THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED SRI LANKA BRANCH

FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH

FOR THE YEAR ENDED 31 DECEMBER 2020

CONTENTS

Independent auditor's report

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

Report on the audit of the financial statements

Our opinion

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Hongkong and Shanghai Banking Corporation Limited Sri Lanka Branch ("the Branch") as at 31 December 2020, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

What we have audited

The financial statements of the Branch, which comprise:

- the statement of financial position as at 31 December 2020;
- income statement and the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Basis for opinion

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

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

Independence

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

Other information

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

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

PricewaterhouseCoopers, P. O. Box 918, 100 Braybrooke Place, Colombo 2, Sri Lanka
T: +94 (11) 771 9700, 771 9838, F: +94 (11) 230 3197, www.pwc.com/lk

Other information (Contd.)

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

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

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

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

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

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

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Branch's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Branch's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Branch to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

[Signed]

CHARTERED ACCOUNTANTS

COLOMBO

19 March 2021

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

FOR THE YEAR ENDED 31 DECEMBER	Note	2020 Rs.'000	2019 Rs.'000
Interest income		**25,672,774**	31,074,853
Interest expenses		**(9,000,911)**	(12,441,140)
Net interest income	**6**	**16,671,863**	18,633,713
Fee and commission income		**3,169,313**	4,232,795
Fee and commission expenses		**(1,004,341)**	(1,279,789)
Net fee and commission income	**7**	**2,164,972**	2,953,006
Net gain from trading	**8**	**1,092,253**	1,366,859
Net fair value gains from financial instruments at fair value thorugh profit or loss	**9**	**748,023**	379,949
Other operating income (net)	**10**	**48,780**	42,621
Total operating income		**20,725,891**	23,376,148
Impairment charge for loans and other losses	**11**	**(3,581,277)**	(810,477)
Net operating income		**17,144,614**	22,565,671
Personnel expenses	**12**	**(3,904,434)**	(4,018,889)
Other expenses	**13**	**(8,568,472)**	(7,441,720)
Operating profit before Value Added Tax, Nation Building Tax and Other Taxes on Financials Services		**4,671,708**	11,105,062
Value Added Tax, Nation Building Tax and Other Taxes on Financial Services	**14.4**	**(846,736)**	(2,779,483)
Profit before tax		**3,824,972**	8,325,579
Income tax expense	**14.1**	**(1,437,432)**	(2,081,999)
Profit for the year		**2,387,540**	6,243,580

Figures in brackets indicate deductions.

The financial statements are to be read in conjunction with the related notes as set out on pages 9 to 87, which form an integral part of the financial statements of the Branch. The Report of the Auditors is given on pages 1 to 3.

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

FOR THE YEAR ENDED 31 DECEMBER	Note	2020	2019
		Rs.'000	Rs.'000
Profit for the year		**2,387,540**	6,243,580
Other comprehensive income / (expenses)			
Items that may be reclassified to profit or loss in subsequent periods			
Net (losses) / gains on investments in debt instruments measured at fair value through other comprehensive income		**(659,980)**	1,325,096
Gains / (losses) from the financial statements of foreign currency operation		**1,413,753**	(187,900)
Tax related to above		**186,500**	(371,027)
Net other comprehensive income that may be reclassified to profit or loss in subsequent periods		**940,273**	766,169
Items that may not be reclassified to profit or loss in subsequent periods			
Remeasurement of post-employment benefit obligations		**(242,073)**	(124,714)
Gains / (losses) on revaluation of land and buildings		**50,989**	(126,228)
Tax related to above		**99,426**	72,366
Net other comprehensive loss that may not be reclassified to profit or loss in subsequent periods		**(91,658)**	(178,576)
Net other comprehensive income		**848,615**	587,593
Total comprehensive income for the year		**3,236,155**	6,831,173

Figures in brackets indicate deductions.

The financial statements are to be read in conjunction with the related notes as set out on pages 9 to 87, which form an integral part of the financial statements of the Branch. The Report of the Auditors is given on pages 1 to 3.

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

AS AT 31 DECEMBER	Note	2020	2019
		Rs.'000	Rs.'000
ASSETS			
Cash and cash equivalents	16	20,411,976	33,986,285
Balances with the Central Bank of Sri Lanka	17	18,453,574	9,740,145
Placements with banks	18	-	27,214,500
Derivative financial instruments	19	656,466	812,121
Financial assets measured at fair value through profit or loss	20	334,968	4,751,028
Financial assets at amortised cost – Loans and advances	21	219,123,466	260,155,127
Financial assets measured at fair value through other comprehensive income	22	136,631,512	107,854,554
Financial assets at amortised cost - debt instruments	23	3,118,017	3,088,314
Property, plant and equipment	24	4,836,206	5,212,836
Deferred tax asset	25	367,616	-
Other assets	26	20,717,448	14,517,471
Total assets		**424,651,249**	467,332,381
LIABILITIES			
Due to banks	27	88,302,330	170,599,897
Derivative financial instruments	28	508,372	1,052,576
Financial liabilities at amortised cost - due to depositors	29	237,257,573	209,805,122
Retirement benefit obligations deficit	30	245,976	79,213
Current tax liabilities		125,919	357,774
Deferred tax liabilities	25	-	366,423
Other liabilities	31	27,905,922	18,445,106
Total liabilities		**354,346,092**	400,706,111
EQUITY			
Assigned capital	32	3,152,358	3,152,358
Statutory reserve fund	33	2,649,711	2,598,158
Other reserves	34	17,289,818	15,770,402
Retained earnings		47,213,270	45,105,352
Total equity		**70,305,157**	66,626,270
Total equity and liabilities		**424,651,249**	467,332,381
Contingent liabilities and commitments	37	**530,833,967**	493,621,668
Memorandum Information			
Number of employees		1,020	1,224
Number of branches		13	14

The financial statements are to be read in conjunction with the related notes as set out on pages 9 to 87, which form an integral part of the financial statements of the Branch. The Report of the Auditors is given on pages 1 to 3.

The Management is responsible for the preparation and presentation of these financial statements. The financial statements have been prepared in compliance with the requirements of the Central Bank of Sri Lanka regulations and guidelines.

Approved and signed for and on behalf of the Management.

[Signed]
...…………………………..
Mark G Prothero
Chief Executive Officer
19th March 2021
Colombo

[Signed]
……………………………
Angelo Pillai
Chief Financial Officer

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

FOR THE YEAR ENDED 31 DECEMBER 2020	Assigned Capital	Exchange Equalisation Reserve	IFA Reserve	FVOCI Reserve	SBP Reserve	Statutory Reserve Fund	Revaluation Reserve	Retained Earnings	Total Equity
	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000
Balance as at 1 January 2019	3,152,358	9,550,267	4,725,708	(263,377)	168,453	2,473,286	2,558,033	37,311,013	59,675,741
Restated balance as at 1 January 2019	3,152,358	9,550,267	4,725,708	(263,377)	168,453	2,473,286	2,558,033	37,311,013	59,675,741
Total comprehensive income for the year									
Profit for the year	-	-	-	-	-	-	-	6,243,580	6,243,580
Other comprehensive income (net of tax)	-	(187,900)	-	954,069	-	-	(90,833)	(87,743)	587,593
Total comprehensive income for the year	-	(187,900)	-	954,069	-	-	(90,833)	6,155,837	6,831,173
Transactions with non equity holders, recognised directly in equity									
Depreciation on revaluation reserve	-	-	-	-	-	-	(7,029)	7,029	-
Deferred tax on revaluation	-	-	-	-	-	-	1,917	(1,917)	-
Transactions with equity holders, recognised directly in equity									
Transfers to reserves during the year	-	-	-	-	48	124,872	-	(124,872)	48
Restricted shares	-	-	-	-	-	-	-	2,629	2,629
Transfer to IFA reserve	-	-	(1,755,633)	-	-	-	-	1,755,633	-
Impairment on FVOCI	-	-	-	116,679	-	-	-	-	116,679
Total transactions with equity holders	-	-	(1,755,633)	116,679	48	124,872	(5,112)	1,638,502	119,356
Balance as at 31 December 2019	3,152,358	9,362,367	2,970,075	807,371	168,501	2,598,158	2,462,088	45,105,352	66,626,270
Balance as at 1 January 2020	**3,152,358**	**9,362,367**	**2,970,075**	**807,371**	**168,501**	**2,598,158**	**2,462,088**	**45,105,352**	**66,626,270**
Profit for the year	-	-	-	-	-	-	-	**2,387,540**	**2,387,540**
Other comprehensive income (net of tax)	-	**1,413,753**	-	**(473,480)**	-	-	**145,953**	**(237,611)**	**848,615**
Total comprehensive income for the year	-	**1,413,753**	-	**(473,480)**	-	-	**145,953**	**2,149,929**	**3,236,155**
Transactions recognised directly in equity									
Depreciation on revaluation reserve	-	-	-	-	-	-	**(7,182)**	**7,182**	-
Deferred tax on revaluation reserve	-	-	-	-	-	-	**2,011**	**(2,011)**	-
Transactions with equity holders, recognised directly in equity									
Transfers to reserves during the year	-	-	-	-	**7,290**	**51,553**	-	**(51,553)**	**7,290**
Restricted shares	-	-	-	-	-	-	-	**4,371**	**4,371**
Impairment on FVOCI	-	-	-	**431,071**	-	-	-	-	**431,071**
Total transactions with equity holders	-	-	-	**431,071**	**7,290**	**51,553**	**(5,171)**	**(42,011)**	**442,732**
Balance as at 31 December 2020	**3,152,358**	**10,776,120**	**2,970,075**	**764,962**	**175,791**	**2,649,711**	**2,602,870**	**47,213,270**	**70,305,157**

Figures in brackets indicate deductions.

The financial statements are to be read in conjunction with the related notes as set out on pages 9 to 87, which form an integral part of the financial statements of the Branch. The Report of the Auditors is given on pages 1 to 3.

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

FOR THE YEAR ENDED 31 DECEMBER		**2020**	2019
	Note	**Rs.'000**	Rs.'000
Cash flow from operating activities			
Interest received		**26,342,990**	32,202,507
Interest paid		**(8,653,052)**	(10,628,905)
Fees and commission received		**2,164,972**	1,673,217
Net receipts from trading activities		**1,092,253**	1,366,860
Payments to employees		**(3,861,675)**	(4,004,775)
VAT and NBT on financial services		**(747,620)**	(1,649,215)
Receipts from other operating activities		**1,139,527**	723,049
Payments to other operating activities		**(7,414,784)**	(7,775,933)
Operating profit before changes in operating assets and liabilities		**10,062,611**	11,906,805
(Increase) / decrease in operating assets			
Balances with Central Bank of Sri Lanka		**(8,713,429)**	(2,407,264)
Financial assets at amortised cost - loans and advances		**54,433,451**	21,066,647
Treasury bills and bonds		**(25,040,230)**	3,708,867
Other assets		**3,283,630**	731,261
		23,963,422	23,099,511
Increase / (decrease) in operating liabilities			
Financial liabilities at amortised cost - due to depositors		**27,452,451**	3,931,798
Financial liabilities at amortised cost - due to other borrowers		**(82,297,567)**	(14,186,991)
Other liabilities		**8,157,576**	(7,186,110)
		(46,687,540)	(17,441,303)
Net cash generated from operating activities before income tax		**(12,661,507)**	17,565,013
Income tax paid		**(2,212,133)**	(4,835,077)
Net cash generated from operating activities		**(14,873,640)**	12,729,936
Cash flow from investing activities			
Proceeds from disposal of property, plant and equipment		**24,945**	336,602
Acquisition of property, plant and equipment		**(233,964)**	(531,313)
Net cash used in investing activities		**(209,019)**	(194,711)
Cash flow from financing activities			
Profit transferred to Head Office		**-**	-
Net cash used in financing activities		**-**	-
Net increase in cash and cash equivalents		**(15,082,659)**	12,535,225
Cash and cash equivalents at the beginning of period	**16**	**33,986,285**	23,502,316
Exchange difference in respect of cash and cash equivalents		**1,508,350**	(2,051,256)
Cash and cash equivalents at the end of the period	**16**	**20,411,976**	33,986,285

Figures in brackets indicate deductions.

The financial statements are to be read in conjunction with the related notes as set out on pages 9 to 87, which form an integral part of the financial statements of the Branch. The Report of the Auditors is given on pages 1 to 3.

1. CORPORATE INFORMATION

1.1 Domicile and legal form

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

1.2 Principal activities and nature of operations

The principal activities of the Branch, which is carrying out banking activities through its branches remained unchanged during the year. The primary banking services include Wholesale Banking (WSB) including Global Trade Receivable Finance (GTRF), Wealth and Personal Banking (WPB) and Global Banking and Markets (GBM).

1.3 Parent company and ultimate parent company

The immediate parent entity is the Hongkong and Shanghai Banking Corporation Limited incorporated in Hongkong and the ultimate parent entity is HSBC Holding plc. (Incorporated in Great Britain and registered in England and Wales). The ultimate parent is listed and shares are traded under the following stock markets:

- London Stock Exchange;
- Hong Kong Stock Exchange;
- New York Stock Exchange;
- Bermuda Stock Exchange; and

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This note provides a list of the significant accounting policies adopted in the preparation of these financial statements. These policies have been consistently applied in all years presented, unless otherwise stated.

2.1 Basis of preparation

2.1.1 Statement of compliance

The financial statements of the Branch which comprise the statement of financial position, income statement, statement of changes in equity, statement of cash flows and notes thereto have been prepared in accordance with relevant Sri Lanka Accounting Standards (SLFRSs and LKASs), relevant interpretations of the Standard Interpretations Committee ("SIC") and International Financial Reporting Interpretations Committee ("IFRIC"). Sri Lanka accounting standards further comprises of Statements of Recommended Practices (SORPs), Statements of Alternative Treatments (SOATs) and financial reporting guidelines issued 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.

2.1.2 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;

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD)

2.1 Basis of preparation (contd)

- Financial instruments measured at fair value through profit or loss, including derivative financial instruments;
- Financial instruments measured at fair value through other comprehensive income;
- Defined benefit obligations and the related Plan assets are measured at fair value; and
- Freehold land and buildings are measured at fair value.

2.1.3 Use of estimates and judgement

The preparation of financial statements in conformity with Sri Lanka Accounting Standards require the use of certain critical accounting estimates. It also requires the management to exercise its judgement in the process of applying the Branch's accounting policies.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period of which the estimate is revised and in any future period affected. The areas involving a higher degree of judgement or complexity, or areas where assumptions are significant to the Branch financial statements are disclosed in note 4.

2.1.4 Changes in accounting standards

The following amendments to the Sri Lanka accounting standards that are relevant for the preparation of financial statements have been adopted by the Branch, (a) new standards and amendments that are effective for the first time for periods commencing on or after 1 January 2020 (i.e. years ending 31 December 2020) and (b) forthcoming requirements, being standards and amendments that will become effective on or after 1 January 2021.

(a) New accounting standards, amendments and interpretations – applicable 1 January 2020

The Branch has applied the following standards and amendments for the first time for their financial reporting periods commencing 1 January 2020:

i. Definition of Material – Amendments to LKAS 1 and LKAS 8 ;
ii. Definition of a Business – Amendments to SLFRS 3;
iii. Revised Conceptual Framework for Financial Reporting; and
iv. COVID19-related Rent Concessions – Amendments to SLFRS 16.

Most of the amendments listed above did not have any impact on the amounts recognised in prior periods and are not expected to significantly affect the current or future periods.

(i) Definition of material – Amendments to LKAS 1 and LKAS 8

The amendments to LKAS 1 Presentation of Financial Statements and LKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors which use a consistent definition of materiality throughout Sri Lanka Financial Reporting Standards and the Conceptual Framework for Financial Reporting, clarify when information is material and incorporate some of the guidance in LKAS 1 about immaterial information.

In particular, the amendments clarify:

a) that the reference to obscuring information addresses situations in which the effect is similar to omitting or misstating that information, and that an entity assesses materiality in the context of the financial statements as a whole, and

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD)

2.1 Basis of preparation (contd)

2.1.4 Changes in accounting standards (contd)

(a) New accounting standards, amendments and interpretations – applicable 1 January 2020

(i) Definition of material – Amendments to LKAS 1 and LKAS 8 (contd)

b) the meaning of ‘primary users of general-purpose financial statements’ to whom those financial statements are directed, by defining them as ‘existing and potential investors, lenders and other creditors’ that must rely on general purpose financial statements for much of the financial information they need.

This amendment is effective for the annual periods beginning on or after 1 January 2020.

(ii) Definition of a business –Amendments to SLFRS 3

The amended definition of a business requires an acquisition to include an input and a substantive process that together significantly contribute to the ability to create outputs. The definition of the term ‘outputs’ is amended to focus on goods and services provided to customers, generating investment income and other income, and it excludes returns in the form of lower costs and other economic benefits. The amendments will likely result in more acquisitions being accounted for as asset acquisitions.

This amendment is effective for the annual periods beginning on or after 1 January 2020.

(iii) Revised conceptual framework for financial reporting

The revised Conceptual Framework which will be used in standard-setting decisions with immediate effect. Key changes include:

- increasing the prominence of stewardship in the objective of financial reporting;
- reinstating prudence as a component of neutrality;
- defining a reporting entity, which may be a legal entity, or a portion of an entity revising the definitions of an asset and a liability;
- removing the probability threshold for recognition and adding guidance on derecognition adding guidance on different measurement basis; and
- stating that profit or loss is the primary performance indicator and that, in principle, income and expenses in other comprehensive income should be recycled where this enhances the relevance or faithful representation of the financial statements.

No changes will be made to any of the current accounting standards. However, entities that rely on the Framework in determining their accounting policies for transactions, events or conditions that are not otherwise dealt with under the accounting standards will need to apply the revised Framework from 1 January 2020. These entities will need to consider whether their accounting policies are still appropriate under the revised Framework.

This amendment is effective for the annual periods beginning on or after 1 January 2020.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD)

2.1 Basis of preparation (contd)

2.1.4 Changes in accounting standards (contd)

(iv) COVID19-related rent concessions – Amendments to SLFRS 16

As a result of the COVID19 pandemic, rent concessions have been granted to lessees. Such concessions might take a variety of forms, including payment holidays and deferral of lease payments. According to the amendment to SLFRS 16 Leases which provides lessees with an option to treat qualifying rent concessions in the same way as they would if they were not lease modifications. In many cases, this will result in accounting for the concessions as variable lease payments in the period in which they are granted.

Entities applying the practical expedients must disclose this fact, whether the expedient has been applied to all qualifying rent concessions or, if not, information about the nature of the contracts to which it has been applied, as well as the amount recognised in profit or loss arising from the rent concessions.

This amendment is effective for the annual periods beginning on or after 1 June 2020.

(b) New standards and amendments but not adopted in 2020

The following standards and interpretations had been issued by IASB but not mandatory for annual reporting periods ending 31 December 2020.

(i) Classification of liabilities as current or non-current – Amendments to IAS 1

The narrow-scope amendments to IAS 1 Presentation of Financial Statements clarify that liabilities are classified as either current or non-current, depending on the rights that exist at the end of the reporting period. Classification is unaffected by the expectations of the entity or events after the reporting date (eg the receipt of a waver or a breach of covenant). The amendments also clarify what IAS 1 means when it refers to the ‘settlement’ of a liability.

The amendments could affect the classification of liabilities, particularly for entities that previously considered management’s intentions to determine classification and for some liabilities that can be converted into equity.

They must be applied retrospectively in accordance with the normal requirements in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

In May 2020, the IASB issued an Exposure Draft proposing to defer the effective date of the amendments to 1 January 2023.

(ii) Property, plant and equipment: proceeds before intended use – Amendments to IAS 16

The amendment to IAS 16 Property, Plant and Equipment (PP&E) prohibits an entity from deducting from the cost of an item of PP&E any proceeds received from selling items produced while the entity is preparing the asset for its intended use. It also clarifies that an entity is ‘testing whether the asset is functioning properly’ when it assesses the technical and physical performance of the asset. The financial performance of the asset is not relevant to this assessment. Entities must disclose separately the amounts of proceeds and costs relating to items produced that are not an output of the entity’s ordinary activities.

This amendment is effective for the annual periods beginning on or after 1 January 2022.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD)

2.1 Basis of preparation (contd)

2.1.4 Changes in accounting standards (contd)

(iii) Reference to the conceptual framework – Amendments to IFRS 3

Minor amendments were made to IFRS 3 Business Combinations to update the references to the Conceptual Framework for Financial Reporting and add an exception for the recognition of liabilities and contingent liabilities within the scope of IAS 37 Provisions, Contingent Liabilities and Contingent Assets and Interpretation 21 Levies. The amendments also confirm that contingent assets should not be recognised at the acquisition date.

This amendment is effective for the annual periods beginning on or after 1 January 2022.

The following improvements were finalised in May 2020:

- IFRS 9 Financial Instruments – clarifies which fees should be included in the 10% test for derecognition of financial liabilities.; and
- IFRS 16 Leases – amendment of illustrative example 13 to remove the illustration of payments from the lessor relating to leasehold improvements, to remove any confusion about the treatment of lease incentives..

This amendment is effective for the annual periods beginning on or after 1 January 2022.

2.1.5 Rounding of amounts

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

3. SIGNIFICANT ACCOUNTING POLICIES

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

3.1 Foreign currency translation

(i) Functional and presentation currency

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

(ii) Transactions and balances

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.1 Foreign currency translation (contd)

(ii) Transactions and balances (contd)

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

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

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

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

3.2 Revenue recognition

(i) Interest

Interest income and expense is recognised in income statement using the effective interest rate (EIR) 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 income statement include interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis.

(ii) 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. Other fees and commissions are recognised in the period in which the services are rendered. The fees and commissions for services relating to periods after the reporting date is deferred in the statement of financial position.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.2 Revenue recognition (contd)

(ii) Fees and commissions (contd)

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

The following table provides information about the nature and timing of the satisfaction of performance obligations in contract with customers, including significant payment terms, and the related revenue recognition policies.

Type of service	Nature and timing of satisfaction of performance obligations including significant payment terms	Revenue recognition under SLFRS 15
WPB and WSB Services	The Bank provides banking services to WPB and WSB customers, including account management, provision of overdraft facilities, foreign currency transactions and servicing fees. Fees for ongoing account management are charged to the customer's account on a monthly basis. The Bank sets the rates separately for WPB and WSB customers in each jurisdiction on annual basis. Transactions based fees for interchange, foreign currency transactions and overdrafts are charged to the customer's account when the transaction takes place. Servicing fees are charged on a monthly basis and are based on fixed rates reviewed annually by the Bank.	Revenue from account servicing is recognised overtime as the services provided. Revenue related to transactions are recognised at the point in time when the transaction takes place.

3.3 Taxation

Current tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amounts are those that are enacted or substantively enacted, at the reporting date in the country of operation. Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate. Current tax assets and Current tax liabilities are offset, if a legally enforceable right exists to set off and when the Current taxes relate to the same taxable entity and payable to the same taxation authority. Management has used its judgment on the application of tax laws including transfer pricing regulations involving identification of associated undertakings, estimation of the respective arm's length price and selection of appropriate pricing mechanisms. The bank has complied with the arm's length principles relating to transfer pricing as prescribed in the Inland Revenue Act.

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.3 Taxation (contd)

Deferred tax

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

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

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

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

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

3.4 Leases

The Company recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove any improvements made to branches or office premises.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company’s incremental borrowing rate. Generally, the Company uses its incremental borrowing rate as the discount rate.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.5 Financial assets and financial liabilities

3.5.1 Classification

The branch classifies its financial assets in the following measurement categories;

- Those to be measured subsequently at fair value (either through other comprehensive income (OCI) or profit or loss) ;
- Those to be measured at amortised cost.

The classification depends on the Branch's business model for managing the financial assets and the contractual terms on the cash flows. For assets measured at fair value, gains or losses will either be recorded in the profit or loss or OCI. The Branch reclassifies debt instruments only when its business model for managing those assets changes.

3.5.2 Recognition and de-recognition

Regular way purchases and sales of financial assets are recognised on trade date, being the date on which the Branch commits to purchase or sell the asset.

Derecognition - financial assets

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

Derecognition - financial liabilities

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

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

3.5.3 Measurement

All financial instruments are initially recognised at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, if there is a difference between the transaction price and the fair value of financial instruments whose fair value is based on a quoted price in an active market or a valuation technique that uses only data from observable markets, the branch recognises the difference as a trading gain or loss at inception (a 'day 1 gain or loss'). In case the market data is not observable, the entire day 1 gain or loss is deferred, subject to thresholds, and income is recognized when the market data becomes observable when the tenor reduces.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.5 Financial assets and financial liabilities (contd)

3.5.3 Measurement (contd)

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

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

3.5.3.1 Financial instruments measured at amortised cost

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

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

The branch may commit to underwriting loans on fixed contractual terms for specified periods of time. When the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative. When the branch intends to hold the loan, the loan commitment is included in the impairment calculations (Refer note 04).

3.5.3.2 Non-trading reverse repurchase, repurchase and similar agreements

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.5 Financial assets and financial liabilities (contd)

3.5.3.2 Non-trading reverse repurchase, repurchase and similar agreements (contd)

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

3.5.3.3 Financial assets measured at fair value through other comprehensive income

Financial assets held for a business model that is achieved by both collecting contractual cash flows and selling and which contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest are measured at fair value through other comprehensive income (‘FVOCI’). These comprise primarily debt securities. They are recognised on the trade date when HSBC enters into contractual arrangements to purchase and are normally derecognised when they are either sold or redeemed. They are subsequently remeasured at fair value and changes therein (except for those relating to impairment, interest income and foreign currency exchange gains and losses) are recognised in other comprehensive income until the assets are sold. Upon disposal, the cumulative gains or losses in other comprehensive income are recognised in the income statement as ‘Gains or losses’ from financial instruments. Financial assets measured at FVOCI are included in the impairment calculations set out below in note 22.2 and impairment is recognised through Fair Value through Other Comprehensive Income (FVOCI) reserve.

3.5.3.4 Financial instruments designated at fair value through profit or loss

Financial instruments, which are held as part of held for trading category get designated at Fair value through P&L. Currently these instruments are LKR denominated T-bills and Government bonds held by Global Markets business for market making. These instruments get revalued on a daily basis based on the market levels observed for the instruments. The mark to market movement will then flow through profit or loss.

3.5.3.5 Derivatives

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, interest rates or other indices. Derivatives are recognized initially and are subsequently measured at fair value through profit or loss. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative.

3.5.3.6 Equity instruments

The branch subsequently measures all the equity instruments at fair value, where the Branch’s management has elected to present fair value gains and losses on equity investments in OCI, there is no subsequent reclassification at fair value gains and losses to income statement following the derecognition of the investment. Dividends from such investments continue to be recognised in income statement as other income when the Branch’s right to receive is established. Changes in the fair value of financial assets at FVPL are recognised in other gains or losses in the income statement as applicable. Impairment losses (and reversal of impairment losses) on equity investments measured at FVOCI are not reported separately from other changes in fair value.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.5 Financial assets and financial liabilities (contd)

3.5.3.7 Assigned capital

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

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

3.6 Assets and bases of their valuation

Property, plant and equipment

Initial measurement

The property, plant and equipment are recorded at cost or revaluation. The cost of property, plant and equipment is the cost of purchase or construction together with any incidental expenses thereon and valuation is carried out once a year for land and building by an independent valuer. The property, plant and equipment are stated at cost or valuation (land, freehold buildings and improvements to buildings are carried at revalued amounts) less accumulated depreciation, which is provided for on the bases specified below and impairment losses. All property and equipment costing less than USD 500 and maintenance and repairs to machinery are charged to the income statement. All major renovations and renewals are capitalised.

Depreciation

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

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

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

Depreciation is charged on monthly basis from the date of acquisition throughout its useful life.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.6 Assets and bases of their valuation (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 non-financial assets

Non-financial assets consist of property, plant and equipment, software and right-of-use assets. They are tested for impairment at the individual asset level when there is indication of impairment at that level, or at the CGU level for assets that do not have a recoverable amount at the individual asset level. In addition, impairment is also tested at the CGU level when there is indication of impairment at that level. For this purpose, CGU is considered as the smallest cash generating unit level (CGU) which is the customer group level as defined by the HSBC group. Impairment testing compares the carrying amount of the non-financial asset or CGU with its recoverable amount, which is the higher of the fair value less costs of disposal or the value in use.

When the recoverable amount of a CGU is less than its carrying amount, an impairment loss is recognised in the income statement to the extent that the impairment can be allocated on a pro-rata basis to the non-financial assets by reducing their carrying amounts to the higher of their respective individual recoverable amount or nil. Impairment is not allocated to the financial assets in a CGU. Impairment loss recognised in prior periods for non-financial assets is reversed when there has been a change in the estimate used to determine the recoverable amount.

VIU impairment assessment was carried out for the non-financial assets held by HSBC Sri Lanka and was concluded as NIL impairment requirement for 2020.

3.7 Export bills negotiated and discounted

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

3.8 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. Cash and cash equivalents include notes and coins on hand, unrestricted balances held with central bank, and highly liquid financial assets with original maturities of three months or less from the date of the acquisition that are subject to and insignificant risk of changes in their fair value, and are used by the bank in the management of its short term commitments.

3.9 Statutory deposits with the Central Bank of Sri Lanka

The Monetary Law Act requires that all commercial banks operating in Sri Lanka to maintain a reserve against all deposit liabilities denominated in Sri Lankan Rupees. The reserve should be maintained for an amount equal to 2% of the total of such rupee deposit liabilities.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.10 Employee share plans

Discretionary awards of shares granted under HSBC Group share plans align the interests of employees with those of shareholders.

3.10.1 Discretionary awards

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

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

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

3.11 Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting letter of credit, guarantees and acceptances. The financial guarantee liability is initially measured at fair value and subsequently at the higher of: the amount determined in accordance with the expected credit loss model under IFRS 9 Financial Instruments and; the amount initially recognised less, where appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15 Revenue from contracts with customers. Any increase in the liability relating to financial guarantee is recorded in the income statement in “impairment charge”. The premium received is recognised in the income statement in “fees and commission income” on a straight-line basis over the life of the guarantee.

3.12 Employee benefits

3.12.1 Pension fund

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

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.12 Employee benefits (contd)

3.12.1 Pension fund (contd)

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

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

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

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

3.12.2 Provident fund

The Branch contributes to the approved Provident Fund, which is maintained outside the financial statements of the Branch. This is a defined contribution plan. The Branch contributes 12% of the employees’ gross salary to this fund whilst the employees contributes 8% of the gross salary. Bank is required to apply interest at a rate or rates higher than five percentum (5%) per annum on the provident fund account. If there is any shortfall in the overall Fund income, the bank shall meet the deficit and recognize it in the Fund accounts and Member accounts.

3.12.3 Trust fund

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.13 Borrowings

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

3.14 Other payables

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

3.15 Provisions

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

3.16 Commitment and contingencies

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

3.17 Other off-balance sheet transactions

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

3.18 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 (CONTD)

3.19 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 equivalents comprise mainly of cash on 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.

3.20 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.

4 SIGNIFICANT MANAGEMENT ESTIMATES AND JUDGEMENTS

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

Critical accounting estimates and assumptions

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

Income and other taxes

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

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

Valuation of financial instruments

The best evidence of fair value is a quoted price in an actively traded principal market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. When a financial instrument has a quoted price in an active market, the fair value of the total holding of the financial instrument is calculated as the product of the number of units and the quoted price.

4. SIGNIFICANT MANAGEMENT ESTIMATES AND JUDGEMENTS (CONTD)

Valuation of financial instruments (contd)

The judgement as to whether a market is active may include, but is not restricted to, consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid / offer spreads. The bid / offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. Valuation techniques may incorporate assumptions about factors that other market participants would use in their valuations, including;

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

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

Pension benefits

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

4. SIGNIFICANT MANAGEMENT ESTIMATES AND JUDGEMENTS (CONTD)

Expected credit losses

Expected credit losses ('ECL') are recognised for loans and advances to branches and customers, non-trading reverse repurchase agreements, other financial assets held at amortised cost, debt instruments measured at FVOCI, and certain loan commitments and financial guarantee contracts. Accounting policy is described below whilst the risk management is covered under risk disclosures.

Credit impaired (stage 3)

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

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

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

Write-off

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

Renegotiation

Loans are identified as renegotiated and classified as credit impaired when we modify the contractual payment terms due to significant credit distress of the borrower. Renegotiated loans remain classified as credit impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows and retain the designation of renegotiated until maturity or de-recognition. For WPB, renegotiated loans are kept at stage 3 until full settlement

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

Other than originated credit-impaired loans, all other modified loans could be transferred out of stage 3 if they no longer exhibit any evidence of being credit impaired and, in the case of renegotiated loans, there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows over the minimum observation period, and there are no other indicators of impairment.

4. SIGNIFICANT MANAGEMENT ESTIMATES AND JUDGEMENTS (CONTD)

Renegotiation (contd)

These loans could be transferred to stage 1 or 2 based on the mechanism as described below by comparing the risk of a default occurring at the reporting date (based on the modified contractual terms) and the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms). Any amount written off as a result of the modification of contractual terms would not be reversed.

Loan modifications that are not credit impaired

Loan modifications that are not identified as renegotiated are considered to be commercial restructuring.

Significant increase in credit risk (stage 2)

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

However, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when 30 days past due and 01 day past due in Wealth and Personal Banking. In addition, Wholesale Banking loans that are individually assessed are included on a watch or worry list; are included in stage 2.

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

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

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

SIGNIFICANT MANAGEMENT ESTIMATES AND JUDGEMENTS (CONTD)

5. ACCOUNTING POLICY ON COVID19

Several programmes were launched by the Branch to assist customers who were temporarily impacted by the recent outbreak of COVID19 in Sri Lanka. The programs were also in response to guidelines issued by the Central Bank of Sri Lanka to roll out temporary relief measures to help customers during this difficult time. All relief programmes were discussed in detail with group accounting policy and conclusions made on the accounting impact is endorsed by the respective regional teams.

Key accounting related considerations are listed below;

1. P&L impact in terms of modification gain/losses
   Modifications to the contractual terms of existing loan contracts result in modification losses being taken to P&L immediately, where contractual cash flows are reduced or interest is forgiven, or deferrals are granted which do not accrue interest. Debt repayment holidays where interest is fully accrued would not result in modification losses.

   Changes that are in line with the contractual terms are not modifications, including government mandated or encouraged changes where the lender has the right to implement within the existing contractual provisions.

   For accounting purposes, we rebut the presumption that the changes and relief trigger derecognition because the relief offered is under a mandated scheme by the regulator, rather than a non-credit related renegotiation of loan terms with individual customers. The principal and interest moratorium and tenor extension do not therefore trigger derecognition of the loans.

2. Significant increase in Credit Risk
   Offers of relief such as payment holidays do not automatically, in and of themselves, result in the loans involved being moved into Stage 2 or Stage 3 for the purposes of calculating ECL. However, they cannot be ignored in the necessary assessments as they may provide relevant information about SICR or credit impairment. Different forms of relief may represent weak to strong indications of credit deterioration, and it is necessary to consider the different forms in the context of other credit information, to assess the effect on the lifetime risk of default.

   The broader assessment for SICR requires the consideration of all available reasonable and supportable information, including a requirement to consider collective assessments, where evidence of SICR at individual level is not yet available, in order to identify groups of customers at higher susceptibility of long term economic impacts. This collective assessment does not just consider reliefs, where relevant, but also other available reasonable and supportable information about lifetime risk of default.

FOR THE YEAR ENDED 31 DECEMBER

6 Net interest income

	2020	2019
	Rs.'000	Rs.'000
Interest income		
Cash and cash equivalents*	**165,111**	896,258
Balances with central bank	**304,977**	13,831
Placements with banks	**35,640**	191,683
Financial assets measured at fair value through profit or loss	**1,413,153**	711,763
Financial assets at amortised cost		
- loans and advances	**15,016,012**	20,208,556
- debt and other instruments	**318,703**	492,279
Financial assets measured at fair value through other comprehensive income	**8,419,178**	8,560,483
Total interest income	**25,672,774**	31,074,853
Interest expenses		
Due to banks	**(200,922)**	(97,192)
Financial liabilities at amortised cost		
- due to depositors	**(6,375,822)**	(7,837,689)
- due to repo holders	**-**	(310,047)
Interest expense on lease liabilities	**(59,049)**	(71,905)
Others**	**(2,365,118)**	(4,124,307)
Total interest expenses	**(9,000,911)**	(12,441,140)
	16,671,863	18,633,713

* Cash and cash equivalents include interest income from intercompany balances.

** Others mainly include interest expenses charged on borrowings from HSBC HK and other HSBC branches (2020: LKR 2.3 Billion, 2019: LKR 4 Billion).

6.1 Net interest income from Sri Lanka Government Securities

Interest income and interest expenses on Government Securities included in Note 6.1 has been extracted from interest income and interest expenses given in Note 6 and disclosed separately, as required by the Guidelines issued by the Central Bank of Sri Lanka.

	2020	2019
	Rs.'000	Rs.'000
Interest income	**10,151,034**	9,764,525
Less: Interest expenses	**-**	-
Net interest income from Sri Lanka Government Securities	**10,151,034**	9,764,525

FOR THE YEAR ENDED 31 DECEMBER

7	**Net fee and commission income**	**2020**	2019
		Rs.'000	Rs.'000
	Fee and commission income	**3,169,313**	4,232,795
	Fee and commission expenses	**(1,004,341)**	(1,279,789)
		2,164,972	2,953,006
7.1	**Comprising**		
	Loans and advances	**73,737**	75,597
	Credit cards	**912,154**	1,672,012
	Trade and remittance transactions	**1,065,619**	1,165,577
	Deposits accounts	**72,490**	108,545
	Trustee and fiduciary services	**49,047**	106,044
	Others	**(8,075)**	(174,769)
	Net fee and commission income	**2,164,972**	2,953,006

8	**Net gain from trading**	**2020**	2019
		Rs.'000	Rs.'000
	Foreign exchange		
	- Losses from transactions with customers	**(1,139,676)**	(1,384,478)
	- Gains from transactions with others	**1,838,784**	2,459,506
	Fixed income securities	**393,145**	291,838
	Derivative financial instruments	**-**	(7)
		1,092,253	1,366,859

Net gain from trading comprises gains less losses related to trading assets and trading liabilities, and also include all realised and unrealised fair value changes, related capital gains and losses and foreign exchange gains / (losses).

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9	**Net fair value gains from financial instruments at fair value through profit or loss**	**2020**	2019
		Rs.'000	Rs.'000
	Net gains on financial assets at fair value through profit or loss	**748,023**	379,949

10	**Other operating income (net)**	**2020**	2019
		Rs.'000	Rs.'000
	Loss on sale of property, plant and equipment	**(582)**	(436)
	Other income from intercompany transactions and dividend from mandatory shares	**49,362**	43,057
		48,780	42,621

11	**Impairment charges and other losses**	**2020**	2019
		Rs.'000	Rs.'000
11.1	**Financial assets at amortised cost - loans and advances (Note 21.2)**		
	Stage 1	**(86,818)**	(144,425)
	Stage 2	**753,995**	(91,287)
	Stage 3	**523,911**	(180,259)
		1,191,088	(415,971)
11.2	**Financial assets at amortised cost – debt instruments (Note 23.2)**		
	Stage 1	**(11,603)**	(368)
		(11,603)	(368)
11.3	**Financial assets measured at fair value through other comprehensive income (Note 22.2)**		
	Stage 1	**421,358**	116,910
		421,358	116,910
11.4	**Contingent liabilities and commitments (Note 37.2)**		
	Stage 1	**13,029**	(40,636)
	Stage 2	**45,335**	26,976
	Stage 3	**-**	(2,716)
		58,364	(16,376)
11.5	**Others**		
	Stage 1	**3,074**	(5,229)
	Stage 2	**133**	(45)
	Stage 3	**-**	-
		3,207	(5,274)
11.6	**Write-off's, recoveries and recovery of assets**	**1,918,863**	1,131,556
		3,581,277	810,477

12 Personnel expenses

	2020 Rs.'000	2019 Rs.'000
Salary and bonus	**(2,563,089)**	(2,716,073)
Contributions to other contributions / benefit plans	**(162,115)**	(164,347)
Provision for defined benefit obligation	**(23,824)**	(1,493)
Others	**(1,155,406)**	(1,136,976)
	(3,904,434)	(4,018,889)

* Others mainly include employer's contribution to employee provident fund of LKR LKR 212 Million (2019: LKR 213 Million) and other allowances paid to the employees amounting to LKR 761 Million (2019: LKR 755 Million).

13 Other expenses

	2020 Rs.'000	2019 Rs.'000
Auditors' remunerations	**(4,887)**	(4,849)
Non-audit fees to auditors	**(2,111)**	(9,464)
Professional and legal expenses	**(183,210)**	(38,133)
Depreciation of property, plant and equipment	**(336,203)**	(327,131)
Property, plant and equipment written-off during the year	**(387,016)**	-
Depreciation of short leasehold and buildings	**(320,476)**	(233,753)
Office administration and establishment expenses	**(1,251,210)**	(1,763,323)
Short-term lease expenses	**(109,708)**	(53,699)
Donations	**(3,072)**	(3,460)
Others	**(5,970,579)**	(5,007,908)
	(8,568,472)	(7,441,720)

Main component of expenses classified as 'Others' are regionally allocated charges (RAC), which is remittable to regional Head Office (2020: LKR 4.7 Billion, 2019: LKR 4.3 Billion).

14 Tax expense

As per LKAS 12 – Income Taxes, deferred tax assets and liabilities should be measured at the tax rate that are expected to be applied in the period in which the asset will be realized or the liability will be settled, based on the tax rate (and tax laws) that have been enacted or substantively enacted by the reporting date.

As per notice dated April 08, 2020 issued by the Inland Revenue Department on "Implementation of Proposed Changes to the Inland Revenue Act No. 24 of 2017", effective from January 01, 2020, Corporate Income Tax rate was revised from 28% to 24%. This amendment was enacted on 26 March 2021 in the Parliament.

The Branch management believes that 24% is the rate at which a realization gain be subjected to tax should an event of realization takes place after the reporting date. Accordingly, the Branch has calculated both current tax and deferred tax at the rate of 24%.

		2020	2019
14	**Tax expense**	**Rs.'000**	Rs.'000
14.1	**Current tax expense**		
	Current tax on profit for the year (Note 14.3)	**(1,772,971)**	(2,657,345)
	Over provision for the previous year	**9,676**	633,254
	Tax of prior years paid in current year	**-**	(8,900)
	Remittance tax	**(122,252)**	(113,976)
		(1,885,547)	(2,146,967)
	Deferred tax expenses		
	-Provision for employee benefit	**14,094**	5,601
	- Owned assets	**34,903**	2,912
	-Allowance for loans losses	**311,345**	38,488
	-SLFRS 16	**56,467**	16,050
	-Depreciation on revaluation of land & building	**31,306**	1,917
		448,115	64,968
	Total tax charge to income statement	**(1,437,432)**	(2,081,999)
14.2	**Tax charge to the statement of other comprehensive income**		
	-Provision for employee benefit	**4,462**	36,971
	-FVOCI reserve	**186,500**	(371,027)
	-Revaluation of buildings	**94,964**	35,395
		285,926	(298,661)
14.3	**Reconciliation between current tax expense and accounting profit**		
	Accounting profit before taxation	**3,824,972**	8,325,536
	Income tax for the period at 24% (2019: 28%)	**917,994**	2,331,150
	Add: Tax effect of expenses that are not deductable for tax purposes	**1,184,561**	838,561
	Less: Tax effect of expenses that are deductable for tax purposes	**(83,988)**	(168,961)
	Tax effect on exempt Income and income taxed at reduced rates	**(245,596)**	(343,405)
	Current tax on profit for the year	**1,772,971**	2,657,345
14.4	**Breakdown of Value Added Tax, Nation Building Tax (NBT) and Other Taxes on financial services**		
	Value Added Tax	**(792,935)**	(1,525,846)
	Nation Building Tax (NBT) and Other Taxes on financial services	**(53,801)**	(1,253,637)
		(846,736)	(2,779,483)

- During the 12 months period ended December 2019 the applicable Value Added Tax (VAT) rate has been at 8%.

- Nation Building Tax (NBT) rate had been 2% for the eleven months ended November 2019 and NBT had been abolished with effect from 1 December 2019.

AS AT 31 DECEMBER

14 Tax expense (contd)

14.5 Reconciliation between tax expense and the product of accounting profit

Accounting profit before taxation	**3,824,972**	8,325,536
Tax effect on accounting profit	**(917,993)**	(2,331,150)
Tax effect on deductible income	**246,179**	343,405
Tax effect on non deductible expenses	**(640,714)**	(647,416)
Tax effect on deductions claimed	**38,721**	42,784
Net tax effect of unrecognised deferred tax assets for the year	**-**	-
Net tax effect of unrecognised deferred tax assets for prior years	**-**	-
(Under) / over provision for previous years	**9,676**	624,354
Tax Effect of transfers	**-**	-
Tax Effect of rate differential	**(50,468)**	-
Other income based taxes	**-**	-
Other rates (Dividend Tax at 14%, Remittance Tax at 14% ,Capital gain tax at 10%)	**(122,833)**	(113,976)
Tax expense	**(1,437,432)**	(2,081,999)

15 Analysis of financial instruments by measurement basis

15.1 As at 31 December 2020

	Fair value through profit or loss	**Amortized cost**	**Fair value through other comprehensive income**	**Total**
	Rs.'000	**Rs.'000**	**Rs.'000**	**Rs.'000**
ASSETS				
Cash and cash equivalents	-	20,411,976	-	20,411,976
Balances with the Central Bank of Sri Lanka	-	18,453,574	-	18,453,574
Placements with banks	-	-	-	-
Derivative financial instruments	656,466	-	-	656,466
Financial assets measured at fair value through profit or loss	334,968	-	-	334,968
Financial assets at amortised cost – loans and advances	-	219,123,466	-	219,123,466
Financial assets measured at fair value through other	-	-	136,631,512	136,631,512
Financial assets at amortised cost - debt instruments	-	3,118,017	-	3,118,017
Acceptances and endorsements	-	14,591,857	-	14,591,857
Total financial assets	**991,434**	**275,698,890**	**136,631,512**	**413,321,836**
LIABILITIES				
Due to banks	-	88,302,330	-	88,302,330
Derivative financial instruments	508,372	-	-	508,372
Financial liabilities at amortised cost - due to depositors	-	237,257,573	-	237,257,573
Acceptances and endorsements	-	14,591,857	-	14,591,857
Total financial liabilities	**508,372**	**340,151,760**	**-**	**340,660,132**

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15 Analysis of financial instruments by measurement basis (contd)

15.2 As At 31 December 2019

	Fair value through profit or loss	Amortized cost	Fair value through other comprehensive income	Total
	Rs.'000	Rs.'000	Rs.'000	Rs.'000
ASSETS				
Cash and cash equivalents	-	33,986,285	-	33,986,285
Balances with Central Bank	-	9,740,145	-	9,740,145
Placements with banks	-	27,214,500	-	27,214,500
Derivative financial instruments	812,121	-	-	812,121
Financial assets measured at fair value through profit or loss	4,751,028	-	-	4,751,028
Financial Assets at Amortised Cost – Loans and Advances	-	260,155,127	-	260,155,127
Financial assets measured at fair value through other comprehensive income	-	-	107,854,554	107,854,554
Financial assets at amortised cost - debt instruments	-	3,088,314	-	3,088,314
	-	6,349,354	-	6,349,354
Total financial assets	**5,563,149**	**340,533,725**	**107,854,554**	**453,951,428**
LIABILITIES				
Due to banks	-	170,599,897	-	170,599,897
Derivative financial instruments	1,052,576	-	-	1,052,576
Financial liabilities at amortised cost - due to depositors	-	209,805,122	-	209,805,122
Acceptances and endorsements	-	6,349,354	-	6,349,354
Total financial liabilities	**1,052,576**	**386,754,373**	**-**	**387,806,949**

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16	**Cash and cash equivalents**	**2020**	2019
		Rs.'000	Rs.'000
	Cash in hand	**944,509**	1,177,287
	Balances with other banks	**19,467,467**	32,808,998
		20,411,976	33,986,285

17	**Balances with the Central Bank of Sri Lanka**	**2020**	2019
		Rs.'000	Rs.'000
	Statutory balances with Central bank of Sri Lanka	**4,353,574**	7,940,145
	Non-statutory balances with central banks		
	- Placements with Central bank of Sri Lanka	**14,100,000**	1,800,000
		18,453,574	9,740,145

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 2% as at 31st December 2020 (2019 : 5%).

Placements with Central bank of Sri Lanka are overnight balances.

18	**Placements with banks**	**2020**	2019
		Rs.'000	Rs.'000
	Placements	**-**	27,214,500
		-	27,214,500

19	**Derivative financial instruments**	**2020**	2019
		Rs.'000	Rs.'000
	Forward foreign exchange contracts	**656,466**	812,121
		656,466	812,121

20	**Financial assets measured at fair value through profit or loss**	**2020**	2019
		Rs.'000	Rs.'000
	Treasury bills	**25,908**	1,347,288
	Treasury bonds	**309,060**	3,403,740
		334,968	4,751,028
20.1	**Analysis**		
	By collateralisation		
	- Unencumbered	**334,968**	4,751,028
	By currency		
	- Sri Lankan rupee	**334,968**	4,751,028

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21 Financial assets at amortised cost – Loans and advances

	Note	2020 Rs.'000	2019 Rs.'000
Gross loans and advances			
Stage 1		**166,708,405**	238,508,685
Stage 2		**54,208,010**	22,606,685
Stage 3		**1,139,820**	746,794
	21.1	**222,056,235**	261,862,164
Less: Accumulated impairment under;			
Stage 1		**(589,337)**	(661,284)
Stage 2		**(1,281,289)**	(507,521)
Stage 3		**(1,062,143)**	(538,232)
	21.2	**(2,932,769)**	(1,707,037)
Net loans and receivables		**219,123,466**	260,155,127

21.1 Analysis

21.1.1 By product

	2020	2019
Overdrafts	**31,969,894**	36,910,890
Trade finance	**35,124,196**	41,263,555
Credit cards	**21,420,021**	26,037,785
Staff loans	**1,806,662**	1,852,073
Term loans	**131,735,462**	155,797,861
Term loans - short term	**12,131,622**	27,570,098
Term loans - long term	**118,878,922**	127,473,969
Mortgages	**724,918**	753,794
Gross total	**222,056,235**	261,862,164

21.1.2 By currency

	2020	2019
Sri Lankan Rupee	**61,920,546**	94,419,969
United States Dollar	**154,570,547**	162,686,358
Great Britain Pound	**317,402**	287,652
Others	**5,247,740**	4,468,185
Gross total	**222,056,235**	261,862,164

21.1.3 By industry

	2020	2019
Agriculture and fishing	**4,634,493**	4,266,765
Manufacturing	**84,451,112**	92,909,048
Tourism	**51,949,938**	45,801,600
Transport	**2,843,624**	13,488,453
Construction	**6,141,233**	7,610,966
Traders	**14,044,721**	23,442,555
New economy	**8,829,965**	9,870,985
Others	**49,161,149**	64,471,792
Gross total	**222,056,235**	261,862,164

AS AT 31 DECEMBER

21 Financial assets at amortised cost – Loans and advances (contd)

21.2 Provision for impairment loss

	2020 Rs.'000	2019 Rs.'000
21.2.1 Stage 1		
Opening balance as at 01 January	**661,284**	817,352
(Write back) to income statement	**(86,818)**	(144,425)
Exchange fluctuations and other movements	**14,871**	(11,643)
Closing balance as at 31 December	**589,337**	661,284
21.2.2 Stage 2		
Opening balance as at 01 January	**507,521**	610,453
Charge / (write back) to income statement	**753,995**	(91,287)
Exchange fluctuations and other movements	**19,773**	(11,645)
Closing balance as at 31 December	**1,281,289**	507,521
21.2.3 Stage 3		
Opening balance as at 01 January	**538,232**	724,381
Charge / (write back) to income statement	**523,911**	(180,259)
Exchange fluctuations and other movements	**-**	(5,890)
Closing balance as at 31 December	**1,062,143**	538,232

22 Financial assets measured at fair value through other comprehensive income

	2020 Rs.'000	2019 Rs.'000
Treasury bills	**83,061,804**	36,249,632
Treasury bonds	**53,569,708**	71,604,922
	136,631,512	107,854,554

22.1 Analysis

By collateralisation		
- Pledged as collateral	**-**	4,263,268
- Unencumbered	**136,631,512**	103,591,286
	136,631,512	107,854,554
By Currency		
- Sri Lankan Rupees	**124,388,424**	76,080,599
- United States Dollar	**12,243,088**	31,773,955
	136,631,512	107,854,554

22.2 Movements in provision for impairment loss during the year

Stage 1	2020 Rs.'000	2019 Rs.'000
Opening balance	**302,385**	184,810
Charge to income statement	**421,358**	116,910
Exchange fluctuations and other movements	**8,818**	665
Closing balance	**732,561**	302,385

		2020	2019
22	**Financial assets measured at fair value through other comprehensive income (contd)**	**2020**	2019
		Rs.'000	Rs.'000
22.3	**Securities pledged against repurchase agreements**		
	Repo value	**-**	4,000,000
	Fair value of securities held	**-**	4,263,268

23	**Financial assets at amortised cost - debt instruments**	**2020**	2019
		Rs.'000	Rs.'000
	Treasury bonds	**3,118,017**	3,099,917
	Accumulated impairment	**-**	(11,603)
		3,118,017	3,088,314
23.1	**Financial assets at amortised cost - debt instruments**		
	By collateralisation		
	- Unencumbered	**3,118,017**	3,099,917
	By currency		
	- Sri Lankan Rupee	**3,118,017**	3,099,917

23.2	**Movements in provision for impairment loss during the year**		
		2020	2019
	Stage 1	**Rs.'000**	Rs.'000
	Opening balance	**11,603**	11,971
	(Write back) to income statement	**(11,603)**	(368)
	Closing balance	**-**	11,603

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24 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 vehicles	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 at 1 January 2019	2,811,106	1,434,901	838,743	16,907	298,164	728,041	118,541	-	6,246,403
Additions during the year	-	78,273	463,341	-	-	67,972	-	266,940	876,526
Disposals during the year	-	-	(40,767)	(697)	(76,838)	(218,299)	-	-	(336,601)
Transfers during the year	-	219,164	62,714	-	(62,714)	-	-	(219,164)	-
Revaluation (loss) / gain	(38,502)	(202,536)	-	-	-	-	-	-	(241,038)
Adjustments	(11,441)	11,441	-	-	-	-	-	-	-
Closing balance as at 31 December 2019	2,761,163	1,541,243	1,324,031	16,210	158,612	577,714	118,541	47,776	6,545,290
Balance as at 1 January 2020	**2,761,163**	**1,541,243**	**1,324,031**	**16,210**	**158,612**	**577,714**	**118,541**	**47,776**	**6,545,290**
Additions during the year	**-**	**28,789**	**185,619**	**-**	**3,082**	**51,078**	**-**	**65,652**	**334,220**
Disposals during the year	**-**	**-**	**(23,589)**	**-**	**(2,521)**	**(32,127)**	**(40,512)**	**-**	**(98,749)**
Write-off's during the year	**-**	**-**	**(504,576)**	**-**	**(543)**	**-**	**-**	**-**	**(505,119)**
Transfers during the year	**-**	**37,594**	**10,182**	**-**	**-**	**-**	**-**	**(47,776)**	**-**
Revaluation (loss) / gain	**(96,000)**	**8,212**	**-**	**-**	**-**	**-**	**-**	**-**	**(87,788)**
Adjustments	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Balance as at 31st December 2020	**2,665,163**	**1,615,838**	**991,667**	**16,210**	**158,630**	**596,665**	**78,029**	**65,652**	**6,187,854**
Accumulated depreciation									
Balance as at 1 January 2019	-	-	576,859	15,953	177,694	572,644	113,423	-	1,456,573
Charge for the year	-	(114,810)	116,825	318	17,463	72,149	4,725	-	96,670
Reclassified during the year	-	-	8,362	-	(8,362)	-	-	-	-
Revaluation adjustment	-	114,810	-	-	-	-	-	-	114,810
Disposals during the year	-	-	(39,999)	(697)	(76,838)	(218,065)	-	-	(335,599)
Balance as at 31 December 2019	-	-	662,047	15,574	109,957	426,728	118,148	-	1,332,454
Balance as at 1 January 2020	**-**	**-**	**662,047**	**15,574**	**109,957**	**426,728**	**118,148**	**-**	**1,332,454**
Charge for the year	**-**	**(138,777)**	**122,034**	**220**	**9,016**	**66,933**	**394**	**-**	**59,820**
Revaluation adjustment	**-**	**138,777**	**-**	**-**	**-**	**-**	**-**	**-**	**138,777**
Disposals during the year	**-**	**-**	**(1,042)**	**-**	**(516)**	**(19,229)**	**(40,513)**	**-**	**(61,300)**
Write-off's during the year	**-**	**-**	**(117,560)**	**-**	**(543)**	**-**	**-**	**-**	**(118,103)**
Balance as at 31 December 2020	**-**	**-**	**665,479**	**15,794**	**117,914**	**474,432**	**78,029**	**-**	**1,351,648**
Carrying value	**2,665,163**	**1,615,838**	**326,188**	**416**	**40,716**	**122,233**	**-**	**65,652**	**4,836,206**
As at 31 December 2019	2,761,163	1,541,243	661,984	636	48,655	150,986	393	47,776	5,212,836
As at 31 December 2020	**2,665,163**	**1,615,838**	**326,188**	**416**	**40,716**	**122,233**	**-**	**65,652**	**4,836,206**

a) As at 31 December 2020, property plant and equipment include fully depreciated assets of amounting to Rs 826,669,525 (2019 - Rs 938,763,591) which are still in use.

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

	Land		**Buildings**	
	2020	2019	**2020**	2019
	Rs.	Rs.	**Rs.**	Rs.
Cost	**4,970,000**	4,970,000	**1,484,891,045**	1,438,930,088
Accumulated depreciation	**-**	-	**(621,769,217)**	(513,547,078)
Net book amount as at 31 December	**4,970,000**	4,970,000	**863,121,828**	925,383,010

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24 Property, plant and equipment (contd)

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

The land and buildings of the Branch as at 31 December 2020 have been revalued and the revalued amounts have been incorporated in the financial statements for the year. This is considered as a level 3 valuation and the details of the valuation are given below.

Property	Name and Qualifications of the independent valuer	Valuation Technique	Significant unobservable inputs	Inter-relationship between key unobservable inputs and fair value measurement
Sir Baron Jayatilaka Mawatha, Colombo 01	1. Nanmadhi R B.E, PGPACM 3 years experience 2. Anuradha Vijay M.Arch 12 years experience 3. Somy Thomas MBA 14 years experience	Summation approach of "Income capitalisation" and "Depreciated Replacement Cost" approach	Rate per square foot (2020: LKR 249, 2019: LKR 263). Yield rate (2020: 9%, 2019: 9%).	Direct correlation - higher the rate per square foot, higher the market value
Independence Avenue, Colombo 07	1. Nanmadhi R, B.E, PGPACM 3 years experience 2. Anuradha Vijay M.Arch 12 years experience 3. Somy Thomas MBA 14 years experience	Direct Sale Comparable approach	Sale price per perch (2020: LKR 21.68 Mn, 2019: LKR 21.1 Mn)	Direct correlation - higher the cost spent, higher the market value

Sensitivity analysis

In order to illustrate the significance of the unobservable inputs used in the valuation as at 31 December 2020, a sensitivity analysis was carried out as follows.

Property	Description	Change in assumption	Present value of the property	
			Increase in assumption (LKR million)	Decrease in assumption
Colombo 01	Rate per sq ft	10%	123	(123)
Colombo 01	Yield rate	1%	(125)	152
Colombo 07	Sale price per perch	10%	171	(171)

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25 Deferred tax assets / (liabilities)

	2020 Rs.'000	2019 Rs.'000
Deferred tax assets	**1,241,569**	855,202
Deferred tax liabilities	**(873,953)**	(1,221,625)
	367,616	(366,423)

25.1 Temporary differences

Deferred tax assets and liabilities are attributable to the following:

	2020		2019	
	Temporary difference Rs. '000	**Tax effects Rs.'000**	Temporary difference Rs.'000	Tax effects Rs.'000
Deferred tax assets on ;				
Provision for retirement benefit	**1,190,195**	**285,646**	953,896	267,091
Allowance for loan losses	**3,680,856**	**883,406**	2,043,074	572,061
IFRS 16	**302,152**	**72,517**	57,322	16,050
Other comprehensive income reserve	**-**	**-**	-	-
	5,173,203	**1,241,569**	3,054,292	855,202
Deferred tax liabilities on ;				
Property revaluation reserve	**(3,463,369)**	**(831,210)**	(3,419,562)	(957,477)
Accelerated depreciation for tax: - Owned assets	**(135,466)**	**(32,511)**	(240,767)	(67,415)
Other comprehensive income reserve	**(42,634)**	**(10,232)**	(702,614)	(196,733)
	(3,641,469)	**(873,953)**	(4,362,943)	(1,221,625)
Net assets/ (liabilities) as at 31 December	**1,531,734**	**367,616**	(1,308,651)	(366,423)

Deferred tax is computed using the effective tax rate of 2020 - 24%, 2019 - 28%.

26 Other assets

	2020 Rs.'000	2019 Rs.'000
Receivables	**4,485,596**	4,218,425
Deposits and prepayments	**67,131**	161,578
Acceptances and endorsements	**14,591,857**	6,349,354
Right-of-use assets (Note 26.1)	**1,564,991**	1,891,998
Others	**7,873**	1,896,116
	20,717,448	14,517,471

26.1 Right-of-use assets and lease liabilities

26.1.1 Amounts recognised in the balance sheet

	2020 Rs.'000	2019 Rs.'000
Right-of-use assets - Buildings	**1,564,991**	1,891,998
Lease liabilities	**523,633**	634,998

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26 Other assets (contd)

	2020	2019
26.1 Right-of-use assets and lease liabilities (contd)	**Rs.'000**	Rs.'000

26.1.2 Amounts recognised in the statement of profit or loss

Depreciation charges	320,476	233,753
Interest expense	59,049	71,905
Expense relating to short-term leases	31,839	53,699
Loss on lease modifications	5,566	-

26.1.3 The group's leasing activities and how these are accounted for;

The Bank leases various offices throughout the country. Majority of the lease contracts are with an option of extension as explained below in note 26.1.5.

Contracts may contain both lease and non-lease components. The Bank allocates the consideration in the contract to the lease and non-lease components based on their relative stand-alone prices. However, for leases of real estate for which the Bank is a lessee, it has elected not to separate lease and non-lease components and instead accounts for these as a single lease component.

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants other than the security interests in the leased assets that are held by the lessor. Leased assets may not be used as security for borrowings.

Until the 2018 financial year, leases of property, plant and equipment were classified as operating leases. From 1 January 2019, leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Bank.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

* fixed payments (including in-substance fixed payments), less any lease incentives receivable
* amounts expected to be payable by the Bank under residual value guarantees
* the exercise price of a purchase option if the Bank is reasonably certain to exercise that option, and
* payments of penalties for terminating the lease, if the lease term reflects the Bank exercising that option.

Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, which is generally the case for leases in the Bank, the lessee's incremental borrowing rate is used, being the rate that the individual lessee would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.

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26 Other assets (contd)

26.1 Right-of-use assets and lease liabilities (contd)

26.1.4 Right-of-use assets are measured at cost comprising the following:

* the amount of the initial measurement of lease liability
* any lease payments made at or before the commencement date less any lease incentives received
* any initial direct costs, and
* restoration costs.

Right-of-use assets are generally depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. While the Bank revalues its land and buildings that are presented within property, plant and equipment, it has chosen not to do so for the right-of-use buildings held by the Bank.

Payments associated with short-term leases are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less.

26.1.5 Extension and termination options

Extension and termination options are included in a number of property and equipment leases across the Bank. These are used to maximise operational flexibility in terms of managing the assets used in the Bank’s operations. The majority of extension and termination options held are exercisable only by the Bank and not by the respective lessor.

Only property leases are managed by the Branch. Both parties (Landlord and the Branch) have the right to exercise the termination option in most of the leases and for renewal , the Bank needs to inform the Landlord as per agreed lease conditions if the Bank wish to renew the lease . However as per the renewal Lease options incorporated to all leases the terms and conditions for the extended (renewal) period are subject to mutual consent at the time of the renewal and are not specified in the current leases in force.

27 Due to banks

	2020	2019
	Rs.'000	Rs.'000
Borrowings	**76,321,746**	157,105,844
Securities sold under repurchase (repo) agreements	**-**	4,000,000
VOSTRO balances with HSBC offices and other banks	**11,980,584**	9,494,053
	88,302,330	170,599,897

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
AS AT 31 DECEMBER

28 Derivative financial instruments

	2020	2019
	Rs.'000	Rs.'000
Forward foreign exchange contracts	**508,372**	1,052,576

	2020	2019
29 Financial liabilities at amortised cost - due to depositors	**Rs.'000**	Rs.'000
Total amount due to other customers (Note 29.1)	**237,257,573**	209,805,122

29.1 Analysis

29.1.1 By product

	2020	2019
Demand deposits (current accounts)	**60,386,336**	55,479,928
Savings deposits	**55,490,405**	47,927,300
Fixed deposits	**113,711,156**	100,737,985
Other deposits	**7,669,676**	5,659,909
Total	**237,257,573**	209,805,122

29.1.2 By currency

	2020	2019
Sri Lankan Rupees	**135,517,076**	116,462,080
United States Dollars	**84,538,778**	78,662,753
Great Britain Pounds	**6,554,810**	6,276,805
Others	**10,646,909**	8,403,484
Total	**237,257,573**	209,805,122

	2020	2019
30 Defined benefit liability - net	**2020**	2019
	Rs.'000	Rs.'000
Present value of defined benefit obligations (Note 30.1)	**1,190,196**	953,896
Fair value of plan assets (Note 30.2)	**(944,220)**	(874,683)
	245,976	79,213

Bank measures the Present Value of Defined Benefit Obligation (PVDBO) with the advice of an actuary using the Projected Unit Credit Method. The acturial valuation involves making assumptions about discount rates, future salary increases and mortality rates. Due to long term nature of these plans, such estimates are subject to significant uncertainty. All assumptions are reviewed at each reporting date. Accordingly, the employee benefits obligation is based on the acturial valuation as at 31 December 2020, carried out by Messrs Willis Towers Watson India, actuaries.

30.1 Movement in the present value of defined benefit obligations

	2020	2019
Opening balance	**953,896**	801,854
Current service cost	**5,867**	3,754
Interest cost	**91,985**	90,758
Benefits paid during the year	**(88,887)**	(74,509)
Actuarial gain for the year	**227,335**	132,039
Closing balance	**1,190,196**	953,896

30.2 Movement in fair value of plan assets

	2020	2019
Opening balance	**874,683**	778,849
Expected return on plan assets	**87,519**	93,018
Contribution by employers	**85,643**	70,000
Benefits paid during the year	**(88,887)**	(74,509)
Actuarial (loss) / gain for the year	**(14,738)**	7,325
Closing balance	**944,220**	874,683

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

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30 Defined benefit liability - net (contd)

30.3 Sensitivity analysis of the defined benefit obligation

	2020 Rs.'000	2019 Rs.'000
a. Discount rate		
Discount rate	**7.80%**	10.10%
1. Effect due to the increase in the discount rate by 1.00% (Rs '000)	**(112,811)**	(84,653)
2. Effect due to the decrease in the discount rate by 1.00% (Rs '000)	**153,136**	103,005
b. Increase in salary escalation rate and post retirement pension		
Salary escalation rate		
- Union members	**3%**	5%
- Non-union members	**3%**	5%
Post retirement pension	**3.5%**	3.5%
1. Effect on DBO due to an increase in the salary escalation and post retirement pension rate by 1% p.a. (Rs '000)	**128,169**	87,224
2. Effect on DBO due to a decrease in the salary escalation and post	**-**	-
retirement pension rate by 1% p.a. (Rs '000)	**10,904**	(75,550)
Weighted average duration of defined benefit obligation	**12.5 years**	9.2 years

31 Other liabilities

	2020 Rs.'000	2019 Rs.'000
Sundry creditors	**760,469**	446,884
Interest payable	**7,788,999**	7,441,758
Acceptances and endorsements	**14,591,857**	6,349,354
Impairment in respect of off-balance sheet credit exposures	**93,946**	63,524
Lease liabilities	**523,633**	634,998
Other payables	**4,147,018**	3,508,588
	27,905,922	18,445,106

Other payable mainly consist of accruals, deferred income and other suspense accounts.

32 Assigned capital

	2020 Rs.'000	2019 Rs.'000
Assigned Capital	**3,152,358**	3,152,358
	3,152,358	3,152,358

33 Statutory reserve fund

	2020 Rs.'000	2019 Rs.'000
Opening balance	**2,598,158**	2,473,286
Transferred during the year	**51,553**	124,872
Closing balance	**2,649,711**	2,598,158

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.

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34	**Other reserves**	**2020**	2019
		Rs.'000	Rs.'000
	Exchange equalisation of reserve (Note 34.1)	**10,776,120**	9,362,367
	Fair value through other comprehensive income reserve (Note 34.2)	**764,962**	807,371
	Revaluation reserve (Note 34.3)	**2,602,870**	2,462,088
	IFA reserve (Note 34.4)	**2,970,075**	2,970,075
	Share based payment reserve (Note 34.5)	**175,791**	168,501
		17,289,818	15,770,402

34.1	**Exchange equalisation reserve**	**2020**	2019
		Rs.'000	Rs.'000
	Opening balance	**9,362,367**	9,550,267
	Fluctuation of foreign exchange reserves	**1,413,753**	(187,900)
	Closing balance	**10,776,120**	9,362,367

Exchange equalisation reserve is used to record exchange rate fluctuations of equity and reserves held in foreign currency as at the reporting date.

34.2	**Fair value through other comprehensive income reserve**	**2020**	2019
		Rs.'000	Rs.'000
	Opening balance	**807,371**	(263,377)
	Net movement in revaluation and impairment	**(42,409)**	1,070,748
	Closing balance	**764,962**	807,371

The Branch has elected to recognise changes in the fair value of certain debt investments in OCI. These changes are accumulated within the FVOCI reserve within equity.

34.3	**Revaluation reserve**	**2020**	2019
		Rs.'000	Rs.'000
	Opening balance	**2,462,088**	2,558,033
	Revaluation surplus / (deficit) for the year	**140,782**	(95,945)
	Closing balance	**2,602,870**	2,462,088

Revaluation reserve is used to record increments and decrements on revaluation of fixed assets. In the event of a sale of an asset, any balance in the reserve in relation to the asset is transferred to retained earnings.

34.4	**IFA reserve**	**2020**	2019
		Rs.'000	Rs.'000
	Opening balance	**2,970,075**	4,725,708
	Transferred during the year	**-**	(1,755,633)
	Closing balance	**2,970,075**	2,970,075

According to the guidelines issued by the Central Bank of Sri Lanka, Banks were required to transfer 8% of the profit calculated for the payment of Value Added Tax (VAT) on financial services and 5% profit before tax calculated for payment of income tax to Investment Fund Account. Operations of IFA ceased with effect from 1 October 2014 and the above indicates the balance accrued up to that date. Movement for the financial year came as a result of maturities of several bonds in the portfolio. These bonds are expected to mature in 2022.

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34 Other reserves (contd)

34.5 Share based payment reserve

	2020 Rs.'000	2019 Rs.'000
Opening balance	**168,501**	168,453
Transferred during the year	**7,290**	48
Closing balance	**175,791**	168,501

34.6 HSBC Restricted Shares based payments and share option plan

HSBC Sri Lanka has a share option plan referred to as "HSBC Restricted Shares". Under this share option plan, HSBC Group defers part of the annual discretionary variable pay of a few senior managers into shares according to a vesting schedule. The shares are granted to the employees within a span of three years' vesting period. The cost of the shares are initially borne by the HSBC Group Head Office in UK and subsequently recharged to the local office (i.e. in the case of Sri Lankan employees, HSBC UK recharges the cost from HSBC Sri Lanka). In addition, HSBC Sri Lanka had a share based payment scheme available for its employees, which provided share options to the employees. Even though this scheme has ceased, the related liability towards the group has been accounted in books as a part of equity.

34.6.1 Restricted share awards - No of shares

	2020	2019
Outstanding at the beginning	**19,601**	22,547
Awards during the year	**8,468**	9,409
Vested during the year	**(10,368)**	(12,355)
Outstanding at the end	**17,701**	19,601

34.6.2 Share-based payments income statement charge

	Rs.'000	Rs.'000
Restricted and performance share awards	**42,759**	14,114
	42,759	14,114

35 Events occurring after the reporting date

The Department of Inland Revenue (IRD) issued a public notification on 12 February 2020 announcing revision of corporate tax rate applicable to the Company from 28% to 24%,which was placed on the Order Paper of the Parliament for the First Reading only on 26 March 2021 which is considered substantially enacted on the same date which is confirmed by the tax guidance issued by CA Sri Lanka on 23 April 2021. The impact on the financial statements due to the changes in tax rate is immaterial.

36 Comparative figures

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

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37 Commitments and contingencies

37.1 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.

	2020	2019
	Rs.'000	Rs.'000
Commitments		
Undrawn loan commitments	**186,644,334**	171,421,356
Foreign Exchange Contracts	**210,434,171**	202,221,938
Other contra accounts	**18,738,792**	18,175,522
Total	**415,817,297**	391,818,816
Contingencies		
Performance bonds	**18,904,919**	15,827,296
Letters of credit	**13,745,574**	10,797,359
Guarantees	**82,366,177**	75,178,197
Total	**115,016,670**	101,802,852
Total commitments and contingencies	**530,833,967**	493,621,668

37.2 Movements in Impairment during the Year	**2020**	2019
	Rs.'000	Rs.'000
Opening balance	**63,524**	77,348
Charge/ (Write back) to income statement	**58,364**	(16,376)
Exchange rate variance and other adjustments	**(27,942)**	2,552
Closing balance	**93,946**	63,524

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

37.3 Pending litigations against the Branch as at 31 December 2020

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

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

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

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

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37 Commitments and contingencies (contd)

37.3 Pending litigations against the Branch as at 31 December 2020 (contd)

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

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

7 Appeal Case No : SC/HCLA/69/2020 Former staff member instituted legal action for alleged unfair termination at the Labour Tribunal (LT) .The Order of the LT was delivered on 28 February 2018 and the LT upheld the position of the Bank accordingly the Applicants case was dismissed. The Applicant has now appealed to the High court to squash the Order given by the LT President. The HC Appeal case HCALT 23/2018- was called on 20 July 2020 for delivering of the Judgment , the Hon. Judge delivered the judgment in favour of HSBC thereby dismissed the appeal made by the applicant appellant , accordingly the Hon Judge has upheld the decision of the hon LT President and has held the termination of services of the applicant by HSBC is justifiable. The Notice of appeal to Supreme Court received by the Bank on 7 October 2020.

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

9 District Court -Case no - DMR 5207/2019, Mohamed Bahaudeen Mohamed Faizal (Plaintiff) v HSBC, Court action has been initiated by the Plaintiff and suing the Bank for the loss and damage suffered by him as a result of the malicious and deliberate conduct of the Bank in blocking his credit cards and for subsequent reporting to Credit Information Bureau of Sri Lanka (CRIB) the Plaintiff as a defaulter. The Plaintiff claims from the Bank as damages a sum of LKR 100,000,000. (approximately USD 555,555.56 (1 USD at 180/- LKR) together with legal interest thereon.

10 Provincial High Court of Civil Appellate ,Case No- WP/ HCCA/COL. 46/2018 (District Court case DLM/134/2015) -The Plaintiff has erroneously named HSBC - CBH as the second defendant in the case, instead of HDPL (The GSC in Sri Lanka). As HSBC and HDPL are two different and distinct legal entities , the Plaintiff cannot maintain the case against HSBC , whereas it should have been filed against HDPL.The Hon. District Court Judge delivered Order in 2018 dismissing the Plaintiff's action and terminated the proceedings.However the Plaintiff has made an appeal against the said judgment.

11 District Court of Colombo- DMR/01766/ 2020/ - The litigation is a Money Recovery Case based on an "Evolve agreement" the customer has enetered in to with the Bank, – on the face of the case it is for the recovery of USD 786,918.50 (the amount that the Bank recovered) plus interest from 20 March 2020 and costs and other reliefs are paryed from Court.

FOR THE YEAR ENDED 31 DECEMBER

38 Related party disclosures

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

38.1 Transactions with related parties

(a) Interest paid to other HSBC branches and group companies	**2020**	2019
	Rs.'000	Rs.'000
Other HSBC Branches		
HSBC Hongkong	**2,262,402**	4,096,768
	2,262,402	4,096,768
Group companies		
HSBC London	**6**	54
HSBC Canada	**5**	-
HSBC Data Processing Ltd	**68,366**	27,343
HSBC France	**-**	141
	68,377	27,538

(b) Interest received from other HSBC branches and broup companies	**2020**	2019
	Rs.'000	Rs.'000
Other HSBC branches		
HSBC Hongkong	**165,111**	896,258
	165,111	896,258

(c) Commission paid to other HSBC branches and group companies	**2020**	2019
	Rs.'000	Rs.'000
Other HSBC Branches		
HSBC Hongkong	**9,628**	30,168
HSBC Japan	**304**	87
HSBC New Zealand	**10**	168
HSBC Singapore	**249**	383
HSBC Thailand	**912**	404
	11,103	31,210
Group companies		
HSBC London	**88**	583
HSBC Canada	**599**	554
HSBC USA	**40,167**	46,394
HSBC China	**41**	27
HSBC Australia	**1,514**	1,455
HSBC France	**3,542**	2,168
	45,951	51,181

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38 Related Party Disclosures (contd)

38.1 Transactions with related parties (contd)

(d) Commission received from other HSBC branches and group companies	2020	2019
	Rs.'000	Rs.'000
Other HSBC branches		
HSBC Hongkong	**11,923**	93,361
HSBC Japan	**8,887**	5,402
HSBC Singapore	**5,796**	4,448
HSBC India	**8,308**	4,542
HSBC Vietnam	**94**	615
HSBC Malaysia	**1,949**	1,813
HSBC Bangladesh	**1**	-
HSBC Maldives	**40**	-
	36,998	110,181
Group companies		
HSBC London	**5,756**	11,179
HSBC Canada	**21**	24
HSBC France	**1,926**	177
HSBC China	**27,572**	21,049
HSBC Australia	**135**	252
HSBC Zurich	**1,435**	1,383
HSBC USA	**3,829**	2,535
HSBC Data processing Ltd	**690**	544
HSBC Trinkaus and Burkhardt	**89**	113
HSBC United Arab Emirates	**1,403**	883
HSBC Germany	**122**	53
HSBC Netherlands	**20**	23
	42,998	38,215

(e) Other operating income - Other HSBC branches and group companies		
Other HSBC branches		
HSBC Maldives	**37,117**	36,134
	37,117	36,134
Group companies		
HSBC USA	**8,712**	-
HSBC Data processing Ltd - Sri Lanka	**2,982**	-
	11,694	-

38 Related Party Disclosures (contd)

38.1 Transactions with related parties (contd)

(f) Receivable from other HSBC branches and group companies	2020	2019
	Rs.'000	Rs.'000
Other HSBC branches		
HSBC Hongkong	**12,747,721**	50,892,757
HSBC New Zealand	**40,775**	30,505
HSBC Japan	**72,894**	136,236
HSBC Singapore	**87,552**	66,130
HSBC India	**1,576,813**	2,483,935
HSBC Thailand	**229**	152
HSBC Maldives	**38,808**	34,264
	14,564,792	53,643,979
Group companies		
HSBC London	**118,545**	590,846
HSBC China	**14,477**	1,030,638
HSBC Canada	**406,282**	19,045
HSBC USA	**4,175,382**	4,284,217
HSBC Data processing Ltd	**18,228**	-
HSBC France	**50,840**	180,590
HSBC United Arab Emirates	**6,177**	9,385
HSBC Australia	**72,504**	53,990
	4,862,435	6,168,711

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38 Related party disclosure (contd)

38.1 Transactions with related parties (contd)

(g) Payable to other HSBC branches and group companies	2020 Rs.'000	2019 Rs.'000
Other HSBC branches		
HSBC Hongkong	**77,636,584**	158,477,636
HSBC Japan	**7,309**	41,076
HSBC Singapore	**11,583**	31,500
HSBC India	**25,725**	828,396
HSBC Bangladesh	**265,096**	337,916
HSBC Maldives	**3,444**	1,069
HSBC Vietnam	**-**	12
HSBC Mauritius	**193,366**	27,528
HSBC Malaysia	**2,126**	2,137
	78,145,233	159,747,270
Group companies		
HSBC London	**30,315**	831,999
HSBC Baharain	**817**	820
HSBC Canada	**38**	12
HSBC China (Bank) Co. Ltd	**23,414**	25,974
HSBC USA	**353,016**	590,141
HSBC Holdings Head Office	**183,560**	-
HSBC France	**424**	20,920
HSBC Qatar	**701**	1,798
HSBC Vietnam	**58**	-
HSBC Trinkaus & Burkhardt	**57**	33
HSBC UAE	**7,527**	8,562
HSBC Switzerland	**102**	-
HSBC Global Services Limited	**2,795,769**	2,739,889
HSBC UK Ring Fenced Bank Limited	**11,271**	-
HSBC Australia	**32**	2,294
	3,407,101	4,222,442

38 Related party disclosure (contd)

38.2 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 Executive Committee and several other senior management of the bank have been identified as key management personnel based on the above requirements. In 2019, only the Executive Committee members and few other senior managers were classified as Key Management Personnel. However, scope was expanded in 2020 to include the senior managers who are direct reports of the respective Executive Committee members.

(a) Compensation of KMPs	**2020**	2019
	Rs.'000	Rs.'000
Short term employment benefits	**414,038**	310,849
Post employment benefits	**42,949**	-
	456,987	310,849

(b) Transactions with KMPs and their close relations	**2020**	2019
	Rs.'000	Rs.'000
Total deposits	**185,122**	59,931
Total loans, advances and undrawn facilities granted	**481,085**	265,552
	666,207	325,483

(c) Direct and indirect accommodation	**2020**	2019
Direct and indirect accommodation as a percentage of the Branch's regulatory capital	**0.7%**	0.4%

(d) Income statement	**2020**	2019
	Rs.'000	Rs.'000
Interest income	**18,942**	-
Interest expenses	**9,102**	-
Compensation to KMP	**456,987**	310,849
	485,031	310,849

Information pertaining to post emplyment, interest income and interest expenses are disclosed starting from financial year 2020.

(e) Share based transactions of KMP

Share based payments are only made to the KMP and the movements during the year is recorded under the note 34.5 and 34.6.

39 Financial risk management

39.1 Risk management framework

All of the Branch's activities involve, to varying degrees, the defining & enabling, identifying and assessing, managing, aggregating & reporting and governing of risks or combinations of risks. An established Risk Management Framework and ownership structure ensures oversight of, and accountability for the effective management of risk at Group, Regional and Site levels. The framework also complies with the Banking Act No 30 of 1988, as amended.

The Branch's Risk Function consists of Wholesale Credit & Market Risk, Wealth & Personal Banking (WPB) Risk, Operational and Resilience Risk, and CRO & Administration which encapsulates Risk Strategy, Enterprise Wide Stress Testing and certain Operational Risk aspects. The HSBC Group provides overall written policies and procedures on Risk management covering specific areas such as Credit risk, Liquidity risk, Market risk and Operational and Resilience risks. The Local Management through the Executive Committee and the Risk Management Committee monitors the execution of Risk management policies and procedures.

Risk appetite and tolerance limits for key types of risks

Bank's risk appetite defines its desired forward-looking risk profile, and informs the strategic and financial planning process. Furthermore, it is integrated with other key Risk management tools such as Enterprise Wide Stress Testing (EWST), Country Risk Map, Top & Emerging Risks (T&Es) and Risk Appetite Statement (RAS) to help ensure consistency in Risk management practices.

The Bank sets out the aggregated level and risk types it accepts in order to achieve its business objectives in the Risk Appetite Statement ('RAS'). This is reviewed on an ongoing basis, and formally approved by Risk Management Committee every six months, with the Regional Risk Appetite and Governance team providing oversight. The bank's actual performance is reported monthly against the approved RAS to the Risk Management Meeting ('RMM'), enabling senior management to monitor the risk profile and guide business activities to balance risk and return. This reporting allows risks to be promptly identified, mitigated and drive a strong risk culture. Risk Appetite and tolerance thresholds are decided by respective Risk Stewards in collaboration with respective business lines.

Stress testing

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

EWST is a mandatory local regulatory reporting requirement to be met annually. The process incorporates Local capital rules, Provisioning rules, and Financial reporting rules, and is an integral part of the Bank's annual ICAAP submission. The exercise covers Wholesale Credit Risk (including concentration risk), WPB Credit Risk, Traded Credit Risk & Market Risk, Funding Risk (including IRRBB) and Operational Risk.

39 Financial risk management (contd)

39.1 Risk management framework (contd)

Stress testing (contd)

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

HSBC Sri Lanka performs EWST under three stress scenarios with ascending levels of severity, i.e minor, medium and major. The approach for 2020 is to leverage on the HSBC Group Internal Stress Testing (GIST) scenarios. The severity of the GIST scenario (adjusted but largely the equivalent of the major scenario) are scaled down to 50% and 10% respectively to arrive at the medium and mild scenarios.

Stress Testing results are reviewed by both local and regional subject matter experts before being presented for approval to the "Design Authority (DA)" consisting of CFO, CRO & Regional Head of Stress Testing. As the final step, results are shared with the local Risk Management Committee.

Internal stress tests are used in our enterprise-wide risk management and capital management frameworks. Risks to our capital plan are assessed through a range of scenarios which explore risks that management needs to consider under stress including potential adverse macroeconomic, geopolitical and operational risk events, and potential events that are specific to HSBC. Based on insights gained from the exercise, the management decides whether risks can or should be mitigated through management actions, or, whether to absorbed through capital if they were to crystallise.

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 cash and cash equivalents, direct lending, trade finance and also from certain other products such as derivative instruments and off balance sheet transactions such as letters of credit and guarantees.

Credit risk:

• Is measured as the amount which could be lost if a customer or counterparty fails to make repayments. In the case of derivatives, the measurement of exposure takes into account the current mark to market value to the Branch of the contract and the expected potential change in that value over time caused by movements in market rates;

• Is monitored within limits, approved by individuals within a framework of delegated authorities. These limits represent the peak exposure or loss to which the Branch could be subjected should the customer or counterparty fail to perform its contractual obligations;

• Is managed through a robust risk control framework which outlines clear and consistent policies, principles and guidance for risk managers.

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.1 Credit risk management (contd)

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) or Head of WPB Risk for Wealth and Personal Banking and Head of Wholesale Banking who in turn delegates limit to local risk executives.

The principle objectives of our credit risk management are;

• To maintain across the Branch a strong culture of responsible lending and a robust risk policy and control framework.

• To both partner and challenge Branch's businesses in defining, implementing and continually re-evaluating our risk appetite under actual and scenario conditions; and

• To ensure there is independent, expert scrutiny of credit risks, their costs and their mitigation.

Credit quality of financial instruments

Branch's credit risk rating systems and processes are designed to differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. In the case of individually significant accounts that are predominantly within the wholesale businesses, the risk ratings are reviewed regularly and any amendments are implemented promptly. Within Branch's WPB 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 III adopted by the HSBC Group to support Prudential Regulation Authority (PRA) reporting requirement and to make risk-based pricing decisions. Credit quality of customers are assessed taking into account their financial position, past experience and other factors. Special attention is paid to problem exposures in order to accelerate remedial action.

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

Impairment assessment

The Branch computes Expected Credit Losses (ECLs) appropriately.

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.1 Credit risk management (contd)

Credit impaired loans

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

• contractual payments of either principal or interest are past due for more than 90 days;

• there are other indications that the borrower is unlikely to pay, such as when a concession has been granted to the borrower for economic or legal reasons relating to the borrower’s financial condition; and

• the loan is otherwise considered to be in default. If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due. Therefore, the definitions of credit impaired and default are aligned as far as possible so that stage 3 represents all loans that are considered defaulted or otherwise credit impaired.

Impairment and credit risk mitigation

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

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

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

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

In general, HSBC calculates ECL using three main components: a probability of default, a loss given default (’LGD’) and the exposure at default (‘EAD’).

The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated using the lifetime PD instead.

The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument respectively.

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.1 Credit risk management (contd)

Impairment and credit risk mitigation

ECLs are calculated for all WPB products and will be done on product level. The determination of ECL is based on the concept of 'staging' which reflects the general classification of credit deterioration of an asset which is primarily on delinquency days. Assets must be allocated into appropriate credit deterioration stages (Stage 1, Stage 2 and Stage 3) before ECL calculations can be performed. The stages drive the recognition of ECLs.

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

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

An assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. The assessment explicitly or implicitly compares the risk of default occurring at the reporting date compared with that at initial recognition, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. The assessment is unbiased, probability-weighted, and to the extent relevant, uses forward-looking information consistent with that used in the measurement of ECL. The analysis of credit risk is multifactor. The determination of whether a specific factor is relevant and its weight compared with other factors depends on the type of product, the characteristics of the financial instrument and the borrower. Therefore, it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk and these criteria will differ for different types of lending, particularly between WSB and WPB. However, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when 30 days past due. In addition, wholesale loans that are individually assessed, typically WSB customers and included on a watch or worry list, are included in stage 2.

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

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

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.1 Credit risk management (contd)

Write off of loans and receivables (contd)

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

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

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

Contractual amount outstanding of financial assets written off during the reporting period that are still subject to enforcement activity are as follows;

As at 31 December	**2020**	2019
LKR '000		
Wealth and Personal Banking (WPB)	**1,244,689**	887,899
Wholesale Banking (WSB)	**415,377**	451,165
	1,660,066	1,339,065

Collateral management and valuation

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

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.1 Credit risk management (contd)

Collateral management and valuation

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

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

Maximum exposure to credit risk before collateral held or other credit enhancements

As at 31 Decemeber	2020	2019
LKR 000's		
Balances with Central Bank	**18,453,574**	9,740,145
Balances with other Banks	**19,467,467**	60,023,498
Derivative financial instruments	**656,466**	812,121
Financial assets measured at fair value through profit or loss	**334,968**	4,751,028
Financial assets at amortised cost - loans and advances	**219,123,466**	260,155,127
Financial assets measured at fair value through other comprehensive income	**136,631,512**	107,854,554
Acceptance & endorsements	**14,591,857**	6,349,354
Total On balance sheet credit exposure	**409,259,309**	449,685,827
Total Off balance sheet credit exposure	**512,095,175**	475,446,146

Impairment movement of financial assets/ liabilities

Consolidated				
LKR '000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Opening Balance	**1,008,409**	**541,885**	**538,232**	**2,088,526**
Charge to income statement	**339,041**	**799,462**	**523,911**	**1,662,414**
Exchange/other	**22,101**	**24,807**	**-**	**46,908**
	1,369,551	**1,366,154**	**1,062,143**	**3,797,848**

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.2 Quantitative Disclosures

Gross Loans and Receivables

Gross loans and receivables, impairment and net loans and receivables from customers are disclosed in Note 21 in the financial Statements. Movements in impairment during the period are disclosed in Note 21.2 in the financial Statements.

Gross loans and receivables - by product

	Gross exposure 2020 Rs.000	**Average gross exposure 2020 Rs.000**	Gross exposure 2019 Rs.000	Average gross exposure 2019 Rs.000
By product - local currency				
Overdrafts	**17,744,155**	**19,612,914**	19,060,896	21,930,367
Term loans	**22,653,175**	**32,605,832**	49,294,096	46,433,065
Credit cards	**21,420,021**	**23,147,040**	26,037,785	25,258,121
Other loans	**103,195**	**26,555**	27,192	2,119,916
Sub total	**61,920,546**	**75,392,341**	94,419,969	95,741,469
By product - foreign currency				
Overdrafts	**14,225,739**	**15,214,079**	17,849,995	16,997,544
Term loans	**139,186,325**	**147,220,881**	134,714,795	141,033,619
Other loans	**6,723,625**	**9,328,047**	14,877,405	10,345,557
Sub total	**160,135,689**	**171,763,007**	167,442,195	168,376,720
Total	**222,056,235**	**247,155,348**	261,862,164	264,118,189

Gross Loans and Receivables - By Currency

	2020 Rs.000	2019 Rs.000
By Product - Currency		
Sri Lankan Rupee	**61,920,546**	94,419,969
United States Dollar	**154,570,547**	162,686,358
Great Britain Pound	**317,402**	287,652
Others	**5,247,740**	4,468,185
Total	**222,056,235**	261,862,164

Expected credit losses on loans and advances to customers - At business segment

	Stage 1 2020 Rs.000	**Stage 2 2020 Rs.000**	**Stage 3 2020 Rs.000**	**Total 2020 Rs.000**	Total 2019 Rs.000
WPB	331,597	607,731	992,061	**1,931,389**	1,126,954
WSB	257,740	673,558	70,082	**1,001,380**	580,083
	589,337	**1,281,289**	**1,062,143**	**2,932,769**	1,707,037

WPB- Wealth and Personal Banking
WSB- Wholesale Banking

39 Financial Risk Management (contd)

39.2 Credit risk (contd)

39.2.2 Quantitative Disclosures (contd)

Gross Loans and Receivables - Sector wise analysis

Sector	Import lending Rs.000	Export lending Rs.000	Overdrafts Rs.000	Credit Cards Rs.000	Short term loans Rs.000	Medium and long term loans Rs.000	Mortgages Rs.000	2020 Total Rs. 000	2019 Total Rs. 000
Agriculture & Fishing	-	650,475	1,931,627	-	-	2,052,391	-	**4,634,493**	4,266,765
Manufacturing	1,400,239	26,151,034	11,444,438	-	8,056,884	37,398,518	-	**84,451,112**	92,909,048
Tourism	-	-	2,703,257	-	-	49,246,680	-	**51,949,938**	45,801,600
Transport	-	-	1,837,847	-	170,051	835,725	-	**2,843,624**	13,488,453
Construction	-	-	2,682,243	-	-	3,458,991	-	**6,141,233**	7,610,966
Traders	5,903,008	1,009,423	3,773,348	-	3,089,615	269,327	-	**14,044,721**	23,442,555
New Economy	10,017	-	79,976	-	666,913	8,073,059	-	**8,829,965**	9,870,985
Financial and Business Services	-	-	713,308	-	-	1,284,857	-	**1,998,165**	5,352,674
Infrastructure	-	-	-	-	-	-	-	**-**	2,917
Other Services	-	-	2,653,742	-	148,160	5,371,996	-	**8,173,897**	8,036,814
Credit card	-	-	-	21,295,713	-	-	-	**21,295,713**	25,909,878
Other	-	-	4,150,108	124,308	-	11,618,363	1,800,596	**17,693,375**	25,169,509
Total	**7,313,263**	**27,810,932**	**31,969,894**	**21,420,021**	**12,131,622**	**119,609,907**	**1,800,596**	**222,056,235**	261,862,164

39 Financial Risk Management (contd)

39.2 Credit risk (contd)

39.2.2 Quantitative Disclosures (contd)

Total Gross Loans and receivables including acceptances - Residual contractual maturity

Sector	Less than 7 days Rs.000	7-30 Days Rs.000	1-3 Months Rs.000	3-6 Months Rs.000	6-12 Months Rs.000	1-3 Years Rs.000	3-5 Years Rs.000	Over 5 years Rs.000	2020 Total Rs. 000	2019 Total Rs. 000
Overdrafts	31,969,894	-	-	-	-	-	-	-	**31,969,894**	36,910,890
Term lending	7,133,469	17,606,541	28,296,204	12,144,904	5,080,339	32,266,985	51,093,671	6,416,790	**160,038,903**	177,428,731
Non-eligible bills	523,425	4,209,416	2,093,980	-	-	-	-	-	**6,826,821**	14,904,596
Money market placements	-	-	-	-	-	-	-	-	**-**	4,638,600
Credit card advances	21,420,021	-	-	-	-	-	-	-	**21,420,021**	26,037,785
Mortgages	243,290	59	912	3,137	9,646	47,969	82,311	1,413,272	**1,800,596**	1,941,562
Total gross loans and receivables	**61,290,099**	**21,816,016**	**30,391,096**	**12,148,041**	**5,089,985**	**32,314,954**	**51,175,982**	**7,830,062**	**222,056,235**	261,862,164
Acceptances and endorsements	854,636	2,820,825	6,018,750	4,505,885	390,445	-	1,316	-	**14,591,857**	6,349,354
Total	**62,144,735**	**24,636,841**	**36,409,846**	**16,653,926**	**5,480,430**	**32,314,954**	**51,177,298**	**7,830,062**	**236,648,092**	268,211,518

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.2 Quantitative disclosures (contd)

Gross loans and receivables - Sector wise analysis of past due not impaired and impaired loans

Sector	Past due not impaired		Impaired	
	2020 Total Rs. 000	2019 Total Rs. 000	**2020 Total Rs. 000**	2019 Total Rs. 000
Agriculture and fishing				
Manufacturing	**2,086,620**	2,715,073	**-**	-
Tourism	**1,281,052**	34,281	**142,381**	134,374
Transport	**-**	369,646	**-**	-
Construction	**-**	-	**-**	-
Traders	**167,785**	4,276,931	**-**	-
New economy	**-**	39,980	**1,530**	2,230
Financial and business services	**-**	-	**-**	-
Infrastructure	**-**	-	**-**	-
Other services	**32,014**	348,923	**87,782**	80,552
Credit card	**-**	-	**779,329**	498,024
Other	**852,568**	1,074,419	**1,946,854**	1,425,643
Total	**4,420,039**	8,859,253	**2,957,876**	2,140,823

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.2 Quantitative Disclosures (contd)

Distribution of financial instruments by credit quality

Sector	Strong Rs.000	Good Rs.000	Satisfactory Rs.000	Sub Standard Rs.000	Past due but not impaired Rs.000	Impaired Rs.000	Impairment Allowance Rs.000	2020 Total Rs. 000	2019 Total Rs. 000
Cash and cash equivalents	13,534,708	6,877,268	-	-	-	-	-	**20,411,976**	33,986,285
Balances with central banks	18,453,574	-	-	-	-	-	-	**18,453,574**	9,740,145
Placements with banks	-	-	-	-	-	-	-	**-**	27,214,500
Derivative financial instruments	26,981	527,166	102,319	-	-	-	-	**656,466**	812,121
Financial assets measured at fair value through profit or loss	334,968	-	-	-	-	-	-	**334,968**	4,751,028
Loans and receivables to customers	852,548	10,424,289	187,351,277	16,050,206	4,420,039	2,957,876	(2,932,769)	**219,123,466**	260,155,127
Financial assets measured at fair value through other comprehensive income	136,631,512	-	-	-	-	-	-	**136,631,512**	107,854,554
Financial assets at amortised cost - debt instruments	3,118,017	-	-	-	-	-	-	**3,118,017**	3,088,314
Acceptances	-	35,431	14,187,044	217,315	152,067	-	-	**14,591,857**	6,349,354
Total	**172,952,308**	**17,864,154**	**201,640,640**	**16,267,520**	**4,572,106**	**2,957,876**	**(2,932,769)**	**413,321,836**	453,951,429

39 Financial risk management (contd)

39.2 Credit risk (contd)

39.2.2 Quantitative disclosures (contd)

Ageing analysis of loans and advances - past due but not impaired

	Contractual residual maturity								
Sector	**Less than 7 Days Rs.000**	**7-30 Days Rs.000**	**1-3 Months Rs.000**	**3-6 Months Rs.000**	**6-12 Months Rs.000**	**1-3 Years Rs.000**	**3-5 Years Rs.000**	**Over 5 Years Rs.000**	**Total Rs.000**
2020	**1,479,675**	**480**	**15,742**	**37,773**	**42,874**	**1,170,452**	**1,569,990**	**103,053**	**4,420,039**
2019	6,073,912	847,893	2,714	8,424	36,302	1,240,578	455,108	194,322	8,859,253

The impairment charges for loans and receivables is disclosed in Note 11. The movement in provision for impairment is disclosed in Note 21.2.

Collateral held and other credit enhancements and their financial effect

	2020		2019	
	Carrying amount of the exposure Rs.000	**Carrying amount of the collateral Rs.000**	Carrying amount of the exposure Rs.000	Carrying amount of the collateral Rs.000
Loans and receivables to customers	**219,123,466**	**103,052,485**	260,155,127	96,298,408

The note aims to provide carrying value of collaterals held by the Branch of its customers where, they can be liquidiated at market value with reasonable certainity. Collaterals such as cash, guarantees from corporates, banks, property and fixed assets pledged are considered as eligible for consideration. Collateral relating to past due but not impaired and impaired loans as at 31 December 2020 amounts to Rs 3,538,828,149.

39 Financial risk management (contd)

39.3 Liquidity risk

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

Liquidity and funding risk is:

• **Measured** using the European Banking Authority - Delegated Act - Liquidity Coverage Ratio (EBA DA LCR) and Net Stable Funding Ratio (NSFR),

• **Monitored** against the Group's liquidity and funding risk framework and overseen by Regional and local Asset and Liability Management Committees ('ALCO's); and

• **Managed** on a stand-alone basis with no reliance on any related party (unless pre-committed) or the Central Bank of Sri Lanka, unless this represents routine established business as usual market practice.

39.3.1 Management of liquidity and funding risk

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

39 Financial risk management (contd)

39.3 Liquidity risk (contd)

39.3.1 Management of liquidity and funding risk (contd)

NSFR

This ratio monitors if the bank has sufficient stable funding to its illiquid assets. The equity and liability side of the balance sheet is considered to "provide" stable funding while on and off balance sheet assets are considered to be "requiring" stable funding. Proportion of stable funding provided/required by each balance sheet item is predetermined based on EBA regulations.

LCR

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

Maturity analysis of financial liabilities based on undiscounted cash flows

Undiscounted cash-flows include capital and interest payable on interest bearing liabilities, spread across its residual maturity.

Sector	Less than 7 Days Rs.000	7-30 Days Rs.000	1-3 Months Rs.000	3-6 Months Rs.000	6-12 Months Rs.000	1-3 Years Rs.000	3-5 Years Rs.000	Over 5 Years Rs.000	2020 Total Rs. 000	2019 Total Rs. 000
Due to banks	11,768,757	5,639,134	19,041,766	15,700,849	26,386,677	3,524,316	6,628,242	-	**88,689,741**	178,240,307
Derivative	508,372	-	-	-	-	-	-	-	**508,372**	1,052,576
Financial liablities at amortised cost - due to depositors	144,915,632	16,241,930	31,125,568	20,562,506	20,568,579	9,239,959	2,004,987	-	**244,659,161**	216,555,670
Acceptances and endorsements	854,636	2,820,825	6,018,750	4,505,885	390,445	-	1,316	-	**14,591,857**	6,349,354
Total	**158,047,397**	**24,701,889**	**56,186,084**	**40,769,240**	**47,345,701**	**12,764,275**	**8,634,545**	-	**348,449,131**	402,197,907

39 Financial risk management (contd)

39.4 Market risk

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

Exposure to market risk is separated into two portfolios:

- Trading portfolios comprise positions arising from market-making and warehousing of customer derived positions.
- Non-trading portfolios comprise positions that primarily arise from the interest rate management of our WSB and WPB banking assets and liabilities, financial investments designated at fair value through other comprehensive income.

39.4.1 Monitoring and limiting market risk exposures

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

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

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

39.4.2 Risk management

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

39 Financial risk management (contd)

39.4 Market risk (contd)

39.4.2 Risk management (contd)

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

The historical simulation models used incorporate the following features:

• Historical market rates and prices are calculated with reference to foreign exchange rates and commodity; prices, interest rates, equity prices and the associated volatilities;

• Potential market movements utilized for VAR are calculated with reference to data from the past two years;

• Potential market movements employed for stressed VAR calculations are based on a continuous one year period of stress for the trading portfolio.

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

39 Financial risk management (contd)

39.4 Market risk (contd)

39.4.2 Risk management (contd)

Foreign exchange position

Currency (LKR' million)	Spot			Forward			Net Open Position	Net position in other exchange contracts	Overall exposure in other respective foreign currency	Overall exposure in Sri Lankan Rupees
	Assets	Liabilities	Net	Assets	Liabilities	Net				
US Dollars	247,089	(267,729)	(20,639)	65,886	(45,018)	20,868	122	-	1	122
Pound Sterling	25,185	(31,524)	(6,339)	12,369	(6,009)	6,361	8	-	0	8
Euro	4,636	(8,752)	(4,116)	7,100	(3,089)	4,010	0	-	0	0
Japanese Yen	8,714	(8,718)	(4)	78	(76)	2	(5)	-	(0)	(5)
Indian Rupee								-		
Australian Dollar	16,933	(20,983)	(4,050)	8,820	(4,758)	4,062	16	-	0	16
Canadian Dollar	7,622	(7,588)	34	370	(402)	(32)	2	-	0	2
Other currencies	204,640	(169,526)	35,114	16,281	(51,552)	(35,271)	(5)	-	(0)	(5)
Total exposure	**514,818**	**(514,820)**	**(1)**	**110,904**	**(110,904)**	**-**	**139**	**-**	**1**	**139**
Total capital funds as per the latest audited financial statements										**65,138**
Total exposure as a % of total capital funds (Basel III) as per the latest audited financial statements (Should not exceed 30%)										**0.2%**

* Monitored at the Branch level

*Balances are in LKR Million (Column 08 to 11 in US Dollar Mn)

Interest Rate risk in the Banking Book (IRRBB)

The Branch has a robust mechanism to monitor and control the IRRBB , the structural interest rate risk is transferred to the Balance Sheet Management division who are the subject matter experts in managing same. This is done through the Interest Rate Risk Behavioralization Policy and the Interest Rate risk Transfer pricing policy. These policies are reviewed and approved by the Asset Liability Committee (ALCO) of the Bank on an annual basis. A monthly monitoring tool is available to monitor the net interest margins of customer lending and deposit products across the different business lines, and forms part of the monthly ALCO packs. Furthermore basis risk of the lending portfolio is monitored and reported to the ALCO on a quarterly basis , same is monitored against a ALCO set limit. Overall ALCO oversight on these aspects ensure that there is sufficient senior management oversight in evaluating the IRRBB of the bank.

39 Financial risk management (contd)

39.4 Market risk (contd)

39.4.2 Risk management (contd)

Maturities of assets and liabilities

Figures in LKR'000	Upto 1 month	Between 1 - 3 months	Between 3 - 6 months	Between 6 - 12 months	1 - 3 years	3 - 5 years	5 years and above	Non financial assets & liabilities	Total
Cash and cash equivalent	20,411,976	-	-	-	-	-	-	-	**20,411,976**
Balances with Central Bank	18,453,574	-	-	-	-	-	-	-	**18,453,574**
Derivative financial instruments	656,466	-	-	-	-	-	-	-	**656,466**
Financial assets measured at fair value through profit or loss	42,874	14,551	1,078	78,543	78,432	119,490	-	-	**334,968**
Financial assets at amortised cost - loans and advances	84,764,864	34,575,662	14,167,610	5,251,133	35,452,317	40,630,481	7,214,168	(2,932,769)	**219,123,466**
Financial assets measured at fair value through other comprehensive income	22,502,599	30,378,642	9,419,556	55,405,040	18,925,675	-	-	-	**136,631,512**
Financial assets at amortised cost - debt instruments	81,633	-	2,500,411	-	535,973	-	-	-	**3,118,017**
Property, plant and equipment	-	-	-	-	-	-	-	4,836,206	**4,836,206**
Deferred Tax Assets	-	-	-	-	-	-	-	367,616	**367,616**
Other assets	4,667,884	6,018,750	4,505,885	390,445	-	1,316	-	5,133,168	**20,717,448**
Total assets	**151,581,870**	**70,987,605**	**30,594,540**	**61,125,161**	**54,992,397**	**40,751,287**	**7,214,168**	**7,404,221**	**424,651,249**
Due to banks	17,283,212	18,802,000	15,699,670	26,373,044	3,522,772	6,621,632	-	-	**88,302,330**
Derivative financial instruments	508,372	-	-	-	-	-	-	-	**508,372**
Financial liablities at amortised cost - due to depositors	157,373,213	29,904,677	19,628,895	19,623,290	8,814,773	1,912,725	-	-	**237,257,573**
Retirement benefit obligations	-	-	-	-	-	-	245,976	-	**245,976**
Current tax liability	-	41,973	41,973	41,973	-	-	-	-	**125,919**
Other liabilities	4,435,930	8,461,491	4,505,885	390,445	-	1,316	-	10,110,855	**27,905,922**
Equity	-	-	-	-	-	-	-	70,305,157	**70,305,157**
Total liabilities	**179,600,727**	**57,210,141**	**39,876,423**	**46,428,752**	**12,337,545**	**8,535,673**	**245,976**	**80,416,012**	**424,651,249**
Cumulative gap	**(28,018,857)**	**13,777,464**	**(9,281,883)**	**14,696,409**	**42,654,852**	**32,215,614**	**6,968,192**	**(73,011,791)**	**-**

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

	Upto 1 month	Between 1 - 3 months	Between 3 - 6 months	Between 6 - 12 months	1 - 3 years	3 - 5 years	5 years and above		Total
Performance bonds	914,598	804,372	1,052,324	4,206,319	10,961,663	965,643	-		**18,904,919**
Letters of credit	3,865,693	6,865,608	2,843,158	171,116	-	-	-		**13,745,575**
Other contingent items	12,924,399	9,844,850	7,700,765	9,125,804	28,128,882	14,641,475	-		**82,366,175**
Undrawn loan commitments	186,644,334	-	-	-	-	-	-		**186,644,334**
Foreign exchange contracts	81,758,964	102,355,650	19,915,563	6,019,221	384,774	-	-		**210,434,172**
Other contra accounts	18,738,792	-	-	-	-	-	-		**18,738,792**
	304,846,780	**119,870,480**	**31,511,810**	**19,522,460**	**39,475,319**	**15,607,118**	**-**	**-**	**530,833,967**

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

39 Financial risk management (contd)

39.4 Market risk (contd)

39.4.2 Risk management (contd)

Sensitivity analysis of assets and liabilities

Figures in LKR'000	Upto 1 month	Between 1 - 3 months	Between 3 - 6 months	Between 6 - 12 months	1 - 3 years	3 - 5 years	5 years and above	Non-Sensitive	Total
Cash and cash equivalent	11,657,240	-	-	-	-	-	-	8,754,736	**20,411,976**
Balances with Central Bank	14,100,000	-	-	-	-	-	-	4,353,574	**18,453,574**
Placements with banks	-	-	-	-	-	-	-	-	**-**
Derivative financial instruments	656,466	-	-	-	-	-	-	-	**656,466**
Financial assets measured at fair value through profit or loss	42,874	14,551	1,078	78,543	78,432	119,490	-	-	**334,968**
Financial assets at amortised cost - loans and advances	129,680,877	62,268,251	4,321,606	679,086	6,142,781	13,759,546	593,184	1,678,135	**219,123,466**
Financial assets measured at fair value through other comprehensive income	22,502,599	30,378,642	9,419,556	55,405,040	18,925,675	-	-	-	**136,631,512**
Financial assets at amortised cost - debt instruments	81,633	-	2,500,411	-	535,973	-	-	-	**3,118,017**
Property,plant and equipment	-	-	-	-	-	-	-	4,836,206	**4,836,206**
Deferred tax assets	-	-	-	-	-	-	-	367,616	**367,616**
Other assets	-	-	-	-	-	-	-	20,717,448	**20,717,448**
Total assets	**178,721,689**	**92,661,444**	**16,242,651**	**56,162,669**	**25,682,861**	**13,879,036**	**593,184**	**40,707,715**	**424,651,249**
Due to banks	29,374,024	30,203,221	2,820,300	6,787,377	977,414	6,621,659	-	11,518,335	**88,302,330**
Derivative financial instruments	508,372	-	-	-	-	-	-	-	**508,372**
Financial liablities at amortised cost - due to depositors	93,770,782	29,904,677	19,628,895	19,623,290	8,814,773	1,912,725	-	63,602,431	**237,257,573**
Retirement benefit obligations	-	-	-	-	-	-	-	245,976	**245,976**
Current tax liability	-	-	-	-	-	-	-	125,919	**125,919**
Other liabilities	-	-	-	-	-	-	-	27,905,922	**27,905,922**
Equity	-	-	-	-	-	-	-	70,305,157	**70,305,157**
Total liabilities	**123,653,178**	**60,107,898**	**22,449,195**	**26,410,667**	**9,792,187**	**8,534,384**	**-**	**173,703,740**	**424,651,249**
Cumulative gap	**55,068,511**	**32,553,546**	**(6,206,544)**	**29,752,002**	**15,890,674**	**5,344,652**	**593,184**	**(132,996,025)**	**-**

39 Financial risk management (contd)

39.5 Operational risk

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

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

Risk and Control Owners supported by Risk Stewards 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 Risk Management Framework helps management to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

Some of the key action taken to mitigate operational risk include the following:

Risk and Control Assessment process is in place that facilitates the assessment of risk and the associated control environment for all operational risks faced by the bank.

Classification of all information based on the potential risk to the Branch, its customers and related parties. This classification is used to invoke policies and procedures to protect the confidentiality and integrity of information.

Vendor management process is in place where due diligence performed by business departments forms part of the risk assessment process. Selecting a financially viable and non sanctioned vendor with appropriate capability, skills and experience is essential part of the HSBC vendor due diligence process in managing risk.

The Branch has also undertaken steps to mitigate the risk of continuation of business through comprehensive Business Continuity Planning, taking into account the risks to the business, impact analysis, resource requirements etc. The Business Continuity Plans are updated regularly, tested and approved. The plans describe how normal business can be resumed following an adverse event or business interruption ensuring minimum impact to the business and customers.

With regard to outsourcing of activities, HSBC Group policy is to outsource activities either internally to Global Service Centre's (GSCs) and affiliates or externally to third parties, where this enables the work to be performed more efficiently gaining economies of scale within the business, due to lack of specialist knowledge or resource constraints. Guidance on the outsourcing of work is contained in the Group policies & procedures and the outsource direction issued by Central Bank of Sri Lanka and Hong Kong Monetary Authority.

Group Insurable Risk (IR) is mandated by the Group Management Board (GMB) to arrange global insurance policies covering: Crime, Civil & Cyber Liability (CCC), Directors' & Officers' Liability including Outside Directors' & Officers' (D&O/ODL), Pension Trustees Liability (PTL). Collectively the three policies are the "Financial Lines Insurance Programmes/Policies". Cover is provided for HSBC Holdings plc and all wholly and majority owned subsidiaries. Policies are placed with insurers in the UK, US, Bermuda and other international markets by the Group's global insurance broker (Aon).

AS AT 31 DECEMBER

39 Financial risk management (contd)

39.5 Operational risk (contd)

The Branch is investing in digital technology to improve the service it provides to customers and stay competitive. The mobile apps are one of the ways the Branch helps customers to manage their money more quickly, conveniently and safely.

Cybersecurity continues to be a focus area and is routinely reported at the Board level to ensure appropriate visibility, governance and executive support for the ongoing cybersecurity activities. The branch continues to strengthen and invest significantly in both business and technical controls in order to prevent, detect and respond to an increasingly hostile cyber threat environment. These include enhancing controls to protect against advanced malware, data leakage, infiltration of payments systems and denial of service attacks.

The Branch has given priority for the Baseline Security Standards introduced by Central Bank of Sri Lanka and compliant with relevant requirements to assure the level of security to customers and regulator.

The Branch continues to monitor and improve service resilience across its technology infrastructure, enhancing problem diagnosis/resolution and change execution capabilities to reduce service disruption to the customers .

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. Risk and Control Assessments are input and maintained by Risk Owners. To ensure that operational risk losses are consistently reported and monitored at HSBC Group level, all branches are required to report individual material losses in excess of a particular threshold which are monitored against risk appetites set.

Total operational losses for the Branch in the year 2020 was Rs. 16,415,756/-

39.6 Capital management

Qualitative disclosures

Capital adequacy ratio (CAR) is calculated based on the Central Bank of Sri Lanka (CBSL) directions stemming from Basel III accord. These guidelines require the Bank to maintain a CAR not less than 8.5% with minimum Tier 1 capital with buffers in relation to total risk weighted assets and a minimum total CAR with buffers of 12.5% in relation to total risk weighted assets.

Tier 1 Capital – Core Capital

This includes assigned capital, statutory reserve fund, published retained profits, accumulated other comprehensive income, general and other reserves. The assigned capital is the amount provided by HSBC Asia Pacific to conduct its operation in Sri Lanka. In order to avoid stress on capital and in line with the guidance given by the Basel Committee on Banking Supervision, licensed banks can stagger audited additional credit loss provisions arising from SLFRS 9 when compared with credit loss provisions under LKAS 39 as at first day of adoption of SLFRS 9, net of any other adjustment on first day impact to retained earnings and net of tax effects, throughout a transitional period of four years for the purpose of calculating CAR under Banking Act Directions No. 01 of 2016 on Capital Requirements under Basel III.

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39 Financial risk management (contd)

39.6 Capital management (contd)

Tier 2 Capital – Supplementary capital

Revaluation gains and general provision are the only constituents of supplementary capital for the Branch. As per the CBSL regulations a prudential revaluation is done reflecting the full possibility of price fluctuations and forced sale, with prior approval from CBSL, which is then subject to a discount of 50%. According to explanatory note no. 03 of 2019 on intepretations of Banking Act Directions no.01 on capital requirements under Basel III for licensed commerical banks and licensed specialized banks; general provisions consist of impaired assets from stage 1 and 2 on the proportion of 100% and 50% respectively. This is subject to 1.25% of risk weighted assets on credit risk under the standardized approach shall be applicable for Tier 2 capital.

Quantative disclosures

Composition of regulatory capital (audited)	**2020** **Rs'000**	2019 Rs'000
Equity capital or stated capital/assigned capital	**3,152,358**	3,152,358
Reserve fund	**2,649,711**	2,598,158
Published retained earnings	**48,138,924**	43,141,527
Accumulated other comprehensive income (OCI)	**5,708,686**	5,203,062
General and other disclosed reserves	**3,145,865**	3,138,575
Total Common Equity Tier I (CET1) Capital	**62,795,544**	57,233,679
Deductions to tier 1 capital	**410,290**	(35,654)
Revaluation losses of property, plant and equipment	**106,000**	-
Net deferred tax assets	**367,616**	-
Amounts due to head office and branches outside Sri Lanka in Sri Lanka Rupees (-)	**(63,326)**	(35,654)
Total Tier 1 Capital	**62,385,254**	57,269,334
Components of tier 2 capital		
Revaluation reserves (as approved by CBSL)	**1,049,765**	1,049,765
General provisions*	**1,680,562**	1,169,605
Total qualifying tier 2 capital prior to deductions	**2,730,327**	2,219,370
Total Capital	**65,115,581**	59,488,704

** Please refer qualitative disclosure on tier 2 capital for explanation*

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39 Financial risk management (contd)

39.6 Capital management(contd)

Capital adequacy

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

All growth measures as targeted in the Rolling Operating Plan (ROP) 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)

	2020	2019
	Rs.'000	Rs.'000
Credit risk	**264,327,111**	296,511,881
Market risk	**12,667,295**	15,671,112
Operational risk	**26,510,200**	27,652,339
Total risk-weighted assets	**303,504,606**	339,835,332

Capital ratios (Audited)		
Common Equity Tier 1 Capital Ratio	**20.55%**	16.85%
Tier 1 ratio	**20.55%**	16.85%
Total capital ratio	**21.45%**	17.51%

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40 Fair value of financial assets and liabilities

40.1 Fair value of financial instruments not carried at fair value

	2020		2019	
	Carrying value	**Fair value**	Carrying value	Fair value
Assets	**Rs'000**	**Rs'000**	Rs'000	Rs'000
Cash and cash equivalents	**20,411,976**	**20,411,976**	33,986,285	33,986,285
Balances with Central Bank	**18,453,574**	**18,453,574**	9,740,145	9,740,145
Placements with banks	**-**	**-**	27,214,500	27,214,500
Financial assets at amortised cost - loans	**219,123,466**	**224,483,126**	260,155,127	262,843,879
Acceptances and endorsements	**14,591,857**	**14,591,857**	6,349,354	6,349,354
Liabilities				
Due to banks	**88,302,330**	**88,302,330**	170,599,897	170,599,897
Financial liablities at amortised cost - due to depositors	**237,257,573**	**237,257,573**	209,805,122	209,805,122
Acceptances and endorsements	**14,591,857**	**14,591,857**	6,349,354	6,349,354

Note:

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

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40 Fair value of financial assets and liabilities (contd)

40.2 Fair value of financial instruments carried at fair value

40.2.1 Fair value hierarchy

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

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

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

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

Financial instruments carried at fair value and bases of valuation

As at 31 December 2020	**Level 1 Rs'000**	**Level 2 Rs'000**	**Level 3 Rs'000**
Assets			
Financial assets measured at fair value through profit or loss	**-**	**334,968**	**-**
Derivatives	**2,440**	**654,026**	**-**
Financial assets measured at fair value through other comprehensive income	**-**	**132,008,827**	**4,622,685**
Financial assets at amortised cost - debt instruments	**-**	**3,118,017**	**-**
	2,440	**136,115,838**	**4,622,685**
Liabilities			
Derivatives	**200**	**508,172**	**-**
	200	**508,172**	**-**
As at 31 December 2019			
Assets			
Financial assets measured at fair value through profit or loss	-	4,751,028	-
Derivatives	1,003	811,118	-
Financial assets measured at fair value through other comprehensive income	-	90,628,547	17,226,007
Financial assets at amortised cost - debt instruments	-	3,088,314	-
	1,003	99,279,007	17,226,007
Liabilities			
Derivative financial instruments	33	1,052,543	-
	33	1,052,543	-

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40 Fair value of financial assets and liabilities (contd)

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

40.2.1 Fair value hierarchy (contd)

Movement in Level 3 financial instruments	**2020**	
	Assets	**Liabilities**
	Rs'000	**Rs'000**
As at 1 January	**17,226,008**	-
Settlements	**(12,603,323)**	-
As at 31 December	**4,622,685**	**-**

	2019	
	Assets	Liabilities
	Rs'000	Rs'000
As at 1 January	-	-
Total gains recognised in profit or loss	32,191,856	-
Settlements	(14,965,849)	-
As at 31 December	17,226,007	-

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 (contd)

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

40.2.2 Valuation of financial instruments (contd)

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

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

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 Branch considers that there are additional factors that would be considered by a market participant which are not incorporated within the valuation model. The Branch 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.

41 Impact from COVID19 pandemic

41.1 Liquidity and Funding

• The Branch's strategic business units frequently monitor the liquidity demands in order to ensure the bank preserve the customer relationships while enhancing controls. The branch enhanced the monitoring mechanisms during the pandemic to regularly track internal/external variables that can affect the bank as well as customers and maintained strong engagement with the regional teams for expert guidance.

•The Branch was able to manage liquidity risk within the banks risk appetite regardless/irrespective of leeway's provided by Central Bank of Sri Lanka in their circulars surrounding extraordinary measure on COVID 19.

41.1 Credit Risk - Mitigation, Recognition and Measurement

In response to the COVID-19 outbreak, governments and regulators around the world have introduced a number of support measures for both personal and wholesale customers in market-wide schemes. In relation to personal lending, the majority of relief measures, including payment holidays, relate to existing lending, while in wholesale lending the relief measures comprise payment holidays, refinancing of existing facilities and new lending under government-backed schemes.

The recognition and measurement of Expected Credit Losses (ECL) involves the use of significant judgement and estimation. The Branch form multiple economic scenarios based on economic forecasts, apply these assumptions to credit risk models to estimate future credit losses, and probability-weight the results to determine an unbiased ECL estimate. Management judgemental adjustments are used to address late-breaking events, data and model limitations, model deficiencies and expert credit judgements. Economic scenarios have been used to capture the exceptional nature of the current economic environment and to articulate management's view of the range of potential outcomes. Scenarios produced to calculate ECL are aligned to HSBC's top and emerging risks. Senarios are drawn from consensus forecasts and distributional estimates. The central scenario is deemed the 'most likely' scenario, and usually attracts the largest probability weighting, while the outer scenarios represent the tails of the distribution, which are less likely to occur. The central scenario is created using the average of a panel of external forecasters, while consensus upside and downside scenarios are created with reference to distributions for select markets that capture forecasters' views of the entire range of outcomes.. The economic assumptions presented in this section have been formed by HSBC with reference to external forecasts specifically for the purpose of calculating ECL. Economic forecasts are subject to a high degree of uncertainty in the current environment. Limitations of forecasts and economic models require a greater reliance on management judgement in addressing both the error inherent in economic forecasts and in assessing associated ECL outcomes. The Branch's central scenario features an improvement in economic growth in 2021 as activity and employment gradually return to the levels experienced prior to the outbreak of COVID19.

Compared with the consensus central scenario, the consensus upside scenario features a faster recovery in economic activity during the first two years, before converging to long-run trends In the consensus downside scenario, economic recovery is considerably weaker compared with the central scenario. GDP growth remains weak, unemployment rates stay elevated and asset and commodity prices fall before gradually recovering towards their long-run trends.

41 Impact from COVID19 pandemic

41.1 Credit Risk - Mitigation, Recognition and Measurement (contd)

The calculation of ECL under IFRS 9 involves significant judgements, assumptions and estimates. The level of estimation uncertainty and judgement has increased during 2020 as a result of the economic effects of the COVID19 outbreak, including significant judgements relating to: the selection and weighting of economic scenarios, given rapidly changing economic conditions in an unprecedented manner, uncertainty as to the effect of government and central bank support measures designed to alleviate adverse economic impacts, and a wider distribution of economic forecasts than before the pandemic. The key judgements are the length of time over which the economic effects of the pandemic will occur, the speed and shape of recovery. The main factors include the effectiveness of pandemic containment measures, the pace of roll-out and effectiveness of vaccines, and the emergence of new variants of the virus, plus a range of geopolitical uncertainties, which together represent a very high degree of estimation uncertainty, particularly in assessing downside scenarios.

- estimating the economic effects of those scenarios on ECL, where there is no observable historical trend that can be reflected in the models that will accurately represent the effects of the economic changes of the severity and speed brought about by the COVID19 outbreak. Modelled assumptions and linkages between economic factors and credit losses may underestimate or overestimate ECL in these conditions, and there is significant uncertainty in the estimation of parameters such as collateral values and loss severity; and

- the identification of customers experiencing significant increases in credit risk and credit impairment, particularly where those customers have accepted payment deferrals and other reliefs designed to address short-term liquidity issues given muted default experience to date. The use of segmentation techniques for indicators of significant increases in credit risk involves significant estimation uncertainty. Models are used to reflect economic scenarios on ECL estimates. As described above, modelled assumptions and linkages based on historical information could not alone produce relevant information. Under the unprecedented conditions experienced in 2020, and it was necessary to place greater emphasis on judgemental adjustments to modelled outcomes than in previous years. We have developed globally consistent methodologies for the application of forward economic guidance into the calculation of ECL for WSB and WPB credit risk. These standard approaches are described below, followed by the management judgemental adjustments made, including those to reflect the circumstances experienced in 2020.

For wholesale, a global methodology is used for the estimation of the term structure of probability of default (‘PD’) and loss given default (‘LGD’). For PDs, we consider the correlation of forward economic guidance to default rates for a particular industry in a country. For LGD calculations, we consider the correlation of forward economic guidance to collateral values and realization rates for a particular country and industry. PDs and LGDs are estimated for the entire term structure of each instrument. For impaired loans, LGD estimates take into account independent recovery valuations provided by external consultants where available or internal forecasts corresponding to anticipated economic conditions and individual company conditions. In estimating the ECL on impaired loans that are individually considered not to be significant, we incorporate forward economic guidance proportionate to the probability-weighted outcome and the central scenario outcome for non-stage 3 populations. For WPB, the impact of economic scenarios on PD is modelled at a portfolio level.

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41 Impact from COVID19 pandemic

41.1 Credit Risk - Mitigation, Recognition and Measurement (contd)

Historical relationships between observed default rates and macroeconomic variables are integrated into IFRS 9 ECL estimates by using economic response models. The impact of these scenarios on PD is modelled over a period equal to the remaining maturity of the underlying asset or assets. The impact on LGD is modelled for mortgage portfolios by forecasting future loan-to-value ('LTV') profiles for the remaining maturity of the asset by using national level forecasts of the house price index and applying the corresponding LGD expectation. These models are based largely on historical observations and correlations with default rates.

Relief schemes offerred during the year

WPB	
Government or Market wide schemes	
Cards	
Number of accounts	112,085
Drawn value of exposures (Rs.'000)	14,558,298
Other WPB products	
Number of accounts	7,722
Drawn value of exposures (Rs.'000)	5,885,380
HSBC specific schemes	
Cards	
Number of accounts	19,085
Drawn value of exposures (Rs.'000)	2,876,554
Other WPB products	
Number of accounts	133
Drawn value of exposures (Rs.'000)	113,939
WSB	
Government or Market wide schemes	
Number of accounts	199
Drawn value of exposures (Rs.'000)	138,343,613

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Pillar III disclosures as per Basel III

Key Regulatory Ratios - Capital and Liquidity

Regulatory Capital Adequacy	2020	2019
Common Equity Tier 1, Rs. '000	**62,385,254**	57,269,332
Tier 1 Capital, Rs. '000	**62,385,254**	57,269,332
Total Capital, Rs. '000	**65,115,581**	59,488,702
Common Equity Tier 1 Capital Ratio, as % of Risk Weighted Assets (Minimum Requirement, 7%)	**20.55%**	16.85%
Tier 1 Capital Ratio, as % of Risk Weighted Assets (Minimum Requirement, 8.5%)	**20.55%**	16.85%
Total Capital Ratio, as % of Risk Weighted Assets (Minimum Requirement, 12.5%)	**21.45%**	17.51%

	2020	2019
Regulatory Liquidity		
Statutory Liquid Assets, Rs.'000		
Domestic Banking unit	**148,237,430**	107,235,873
Off-Shore Banking Unit	**29,940,230**	77,675,082
Statutory Liquid Assets Ratio,% (Minimum Requirement, 20%)		
Domestic Banking Unit	**66.30%**	50.14%
Off-Shore Banking Unit	**23.19%**	44.69%
Liquidity Coverage Ratio (%) - Rupee (Minimum Requirement, 100%)	**424.02%**	231.15%
Liquidity Coverage Ratio (%) - All currency (Minimum Requirement, 100%)	**316.12%**	360.57%
Leverage Ratio (%) (Minimum Requirement 3%)	**12.26%**	9.53%
Net Stable Funding Ratio (%) (Minimum Requirement 100%)	**129.66%**	121.44%

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Pillar III disclosures as per Basel III (contd)

Computation of capital adequacy ratio

Item	Rs. '000
Common Equity Tier I (CETI) Capital after Adjustments	**62,385,254**
Total Common Equity Tier I (CET1) Capital	**62,795,544**
Equity capital or stated capital/assigned capital	3,152,358
Reserve fund	2,649,711
Published retained earnings/(accumulated retained losses)	48,138,924
Accumulated other comprehensive income (OCI)	5,708,686
General and other disclosed reserves	3,145,865
Total Adjustments to CET1 Capital	**410,290**
Revaluation losses of property, plant and equipment	106,000
Deferred tax assets (net)	367,616
Amount due to head office & branches outside Sri Lanka in Sri Lanka Rupees	(63,326)
Tier 2 Capital after Adjustments	**2,730,327**
Total Tier 2 Capital	**2,730,327**
Revaluation gains	1,049,765
General provisions	1,680,562
Total Adjustments to Tier 2 Capital	**-**
Total Tier 1 Capital	**62,385,254**
Total Capital	**65,115,581**
Total Risk Weighted Assets (RWA)	**303,504,606**
RWAs for Credit Risk	264,327,111
RWAs for Market Risk	12,667,295
RWAs for Operational Risk	26,510,200
CET1 Capital Ratio (including Capital Conservation Buffer,	
Countercyclical Capital Buffer & Surcharge on D-SIBs) (%)	**20.55%**
of which: Capital Conservation Buffer (%)	1.25%
of which: Countercyclical Buffer (%)	
of which: Capital Surcharge on D-SIBs (%)	
Total Tier 1 Capital Ratio (%)	**20.55%**
Total Capital Ratio (including Capital Conservation Buffer, Countercyclical	**21.45%**
Capital Buffer & Surcharge on D-SIBs) (%)	
of which: Capital Conservation Buffer (%)	1.25%
of which: Countercyclical Buffer (%)	
of which: Capital Surcharge on D-SIBs (%)	

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Pillar III disclosures as per Basel III (contd)

Computation of Leverage Ratio

Item	Amount in Rs.'000	
	2020	2019
Tier 1 Capital	**59,762,024**	50,097,072
Total Exposures	**487,650,818**	525,634,765
On Balance Sheet Items (Excluding Derivatives and Securities Financing Transactions, but including Collateral)	**426,578,558**	468,152,506
Derivative Exposures	**2,357,762**	2,434,714
Securities Financing Transaction Exposures		
Other Off-Balance Sheet Exposures	**58,714,498**	55,047,545
Basel III Leverage Ratio	**12.26%**	9.53%

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Pillar III disclosures as per Basel III (contd)

Computation of Liquidity Coverage Ratio (All Currency)

Item	Rs.'000		Rs.'000	
	2020		2019	
	Total Un-weighted Value	Total Weighted Value	Total Un-weighted Value	Total Weighted Value
Total Stock of High-Quality Liquid Assets (HQLA)	**125,764,328**	**125,764,328**	79,343,979	79,078,821
Total Adjusted Level 1A Assets	**125,764,328**	**125,764,328**	79,343,979	79,343,979
Level 1 Assets	**125,764,328**	**125,764,328**	79,078,821	79,078,821
Total Adjusted Level 2A Assets	**-**	**-**	-	-
Level 2A Assets	**-**	**-**	-	-
Total Adjusted Level 2B Assets	**-**	**-**	-	-
Level 2B Assets	**-**	**-**	-	-
Total Cash Outflows	**582,198,839**	**83,696,958**	361,498,492	87,727,646
Deposits	114,430,106	11,443,011	107,351,212	10,735,121
Unsecured Wholesale Funding	139,873,169	58,929,230	124,316,603	58,174,109
Secured Funding Transactions	-	-	4,000,000	-
Undrawn Portion of Committed (Irrevocable) Facilities and Other Contingent Funding Obligations	316,253,008	1,682,161	114,631,185	7,618,924
Additional Requirements	11,642,556	11,642,556	11,199,492	11,199,492
Total Cash Inflows	**70,352,607**	**43,912,682**	74,931,778	72,594,388
Maturing Secured Lending Transactions Backed by Collateral				
Committed Facilities				
Other Inflows by Counterparty which are Maturing within 30 Days	56,538,359	41,147,799	51,249,544	66,247,142
Operational Deposits	8,680,353	-	11,293,272	-
Other Cash Inflows	5,133,895	2,764,883	12,388,962	6,347,246
Liquidity Coverage Ratio (%) (Stock of High Quality Liquid Assets/Total Net Cash Outflows over the Next 30 Calendar Days) * 100		**316.12%**		360.57%

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Pillar III disclosures as per Basel III (contd)

Main Features of Regulatory Capital Instruments - This elaborated in note 39.6 under capital management.

Summary discussion on Adequacy/Meeting Current and Future Capital Requirements - Covered through note 39.6 under capital management.

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

Asset Class	Rs.'000					
	Exposures before Credit Conversion		Exposures post CCF and CRM		RWA and RWA Density (%)	
	On-Balance Sheet Amount	Off-Balance Sheet Amount	On-Balance Sheet Amount	Off-Balance Sheet Amount	RWA	RWA Density(ii)
Claims on Central Government and CBSL	158,538,071	28,203,000	158,538,071	1,410,150	2,448,617	1.53%
Claims on Foreign Sovereigns and their Central Banks	-	-	-	-	-	-
Claims on Public Sector Entities	-	-	-	-	-	-
Claims on Official Entities and Multilateral Development Banks	-	-	-	-	-	-
Claims on Banks Exposures	5,999,417	97,450,347	5,999,417	24,916,166	9,104,420	29.45%
Claims on Financial Institutions	-	4,280,182	-	1,000,000	500,000	50.00%
Claims on Corporates	145,959,233	230,022,704	145,446,449	35,882,860	179,329,955	98.90%
Retail Claims	35,513,997	52,929,867	30,171,522	63,563	22,834,339	75.52%
Claims Secured by Residential Property	2,673,368	-	2,673,368	-	2,673,368	100.00%
Claims Secured by Commercial Real Estate	37,420,658	-	37,420,658	-	37,420,658	100.00%
Non-Performing Assets (NPAs)	618,934	-	618,934	-	624,436	100.89%
Higher-risk Categories	-	-	-	-	-	-
Cash Items and Other Assets	11,031,928	-	11,031,928	-	9,391,318	85.13%
Total	**397,755,605**	**412,886,100**	**391,900,346**	**63,272,739**	**264,327,111**	

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

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Pillar III disclosures as per Basel III (contd)

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

Description	**Rs.'000**							
Risk Weight **Asset classes**	**0%**	**20%**	**50%**	**75%**	**100%**	**150%**	**>150%**	**Total Credit Exposures Amount**
Claims on Central Government and Central Bank of Sri Lanka	147,705,134	12,243,087	-	-	-	-	-	**159,948,221**
Claims on Foreign Sovereigns and their Central Banks	-	-	-	-	-	-	-	**-**
Claims on Public Sector Entities	-	-	-	-	-	-	-	**-**
Claims on Official Entities and Multilateral Development Banks	-	-	-	-	-	-	-	**-**
Claims on Banks Exposures	-	24,986,970	3,643,173	-	2,285,439	-	-	**30,915,582**
Claims on Financial Institutions	-	-	1,000,000	-	-	-	-	**1,000,000**
Claims on Corporates	-	2,499,194	-	-	178,830,116	-	-	**181,329,310**
Retail Claims	-	-	-	29,602,984	632,101	-	-	**30,235,085**
Claims Secured by Residential Property	-	-	-	-	2,673,368	-	-	**2,673,368**
Claims Secured by Commercial Real Estate	-	-	-	-	37,420,658	-	-	**37,420,658**
Non-Performing Assets (NPAs)	-	-	27,482	-	552,965	38,487	-	**618,934**
Higher-risk Categories	-	-	-	-	-	-	-	**-**
Cash Items and Other Assets	944,509	870,126	-	-	9,217,292	-	-	**11,031,927**
Total	**148,649,643**	**40,599,377**	**4,670,655**	**29,602,984**	**231,611,939**	**38,487**	**-**	**455,173,085**

Figures are subjected to credit conversion factors and credit risk mitigation

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Pillar III disclosures as per Basel III (contd)

Market risk under standardised measurement method

Item	Rs.'000
(a) RWA for Interest Rate Risk	**12,399,450**
General Interest Rate Risk	
(i) Net Long or Short Position	1,549,931
(ii) Horizontal Disallowance	
(iii) Vertical Disallowance	
(iv) Options	
Specific Interest Rate Risk	
(b) RWA for Equity	
(i) General Equity Risk	
(ii) Specific Equity Risk	
(c) RWA for Foreign Exchange & Gold	**267,845**
Capital Charge for Market Risk [(a) + (b) + (c)] * CAR	**1,583,412**

Operational risk under basic indicator approach

	Capital Charge Factor	Gross Income Rs.'000		
		1st Year	2nd Year	3rd Year
The Basic Indicator Approach	15%	19,981,034	22,992,653	23,301,812
Capital Charges for Operational Risk (LKR'000)				
The Basic Indicator Approach	3,313,775			
Risk Weighted Amount for Operational Risk (LKR'000)				
The Basic Indicator Approach	26,510,200			

AS AT 31 DECEMBER

Pillar III disclosures as per Basel III (contd)

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

Item	Rs.'000				
	a	b	c	d	e
	Carrying Values as Reported in Published Financial Statements	Carrying Values under Scope of Regulatory Reporting	Subject to Credit Risk Framework	Subject to Market Risk Framework	Not subject to Capital Requirements or Subject to Deduction from Capital
Assets					
Cash and Cash Equivalents	20,411,976	21,916,136	6,398,133	15,529,162	15,518,003
Balances with Central Banks	18,453,574	18,453,574	18,453,574		
Placements with Banks	-	11,657,240	-	13,161,400	11,657,240
Derivative Financial Instruments	656,466	656,466	610,304		46,161
Other Financial Assets Held-For-Trading	334,968	136,966,480	136,966,480	136,966,480	
Financial Assets Designated at Fair Value through Profit or Loss	-	-	-		
Loans and Receivables to Banks	-	-	-		
Loans and Receivables to Other Customers	219,123,466	221,563,924	221,566,405	13,310,534	(1,226,033)
Financial assets measured at fair value through other comprehensive income	136,631,512	-	-	-	
Financial assets at amortised cost - debt instruments	3,118,017	3,120,147	3,120,147	3,120,147	
Investments in Subsidiaries	-	-	-		
Investments in Associates and Joint Ventures	-	-	-		
Property, Plant and Equipment	4,836,206	4,824,372	4,836,206		
Investment Properties	-	-	-		
Goodwill and Intangible Assets	-	-	-		
Deferred Tax Assets	367,616	268,968	-		268,968
Other Assets	20,717,448	5,287,176	5,287,176	570,670	
Liabilities					
Due to Banks	88,302,330	101,125,732		24,865,105	76,260,627
Derivative Financial Instruments	508,372	508,372		491,631	16,740
Other Financial Liabilities Held-For-Trading		-			
Financial Liabilities Designated at Fair Value Through Profit or Loss		-			
Due to Other Customers	237,257,573	237,595,572		51,843,974	185,751,598
Other Borrowings					
Retirement Benefit Obligations	245,976				
Current Tax Liabilities	125,919	396,380			396,380
Deferred Tax Liabilities	-	-			-
Other Provisions					
Other Liabilities	27,905,922	13,510,530		1,256,213	12,254,317
Due to Subsidiaries					
Subordinated Term Debts					
Off-Balance Sheet Liabilities					
Guarantees	82,366,177	82,366,177	82,366,177		
Performance Bonds	18,904,919	18,904,919	18,904,919		
Letters of Credit	13,745,574	13,745,574	13,745,574		
Other Contingent Items	-	14,591,857	14,591,857	8,216,933	
Undrawn Loan Commitments	186,644,334	186,644,334	186,644,334		
Other Commitments	229,172,963	166,348,294	96,633,239	36,305,098	31,091,546
Shareholders' Equity					
Equity Capital (Stated Capital)/Assigned Capital	3,152,358	3,152,358	3,152,358		
of which Amount Eligible for CET1			3,152,358		
of which Amount Eligible for AT1					
Retained Earnings	47,213,270	50,697,098	48,138,924		
Accumulated Other Comprehensive Income	11,541,082		5,708,686		
Statutory reserve fund	2,649,711	2,598,159	2,649,711		
Other Reserves	5,748,736	15,130,282	3,145,865		
Total Shareholders' Equity	**70,305,157**	**71,577,897**	**62,795,544**		

Notes :
- Items subject to both credit risk and market risk are reported in both columns, therefore in such instances sum of column c to e may be greater than column b
- Amounts reported in column 'Subject to credit risk framework' under Shareholders' Equity represent the position of regulatory capital as at 31 December 2020 computed based on Banking Act Direction No. 01 of 2016 - Capital requirements under Basel III

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Pillar III disclosures as per Basel III (contd)

D-SIB Assessment Exercise

Assessment exercise disclosed as required by the Banking Act Direction No. 10 of 2019 on Framework for dealing with domestic systemically important banks.

General Information	**Bank only Rs.'million**
Size Indicator	
Section 1 - Total Exposures	
Total exposures measure	487,651
Interconnectedness Indicators	
Section 2 - Intra-Financial System Assets	
a. Funds deposited with or lent to other financial institutions (including unused portion of committed lines extended)	14,595
(i) Funds deposited	495
(ii) Lending	14,100
b. Holdings of securities issued by other financial institutions	-
c. Net positive current exposure of securities financing transactions (SFTs) with other financial institutions	-
d. Over-the-counter (OTC) derivatives with other financial institutions that have a net positive mark to market value	33
Intra-financial system assets	14,627
Section 3 - Intra-Financial System Liabilities	
a. Funds deposited by or borrowed from other financial institutions (including unused portion of committed lines obtained)	88,153
(i) Funds deposited	88,153
(ii) Borrowings	0
b. Net negative current exposure of securities financing transactions with other financial institutions	-
c. Over-the-counter derivatives with other financial institutions that have a net negative mark to market value	367
Intra-financial system liabilities	88,521
Section 4 - Securities Outstanding	
Securities outstanding	-
Substitutability / Financial Institution Infrastructure Indicators	
Section 5 - Payments made in the reporting year (excluding intragroup payments)	
Payments activity	7,633,443
Section 6 - Assets Under Custody	
Assets under custody	115,486
Section 7 - Underwritten Transactions in Debt and Equity Markets	
Underwriting activity	-
Section 8 - Trading Volume	
Trading volume	-
Complexity indicators	
Section 9 - Notional Amount of Over-the-Counter (OTC) Derivatives	
OTC derivatives	105,422
Section 10 - Level 2 Assets	
Level 2 assets	-
Section 11 - Fair value through other comprehensive income	
FVOCI securities	137,623
Section 12 - Cross-Jurisdictional Liabilities	
Foreign liabilities (excluding derivatives and local liabilities in local currency)	87,594
Section 13 - Cross-Jurisdictional Claims	
Foreign claims (excluding derivatives and intragroup claims)	45,358