurement method

Item	RWA amount (LKR'000) as at 31 December 2018
(a) RWA for Interest Rate Risk	17,506,057
General Interest Rate Risk	-
(i) Net Long or Short Position	**2,053,801**
(ii) Horizontal Disallowance	-
(iii) Vertical Disallowance	-
(iv) Options	-
Specific Interest Rate Risk	-
(b) RWA for Equity	-
(i) General Equity Risk	-
(ii) Specific Equity Risk	-
(c) RWA for Foreign Exchange & Gold	25,043
Capital Charge for Market Risk [(a) + (b) + (c)] * CAR	2,078,844

41.7 Operational risk under basic indicator approach

	Capital Charge Factor	Gross Income (LKR'000) as at 31-Dec-18		
		1st Year	2nd Year	3rd Year
The Basic Indicator Approach	15%	23,299,997	22,829,116	22,316,906
Capital Charges for Operational Risk (LKR'000)				
The Basic Indicator Approach	3,422,301			
Risk Weighted Amount for Operational Risk (LKR'000)				
The Basic Indicator Approach	28,819,376			

AS AT 31 DECEMBER

41 Basel III disclosures (contd)

41.8

Differences between accounting and regulatory scopes and mapping of financial statement categories with regulatory risk categories – bank only

Item	Amount (LKR '000) as at 31 December 2018				
	a	b	c	d	e
	Carrying Values as Reported in Published Financial Statements	Carrying Values under Scope of Regulatory Reporting	Subject to Credit Risk Framework	Subject to Market Risk Framework	Not subject to Capital Requirements or Subject to Deduction from Capital
Assets					
Cash and Cash Equivalents	23,502,316	23,502,050	17,534,080	8,210,924	5,967,970
Balances with Central Banks	7,332,880	7,332,880	7,332,880	-	-
Placements with Banks	49,385,700	53,043,900	3,658,200	46,276,230	3,109,470
Derivative Financial Instruments	4,466,754	4,466,754	4,440,396	-	26,358
Other Financial Assets Held-For-Trading	-	112,465,730	112,465,730	112,465,730	-
Financial Assets Designated at Fair Value through Profit or Loss	11,516,593	-	-	-	-
Loans and Receivables to Banks	-	-	-	-	-
Loans and Receivables to Other Customers	255,830,602	253,720,917	255,217,363	16,222,156	(1,496,446)
Financial Investments - Available-For-Sale	100,949,137	-	-	-	-
Financial Investments - Held-To-Maturity	5,308,259	5,322,359	5,322,359	5,322,359	-
Investments in Subsidiaries	-	-	-	-	-
Investments in Associates and Joint Ventures	-	-	-	-	-
Property, Plant and Equipment	4,789,830	4,789,830	4,789,830	-	-
Investment Properties	-	-	-	-	-
Goodwill and Intangible Assets	-	-	-	-	-
Deferred Tax Assets	-	88,288	-	-	88,288
Other Assets	14,357,782	6,083,754	6,083,756	5,149,131	-
Liabilities	-	-	-	-	-
Due to Banks	184,786,888	184,786,887	-	14,513,411	170,273,476
Derivative Financial Instruments	3,875,848	3,875,848	-	3,826,052	49,797
Other Financial Liabilities Held-For-Trading	-	-	-	-	-
Financial Liabilities Designated at Fair Value Through Profit or Loss	-	-	-	-	-
Due to Other Customers	205,873,323	205,873,322	-	67,711,236	138,162,086
Other Borrowings	-	-	-	-	-
Debt Securities Issued	23,005	-	-	-	-
Current Tax Liabilities	1,925,367	2,094,079	-	-	2,094,079
Deferred Tax Liabilities	132,730	-	-	-	-
Other Provisions	-	-	-	-	-
Other Liabilities	21,146,951	14,177,439	-	4,238,798	9,938,641
Due to Subsidiaries	-	-	-	-	-
Subordinated Term Debts	-	-	-	-	-
Off-Balance Sheet Liabilities	-	-	-	-	-
Guarantees	63,441,836	63,441,836	63,441,836	-	-
Performance Bonds	9,000,541	9,000,541	9,000,541	-	-
Letters of Credit	6,420,366	6,420,366	6,420,366	-	-
Other Contingent Items	4,572,750	11,415,955	11,415,955	2,671,134	-
Undrawn Loan Commitments	183,240,708	183,240,708	183,240,708	-	-
Other Commitments	345,906,501	204,800,483	161,220,709	15,400,021	49,839,936
Shareholders' Equity	-	-	-	-	-
Equity Capital (Stated Capital)/Assigned Capital	3,152,358	3,152,358	3,152,358	-	-
of which Amount Eligible for CET1	-	-	3,152,358	-	-
of which Amount Eligible for AT1	-	-	-	-	-
Retained Earnings	37,298,783	38,021,094	36,882,472	-	-
Accumulated Other Comprehensive Income	9,299,124	-	4,476,850	-	-
Statutory reserve fund	2,473,285	2,350,856	2,473,285	-	-
Other Reserves	7,452,191	16,484,578	4,894,161	-	-
Total Shareholders' Equity	**59,675,741**	**60,008,886**	**51,879,126**		

Notes :

- Items subject to both credit risk and market risk are reported in both columns, therefore in such instances sum of column c to e may be greater than column b

- Amounts reported in column 'Subject to credit risk framework' under Shareholders' Equity represent the position of regulatory capital as at 31 December 2018 computed based on Banking Act Direction No. 01 of 2016 - Capital requirements under Basel III

AS AT 31 DECEMBER

42 Orther disclosures

Economic value of equity

EVE is essentially the move in the Bank's "market value" due to a predefined move in interest rates. Market value for these purposes is defined as the present value of certain predefined predicted cash flows.

To calculate EVE cash flows will be predicted based on the current yield curve and yield curves shifted 200bps (parallel) higher and lower than the current curve. These cash flows will then be present valued based on the appropriate curve. EVE is the difference between these present values i.e. there will be two EVE figures; one based on an increase of 200bps and one based on a decrease of 200bps vs the base case.

	Sensitivity	
Interest Rate Shock	+200 bps	-200 bps
Total EVE Sensitivity	1,629	(1,891)
Equity (in LKR million)	(59,603)	(59,603)
Total EVE as a % of Equity	2.70%	-3.20%