THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH

FINANCIAL STATEMENTS FOR THE YEAR ENDED 31ST DECEMBER 2014

KPMG
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INDEPENDENT AUDITORS' REPORT

TO THE MANAGEMENT OF THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED – SRI LANKA BRANCH

Report on the Financial Statements

We have audited the accompanying financial statements of The Hongkong And Shanghai Banking Corporation Limited – Sri Lanka Branch, which comprise the statement of financial position as at 31st December 2014, and the income statement, statement of other comprehensive income, statement of changes in equity and, cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information set out on pages 3 to 64 of the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these 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.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of The Hongkong and Shanghai Banking Corporation Limited – Sri Lanka Branch as at 31st December 2014, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

KPMG

Chartered accountants
Colombo
25th March 2015

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

FOR THE YEAR ENDED 31ST DECEMBER	Note	2014 Rs.'000	2013 Rs.'000
Interest income		**24,121,085**	25,839,261
Interest expenses		**(7,136,321)**	(7,860,324)
Net interest income	**5**	**16,984,764**	17,978,937
Fee and commission income		**3,931,030**	4,444,812
Fee and commission expenses		**(670,334)**	(660,675)
Net fee and commission income	**6**	**3,260,696**	3,784,137
Net gain from trading	**7**	**1,447,165**	1,547,379
Net gain from financial investments	**8**	**357,473**	-
Other operating income (net)	**9**	**496,989**	117,696
Total operating income		**22,547,087**	23,428,149
Impairment charge for loans and other losses	**10**	**(515,658)**	(807,642)
Net operating income		**22,031,429**	22,620,507
Personnel expenses	**11**	**(3,246,473)**	(2,944,260)
Other expenses	**12**	**(5,940,957)**	(4,994,494)
Operating profit before Value Added Tax		**12,843,999**	14,681,753
Value Added Tax on financial services		**(1,626,600)**	(2,043,160)
Profit before tax		**11,217,399**	12,638,593
Income tax expense	**13**	**(3,746,544)**	(4,406,918)
Profit for the year		**7,470,855**	8,231,675

Figures in brackets indicate deductions.

The Financial Statements are to be read in conjunction with the related notes, which form a part of the Financial Statements of the Branch set out on pages 3 to 64. The Report of the Auditors is given on pages 1 and 2.

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

FOR THE YEAR ENDED 31ST DECEMBER	Note	2014 Rs.'000	2013 Rs.'000
Profit for the year		**7,470,855**	8,231,675
Other comprehensive income/(expenses)			
Actuarial gain/(loss) on defined benefit plans		**(14,148)**	200,599
Gain / (loss) from the financial statements of foreign currency operation		**(292,898)**	363,401
Gain on re-measuring available-for-sale financial assets		**1,480,503**	2,701,955
Gain on revaluation of property plant and equipment		**438,728**	416,400
Tax expense relating to components of other comprehensive income	**13.d**	**(427,923)**	(946,975)
Other comprehensive income for the year		**1,184,262**	2,735,380
Total comprehensive income for the year		**8,655,117**	10,967,055

Figures in brackets indicate deductions.

The Financial Statements are to be read in conjunction with the related notes, which form a part of the Financial Statements of the Branch set out on pages 3 to 64. The Report of the Auditors is given on pages 1 and 2.

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

AS AT 31ST DECEMBER	Note	2014 Rs.'000	2013 Rs.'000
ASSETS			
Cash and cash equivalents	15	**17,170,378**	9,471,769
Balances with Central bank	16	**6,845,170**	8,045,947
Placements with banks	17	**15,444,288**	5,636,400
Derivative financial instruments	18	**1,140,619**	2,983,392
Other Financial assets held-for-trading	19	**1,722,700**	11,995,713
Loans and receivables from banks	20	**26,321,100**	30,559,850
Loans and receivables from other customers	21	**168,934,941**	129,012,751
Financial investments – Available-for-sale	22	**142,316,265**	107,011,206
Property, plant and equipment	23	**3,282,332**	2,460,791
Other assets	25	**21,438,471**	18,980,891
Total Assets		**404,616,264**	326,158,710
LIABILITIES			
Due to banks	26	**149,200,815**	97,620,005
Derivative financial instruments	27	**609,806**	4,088,096
Due to other customers	28	**176,346,760**	154,946,963
Current tax liabilities		**1,445,077**	2,687,452
Deferred tax liabilities	24	**998,463**	683,869
Other liabilities	29	**27,840,553**	23,085,546
Total Liabilities		**356,441,474**	283,111,931
EQUITY			
Assigned capital	30	**3,152,358**	3,152,358
Statutory reserve fund	31	**1,940,002**	1,790,585
Other reserves	32	**9,349,728**	8,694,576
Retained earnings		**33,732,702**	29,409,260
Total Equity		**48,174,790**	43,046,779
Total equity and liabilities		**404,616,264**	326,158,710
Contingent liabilities and commitments	35	**582,340,237**	741,593,231

The Financial Statements are to be read in conjunction with the related notes, which form a part of the Financial Statements of the Branch set out on pages 3 to 64. The Report of the Auditors is given on pages 1 and 2.

The Management is responsible for the preparation and presentation of these Financial Statements.

Approved and signed for and on behalf of the Management

Patrick J Gallagher
(Signed) Chief Executive Officer

Kanchana Hewavitharana
(Signed) Chief Financial Officer

25th March 2015
Colombo

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

FOR THE YEAR ENDED 31ST DECEMBER 2014	**Assigned Capital**	**Exchange Equalisation of Capital**	**Exchange Equalisation of Reserves**	**IFA Reserve**	**AFS Reserve**	**SBP Reserve**	**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**	**Rs.'000**
Balance as at 1st January 2013	3,152,358	405,450	1,824,232	2,376,085	266,528	150,000	1,625,952	999,132	22,841,064	33,640,801
Total comprehensive income for the year										
Profit for the year	-	-	-	-	-	-	-	-	8,231,675	8,231,675
Other comprehensive income (net of tax)	-	50,100	313,301	-	1,947,607	-	-	361,196	63,176	2,735,380
Total comprehensive income for the year	-	50,100	313,301	-	1,947,607	-	-	361,196	8,294,851	10,967,055
Transactions with equity holders, recognised directly in equity										
Transfers to reserves during the year	-	-	-	-	-	-	164,633	-	(164,633)	-
Cost of share options granted during the year	-	-	-	-	-	7,666	-	-	-	7,666
Change in fair value of restricted share awards	-	-	-	-	-	-	-	-	4,257	4,257
Transfer to IFA reserve	-	-	-	2,207,414	-	-	-	-	(2,207,414)	-
Deferred Tax on Revaluation	-	-	-	-	-	-	-	-	(1,573,000)	(1,573,000)
Total transactions with equity holders	-	-	-	2,207,414	-	7,666	164,633	-	(3,940,790)	(1,561,077)
Balance as at 31st December 2013	3,152,358	455,550	2,137,533	4,583,499	2,214,135	157,666	1,790,585	1,360,328	27,195,125	43,046,779
Balance as at 1st January 2014	**3,152,358**	**455,550**	**2,137,533**	**4,583,499**	**2,214,135**	**157,666**	**1,790,585**	**1,360,328**	**27,195,125**	**43,046,779**
Total comprehensive income for the year										
Profit for the year	-	-	-	-	-	-	-	-	**7,470,855**	**7,470,855**
Other comprehensive income (net of tax)	-	**(455,550)**	**162,652**	-	**1,066,013**	-	-	**421,354**	**(10,207)**	**1,184,262**
Total comprehensive income for the year	-	**(455,550)**	**162,652**	-	**1,066,013**	-	-	**421,354**	**7,460,648**	**8,655,117**
Transactions with equity holders, recognised directly in equity										
Transfers to reserves during the year	-	-	-	-	-	-	**149,417**	-	**(149,417)**	-
Cost of share options granted during the year	-	-	-	-	-	**1,736**	-	-	-	**1,736**
Change in fair value of restricted share awards	-	-	-	-	-	-	-	-	**2,158**	**2,158**
Transfer to IFA reserve	-	-	-	**524,960**	-	-	-	-	**(524,960)**	-
Profit transferred to head office	-	-	-	-	-	-	-	-	**(3,531,000)**	**(3,531,000)**
Total transactions with equity holders	-	-	-	**524,960**	-	**1,736**	**149,417**	-	**(4,203,219)**	**(3,527,106)**
Balance as at 31st December 2014	**3,152,358**	-	**2,300,185**	**5,108,459**	**3,280,148**	**159,402**	**1,940,002**	**1,781,682**	**30,452,554**	**48,174,790**

Figures in brackets indicate deductions.

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

FOR THE YEAR ENDED 31ST DECEMBER	#REF!	#REF!
	Rs.'000	Rs.'000
Cash Flow From Operating activities		
Interest received	**24,359,423**	26,281,178
Interest paid	**(6,684,049)**	(7,515,127)
Recoveries on previously written off loans	**642,774**	825,184
Fees and commission received	**3,260,696**	3,784,138
Dividends received	**-**	-
Net receipts from trading activities	**1,804,638**	1,547,379
Operating expenses paid	**(7,910,900)**	(7,531,718)
Operating profit before changes in operating assets and liabilities	**15,472,582**	17,391,034
Changes In Operating Assets and Liabilities		
Increase in treasury bills and other eligible bills	**(27,591,368)**	(16,584,085)
(Increase) / Decrease in treasury bonds	**8,104,192**	(11,399,339)
Increase in loans to other banks	**(5,569,138)**	(5,538,599)
Increase in loans and advances	**(40,284,934)**	(6,899,202)
Increase in government bonds	**(5,507,247)**	(3,270,500)
Decrease in other assets	**1,272,617**	3,258,357
Increase in deposits from customers	**21,399,797**	4,757,324
Increase in borrowings	**51,580,810**	23,358,311
Increase/ (Decrease) in other liabilities	**(1,133,471)**	217,676
Net Cash from / (used in) Operating	**2,271,258**	(12,100,057)
Income Tax Paid	**(6,885,579)**	(6,837,571)
Net Cash Flows generated from/ (used in) Operating Activities	**10,858,262**	(1,546,594)
Cash Flow From Investing Activities		
Proceeds from disposal of property, plant and equipment	**13,485**	34,533
Acquisition of property, plant and equipment	**(547,906)**	(510,312)
Net Cash Flow used in Investing Activities	**(534,421)**	(475,779)
Cash Flow From Financing Activities		
Profit transferred to Head Office	**(3,531,000)**	(1,573,000)
Net Cash Flow used in Financing Activities	**(3,531,000)**	(1,573,000)
Net Increase/(Decrease) in Cash and Cash Equivalents	**6,792,841**	(3,595,373)
Cash and Cash Equivalents at the Beginning of period	**17,517,716**	20,942,883
Exchange Adjustment	**(295,009)**	170,206
Cash and Cash Equivalents at the end of the year (Note A)	**24,015,548**	17,517,716

Note A
Analysis of Cash and Cash Equivalents at the end of the year

Cash in Hand and Balances with Banks	**1,222,493**	1,367,826
Balances with Other Banks	**15,947,885**	8,103,943
Balances with Central Bank	**6,845,170**	8,045,947
	24,015,548	17,517,716

Figures in brackets indicate deductions.

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

1. CORPORATE INFORMATION

1.1 Domicile and Legal form

The Hongkong and Shanghai Banking Corporation Limited is a Public company incorporated in Hongkong SAR with the limited liability and carries out Banking activities in Sri Lanka through HSBC Sri Lanka Branch. 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 branches remained unchanged during the year. However HSBC re-entered the Primary Dealership in October 2013 and this provided HSBC the direct access to the primary auctions for government securities and Central Branch securities.

1.3 Parent Company and Ultimate Parent Company

The immediate parent entity is the Hongkong and Shanghai Banking Corporation Limited and the ultimate parent entity is HSBC Holding plc. (incorporated in Great Britain and registered in England and Wales).

2. BASIS OF PREPARATION

2.1 Statement of Compliance

The financial statements of the Bank which comprise the statement of financial position, statement of comprehensive income, 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 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
- Available for sale financial assets are measured at fair value
- Liability for defined benefit obligations is recognized as the present value of the defined benefit obligation.

2.3 Functional and Presentation Currency

Financial Statements are presented in Sri Lankan Rupees, which is the Branch’s functional currency.

2.4 Use of Estimates and Judgment

The preparation of Financial Statements require management to make judgment estimates and assumptions that effects the application of accounting policies and the reported amount of assets, liabilities, income and expenses. Actual results may differ from these estimates.

2. BASIS OF PREPARATION (CONTINUED)

2.4 Use of Estimates and Judgment (Continued)

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period of which the estimate is revised and in any future period affected.

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

Assets and liabilities denominated in foreign currencies are translated at the spot rate of exchange ruling on the reporting date. Translation gains and losses are dealt with through the income statement.

Transactions in foreign currencies are translated to Sri Lankan Rupees at the spot rate of exchange ruling at the date of transaction.

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 recognized in profit or loss 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.

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 Statement of Comprehensive Income include;

- interest on financial assets and financial liabilities measured at amortized cost calculated on an effective interest basis;
- fair value changes in qualifying derivatives;

3.3 Fees and commissions

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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.3 Fees and commissions (Continued)

Other fees and commission income, including account servicing fees, Trade fees are recognized 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.10 of 2006 and subsequent amendments thereto.

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 for all temporary differences. 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 utilized.

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. Unrecognized deferred tax assets are assessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the year when the asset is realised or liability is settled, based on the tax rates and tax laws that have been enacted or substantively enacted as at the reporting date.

Deferred Tax relating to items recognised directly in equity is recognised in equity.

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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5 Financial Assets and Financial Liabilities

3.5.1 Initial Recognition and Measurement

3.5.1.1 Financial Assets

All financial instruments are recognised initially at fair value.

In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (that is, the fair value of the consideration given or received).In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, HSBC recognises a trading gain or loss on inception of the financial instrument, being the difference between the transaction price and the fair value.

When unobservable market data have a significant impact on the valuation of financial instruments, the entire initial difference in fair value from the transaction price as indicated by the valuation model is not recognised immediately in the income statement. Instead, it is recognised over the life of the transaction on an appropriate basis, when the inputs become observable, the transaction matures or is closed out, or when HSBC enters into an offsetting transaction.

Financial assets are classified into following catergories at the initial recognition:

- Financial investments - Held for trading
- Loans and Advances
- Financial investments Available-for-sale

Subsequent to initial recognition, the fair values of financial instruments measured at fair value are measured in accordance with HSBC’s valuation methodologies.

- **Financial Investments-Held for Trading**

  Financial assets at fair value through profit or loss include financial assets held for trading. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. This category includes derivative financial instruments entered into by the Branch that are not designated as hedging instruments in hedge relationships as defined by LKAS 39. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Financial assets at fair value through profit and loss are carried in the statement of financial position at fair value with changes in fair value recognized in finance income or finance costs in the income statement.

- **Loans and Advances**

  Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortized cost using the effective interest rate method

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5 Financial Assets and Financial Liabilities (Continued)

3.5.1 Initial Recognition and Measurement (Continued)

3.5.1.1 Financial Assets (Continued)

(EIR), less impairment. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortization is included in interest income in the income statement. The losses arising from impairment are recognized in the income statement in impairment charges for loans and other losses.

- **Available for Sale Financial Investments**

Available-for-sale investments are non-derivative investments that were designated as available-for-sale or are not classified as another category of financial assets. All available-for-sale investments are carried at fair value.

Interest income on AFS financial assets is recognized in profit or loss on straight line basis. However, the year to date gap between the straight line basis and the effective interest rate is monitored using a set threshold (currently, 2.5% of total year to date NII) and accounted for if the gap is material. Foreign exchange gain or loss on available-for-sale debt security investments are recognized in profit or loss.

Other fair value changes are recognized in other comprehensive income until the investment is sold or impaired, whereupon the cumulative gains and losses previously recognized as in other comprehensive income are reclassified to profit or loss as a reclassification adjustment.

3.5.1.2 Financial liabilities measured at amotised cost

Financial liabilities not classified as fair value through profit or loss are classified as amotised cost instruments.Deposits liabilities including non interest bearing deposits,savings deposits,term deposits,deposits redeemable at call and certificates of deposit and borrowings are classified as financial liabilities measured at amotised cost.

3.5.2 Derecognition

3.5.2.1 Financial Assets

A financial asset (or, where applicable a part of a financial asset or part of a Branch of similar financial assets) is derecognized when:

- The right to receive cash flows from the asset have expired.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5 Financial Assets and Financial Liabilities (Continued)

3.5.2 Derecognition (Continued)

3.5.2.1 Financial Assets (Continued)

- The Branch has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either

a) The Branch has transferred substantially all the risks and rewards of the asset,or
b) The Branch has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

3.5.2.2 Financial Liabilities

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expired. 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 recognized in profit or loss.

3.5.3 Offsetting

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Branch has a legal right to set off the recognized amounts and it intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

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

3.5.4 Amortized Cost Measurement

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

3.5.5 Fair Value Measurement

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

When available, the Branch measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5 Financial Assets and Financial Liabilities (Continued)

3.5.5 Fair Value Measurement (Continued)

If a market for a financial instrument is not active, then the Branch establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Branch, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Branch calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available observable market data.

Assets and long positions are measured at a bid price; liabilities and short positions are measured at an asking price. Where the Branch has positions with offsetting risks, mid-market prices are used to measure the offsetting risk positions and a bid or asking price adjustment is applied only to the net open position as appropriate. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Branch and the counterparty where appropriate.

3.5.6 Impairment of Financial Assets

The Branch assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, the probability that they will enter Branchruptcy or other financial reorganization, default or delinquency in interest or principal payments and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

3.5.6.1 Financial Assets Carried at Amortized Cost

For financial assets carried at amortized cost (such as amounts Loans and Receivables from Branchs, loans and advances to customers as well as held–to–maturity investments), the Branch first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Branch determines that no objective evidence of impairment exists for an individually assessed financial asset; it includes the asset in a group of financial assets with

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5 Financial Assets and Financial Liabilities (Continued)

3.5.6 Impairment of Financial Assets (Continued)

3.5.6.1 Financial Assets Carried at Amortized Cost (Continued)

similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be recognized, are not included in the collective assessment for impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the Statement of Comprehensive Income. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of 'Interest and similar income'.

Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Branch. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write–off is later recovered, the recovery is credited to the' Impairment charges for loans and other losses'.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. If the Branch has reclassified trading assets to loans and advances, the discount rate for measuring any impairment loss is the new effective interest rate determined at the reclassification date. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped based on the nature and type of the asset. It also considers credit risk characteristics such as asset collateral type, past–due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5 Financial Assets and Financial Liabilities (Continued)

3.5.6 Impairment of Financial Assets (Continued)

3.5.6.1 Financial Assets Carried at Amortized Cost (Continued)

consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

3.5.6.2 Available-For-Sale Financial Investments

For available–for–sale financial investments, the Branch assesses at each reporting date whether there is objective evidence that an investment is impaired.

In the case of debt instruments classified as available–for–sale, the Branch assesses individually whether there is objective evidence of impairment based on the same criteria as financial assets carried at amortized cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortized cost and the current fair value, less any impairment loss on that investment previously recognized in the Comprehensive Income. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of ‘Interest and similar income’. If, in a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to a credit event occurring after the impairment loss was recognized in the Comprehensive Income, the impairment loss is reversed through Comprehensive Income.

3.5.7 Re-structured Loans

Where possible, the Branch seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan’s original effective interest rate, unless there is a significant modification.

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. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

3.9 Assets and Bases of their Valuation

3.9.1 Property, Plant and Equipment

Initial measurment

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 (Land, Free hold buildings and improvements to buildings are carried at revalued amounts.) valuation 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 capitalized.

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 building	over 50 years
Fixed assets relating to Head Office refurbishment project	over 10 years
Equipment and Office Machinery	over 5 years
Furniture and Equipment	over 5 years
ATM Machines	over 7 years
Motor Vehicles and Boats	over 4 years
Computer Equipment including AS 400 system	over 5 years
Computer Terminals	over 5 years
PC and Local Area Networks	over 4 years

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.9 Assets and Bases of their Valuation (Continued)

3.9.1 Property, Plant and Equipment (Continued)

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 recognized 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 largely are independent from other assets & groups. Impairment losses are recognized in profit or loss.

3.9.2 Bills negotiated and discounted

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

3.9.3 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.

3.9.4 Statutory Deposits with Central Branch

The Monetary Law Act requires that all commercial Branchs 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% of the total of such rupee deposit liabilities.

3.10 Employee share plans

Share options and discretionary awards of shares granted under HSBC Group share plans align the interests of employees with those of shareholders. HSBC Sri Lanka's employee share plan is also aligned to group policy.

3.10.1 Share save Scheme

The HSBC Holdings savings-related share option plans are all-employee share plans under which eligible employees may be granted options to acquire HSBC Holdings ordinary shares. This has been extended to HSBC Sri Lanka employees as well. Employees may make contributions of up to £250 (or equivalent) each month over a period of one, three or five years which may be used on the first, third or fifth anniversary of the commencement of the

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.10 Employee share plans (Continued)

3.10.1 Share save Scheme (Continued)

relevant savings contract, at the employee's election, to exercise the options. The plans help align the interests of employees with the creation of shareholder value. The options were awarded for nil consideration and are exercisable at a 20% discount to the average market value of the ordinary shares on the five business days immediately preceding the invitation date. There are no performance criteria conditional upon which the outstanding options are exercisable and there have been no variations to the terms and conditions since the awards were made.

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

3.10.2 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.

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.

3.11 Liabilities and Provisions

3.11.1 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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11 Liabilities and Provisions (Continued)

3.11.1 Employee Retirement Benefit Obligation (Continued)

Pension Fund

Up to 31 December 2008, the Branch operates the Pension Fund outside the Financial Statements of the Branch. Accordingly, no asset or liability was recognized in the financial statements of the Branch.

Upto 2012, the 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 and fair value of plan assets has been recognized in the Statement of Financial position. Current service cost, interest cost, expected return on plan assets are charged / credited to income statement and the and all actuarial gains/losses are recongnised through other comprehensive income statement.The Branch carries out an actuarial valuation of the fund annually. The actuarial valuation is carried out by Messers. Piyal S Goonetilleke and Associates. The actuary has used the “Projected Unit Credit 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 Fund.

In 2012, the Branch introduced an optional pension scheme which is 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 will contribute 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.

Trust Fund

The Branch contributes to the Employees Trust Fund, which is a defined contribution plan.

3.11.2 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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11 Liabilities and Provisions (Continued)

3.11.3 Off-Balance Sheet Transactions

The Branch enters into off- balance sheet transactions such as forward exchange contracts, currency swaps, Interest rate swaps and options. All these trasnsactions are currently recorded in the trading position and the Mark to Mark is recognized in the Income Statement.

3.12 Segment Reporting

Segment information is presented for the identifiable operative business lines of the Branch and classified accordingly, which are the primary segments identified by the Branch.

4. NEW ACCOUNTING STANDARDS ISSUED BUT NOT EFFECTIVE AS AT REPORTING DATE

4.1 Sri Lanka Accounting Standard – SLFRS 9 "Financial Instruments"

The objective of this SLFRS is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows.

An entity shall apply this SLFRS to all items within the scope of LKAS 39 Financial Instruments: Recognition and Measurement. SLFRS 9 is effective for annual reporting periods beginning on or after 1st January 2018, with early adoption permitted.

4.2 Sri Lanka Accounting Standard – SLFRS 15 "Revenue from Contracts with Customers"

SLFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including LKAS 18 Revenue, LKAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programmes.

SLFRS 15 is effective for annual reporting periods beginning on or after 1st January 2017, with early adoption permitted. However, IASB has deferred the adoption of IFRS 15 which corresponds to SLFRS 15 to be adopted from financial reporting periods beginning on or after 1st January 2018.

4.3 Sri Lanka Accounting Standard 14 – SLFRS 14 "Regulatory Deferral Accounts"

SLFRS 14 establishes the financial reporting requirements for regulatory deferral account balances that arise when an entity provides goods or services to customers at a price or rate that is subject to rate regulation. SLFRS 14 is effective for annual reporting periods beginning on or after 1st January 2016, with early adoption permitted.

FOR THE YEAR ENDED 31ST DECEMBER

		2014	2013
		Rs.'000	Rs.'000
5	**Net interest income**		
	Interest income		
	Other financial assets held-for-trading	**533,635**	1,394,654
	Loans and receivables to banks	**1,948,280**	814,815
	Loans and receivables to other customers	**11,393,985**	13,497,529
	Financial investments - Available-for-sale	**10,228,216**	10,120,535
	Others	**16,969**	11,728
	Total Interest Income	**24,121,085**	25,839,261
	Interest expenses		
	Due to banks	**(64,129)**	(362,355)
	Due to other customers	**(6,441,300)**	(6,989,813)
	Others	**(630,892)**	(508,156)
	Total Interest Expenses	**(7,136,321)**	(7,860,324)
		16,984,764	17,978,937
	Net Interest Income from Sri Lanka Government Securities		
	Interest income	**10,761,851**	11,515,189
	Net interest income	**27,746,615**	29,494,126

		2014	2013
		Rs.'000	Rs.'000
6	**Net fee and commission income**		
	Fee and commission income	**3,931,030**	4,444,812
	Fee and commission expenses	**(670,334)**	(660,675)
		3,260,696	3,784,137
6.1	**Comprising**		
	Loans	**192,172**	542,171
	Credit Cards	**1,705,618**	1,848,142
	Trade and remittances	**1,089,747**	1,085,872
	Deposits	**181,740**	252,622
	Others	**91,419**	55,330
	Net fee and commission income	**3,260,696**	3,784,137

		2014	2013
		Rs.'000	Rs.'000
7	**Net gain from trading**		
	Foreign exchange (excluding derivatives)		
	- Gain from transaction with customers	**2,115,168**	1,826,874
	- Loss from transactions with others	**(1,143,656)**	(1,479,085)
	Government Securities	**375,726**	980,395
	Derivatives	**99,927**	219,195
		1,447,165	1,547,379

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

FOR THE YEAR ENDED 31ST DECEMBER

8	**Net gain from financial investments**	**2014**	2013
		Rs.'000	Rs.'000
	Net gain from financial investments	**357,473**	-
		357,473	-

9	**Other operating income (net)**	**2014**	2013
		Rs.'000	Rs.'000
	Profit on sale of property, plant and equipment	**13,485**	29,320
	Foreign exchange gain from capital transfer to DBU from FCBU	**450,000**	-
	Others	**33,504**	88,376
		496,989	117,696

10	**Impairment charges for loans and other losses**	**2014**	2013
		Rs.'000	Rs.'000
	Individual significant impairment (charge)/reversal **(Note 10.1)**	**508,837**	(251,270)
	Collective impairment charge **(Note 10.2)**	**(1,024,495)**	(556,372)
		(515,658)	(807,642)

10.1	**Individual significant impairment (charge)/reversal**		
	Impairment provision (charge)/reversal		
	- For customer balances	**468,870**	239,832
	- For commitments and gurantees	**8,424**	(8,407)
	Direct write-offs for the year	**(19,665)**	(588,085)
	Recoveries during the year	**51,208**	105,390
		508,837	(251,270)

10.2	**Collective impairment charge**		
	Impairment provision for the year	**(514,412)**	(384,481)
	Direct write-offs for the year	**(1,101,649)**	(891,685)
	Recoveries during the year	**591,566**	719,794
		(1,024,495)	(556,372)

11	**Personnel expenses**	**2014**	2013
		Rs.'000	Rs.'000
	Salary and bonus	**(2,255,148)**	(2,051,998)
	Others	**(991,325)**	(892,262)
		(3,246,473)	(2,944,260)

FOR THE YEAR ENDED 31ST DECEMBER

		2014	2013
12	**Other expenses**	**Rs.'000**	Rs.'000
	Auditors' remunerations	**(3,316)**	(3,233)
	Non-audit fees to auditors	**(1,838)**	(3,546)
	Professional and legal expenses	**(308)**	(50,216)
	Depreciation of property, plant and equipment	**(164,770)**	(144,768)
	Office administration and establishment expenses	**(2,223,188)**	(1,898,035)
	Others	**(3,547,537)**	(2,894,696)
		(5,940,957)	(4,994,494)

		2014	2013
13	**Tax expense**	**Rs.'000**	Rs.'000
13.a	**Current Tax Expense**		
	Current tax on profit for the year **(Note 13.c)**	**(3,825,670)**	(4,144,594)
	Over provision for the previous year	**156,434**	80,243
	Tax of prior years paid in current year	**(48,724)**	(273,880)
	Remittance Tax	**(141,913)**	(138,653)
		(3,859,873)	(4,476,884)
13.b	**Deferred Tax Expenses**		
	- Provision for Employee benefit	**-**	13,414
	- Allowance for loans losses	**123,087**	74,817
	- Depreciation on Revaluation of Building	**3,314**	1,859
	Deferred tax assets reversed during the year	**126,401**	90,090
	- Property, Plant and Equipment	**(10,474)**	(7,179)
	- Provision for Employee benefit	**(2,598)**	-
	- Others	**-**	(12,945)
	Deferred tax liabilities recognized during the year	**(13,072)**	(20,124)
		113,329	69,966
	Total Tax charge to Income statement	**(3,746,544)**	(4,406,918)
13.c	**Reconciliation Between the Tax Expense and the Accounting Profit**		
	Accounting Profit before Taxation	**11,217,400**	12,638,593
	Add: Disallowable items	**5,171,137**	5,104,703
	Less: Allowable items	**(2,725,430)**	(2,941,246)
	Taxable Income	**13,663,107**	14,802,050
	Income tax @ 28%	**(3,825,670)**	(4,144,594)
13.d	**Tax charge to the Statement of Other Comprehensive Income**		
	-Provision for Employee benefit	**3,941**	(137,423)
	-AFS Reserve	**(414,490)**	(754,348)
	-Revaluation of Buildings	**(17,374)**	(55,204)
		(427,923)	(946,975)

AS AT 31ST DECEMBER

14 Analysis of Financial Instruments on Measurement Basis

14.1 As at 31st December 2014

	Held for Trading Rs.'000	Amortized Cost Rs.'000	Available for Sale Rs.'000	Total Rs.'000
ASSETS				
Cash and cash equivalents	-	17,170,378	-	17,170,378
Balances with central bank	-	6,845,170	-	6,845,170
Placements with banks	-	15,444,288	-	15,444,288
Derivative financial instruments	1,140,619	-	-	1,140,619
Financial assets held for trading	1,722,700	-	-	1,722,700
Loans and receivables from banks	-	26,321,100	-	26,321,100
Loans and receivables from other customers	-	168,934,941	-	168,934,941
Financial investments	-	-	142,316,265	142,316,265
Acceptances and endorsements	-	14,719,102	-	14,719,102
Total financial assets	**2,863,319**	**249,434,979**	**142,316,265**	**394,614,563**
LIABILITIES				
Due to banks	-	149,200,815	-	149,200,815
Derivative financial instruments	609,806	-	-	609,806
Due to other customers	-	176,346,760	-	176,346,760
Acceptances and endorsements	-	14,719,102	-	14,719,102
Total financial liabilities	**609,806**	**340,266,677**	**-**	**340,876,483**

14.2 As At 31st December 2013

	Held for Trading Rs.'000	Amortized Cost Rs.'000	Available for Sale Rs.'000	Total Rs.'000
ASSETS				
Cash and cash equivalents	-	9,471,769	-	9,471,769
Balances with central bank	-	8,045,947	-	8,045,947
Placements with banks	-	5,636,400	-	5,636,400
Derivative financial instruments	2,983,392	-	-	2,983,392
Financial assets held for trading	11,995,713	-	-	11,995,713
Loans and receivables from banks	-	30,559,850	-	30,559,850
Loans and receivables from other customers	-	129,012,751	-	129,012,751
Financial investments	-	-	107,011,206	107,011,206
Acceptances and endorsements	-	12,761,161	-	12,761,161
Total financial assets	**14,979,105**	**195,487,878**	**107,011,206**	**317,478,189**
LIABILITIES				
Due to banks	-	97,620,005	-	97,620,005
Derivative financial instruments	4,088,096	-	-	4,088,096
Due to other customers	-	154,946,963	-	154,946,963
Acceptances and endorsements	-	12,761,161	-	12,761,161
Total financial liabilities	**4,088,096**	**265,328,129**	**-**	**269,416,225**

AS AT 31ST DECEMBER

15 Cash and cash equivalents	2014 Rs.'000	2013 Rs.'000
Cash in hand	**1,222,493**	1,367,826
Balances with other banks	**15,947,885**	8,103,943
	17,170,378	9,471,769

16 Balances with Central bank	2014 Rs.'000	2013 Rs.'000
Balances with central bank	**6,845,170**	8,045,947
	6,845,170	8,045,947

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% as at 31st December 2014 (2013 : 6%).

17 Placements with banks	2014 Rs.'000	2013 Rs.'000
Placements	**15,444,288**	5,636,400
	15,444,288	5,636,400

18 Derivative financial instruments	2014 Rs.'000	2013 Rs.'000
Interest rate derivatives		
Interest rate swaps	**186,730**	146,372
Currency options	**52,391**	323,530
Forward foreign exchange contracts	**901,498**	2,513,490
	1,140,619	2,983,392

19 Other Financial assets held-for-trading	2014 Rs.'000	2013 Rs.'000
Treasury bills	**734,685**	5,551,759
Treasury bonds	**988,015**	6,443,954
	1,722,700	11,995,713

AS AT 31ST DECEMBER

20	**Loans and receivables from banks**	**2014 Rs.'000**	2013 Rs.'000
	Gross loans and receivables **(Note 20.1)**	**26,321,100**	30,559,850
		26,321,100	30,559,850
20.1	**Analysis**		
a.	By product		
	Short-term loans	**1,321,100**	5,559,850
	Reverse repo agreements	**25,000,000**	25,000,000
	Gross Total	**26,321,100**	30,559,850
b.	By currency		
	Sri Lankan Rupee	**25,000,000**	25,000,000
	United States Dollar	**1,321,100**	5,559,850
	Gross Total	**26,321,100**	30,559,850

21	**Loans and receivables from other customers**	**2014 Rs.'000**	2013 Rs.'000
	Gross loans and receivables **(Note 21.1)**	**171,113,828**	131,366,182
	Less: Provision for impairment loss **(Note 21.2)**	**(2,178,887)**	(2,353,431)
	Net loans and receivables	**168,934,941**	129,012,751
21.1	**Analysis**		
a.	**By product**		
	Overdrafts	**11,870,082**	15,735,932
	Trade finance	**44,705,679**	41,335,937
	Credit cards	**19,704,899**	19,987,344
	Staff loans	**2,205,311**	2,053,091
	Term loans - short term	**25,304,821**	4,734,904
	Term loans - long term	**65,818,187**	45,938,121
	Mortgages	**1,504,849**	1,580,853
	Gross Total	**171,113,828**	131,366,182
b.	**By currency**		
	Sri Lankan Rupee	**61,857,205**	68,450,112
	United States Dollar	**107,817,359**	61,320,344
	Great Britain Pound	**520,253**	719,497
	Others	**919,011**	876,229
	Gross Total	**171,113,828**	131,366,182
c.	**By industry**		
	Agriculture and fishing	**5,105,732**	5,349,301
	Manufacturing	**62,042,166**	32,790,813
	Tourism	**8,878,456**	5,915,119
	Transport	**4,976,432**	10,125,123
	Construction	**5,399,372**	3,458,525
	Traders	**22,973,156**	20,837,705
	Others	**61,738,514**	52,889,596
	Gross Total	**171,113,828**	131,366,182

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21.2 Provision for Impairment loss

	2014	2013
	Rs.'000	Rs.'000
a. Individual impairment charges		
Opening balance	**1,564,713**	2,142,122
Reversal during the year	**(480,861)**	(242,390)
Write-off during the year	**-**	(330,760)
Exchange fluctuations and other movements	**(133,215)**	(4,259)
Closing balance	**950,637**	1,564,713
b. Collective impairment charges		
Opening balance	**788,718**	490,047
Charge for the year	**514,411**	384,481
Exchange fluctuations and other movements	**(74,879)**	(85,810)
Closing balance	**1,228,250**	788,718
Total	**2,178,887**	2,353,431

22 Financial investments – Available-for-Sale

	2014	2013
	Rs.'000	Rs.'000
Treasury bills	**61,880,519**	30,738,233
Treasury bonds	**80,435,746**	76,272,973
	142,316,265	107,011,206

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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	Capital * Work in Progress	Total
	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000
Cost/Revalued Amount									
Balance as previously reported as at 1st January 2013	788,500	391,500	378,384	17,593	202,656	455,310	279,740	-	2,513,683
Reclassified from Other Receivables **(Note 34.1)**	-	-	-	-	-	-	-	212,003	212,003
Additions during the year **(Note 34.1**	-	-	43,437	214	3,663	57,935	73,598	331,465	510,312
Disposals during the year	-	-	-	(653)	-	(903)	(69,644)	-	(71,200)
Revaluation Gain	218,500	189,000	-	-	-	-	-	-	407,500
Balance as at 31st December 2013	1,007,000	580,500	421,821	17,154	206,319	512,342	283,694	543,468	3,572,298
Balance as at 1st January 2014	**1,007,000**	**580,500**	**421,821**	**17,154**	**206,319**	**512,342**	**283,694**	**543,468**	**3,572,298**
Additions during the year	**-**	**-**	**20,233**	**-**	**4,266**	**147,678**	**54,381**	**321,347**	**547,906**
Disposals during the year	**-**	**-**	**-**	**-**	**-**	**-**	**(23,399)**	**-**	**(23,399)**
Transfers during the year	**-**	**394,549**	**3,944**	**-**	**-**	**-**	**-**	**(398,493)**	**-**
Revaluation Gain	**354,000**	**63,951**	**-**	**-**	**-**	**-**	**-**	**-**	**417,951**
Balance as at 31st December 2014	**1,361,000**	**1,039,000**	**445,998**	**17,154**	**210,585**	**660,020**	**314,676**	**466,322**	**4,514,755**
Accumulated depreciation									
Balance as at 1st January 2013	-	-	341,307	14,464	174,093	327,520	184,241	-	1,041,625
Charge for the year	-	8,900	13,927	1,819	13,219	49,916	56,987	-	144,768
Disposals during the year	-	-	-	(653)	-	-	(65,333)	-	(65,986)
Revaluation Adjustment	-	(8,900)	-	-	-	-	-	-	(8,900)
Balance as at 31st December 2013	-	-	355,234	15,630	187,312	377,436	175,895	-	1,111,507
Balance as at 1st January 2014	**-**	**-**	**355,234**	**15,630**	**187,312**	**377,436**	**175,895**	**-**	**1,111,507**
Charge for the year	**-**	**14,094**	**29,815**	**863**	**8,484**	**57,061**	**54,453**	**-**	**164,770**
Reclassified during the year	**-**	**6,683**	**(6,683)**	**-**	**-**	**-**	**-**	**-**	**-**
Revaluation Adjustment	**-**	**(20,777)**	**-**	**-**	**-**	**-**	**-**	**-**	**(20,777)**
Disposals during the year	**-**	**-**	**-**	**-**	**-**	**-**	**(23,077)**	**-**	**(23,077)**
Balance as at 31st December 2014	**-**	**-**	**378,366**	**16,493**	**195,796**	**434,497**	**207,271**	**-**	**1,232,423**
Carrying Value									
As at 31st December 2013	1,007,000	580,500	66,587	1,525	19,007	134,906	107,799	543,468	2,460,791
As at 31st December 2014	**1,361,000**	**1,039,000**	**67,632**	**661**	**14,789**	**225,523**	**107,405**	**466,322**	**3,282,332**

* The Capital work-in-progress as at 1st January 2013 and the additions during the year ended 31st December 2013 which was previously reported under other receivables as at 31st December 2013 , was reclassified from other receivables to Property, Plant and Equipment during the year for better presentation of the financial position of the Branch.

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23 Property, plant and equipment (Continued)

23.1 Methods and Assumptions used in the Fair Valuation of Property, Plant and Equipment

The Lands and buildings of the branch as at 31st December 2014 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 valuer	Valuation Technique	Significant unobservable inputs	Inter-relationship between key unobservable inputs and fair value measurement
Sir Baron Jayatilaka Mawatha, Colombo 01	Mr.Siri Nissanka - FIV, FSVA, MSIZ, IRRV, FIABIC. Diploma in Valuation Registered and Incorporated Valuer	The Open Market Value, the Income Basis and the Depreciated Replacement Cost (DRC) Basis techniques have been used.	The comparable market values of lands situated in the area.	Estimated fair value would increase if the market value of the land increases
			The expected rent from the buildings.	Reduction of market rents cause negative impact on estimated fair value. Estimated fair value would increase if the value of the expected rent gets higher
Independence Avenue, Colombo 07	Mr.Siri Nissanka - FIV, FSVA, MSIZ, IRRV, FIABIC. Diploma in Valuation Registered and Incorporated Valuer	The Open Market Value, the Income Basis and the Depreciated Replacement Cost (DRC) Basis techniques have been used.	The comparable market values of lands situated in the area.	Estimated fair value would increase if the market value of the land increases
			The expected rent from the buildings.	Reduction of market rents cause negative impact on estimated fair value. Estimated fair value would increase if the value of the expected rent gets higher

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24 Deferred tax assets / (liabilities)

	2014 Rs.'000	2013 Rs.'000
Deferred tax assets	**424,645**	310,689
Deferred tax liabilities	**(1,423,108)**	(994,558)
	(998,463)	(683,869)

24.1 Reconciliation of Deferred Tax

Deferred tax assets and liabilities are attributable to the following:

	2014		2013	
	Temporary Difference Rs. '000	**Tax Effects Rs.'000**	Temporary Difference Rs.'000	Tax Effects Rs.'000
Deferred tax assets on ;				
Accelerated Depreciation for tax				
- Property, Plant and Equipment	**17,741**	**4,968**	55,147	15,441
Provision for Retirement Benefit Obligation	**399,343**	**111,816**	394,549	110,474
Allowance for loan losses	**1,099,506**	**307,861**	659,909	184,774
	1,516,590	**424,645**	1,109,605	310,689
Deferred tax liabilities on ;				
Revaluation of buildings	**(568,108)**	**(159,070)**	(486,659)	(145,010)
Available for sale reserve	**(4,514,422)**	**(1,264,038)**	(3,034,101)	(849,548)
	(5,082,530)	**(1,423,108)**	(3,520,760)	(994,558)
Net assets / (liabilities) as at 31st December	**(3,565,940)**	**(998,463)**	(2,411,155)	(683,869)

25 Other assets

	2014 Rs.'000	2013 Rs.'000
Receivables	**4,475,353**	4,078,558
Deposits and prepayments	**467,932**	218,677
Sundry debtors	**13,249**	2,349
Acceptances and endorsements	**14,719,102**	12,761,161
Others	**1,762,835**	1,920,146
	21,438,471	18,980,891

26 Due to banks

	2014 Rs.'000	2013 Rs.'000
Borrowings	**140,213,210**	77,445,440
Others	**8,987,605**	20,174,565
	149,200,815	97,620,005

27 Derivative financial instruments

	2014 Rs.'000	2013 Rs.'000
Currency options	**60,316**	399,834
Interest rate derivatives	**196,499**	151,259
Forward foreign exchange contracts	**352,991**	3,537,003
	609,806	4,088,096

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		2014	2013
28	**Due to other customers**	**Rs.'000**	Rs.'000
	Total amount due to other customers **(Note 28.1)**	**176,346,760**	154,946,963
		176,346,760	154,946,963
28.1	**Analysis**		
a.	By product		
	Demand deposits (current accounts)	**26,501,632**	25,081,772
	Savings deposits	**42,739,651**	27,769,049
	Fixed deposits	**99,537,764**	93,919,279
	Other deposits	**7,567,713**	8,176,863
	Total	**176,346,760**	154,946,963
b.	By currency		
	Sri Lankan Rupees	**109,434,679**	94,462,425
	United State Dollar	**49,489,857**	41,709,727
	Great Britain Pound	**5,776,845**	6,585,255
	Others	**11,645,379**	12,189,556
	Total	**176,346,760**	154,946,963

		2014	2013
29	**Other liabilities**	**Rs.'000**	Rs.'000
	Sundry creditors	**1,119,458**	1,383,600
	Interest payable	**4,422,150**	3,939,543
	Acceptances and endorsements	**14,719,102**	12,761,161
	Defined Benefit Liability - Net **(Note 29.1)**	**399,418**	394,549
	Other payables	**7,180,425**	4,606,693
		27,840,553	23,085,546

		2014	2013
		Rs.'000	Rs.'000
29.1	**Defined Benefit liability - Net**		
	Present Value of Defined Benefit Obligations **(Note 29.1.a)**	**934,107**	901,811
	Fair Value of Plan Assets **(Note 29.1.b)**	**(534,689)**	(507,262)
		399,418	394,549
29.1.a	**Movement in the Present Value of Defined Benefit Obligations**		
	Opening balance	**901,811**	1,029,683
	Current Service Cost	**5,544**	5,017
	Interest Cost	**107,439**	119,923
	Benefits Paid during the year	**(69,286)**	(79,750)
	Actuarial gain for the year	**(11,401)**	(173,062)
	Closing balance	**934,107**	901,811
29.1.b	**Movement in Fair Value of Plan Assets**		
	Opening balance	**507,262**	500,595
	Expected return on Plan Assets	**62,262**	56,326
	Contribution by Employers	**60,000**	2,554
	Benefits Paid during the year	**(69,286)**	(79,750)
	Actuarial gain/(loss) for the year	**(25,549)**	27,537
	Closing balance	**534,689**	507,262

29.1.c Sensitivity Analysis of the Defined Benefit Obligation - Discount rate

	Decrease -1%	**Assumptions Used**	**Increase +1%**
Discount rate	8.00%	9.00%	10.00%
Return on Assets	7.33%	7.33%	7.33%
Salary Increase Union/Non Union	12%/10%	12%/10%	12%/10%
COLA	7.5%	7.5%	7.5%
StaffTurnover	None	None	None
Post retirement pension increases	5.00%	5.00%	5.00%
Active Members Benefit (Rs.'000)	146,004	109,716	83,463
Retired Members pension benefit (Rs.'000)	897,263	824,391	761,328
Total Present value of defined benefit obligation (Rs.'000)	1,043,267	934,107	844,791

30 Assigned capital

	2014 Rs.'000	2013 Rs.'000
Assigned Capital	**3,152,358**	3,152,358
	3,152,358	3,152,358

31 Statutory reserve fund

	2014 Rs.'000	2013 Rs.'000
Opening balance	**1,790,585**	1,625,952
Transferred during the year	**149,417**	164,633
Closing balance	**1,940,002**	1,790,585

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.

32 Other reserves

	2014 Rs.'000	2013 Rs.'000
Exchange equalisation of capital **(Note 32.1)**	**-**	455,550
Exchange equalisation of reserve **(Note 32.2)**	**2,300,185**	2,137,533
Revaluation reserve **(Note 32.4)**	**1,781,682**	1,360,328
IFA reserve **(Note 32.5)**	**5,108,459**	4,583,499
SBP reserve **(Note 32.6)**	**159,402**	157,666
	9,349,728	8,694,576

32.1 Exchange equalisation of capital

	2014 Rs.'000	2013 Rs.'000
Opening balance	**455,550**	405,450
Fluctuation of foreign exchange reserves	**(455,550)**	50,100
Closing balance	**-**	455,550

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32 Other reserves (Continued)

32.2 Exchange equalisation of reserve

	2014	2013
	Rs.'000	Rs.'000
Opening balance	**2,137,533**	1,824,232
Fluctuation of foreign exchange reserves	**162,652**	313,301
Closing balance	**2,300,185**	2,137,533

32.3 Available for sale reserve

	2014	2013
	Rs.'000	Rs.'000
Opening balance	**2,214,135**	266,528
Net gain on revaluation	**1,066,013**	1,947,607
Closing balance	**3,280,148**	2,214,135

32.4 Revaluation reserve

	2014	2013
	Rs.'000	Rs.'000
Opening balance	**1,360,328**	999,132
Revaluation surplus for the year	**421,354**	361,196
Closing balance	**1,781,682**	1,360,328

32.5 IFA reserve

	2014	2013
	Rs.'000	Rs.'000
Opening balance	**4,583,499**	2,376,085
Transferred during the year	**524,960**	2,207,414
Closing balance	**5,108,459**	4,583,499

According to the guidelines issued by 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.

32.6 Share Based Payment Reserve

	2014	2013
	Rs.'000	Rs.'000
Opening balance	**157,666**	150,000
Transferred during the year	**1,736**	7,666
Closing balance	**159,402**	157,666

HSBC Sri Lanka has a share based payment scheme available for its employees, which provides share options to the employees. HSBC Holdings plc , registered in United Kingdom issues shares to the employees of HSBC Sri Lanka and the scheme does not contain any recharge arrangement to HSBC Holdings plc. Accordingly the value of shares granted by HSBC Holdings plc is accounted as a contribution from HSBC Holdings plc under equity of the Branch.

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		2014	2013
32.7	**Share based payments and share option**	**2014**	2013
32.7.1	**Restricted share awards -** *No of Shares ('000)*		
	Outstanding at the beginning	**7,604**	13,803
	Awards during the year	**24,951**	1,516
	Vested during the year	**(9,553)**	(7,715)
	Outstanding at the end	**23,002**	7,604
32.7.2	**Share-based payments income statement charge**	**Rs.'000**	Rs.'000
	Restricted and performance share awards	**26,614**	8,240
	Share award option plans	**1,736**	7,666
		28,350	15,906

33 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 other than the N**ote 33.1** .

33.1 Super Gain Tax

In the interim budget proposal presented by the Minister of Finance on 29th January 2015, an additional one off tax of 25% was proposed to be charged on entities who earned a profit in excess of Rs.2,000 mn for the year of assessment 2013/2014. Though the Branch made a profit in excess of such amount for such year, in the absence of a measurement criteria being enacted or substantially enacted at the time of issue of these financial statements, no provision has been made for such amount in these financial statements.

34 Comparative figures

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

34.1 Reclassification of Capital work-in-progress

The Capital work-in-progress as at 1st January 2013 and the additions during the year ended 31st December 2013 which was previously reported under other receivables as at 31st December 2013 , was reclassified from other receivables to Property, Plant and Equipment during the year for better presentation of the financial position of the Branch. This reclassification has no impact on the profit or total comprehensive income for the year ended 31st December 2013 and the total assets, total liabilities or net assets of the Branch as at 1st January 2013. Accordingly, the statement of financial position as at 1st January 2013 is not presented.

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35 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.

	2014	2013
	Rs.'000	Rs.'000
Performance bonds	**1,831,642**	3,777,065
Letters of credit	**11,765,364**	10,810,392
Other contingent items	**26,356,056**	23,690,131
Undrawn loan commitments	**141,787,808**	145,870,008
Foreign Exchange Contracts	**259,238,116**	401,838,797
Derivatives- Principal amount	**126,112,035**	139,168,453
Other contra accounts	**15,249,216**	16,438,385
Total	**582,340,237**	741,593,231

b. Pending litigations against the Branch as at 31st December 2014

1. Law suit instituted by a former staff case no: DSP/214/2011; now terminated - praying for inter alia

1. an interim injunction against the Branch for restraining the Branch from withholding his salary (case was instituted in year 2011 when the staff member was under suspension)

2. A permanent injunction in the form of a mandatory order directing the Branch to pay his full salaries and all allowances that are usually paid to the staff of his category during his period of suspension.

2. Court action has been initiated by Christy Lanka Apparels (Pvt) Ltd; a customer of the Branch in proceedings case no: 102/2007/MR; suing the Branch for loss of business and reputation as a result of the Branch purporting to grant increased facilities and later withdrawing them.

3. Case filed by the Plaintiff under proceeding case no: 69/12/Trust in the District Court of Mount Lavinia mainly against the 1st Defendant who is his spouse. Enjoining order issued against the Branch to freeze certain funds held under the name of the 1st Defendant.

4. Under proceedings in case no: 33/2012/CO; HSBC is the 6th Defendant, action filed mainly against the 1st and the 2nd defendant , under section 224,225 of the Companies Act (oppression against Minority).

5. 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 Branch has been enlisted as the 4th defendant for giving evidence on certain transactions of the plaintiff.

6. Plaintiff Millennium Teas Pvt Ltd is suing the Branch for breach of duty of care and for acting negligently under court proceeding (Case No. DMR/2275/2012)

7. Three court actions have been taken under case numbers LT 2/150/2010, LT 2/315/2012, LT 8/648/12 and LT 13/25/2014 by former staff members for alleged unfair termination.

8. 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.

The Branch is of the view that the above litigations will not have any material impact on the Financial Statements.

36 Related Party Disclosure

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.

36.1 Transactions with related parties

(a) Interest Paid to Other HSBC Branches and Group Companies

	2014 Rs.'000	2013 Rs.'000
Other HSBC Branches		
HSBC Hongkong	**188,167**	36
HSBC Singapore	**-**	28
	188,167	64
Group Companies		
HSBC London	**16**	20
HSBC Markets	**297,127**	328,171
HSBC Canada	**-**	130
HSBC Melbourne	**1**	13
HSBC USA	**87,948**	74,133
HSBC Data processing Ltd	**57,633**	105,622
HSBC TUB Dusseldorf	**-**	3
HSBC Middle East	**1**	-
	442,726	508,092

(b) Interest Received from Other HSBC Branches and Group Companies

	2014 Rs.'000	2013 Rs.'000
Other HSBC Branches		
HSBC Hongkong	**4,139**	3,182
	4,139	3,182
Group Companies		
HSBC London	**4**	630
HSBC Markets	**2,722**	7,882
HSBC Data processing Ltd	**5**	34
	2,731	8,546

(c) Commission Paid to Other HSBC Branches and Group Companies

	2014 Rs.'000	2013 Rs.'000
Other HSBC Branches		
HSBC Hongkong	**441**	87,515
HSBC Auckland	**128**	90
HSBC Tokyo	**202**	291
HSBC Singapore	**386**	226
HSBC India	**2**	-
HSBC Thailand	**56**	46
HSBC Male'	**-**	59,824
HSBC Malaysia	**-**	6
	1,215	147,998
Group Companies		
HSBC London	**255**	374
HSBC Canada	**588**	641
HSBC Australia	**1,672**	1,540
HSBC USA	**155,713**	92,106
HSBC TUB Dusseldorf	**92**	851
HSBC Dubai	**41**	-
	158,361	95,512

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36 Related Party Disclosure (Continued)

36.1 Transactions with related parties (Continued)

(d) Assets of Other HSBC Branches and Group Companies	2014 Rs.'000	2013 Rs.'000
Other HSBC Branches		
HSBC Hongkong	**13,092,713**	252,009
HSBC Auckland	**34,536**	67,131
HSBC Tokyo	**32,770**	131,812
HSBC Singapore	**100,429**	59,175
HSBC India	**380,538**	463,013
HSBC Thailand	**1,124,329**	799
HSBC Male'	**1,212,081**	860,898
HSBC Malaysia	**1,211**	1,277
	15,978,607	1,836,114
Group Companies		
HSBC London	**628,107**	1,086,499
HSBC Markets	-	2,616,404
HSBC Canada	**31,871**	52,174
HSBC Melbourne	-	301,868
HSBC USA	**6,341,837**	4,321,610
HSBC Pakistan	-	121,217
HSBC UAE	**4,172**	2,926
HSBC Australia	**101,929**	-
	7,107,916	8,502,698

(e) Liabilities of Other HSBC Branches and Group Companies	2014 Rs.'000	2013 Rs.'000
Other HSBC Branches		
HSBC Hongkong	**130,400,536**	79,972,181
HSBC Thailand	-	-
HSBC Singapore	**2,880**	7,378
HSBC India	**101,380**	248
HSBC Bangladesh	**84,275**	28,945
HSBC Bahrain	**841**	618
HSBC Male'	**744**	578
HSBC Malaysia	**4,850**	13,667
	130,595,506	80,023,615
Group Companies		
HSBC London	**161,734**	169,909
HSBC Canada	**12**	24,819
HSBC Melbourne	-	19,416
HSBC USA	**2,432,068**	2,692,302
HSBC Data processing Ltd	**1,987,234**	1,679,104
HSBC Trinkaus and Burkhardt	-	190
HSBC Kuwait	**437**	437
HSBC Qatar	**322**	2,002
HSBC Dubai	**3,204**	803
HSBC Australia	**31,679**	-
	4,616,690	4,588,982

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36 Related Party Disclosure (Continued)

36.2 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 Excutive Officer, Chief Operating Officer, Head of Commercial Banking, Country Head of Retail Banking and Wealth Management, Head of Global Markets, General Counsel and Area Compliance Officer, Head of Human Reasources, Chief Financial Officer, Chief Risk Officer, Senior Marketing and Communications Manager, Financial Controller, Chief Information Officer and Global Standard Program Country Execution Lead as its key management personnel based on the above requirements.

36.2.a Compensation of KMPs	2014 Rs.'000	2013 Rs.'000
Aggregate remuneration paid for the year	**236,904**	156,347
	236,904	156,347

36.2.b Transactions with KMPs and Close Relations	2014 Rs.'000	2013 Rs.'000
Total deposits	**73,087**	61,521
Total accommodation granted	**212,435**	197,083
	285,522	258,604

37 Segment Analysis by Line of Business

Business level performance

	Retail Banking and Wealth Management Rs.'000	Commercial Banking Rs.'000	Global Banking and Markets Rs.'000	Others Rs.'000	Total Rs.'000
Net Operating Income	7,323,674	4,938,199	8,080,694	1,688,862	22,031,429
Operating Expenses	(5,242,410)	(2,234,591)	(1,343,338)	(367,090)	(9,187,429)
Profit Before tax	1,785,652	2,346,896	5,888,736	1,196,115	11,217,399
Income tax expense	(680,885)	(821,615)	(1,954,626)	(289,418)	(3,746,544)
Profit after tax	**1,104,767**	**1,525,281**	**3,934,110**	**906,697**	**7,470,855**
Segment Assets	**48,325,763**	**145,783,270**	**182,193,144**	**28,314,087**	**404,616,264**
Segment Liabilities	**113,549,408**	**88,595,795**	**151,644,823**	**50,826,238**	**404,616,264**

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

AS AT 31ST DECEMBER

38 Investment Fund Account (IFA)

In terms of the guideline issued by the Central Bank of Sri Lanka dated 29 April 2011 on "Operations of the Investment Fund Account", the following is disclosed;

(a) Number of loans granted and total amount outstanding for each purpose, interest rates and tenure of loans : NIL

(b) Total investments in government securities as at 31st December 2014, interest rates and maturity :

Investment amount Rs.	Interest rate	Maturity
382,751,310	8.65%	15-Aug-18
113,566,289	8.85%	15-Jan-19
57,422,457	8.85%	15-Jan-19
74,344,569	8.92%	15-Jan-19
85,136,503	8.95%	15-Jan-19
89,501,687	9.75%	15-Jan-19
49,054,293	9.75%	15-Jan-19
50,928,959	10.00%	1-May-19
264,479,065	14.15%	1-Nov-19
111,565,023	14.20%	1-Nov-19
86,446,265	14.30%	1-Nov-19
110,836,480	14.50%	1-Nov-19
77,908,218	14.40%	1-Nov-19
100,399,598	14.40%	1-Nov-19
151,093,292	14.50%	1-Nov-19
101,709,709	14.50%	1-Nov-19
81,985,306	14.40%	1-Nov-19
81,073,800	12.90%	1-Nov-19
78,639,500	13.68%	1-Nov-19
3,225,386	13.40%	1-Aug-20
3,578,377	11.40%	1-Aug-20
12,480,705	11.00%	1-Jan-22
47,342,368	11.60%	1-May-21
92,402,230	12.00%	1-May-21
78,445,204	11.60%	1-May-21
96,997,512	11.60%	1-May-21
122,963,298	11.40%	1-May-21
144,465,650	11.55%	1-May-21
210,668,248	11.72%	1-May-21
122,963,298	11.45%	1-May-21
94,674,453	11.50%	1-May-21
74,625,964	11.53%	1-May-21
112,503,258	11.50%	1-May-21
179,504,200	11.56%	1-May-21
107,883,720	11.55%	1-May-21
32,670,648	11.60%	1-May-21
46,827,097	11.64%	1-May-21
153,376,581	11.03%	1-May-21
44,729,200	11.23%	1-May-21
44,852,100	11.24%	1-May-21
44,785,250	11.20%	1-May-21
541,072,950	10.00%	1-May-21
109,433,500	9.50%	1-Jul-22
27,431,625	9.45%	1-Jul-22
121,113,600	7.78%	1-Jul-22
60,491,400	7.80%	1-Jul-22
60,524,100	7.79%	1-Jul-22
60,556,800	7.78%	1-Jul-22
60,524,100	7.79%	1-Jul-22
62,873,150	7.30%	1-Jul-22
5,124,828,295		

39 Financial Risk Management

39.1 Risk Management Framework

All of the Branch' 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. HSBC Sri Lanka Risk Function consists of Wholesale & Market Risk **-** Retail Banking & Wealth Management (RBWM) Risk, Security & Fraud Risk and Operational Risk.

39.2 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 direct lending, trade finance and also from certain other products such as guarantees, derivatives.

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 HSBC 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 HSBC 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.

39.2.1 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 principal objectives of our credit risk management are;

- To maintain across HSBC 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.

AS AT 31st DECEMBER

39 Financial Risk Management (Continued)

39.2 Credit risk (Continued)

39.2.1 Credit Risk Management (Continued)

Credit Quality of Financial Instruments

Branch’s credit risk rating systems and processes are differentiating 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 our 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 Group to support calculation of our minimum credit regulatory capital requirement. Special attention is paid to problem exposures in order to accelerate remedial action.

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

It is the policy of HSBC Sri Lanka creates impairment allowances for impaired loans promptly and appropriately.

Impairment and Credit Risk Mitigation
The existence of collateral has an impact when calculating impairment on individually assessed impaired loans. When Branch no longer expect to recover the principal and interest due on a loan in full or in accordance with the original terms and conditions, it is assessed for impairment. If exposures are secured, the current net realizable value of the collateral will be taken into account when assessing the need for an impairment allowance. No impairment allowance is recognized in cases where all amounts due are expected to be settled in full on realization of the collateral.

Personal lending portfolios are generally assessed for impairment on a collective basis as the portfolios typically consist of large groups of homogeneous loans. Methodologies used to calculate allowances on a collective basis: a roll rate methodology, discounted recovery methodology or a more basic formulaic approach based on historical losses. For individually assessed impairment the Discounted Cash Flow methodology is used.

39 Financial Risk Management (Continued)

39.2 Credit risk (Continued)

39.2.1 Credit Risk Management (Continued)

Impairment and Credit Risk Mitigation (Continued)

The historical loss methodology is typically used to calculate collective impairment allowances for secured or low default portfolios such as personal loans. For loans which are collectively assessed using historical loss methodology, the historical loss rate is derived from the average contractual write-off net of recoveries over a defined period. The net contractual write-off rate is the actual amount of loss experienced after the realization of collateral and receipt of recoveries.

A roll rate methodology is more commonly adopted for unsecured portfolios when there are sufficient volumes of empirical data to develop robust statistical models. In certain circumstances personal loan portfolios have a statistically significant number of defaults and losses available, enabling reliable roll rates to be generated. In these cases a roll rate methodology is applied, and the average loss rate for each delinquency bucket is adjusted to reflect the average loss expected following receipt of recoveries. The average loss expected is derived from average historical collateral realization values.

As an extended method to roll rate methodology, discounted recovery methodology uses the gross contractual loss of the portfolio from the roll rate methodology and determines the recovery out of the gross loss. The Discounted Recovery is then estimated for the recovery at the end of the realization period. Individual impairment is done for the non performing portion of the mortgage portfolio using the Discounted Cash Flow methodology where mortgage accounts are individually assessed to determine the impairment.

For wholesale portfolio, collectively assessed loans historical loss methodologies are applied to measure loss event impairments which have been incurred but not reported. Loss rates are derived from the observed contractual write off net of recoveries over a defined period. The net contractual write-off rate is the actual amount of loss experienced after realization of collateral and receipt of recoveries. These historical loss rates are adjusted by an economic factor which adjusts the historical averages to better represent current economic conditions affecting the portfolio. In order to reflect the likelihood of a loss event not being identified and assessed an emergence period assumption is applied. This reflects the period between a loss occurring and its identification. The emergence period is estimated by regional management for each identified portfolio. The factors that may influence this estimation include economic and market conditions, customer behavior, portfolio management information, credit management techniques and collection and recovery experiences in the market. A fixed range for the period between a loss occurring and its identification is assessed empirically on a periodic basis, it may vary over time as these factors change. Given that credit management policies require all customers to be reviewed at least annually, Branch expects this estimated period would be at most 12 months.

39 Financial Risk Management (Continued)

39.2 Credit risk (Continued)

39.2.1 Credit Risk Management (Continued)

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 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.

Unsecured personal facilities, including credit cards, are generally charge off at 180 days. It is done on the billing date of the month, the account reaches 180 days and the process is automated and any exception is tracked and manually done the next day. However early charge off could be triggered looking at the circumstance of the account for example on death, bankruptcy.

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

Collateral Management and Valuation

Although collateral can be an important mitigation of credit risk, 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 security offered. 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. Depending on its form, collateral can have a significant financial effect in mitigating our exposure to credit risk.

39.2.2 Quantitative Disclosures

Gross Loans and Receivables

Gross loans, impairment and net loans are disclosed in Note 21 in the financial Statements.

Movements in Individual and Collective Impairment during the period are disclosed in Note 21.2 in the financial Statements.

AS AT 31st DECEMBER

39 Financial Risk Management (Continued)

39.2 Credit risk (Continued)

39.2.2 Quantitative Disclosures (Continued)

Gross Loans and Receivables - By product

Loans and Receivables from Other Customers		
	2014	2013
	Rs.'000	Rs.'000
By product - Domestic currency		
Overdrafts	**9,271,529**	13,027,588
Term loans	**32,786,376**	35,435,179
Credit cards	**19,704,899**	19,987,344
Other loans	**94,402**	-
Sub total	**61,857,206**	68,450,111
By product - Foreign currency		
Overdrafts	**2,598,552**	2,708,344
Term loans	**103,236,808**	60,207,727
Other loans	**3,421,262**	-
Sub total	**109,256,622**	62,916,071
Total	**171,113,828**	131,366,182

Gross Loans and Receivables - By currency

Loans and Receivables from Other Customers		
	2014	2013
	Rs.'000	Rs.'000
By currency		
Sri Lanka Rupee	**61,857,205**	68,450,112
United States Dollar	**107,817,359**	61,320,344
Great Britain Pound	**520,253**	719,497
Others	**919,011**	876,229
Total	**171,113,828**	131,366,182

AS AT 31st DECEMBER

39 Financial Risk Management (Continued)

39.2 Credit risk (Continued)

39.2.2 Quantitative Disclosures (Continued)

Individual impairment - sector wise analysis

Specific Provision - Sector wise		
	2014 Rs.'000	2013 Rs.'000
Manufacturing	**607,478**	1,011,368
Traders	**64,312**	197,295
Construction	**208,203**	251,946
Financial & Business Services	**39,042**	35,579
Retail Banking	**-**	68,525
Others	**31,602**	-
Total	**950,637**	1,564,713

AS AT 31st DECEMBER

39 Financial Risk Management (Continued)

39.2 Credit Risk (Continued)

39.2.2 Quantitative Disclosures (Continued)

Gross Loans and Receivables - Sector wise analysis

Sector	Import bills Rs.'000	Export bills Rs.'000	Overdrafts Rs.'000	Credit card Rs.'000	Short term loans Rs.'000	Medium and long term loans Rs.'000	Mortgages Rs.'000	2014 Total Rs.'000	2013 Total Rs.'000
Agriculture & Fishing	-	3,979,541	583,325	-	303,050	239,815	-	**5,105,731**	5,349,301
Manufacturing	12,471,881	6,898,966	3,119,731	-	21,996,764	17,554,824	-	**62,042,166**	32,790,812
Tourism	-	-	570,279	-	-	8,308,177	-	**8,878,456**	5,915,119
Transport	-	-	204,864	-	-	4,771,569	-	**4,976,433**	10,125,122
Construction	236,592	-	107,209	-	-	2,469,831	2,585,740	**5,399,372**	3,458,526
Traders	1,948,558	17,974,430	498,613	-	954,467	1,597,088	-	**22,973,156**	20,837,706
New Economy	713,448	-	725,625	-	-	12,912,429	-	**14,351,502**	1,794,976
Financial and Business Services	237,829	3,401	192,964	-	2,050,539	2,621,158	-	**5,105,891**	7,309,344
Infrastructure	130,663	-	318,154	-	-	452,520	-	**901,337**	3,491,065
Other Services	107,612	2,758	509,612	-	-	1,834,915	-	**2,454,897**	2,853,361
Credit card	-	-	-	19,704,899	-	-	-	**19,704,899**	19,987,344
Other	-	-	5,039,706	-	-	14,180,282	-	**19,219,988**	17,453,506
Total	**15,846,583**	**28,859,096**	**11,870,082**	**19,704,899**	**25,304,820**	**66,942,608**	**2,585,740**	**171,113,828**	131,366,182

AS AT 31st DECEMBER

39 Financial Risk Management (Continued)

39.2 Credit Risk (Continued)

39.2.2 Quantitative Disclosures (Continued)

Total Gross Loans and receivables including acceptances - Residual Contractual Maturity

	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	2014 Total Rs.'000	2013 Total Rs.'000
Overdrafts	11,870,082	-	-	-	-	-	-	-	**11,870,082**	15,735,932
Term Lending	3,842,120	9,553,241	30,344,838	1,990,558	2,327,100	39,748,887	36,941,041	5,286,584	**130,034,369**	83,604,430
Non-Eligible Bills	775,946	727,899	1,493,070	518,747	-	-	-	-	**3,515,663**	4,628,274
Money Market Term Placements	837,376	1,560,100	1,005,600	-	-	-	-	-	**3,403,076**	5,146,221
Credit Card Advances	19,704,899	-	-	-	-	-	-	-	**19,704,899**	19,987,344
Mortgages	430,715	99	9,853	2,071	22,211	93,456	145,437	1,881,898	**2,585,740**	2,263,980
Total Gross Loans and Receivables	**37,461,138**	**11,841,339**	**32,853,361**	**2,511,376**	**2,349,311**	**39,842,343**	**37,086,478**	**7,168,482**	**171,113,828**	131,366,182
Acceptances	698,380	2,884,685	5,040,998	3,444,527	1,415,194	1,107,152	-	128,166	**14,719,102**	12,761,161
Total	**38,159,518**	**14,726,024**	**37,894,359**	**5,955,903**	**3,764,505**	**40,949,495**	**37,086,478**	**7,296,648**	**185,832,930**	144,127,343

AS AT 31st DECEMBER

39 Financial Risk Management (Continued)

39.2 Credit Risk (Continued)

39.2.2 Quantitative Disclosures (Continued)

Distribution of financial instruments by credit quality

	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	2014 Total Rs.'000	2013 Total Rs.'000
Cash and cash equivalents	1,222,493	15,947,885	-	-	-	-	-	**17,170,378**	9,471,769
Balances with central banks	6,845,170	-	-	-	-	-	-	**6,845,170**	8,045,947
Placements with banks	-	15,444,288	-	-	-	-	-	**15,444,288**	5,636,400
Derivative financial instruments	257,304	705,293	178,022	-	-	-	-	**1,140,619**	2,983,392
Other financial assets held-for-trading	1,722,700	-	-	-	-	-	-	**1,722,700**	11,995,713
Loans and receivables from banks	25,000,000	1,321,100	-	-	-	-	-	**26,321,100**	30,559,850
Loans and receivables from other customers	1,675,187	12,622,247	143,029,788	6,109,484	5,019,935	2,657,187	(2,178,887)	**168,934,941**	129,012,751
Financial investments	142,316,265	-	-	-	-	-	-	**142,316,265**	107,011,206
Acceptances	-	170,686	11,088,302	2,665,539	775,680	18,895	-	**14,719,102**	12,761,161
Total	**179,039,119**	**46,211,499**	**154,296,112**	**8,775,023**	**5,795,615**	**2,676,082**	**(2,178,887)**	**394,614,563**	317,478,189

AS AT 31st DECEMBER

39 Financial Risk Management (Continued)

39.2 Credit Risk (Continued)

39.2.2 Quantitative Disclosures (Continued)

Ageing analysis of days past due but not impaired

Year	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	More than 5 Years Rs.'000	Total Rs.'000
2014	**1,223,548**	**934**	**1,030**	**12,816**	**27,879**	**1,820,233**	**1,503,122**	**430,371**	**5,019,933**
2013	-	12,174,834	1,119,539	1,645	-	-	-	-	13,296,018

Collateral held and other credit enhancements, and their financial effect

Description	2014		2013	
	Carrying Amount Rs.'000	Collateral Value Rs.'000	Carrying Amount Rs.'000	Collateral Value Rs.'000
Loans and receivable from banks	**26,321,100**	**-**	30,559,850	-
Loans and receivable from other customers	**168,934,941**	**62,422,492**	129,012,751	54,595,734

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 internal metrics including stressed operational cash flow projections, coverage ratio and advances to core funding ratios;
- **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 CBSL unless this represents routine established business as usual market practice.

AS AT 31st DECEMBER

39 Financial Risk Management (Continued)

39.3 Liquidity Risk (Continued)

39.3.1 Management of liquidity and funding risk

HSBC's liquidity and funding risk management framework ('LFRF') employs two key measures to define, monitor and control the liquidity and funding risk of each of its operating entities. The advances to core funding ratio is used to monitor the structural long-term funding position, and the stressed cash flow projection, incorporating Group-defined stress scenarios, is used to monitor the resilience to severe liquidity stresses.

The advances to core funding ratio (ACF) and Stressed cash flow project (OCP) are monitored on a daily by the local management team, with monthly monitoring carried out by the Regional Office.

Advances to core funding ratio
Core funding represents the core component of customer deposits and any term professional funding with a residual contractual maturity beyond one year. Capital is excluded from our definition of core funding.

Stressed cash flow projection
HSBC monitors stressed cash inflows as against stressed cash outflows over both one-month and three-month time horizons, under Group specified and locally defined scenarios. The Branch is required to maintain a positive variance out to three months. Inflows included are generated from liquid assets net of assumed haircuts, and cash inflows related to assets contractually maturing within the time period.

In general, customer advances are assumed to be renewed and as a result do not generate a cash inflow.

AS AT 31st DECEMBER

39 Financial Risk Management (Continued)

39.3 Liquidity Risk (Continued)

39.3.2 Quantitative Disclosures

A maturity analysis of financial liabilities

	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	More than 5 Years Rs'000	2014 Total Rs'000	2013 Total Rs'000
Due to banks	24,795,305	16,603,750	38,179,790	11,889,900	35,141,260	22,590,810	-	-	**149,200,815**	97,620,005
Derivative financial instruments	66,294	1,395	41,564	12,860	75,195	224,720	75,583	112,485	**609,806**	4,088,096
Due to other customers	90,452,482	15,526,605	22,268,594	15,829,364	20,134,405	8,586,710	3,548,600	-	**176,346,760**	154,946,963
Acceptances	698,380	2,884,685	5,040,998	3,444,527	1,415,194	1,107,152	-	128,166	**14,719,102**	12,761,161
Total	**116,012,461**	**35,016,435**	**65,531,036**	**31,176,471**	**56,766,054**	**32,509,392**	**3,623,983**	**240,561**	**340,876,483**	269,416,225

AS AT 31st DECEMBER

39 Financial Risk Management (Continued)

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 our income or the value of Branch's portfolios.

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 asset 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 we 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 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.

AS AT 31st DECEMBER

39 Financial Risk Management (Continued)

39.4 Market Risk (Continued)

39.4.2 Risk Management (Continued)

Both the VAR and Stressed VAR models 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-modeled items such as fees and commissions, against the corresponding VAR numbers.

AS AT 31st DECEMBER

39 Risk Management Structure (Continued)

39.4 Market Risk (Continued)

Foreign Currency Exposures

Currency	2014 USD '000	2013 USD '000
CHF	**(10.65)**	(26.56)
EUR	**16.30**	(96.88)
GBP	**(69.02)**	(107.82)
HKD	**106.01**	261.77
JPY	**(42.16)**	21.95
USD	**10,343.21**	379.35
AUD	**17.82**	9.91
LKR	**(10,498.89)**	(467.06)
CAD	**34.21**	14.08
DKK	**10.83**	4.17
CNY	**(10.96)**	7.90
MYR	**9.16**	10.26
NOK	**-**	0.47
NZD	**(1.04)**	(14.94)
SEK	**43.59**	(19.58)
SGD	**(1.46)**	(0.53)
THB	**7.51**	6.43
ZAR	**-**	(0.00)
AED	**45.47**	17.08

Sensitivity of reported reserves to Interest rate movements

AFS Reserves (Currency Wise)	31/12/2014			31/12/2013		
	Month end balance Rs'000	+100 bps Rs'000	-100 bps Rs'000	Month end balance Rs'000	+100 bps Rs'000	-100 bps Rs'000
USD	(324)	(838)	838	(1,817)	(555)	555
LKR	34,733	(9,253)	9,253	23,369	(9,812)	9,812
AFS Total	**34,409**	**(10,094)**	**10,094**	**21,552**	**(10,367)**	**10,367**

39 Risk Management Structure (Continued)

39.4 Market Risk (Continued)

NII Sensitivity Calculations

The Branch has two standard scenarios; the parallel movement in the yield curve by +/-100 bps (the 100bps bullet scenario) and the +/-100bps ramp scenario, whereby rates are assumed to rise/fall in parallel by 25bps on the first day of each quarter.

The interest rate sensitivity of the Trading book and the rest of the Branch must be separately analyzed. The split should take account of internal transfer pricing deals and is important for management analysis and reporting.

The sensitivity calculations should reflect the sites' best estimates of the future movements in NII under the prescribed scenarios.

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39 Risk Management Structure (Continued)

39.4 Market Risk (Continued)

Interest rate sensitivity analysis

USD'000	Retail Banking Rs'000	Corporate Banking Rs'000	Global Banking Rs'000	Total Retail and Commercial Banking Rs'000	ALCO Pool Rs'000	Treasury /Global Markets Rs'000	Total Rs'000
Projected NII of the next twelve months	**40,652**	**23,049**	**27,918**	**91,619**	**24,458**	**10,868**	**126,945**
Incremental NII of the next twelve months							
Parallel Movements in Yield Curve							
+100 bps	(1,172)	1,429	2,569	2,826	1,963	5,319	1,563
- 100 bps	711	(1,681)	(2,840)	(3,810)	(1,478)	(2,283)	(7,571)
Ramp Movements in Yield Curve*							
+100 bps	(735)	837	1,681	1,783	1,195	1,026	4,004
- 100 bps	504	(938)	(1,817)	(2,251)	(899)	(1,547)	(4,698)
Base Case	**48,166**	**24,671**	**42,364**	**115,201**	**46,897**	**(2,636)**	**159,462**
With +100 bps in 1st year	47,021	26,491	47,109	120,621	50,492	(5,090)	166,024
Difference	**(1,144)**	**1,820**	**4,745**	**5,420**	**3,595**	**(2,454)**	**6,561**
With -100 bps in 1st year	48,639	22,616	37,370	108,625	44,678	(1,914)	151,389
Difference	**473**	**(2,055)**	**(4,995)**	**(6,576)**	**(2,219)**	**721**	**(8,074)**

* Rates are assumed to rise / fall in parallel by 25bps on the first day of each quarter.

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39 Risk Management Structure (Continued)

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 Committee, meets 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 fulfill these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

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 Group level, all Group companies are required to report individual losses in excess of a particular threshold.

39 Financial Risk Management (Continued)

39.5 Operational Risk (Continued)

39.5.1 Capital Management

Qualitative disclosures

The Bank'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, 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 Bank. 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)	**2014**	2013
	Rs'000	Rs'000
Assigned Capital	**3,152,358**	3,152,358
Statutory Reserve Fund	**1,940,003**	1,790,585
Published Retained Profits	**33,732,702**	32,003,444
General and Other Reserves	**7,568,046**	4,740,064
Total qualifying tier 1 capital prior to deductions	**46,393,109**	41,686,451
Deductions to tier 1 capital	**(153,104)**	1,863,163
Net deferred tax assets	**-**	-
Amounts due to head office and branches outside Sri Lanka in Sri Lanka Rupees (-)	**(153,104)**	(186,295)
Amounts due from head office and branches outside Sri Lanka in Foreign Currency (Net)		2,049,458
Tier 1 Capital	**46,546,213**	39,823,288
Components of tier 2 capital		
Revaluation Reserves (as approved by CBSL)	**356,917**	356,917
General Provisions*	**-**	-
Total qualifying tier 2 capital prior to deductions	**356,917**	356,917
Tier 3 capital	**-**	-
Total capital	**46,903,130**	40,180,205

* Note: As per the LKAS 32/39 which came into effect on 1 January 2012, instructs to exclude general provision from accounts, hence Tier 2 general provision is zero.

39 Financial Risk Management (Continued)

39.5 Operational Risk (Continued)

39.5.1 Capital Management(Continued)

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. In the matter of capital planning, the Branch relies on the monthly stress testing carried out in form of the Economic Value of Equity (EVE) calculation, to evaluate capital adequacy. An annual stress testing on credit risk is also carried out to establish the relevant impact on capital.

The Branch maintains records of Risk Weighted Assets (RWA) based on both the local regulatory requirement as set out by CBSL as well as on the basis set out by the Prudential Regulatory Authority (PRA) of the United Kingdom. Growth of the balance sheet is subject to RWA limits on the PRA basis, which are set and monitored by the Regional Office. Assets, Liabilities and Capital Management (ALCM) monitors growth against these limits and works closely with the Businesses to ensure that any increased growth meets with the expected returns on such growth.

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)	**2014**	2013
	Rs.'000	Rs.'000
Credit risk	**158,479,122**	137,621,446
Market risk	**10,647,430**	8,665,665
Operational risk	**33,765,813**	31,042,239
Total risk-weighted assets	**202,892,365**	177,329,350
Capital ratios (Audited)		
Tier 1 ratio	**22.94%**	22.46%
Total capital ratio	**23.12%**	22.66%

39.5.2 Exposure to Stock Market (Un-audited)

In terms of the Central Branch of Sri Lanka Direction no 03 of 2011 on "Exposure to Stock Market", the following are outstanding exposures as at the reporting date:

	2014	2013
	Rs. '000	Rs. '000
On Balance sheet exposure	**117,086**	805,252
Off Balance sheet exposure	**Nil**	Nil

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

AS AT 31ST 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	17,170,378	17,170,378
Balances with Central Bank	6,845,170	6,845,170
Placements with banks	15,444,288	15,444,288
Loans and receivables to banks	26,321,100	26,321,100
Loans and receivables to other customers	168,934,941	175,231,566
Acceptances and endorsements	14,719,102	14,719,102
Liabilities		
Due to banks	149,200,815	149,200,815
Due to customers	176,346,760	176,346,760
Acceptances and endorsements	14,719,102	14,719,102

Note:
The above list of financial instruments excluding “Loans and receivables to other customers” whose carrying amount is reasonable approximation of fair value because, for example, they are short term in nature or re-price to current market rates frequently.

The following table sets out the fair values of financial instruments not carried at fair value and analyses them by the level in the fair value hierarchy into which each fair value measurement is categorised.

Assets	Carrying Value Rs'000	Level 1 Rs'000	Level 2 Rs'000	Level 3 Rs'000
Cash and Cash Equivalents	17,170,378	-	17,170,378	-
Balances with Central Bank	6,845,170	-	6,845,170	-
Placements with banks	15,444,288	-	15,444,288	-
Loans and receivables from banks	26,321,100	-	-	26,321,100
Loans and receivables from other customers	168,934,941	-	-	175,231,566
Acceptances and endorsements	14,719,102	-	-	14,719,102
Liabilities				
Due to banks	149,200,815	-	-	149,200,815
Due to customers	176,346,760	-	-	176,346,760
Acceptances and endorsements	14,719,102	-	-	14,719,102

AS AT 31ST DECEMBER

40 Fair value of Financial Assets and Liabilities (Continued)

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 31st December 2014	**Level 1 Rs'000**	**Level 2 Rs'000**	**Level 3 Rs'000**
Assets			
Other Financial assets held-for-trading	**-**	**1,722,700**	**-**
Derivative financial instruments	**1,172**	**1,026,503**	**112,944**
Financial investments : Available-for-sale	**-**	**142,316,265**	**-**
	1,172	**145,065,468**	**112,944**
Liabilities			
Derivatives	**4,061**	**492,027**	**113,718**
	4,061	**492,027**	**113,718**
As at 31st December 2013			
Assets			
Other Financial assets held-for-trading	-	11,995,713	-
Derivative financial instruments	5,485	2,927,935	49,973
Financial investments : Available-for-sale	-	107,011,206	-
	5,485	121,934,853	49,973
Liabilities			
Derivative financial instruments	4,260	3,949,222	134,614
	4,260	3,949,222	134,614

AS AT 31ST DECEMBER

40 Fair value of Financial Assets and Liabilities (Continued)

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

40.2.1 Fair Value Hierarchy (Continued)

Movement in Level 3 financial instruments	2014	
	Assets	Liabilities
	Rs'000	Rs'000
As at 1st January	49,973	134,614
Total gains/(losses) recognised in profit or loss	67,890	(20,896)
Settlements	(4,919)	-
As at 31st December	**112,944**	**113,718**

	2013	
	Assets	Liabilities
	Rs'000	Rs'000
As at 1st January	321,948	145,210
Total gains/(losses) recognised in profit or loss	16,353	185,764
Settlements	(288,327)	(196,361)
As at 31st December	**49,973**	**134,614**

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;

40 Fair value of Financial Assets and Liabilities (Continued)

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

40.2.2 Valuation of financial instruments (Continued)

• 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. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's inception profit or greater than 5% of the instrument's valuation is driven by unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur.

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.