

**THE HONGKONG AND SHANGHAI
BANKING CORPORATION LIMITED
SRI LANKA BRANCH**

**FINANCIAL STATEMENTS
FOR THE YEAR ENDED
31 DECEMBER 2022**



**THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH**

FOR THE YEAR ENDED 31 DECEMBER 2022

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Independent auditor's report

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

Report on the audit of the financial statements

Our opinion

In our opinion, the financial statements give a true and fair view of the financial position of Hongkong and Shanghai Banking Corporation Limited Sri Lanka Branch (“the Branch”) as at 31 December 2022, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

What we have audited

The Branch’s financial statements comprise:

- the statement of financial position as at 31 December 2022;
- 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 significant accounting policies and other explanatory information.

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 for Professional Accountants issued by the Institute of Chartered Accountants of Sri Lanka (“CA Sri Lanka Code of Ethics”). We have fulfilled our other ethical responsibilities in accordance with the CA Sri Lanka 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 express any form of assurance conclusion thereon.

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Independent auditor's report

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

Report on the audit of the financial statements (Contd)

Other information (Contd)

In connection with our audit of the financial statements, our responsibility is to read the other information 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, 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 scepticism 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.



Independent auditor's report

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

Report on the audit of the financial statements (Contd)

Auditor's responsibilities for the audit of the financial statements

- 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 Company'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 Company'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 Company 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.

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

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

31 March 2023

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

FOR THE YEAR ENDED 31 DECEMBER

	Note	2022 Rs.'000	2021 Rs.'000
Interest income		46,946,415	19,920,338
Interest expenses		(13,320,621)	(6,775,485)
Net interest income	6	33,625,794	13,144,853
Fee and commission income		6,627,143	4,608,736
Fee and commission expenses		(1,753,299)	(1,269,212)
Net fee and commission income	7	4,873,844	3,339,521
Net gain from trading	8	4,675,520	2,660,128
Net fair value gains from financial instruments at fair value through other comprehensive income	9	-	-
Other operating income (net)	10	220,390	60,778
Total operating income		43,395,548	19,205,283
Impairment (charge) / reversal for loans and other losses	11	(12,480,098)	748,700
Net operating income		30,915,450	19,953,983
Personnel expenses	12	(5,567,739)	(3,681,634)
Other expenses	13	(12,080,893)	(8,406,282)
Operating profit before Value Added Tax, Nation Building Tax and Other Taxes on Financials Services		13,266,818	7,866,067
Value Added Tax, Nation Building Tax and Other Taxes on Financial Services	14.4	(3,373,498)	(2,221,506)
Profit before tax		9,893,320	5,644,561
Income tax expense	14.1	(2,921,260)	(2,361,307)
Profit for the year		6,972,060	3,283,254

The financial statements are to be read in conjunction with the related notes as set out on pages 9 to 93, 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	2022 Rs.'000	2021 Rs.'000
Profit for the year		6,972,060	3,283,254
Other comprehensive income / (expenses)			
Items that may be reclassified to profit or loss in subsequent periods			
Net Gain / (loss) on investments in debt instruments measured at fair value through other comprehensive income (Net of tax)		837,123	(2,152,501)
Gains from the financial statements of foreign currency operation		38,737,882	2,194,237
Net other comprehensive income that may be reclassified to profit or loss in subsequent periods		39,575,005	41,736
Items that may not be reclassified to profit or loss in subsequent periods			
Remeasurement of post-employment benefit obligations		(482,193)	299,576
Gains on revaluation of land and buildings		(260,670)	343,154
Net other comprehensive gain / (loss) that may not be reclassified to profit or loss in subsequent periods		(742,863)	642,730
Net other comprehensive income		38,832,142	684,466
Total comprehensive income for the year		45,804,202	3,967,720

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 93, 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	2022 Rs.'000	2021 Rs.'000
ASSETS			
Cash and cash equivalents	16	190,932,418	35,459,758
Balances with the Central Bank of Sri Lanka	17	163,595,024	31,059,227
Derivative financial instruments	18	285,614	38,552
Financial assets measured at fair value through profit or loss	19	57,230	151,989
Financial assets at amortised cost – Loans and advances	20	227,053,508	223,667,772
Financial assets measured at fair value through other comprehensive income	21	43,635,387	137,684,067
Financial assets at amortised cost - debt instruments	22	70,283	592,611
Retirement benefit obligations surplus	32	-	223,570
Property, plant and equipment	26	5,233,076	5,342,466
Deferred tax asset	27	4,355,291	189,348
Other assets	28	28,552,589	23,817,869
Total assets		663,770,420	458,227,229
LIABILITIES			
Due to banks	29	34,995,689	60,784,793
Derivative financial instruments	30	126,843	286,459
Financial liabilities at amortised cost - due to depositors	31	468,266,115	290,010,108
Current tax liabilities	14	7,449,684	2,617,115
Retirement benefit obligations deficit	32	513,703	-
Other liabilities	33	37,436,270	33,865,823
Total liabilities		548,788,304	387,564,298
EQUITY			
Assigned capital	34	3,152,358	3,152,358
Statutory reserve fund	35	2,997,367	2,782,644
Other reserves	36	54,066,530	15,323,868
Retained earnings		54,765,861	49,404,061
Total equity		114,982,116	70,662,931
Total equity and liabilities		663,770,420	458,227,229
Contingent liabilities and commitments	38	482,537,251	391,233,798
Memorandum Information			
Number of employees		884	972
Number of branches		13	13

The financial statements are to be read in conjunction with the related notes as set out on pages 9 to 93, 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]
Kelum Edirisinghe
Acting Chief Executive Officer
31st March 2023
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 2021

	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 2021	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
Restated balance as at 1 January 2021	<u>3,152,358</u>	<u>10,776,120</u>	<u>2,970,075</u>	<u>764,962</u>	<u>175,791</u>	<u>2,649,711</u>	<u>2,602,870</u>	<u>47,213,270</u>	<u>70,305,157</u>
Total comprehensive income for the year									
Profit for the year	-	-	-	-	-	-	-	3,283,254	3,283,254
Other comprehensive income (net of tax)	-	2,194,237	-	(2,152,501)	-	-	343,154	299,576	684,466
Total comprehensive income for the year	<u>-</u>	<u>2,194,237</u>	<u>-</u>	<u>(2,152,501)</u>	<u>-</u>	<u>-</u>	<u>343,154</u>	<u>3,582,830</u>	<u>3,967,720</u>
Transactions with non equity holders, recognised directly in equity									
Depreciation on revaluation reserve	-	-	-	-	-	-	(1,837)	1,837	-
Deferred tax on revaluation	-	-	-	-	-	-	514	(514)	-
Transactions with equity holders, recognised directly in equity									
Transfers to reserves during the year	-	-	-	-	17,591	132,933	-	(132,933)	17,591
Restricted shares	-	-	-	-	-	-	-	-	-
Transfer to IFA reserve	-	-	-	-	-	-	-	-	-
Transfer to IFA reserve	-	-	(2,367,108)	-	-	-	-	2,367,108	-
Impairment on FVOCI	-	-	-	-	-	-	-	-	-
Profit transferred to head office	-	-	-	-	-	-	-	(3,627,537)	(3,627,537)
Total transactions with equity holders	<u>-</u>	<u>-</u>	<u>(2,367,108)</u>	<u>-</u>	<u>17,591</u>	<u>132,933</u>	<u>(1,323)</u>	<u>(1,392,039)</u>	<u>(3,609,946)</u>
Balance as at 31 December 2021	<u>3,152,358</u>	<u>12,970,357</u>	<u>602,967</u>	<u>(1,387,539)</u>	<u>193,382</u>	<u>2,782,644</u>	<u>2,944,701</u>	<u>49,404,061</u>	<u>70,662,931</u>
Balance as at 1 January 2022	3,152,358	12,970,357	602,967	(1,387,539)	193,382	2,782,644	2,944,701	49,404,061	70,662,931
Surcharge Tax 2021 (Note 14.7)								(1,516,311)	(1,516,311)
Adjusted opening balance as at 1 January 2022 after the surcharge tax								47,887,750	69,146,620
Profit for the year	-	-	-	-	-	-	-	6,972,060	6,972,060
Other comprehensive income (net of tax)	-	38,737,882	-	837,123	-	-	(260,670)	(482,193)	38,832,142
Total comprehensive income for the year	<u>-</u>	<u>38,737,882</u>	<u>-</u>	<u>837,123</u>	<u>-</u>	<u>-</u>	<u>(260,670)</u>	<u>54,377,617</u>	<u>114,950,822</u>
Transactions recognised directly in equity									
Depreciation on revaluation reserve	-	-	-	-	-	-	-	-	-
Deferred tax on revaluation reserve	-	-	-	-	-	-	-	-	-
Transactions with equity holders, recognised directly in equity									
Transfers to reserves during the year	-	-	-	-	31,294	214,723	-	(214,723)	31,294
Profit transferred to head office	-	-	-	-	-	-	-	-	-
Transfer from IFA reserve	-	-	(602,967)	-	-	-	-	602,967	-
Total transactions with equity holders	<u>-</u>	<u>-</u>	<u>(602,967)</u>	<u>-</u>	<u>31,294</u>	<u>214,723</u>	<u>-</u>	<u>388,244</u>	<u>31,294</u>
Balance as at 31 December 2022	<u>3,152,358</u>	<u>51,708,239</u>	<u>-</u>	<u>(550,416)</u>	<u>224,676</u>	<u>2,997,367</u>	<u>2,684,031</u>	<u>54,765,861</u>	<u>114,982,116</u>

The financial statements are to be read in conjunction with the related notes as set out on pages 9 to 93, 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

	Note	2022 Rs.'000	2021 Rs.'000
Cash flow from operating activities			
Interest received		45,970,723	18,530,179
Interest paid		(14,355,452)	(6,208,961)
Fees and commission received		4,873,845	3,339,525
Net receipts from trading activities		4,680,130	2,660,128
Payments to employees		(5,210,546)	(3,652,310)
VAT and NBT on financial services		(2,957,069)	(905,068)
Receipts from other operating activities		730,341	535,362
Payments to other operating activities		(10,957,925)	(8,084,178)
Operating profit before changes in operating assets and liabilities		<u>22,774,047</u>	<u>6,214,677</u>
(Increase) / decrease in operating assets			
Balances with Central Bank of Sri Lanka		(132,535,797)	(12,605,653)
Financial assets at amortised cost - loans and advances		3,190,524	(5,364,946)
Treasury bills and bonds		87,038,569	797,619
Other assets		(2,258,213)	(421,038)
		<u>(44,564,917)</u>	<u>(17,594,018)</u>
Increase / (decrease) in operating liabilities			
Financial liabilities at amortised cost - due to depositors		178,256,008	52,752,536
Financial liabilities at amortised cost - due to other borrowers		(25,789,105)	(27,517,537)
Other liabilities		(9,858,607)	4,356,596
		<u>142,608,296</u>	<u>29,591,595</u>
Net cash generated from operating activities before income tax		<u>120,817,426</u>	<u>18,212,254</u>
Income tax paid		(2,937,713)	(2,436,481)
Net cash generated from operating activities		<u>117,879,713</u>	<u>15,775,773</u>
Cash flow from investing activities			
Proceeds from sale of joint venture		-	-
Proceeds from disposal of property, plant and equipment		-	-
Acquisition of property, plant and equipment		(247,938)	(92,962)
Net cash used in investing activities		<u>(247,938)</u>	<u>(92,962)</u>
Cash flow from financing activities			
CASH FLOW FROM FINANCING ACTIVITIES			
Lease payments in lieu of leases with >1 year contract period		(333,845)	-
Profit transferred to Head Office		-	(3,627,537)
Net cash used in financing activities		<u>(333,845)</u>	<u>(3,627,537)</u>
Net increase in cash and cash equivalents		<u>117,297,930</u>	<u>12,055,274</u>
Cash and cash equivalents at the beginning of period	16	<u>35,459,758</u>	<u>20,411,976</u>
Exchange difference in respect of cash and cash equivalents		<u>38,174,730</u>	<u>2,992,508</u>
Cash and cash equivalents at the end of the period	16	<u>190,932,418</u>	<u>35,459,758</u>

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 93, 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
NOTES TO THE FINANCIAL STATEMENTS

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

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 Bank have been prepared in accordance with Sri Lanka Accounting Standards, which comprise Sri Lanka Financial Reporting Standards (“SLFRS”s), Sri Lanka Accounting Standards (“LKAS”s), relevant interpretations of the Standing Interpretations Committee (“SIC”) and International Financial Reporting Interpretations Committee (“IFRIC”). Sri Lanka Accounting Standards further comprises of Statements of Recommended Practices (SoRPs), Statements of Alternate Treatments (SoATs) and Financial Reporting Guidelines issued by the Institute of Chartered Accountants of Sri Lanka. These financial statements have been prepared under the historical cost convention except for financial assets and liabilities which are measured at fair value. The preparation of financial statements in conformity with Sri Lanka Accounting Standards requires the use of certain critical accounting estimates. It also requires Branch management to exercise its judgment in the process of applying the Bank’s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the Bank’s financial statements are disclosed in note 4 to the financial statements.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD)

2.1 Basis of preparation (contd)

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**;

- 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;
- 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 Going Concern

The management has made an assessment of the Group's ability to continue as a going concern and are satisfied that it has the resources to continue in business for the foreseeable future.

2.1.5 Changes in accounting standards

The following amendments to the Sri Lanka Accounting Standards that are relevant for the preparation of the Group's financial statements have been adopted by the Group (a) new standards and amendments that are effective for the first time for periods commencing on or after 1 January 2022 (i.e., year ending 31 December 2022) and (b) forthcoming requirements, being standards and amendments that will become effective on or after 1 January 2023.

(a) New accounting standards, amendments and interpretations – applicable for the first time for periods commencing 1 January 2022

(i) Amendment to LKAS 16, Property, Plant and Equipment

Proceeds before intended use –this amendment 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 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.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD)

2.1 Basis of preparation (contd)

(ii) Amendments to LKAS 37, Onerous Contracts – Cost of Fulfilling a Contract

The amendment to LKAS 37 clarifies that the direct costs of fulfilling a contract include both the incremental costs of fulfilling the contract and an allocation of other costs directly related to fulfilling contracts. Before recognising a separate provision for an onerous contract, the entity recognises any impairment loss that has occurred on assets used in fulfilling the contract.

(a) New accounting standards, amendments and interpretations – applicable for the first time for periods commencing 1 January 2022 (contd)

(iii) Annual Improvements to SLFRS Standards 2018–2020

The following improvements were finalised in May 2020:

- SLFRS 9 Financial Instruments – clarifies which fees should be included in the 10% test for derecognition of financial liabilities.
- SLFRS 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.

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.

These Standard and amendments are effective for the annual periods beginning on or after 1 January 2022

(b) New standards and amendments but not adopted in 2022

(i) Disclosure Initiative: Accounting Policies - Amendments to LKAS 1

The amendments to LKAS 1 require companies to disclose their material accounting policy information rather than their significant accounting policies.

The amendments to LKAS 1 will be effective for annual reporting periods beginning on or after 1 January 2023. This amendment is not yet adopted in Sri Lanka.

(ii) Definition of Accounting Estimates (Amendments to LKAS 8)

The amendments introduced the definition of accounting estimates and included other amendments to LKAS 8 to help entities distinguish changes in accounting estimates from changes in accounting policies. The amendments are effective for annual periods beginning on or after 1 January 2023. This amendment is not yet adopted in Sri Lanka.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD)

2.1 Basis of preparation (contd)

(iii) Amendment to LKAS 12 – Deferred tax related to assets and liabilities arising from a single transaction

LKAS 12 Income Taxes specifies how a company accounts for income tax, including deferred tax, which represents tax payable or recoverable in the future. In specified circumstances, companies are exempt from recognising deferred tax when they recognise assets or liabilities for the first time. Previously, there had been some uncertainty about whether the exemption applied to transactions such as leases and decommissioning obligations—transactions for which companies recognise both an asset and a liability.

The amendments clarify that the exemption does not apply and that companies are required to recognise deferred tax on such transactions. The aim of the amendments is to reduce diversity in the reporting of deferred tax on leases and decommissioning obligations.

The amendments are effective for annual reporting periods beginning on or after 1 January 2023. This amendment is not yet adopted in Sri Lanka.

2.1.6 Rounding of Amounts

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

3. SIGNIFICANT ACCOUNTING POLICIES

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

3.1 Foreign currency translation

(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.

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

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.

Interest income and expense presented in the Income Statement include:

- Interest on financial assets measured at amortised cost (AC) calculated using EIR method
- Interest on financial assets measured at fair value through other comprehensive income (FVOCI) calculated using EIR method
- Interest on financial assets measured at fair value through profit or loss (FVTPL) calculated using EIR method
- Interest on financial liabilities measured at amortised cost calculated using EIR method.

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.3 Revenue recognition (contd)

(i) 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.

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	<p>The Bank provides banking services to WPB and WSB customers, including account management, provision of overdraft facilities, foreign currency transactions and servicing fees.</p> <p>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.</p> <p>Transactions based fees for interchange, foreign currency transactions and overdrafts are charged to the customer's account when the transaction takes place.</p> <p>Servicing fees are charged on a monthly basis and are based on fixed rates reviewed annually by the Bank.</p>	<p>Revenue from account servicing is recognised overtime as the services provided.</p> <p>Revenue related to transactions are recognised at the point in time when the transaction takes place.</p>

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.3 Taxation

(i) 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 Tax authorities. The tax rates and tax laws used to compute the amounts are those that are enacted or substantively enacted, in the country of operation, as at the reporting date. 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 & regulations.

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

(ii) Deferred tax

Deferred tax is provided in full using the balance sheet method on all temporary differences between the tax bases of assets and liabilities and their accounting carrying amounts at the reporting date. 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, tax credits and tax losses carried forward, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carried-forward tax credits and 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 tax is determined using Income 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 tax asset is realised or the deferred tax liability is settled.

Similar to Current Tax, Deferred tax assets and deferred tax liabilities can be offset if a legally enforceable right exists to set off, that is, when the taxes relate to the same taxable entity and owed to 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.

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

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.

3.5 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.

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.5.2 Financial assets and financial liabilities (contd)

3.5.3 Recognition and de-recognition (contd)

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.

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).

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.5 Financial assets and financial liabilities (contd)

3.5.3 Measurement (contd)

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.

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

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 21 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.

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

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
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.

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

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 2022.

3.7 Import/export bills negotiated and discounted

The import/export bills are shown in the books at their face values. Import/Export bills in foreign currencies are converted at the year-end exchange rates. The resulting gain or loss is dealt with in 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 at 4%.

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

3.10 Employee share plans

Discretionary awards of shares granted under HSBC Group share plans which aligns 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 Capital contribution. As the shares are issued by HSBC Holdings Plc, an annual invoice is issued to reimburse Holdings for the issued shares, which is funded by the accrual accumulated on the SBP Liability account. This is posted as Dr Capital contribution / Cr SBP Liability, and is measured at market value.

Upon settlement of the annual invoice the invoiced amount needs to be reclassified from SBP Liability to Interco Payable and then settled. If the invoiced amount is different to what have been accrued on the SBP Liability for the awards with the vesting dates specified on the invoice, the difference between the accrual and the invoiced amount needs to be reclassified to Retained earnings. As a result, the SBP Liability account would only hold accruals for the yet unvested and the vested but not yet invoiced awards.

The Capital contribution account will show the FV/MV difference for the awards, this however should only be for the yet unvested awards, and so on a monthly basis the FV/MV difference for the vested awards would need to be reclassified to Retained earnings.

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 of 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.

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD)

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.

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 private Provident Fund named HSBC Sri Lanka Local Staff 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 contribute 8% of the gross salary. Bank is required to apply interest at a rate or rates higher than five per centum (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.

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.

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

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 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.

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

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 significant pending tax matters with the tax authorities on estimate basis. 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 tax assets and liabilities in the period in which such determination is given by the Tax regulators.

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 & other business decisions.

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 credit distressed are considered to be in stage 1 or 2 based on the mechanism described below.

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.

Fair value of freehold land and buildings

The freehold land and buildings of the branch are reflected at fair value. The branch engages independent valuers to determine the fair value of freehold land and buildings in terms of Sri Lanka Accounting Standard – SLFRS 13 on "Fair Value Measurement".

The methods used to determine the fair value of the freehold land and buildings, are further explained in Note 26.1 to the financial statements.

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

4. SIGNIFICANT MANAGEMENT ESTIMATES AND JUDGEMENTS (CONTD)

Useful Lifetime of Property, Plant and Equipment

The branch reviews the residual values, useful lives and methods of depreciation of property, plant and equipment at each reporting date. Management exercise judgement in the estimation of these values, rates, methods and hence, those are subject to uncertainty.

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.

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

FOR THE YEAR ENDED 31 DECEMBER

6 Net interest income	2022	2021
	Rs.'000	Rs.'000
Interest income		
Cash and cash equivalents*	3,635,182	14,342
Balances with central bank	12,785,158	637,509
Placements with banks	257,553	233,756
Financial assets measured at fair value through profit or loss	6,862	26,798
Financial assets at amortised cost		
- loans and advances	20,514,019	10,959,322
- debt and other instruments	1,456,252	134,882
Financial assets measured at fair value through other comprehensive income	8,291,389	7,913,729
Total interest income	46,946,415	19,920,338
Interest expenses		
Due to banks	(66,062)	(82,537)
Financial liabilities at amortised cost		
- due to depositors	(10,784,856)	(5,706,467)
- due to repo holders	-	-
Interest expense on lease liabilities	(64,764)	(84,935)
Others**	(2,404,939)	(901,546)
Total interest expenses	(13,320,621)	(6,775,485)
	33,625,794	13,144,853

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

** Others mainly include interest expenses charged on borrowings from HSBC Group entities (2022: LKR 2.2 Billion , 2021: LKR 551.2 Million).

6.1 Net interest income from Sri Lanka Government Securities

Interest income on Government Securities included in Note 6.1 has been extracted from interest income given in Note 6 under Financial assets measured at fair value through profit or loss, Financial assets at amortised cost - Debt instruments and Financial assets measured at fair value through other comprehensive income and has been disclosed separately, as required by the Guidelines issued by the Central Bank of Sri Lanka.

	2022	2021
	Rs.'000	Rs.'000
Interest income	9,754,503	8,075,409
Less: Interest expenses	-	-
Net interest income from Sri Lanka Government Securities	9,754,503	8,075,409

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

FOR THE YEAR ENDED 31 DECEMBER

7	Net fee and commission income	2022	2021
		Rs.'000	Rs.'000
	Fee and commission income	6,627,143	4,608,736
	Fee and commission expenses	(1,753,299)	(1,269,211)
		<u>4,873,844</u>	<u>3,339,525</u>
7.1	Comprising		
	Fee Income		
	Loans and advances	32,088	92,776
	Credit cards	3,393,580	2,595,345
	Trade and remittance transactions	1,018,038	1,751,965
	Deposits accounts	90,688	73,045
	Trustee and fiduciary services	37,040	35,448
	Off Balance sheet Facilities	2,055,709	60,157
	Net fee and commission income	<u>6,627,143</u>	<u>4,608,736</u>
	Fee expense		
	Credit cards	1,533,422	1,135,542
	Other	219,877	133,669
		<u>1,753,299</u>	<u>1,269,211</u>
	Net Fee Income	4,873,844	3,339,525
8	Net gain from trading	2022	2021
		Rs.'000	Rs.'000
	Foreign exchange		
	- Gains/(losses) from transactions with customers	1,223,128	1,016,185
	- Gains from transactions with others	3,461,859	1,660,108
	Gains/(losses) on Fixed income securities	(9,467)	(16,165)
		<u>4,675,520</u>	<u>2,660,128</u>

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).

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

FOR THE YEAR ENDED 31 DECEMBER

9	Net fair value gains from financial instruments at fair value through other comprehensive income	2022 Rs.'000	2021 Rs.'000
	Net gains on financial assets at fair value through other comprehensive income	<u>-</u>	<u>-</u>
10	Other operating income (net)	2022 Rs.'000	2021 Rs.'000
	Loss on sale of property, plant and equipment	-	(252)
	Other income from intercompany transactions and dividend from mandatory shares	<u>220,390</u>	<u>61,030</u>
		<u>220,390</u>	<u>60,778</u>
11	Impairment charges / (reversals) and other losses	2022 Rs.'000	2021 Rs.'000
11.1	Financial assets at amortised cost - loans and advances		
	Stage 1	107,492	(180,658)
	Stage 2	5,844,590	(373,160)
	Stage 3	(79,672)	(248,076)
		<u>5,872,410</u>	<u>(801,894)</u>
11.2	Financial assets at amortised cost – debt instruments		
	Stage 1	-	(11,603)
	Stage 2	34,262	-
	Stage 3	-	-
		<u>34,262</u>	<u>(11,603)</u>
11.3	Financial assets measured at fair value through other comprehensive income		
	Stage 1	(302,605)	(459,662)
	Stage 2	4,454,261	-
	Stage 3	973,046	-
		<u>5,124,702</u>	<u>(459,662)</u>
11.4	Off Balance Sheet Facilities		
	Stage 1	185,004	(11,946)
	Stage 2	382,226	(77,081)
	Stage 3	-	-
		<u>567,230</u>	<u>(89,027)</u>

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

FOR THE YEAR ENDED 31 DECEMBER

11	Impairment charges / (reversals) and other losses	2022	2021
		Rs.'000	Rs.'000
11.5	Others		
	Stage 1	440,313	(2,328)
	Stage 2	73,717	2,364
	Stage 3	-	-
	Other	-	-
		<u>514,030</u>	<u>36</u>
11.5.1	Others		
	Stage 1		
	Acceptances	66,976	(463)
	Balances with Banks	330,971	(8)
	Loan Interest Receivable	42,366	(1,857)
		<u>440,313</u>	<u>(2,328)</u>
	Stage 2		
	Acceptances	56,041	(226)
	Balances with Banks	17,676	2,590
		<u>73,717</u>	<u>2,364</u>
	Total	514,030	36
11.6	Write-off's, recoveries and recovery of assets*	367,464	613,450
		<u>12,480,098</u>	<u>(748,700)</u>

*Comprised of Credit Card write offs of LKR 841 mn (2021: LKR 1200 mn), Credit Card Recoveries of LKR 514.5 mn (LKR 474.8mn), and of Recovery of Assets of LKR 41.1 mn (2021: LKR 111.7 mn)

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

FOR THE YEAR ENDED 31 DECEMBER

12 Personnel expenses	2022	2021
	Rs.'000	Rs.'000
Salary and bonus	(3,220,290)	(2,454,583)
Contributions to defined benefit obligation	(184,701)	(156,836)
Contributions to defined contribution plans / other benefit plans	(236,709)	(232,820)
Others	(1,926,039)	(837,395)
	<u>(5,567,739)</u>	<u>(3,681,634)</u>

* Others mainly include Termination benefits of LKR 482 mn (2021: 32 mn) and other allowances paid to the employees amounting to LKR1.4 Billion (2021: LKR 724 Million).

13 Other expenses	2022	2021
	Rs.'000	Rs.'000
Auditors' remuneration	(5,413)	(6,121)
Non-audit fees to auditors	(4,375)	(1,695)
Professional and legal expenses	(159,857)	(174,685)
Depreciation of property, plant and equipment	26	(301,931)
Property, plant and equipment written-off during the year	26	-
Depreciation on Right of use Assets	(283,634)	(336,304)
Office administration and establishment expenses	(2,033,741)	(1,412,984)
Short-term lease expenses	(19,749)	38,037
Donations	-	(3,935)
Others	(9,272,193)	(6,243,402)
	<u>(12,080,893)</u>	<u>(8,406,282)</u>

Main component of expenses classified as 'Others' are regionally allocated charges (RAC), which is remittable to regional Head Office (2022: LKR 8.1 Billion, 2021: LKR 5.2 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.

The Branch has calculated deferred tax at the rate of 30% which is the substantially enacted rate as at the reporting date. Current Tax has been computed at the rate of 24% for the first half of the financial year and at the rate of 30% for the second half of the financial year

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER

14 Tax expense	2022	2021
	Rs.'000	Rs.'000
14.1 Current tax expense		
Current tax on profit for the year (Note 14.3)	(6,738,847)	(1,904,518)
Over provision for the previous year	-	31,546
Exchange	20,669	-
Remittance tax	(42,317)	(38,343)
	<u>(6,760,495)</u>	<u>(1,911,315)</u>
Deferred tax expenses		
-Provision for employee benefit	(23,917)	-
- Owned assets	-	(8,573)
-Allowance for loans losses	-	(420,777)
-SLFRS 16	-	-
-Depreciation on revaluation of land & building	-	(28,779)
Deferred tax assets recognised during the year	<u>(23,917)</u>	<u>(458,129)</u>
- Provision for employee benefit	-	760
- Depreciation on revaluation of land & building	-	7,377
- Owned assets	33,296	-
-Allowance for Expected Credit Loss	3,813,730	-
-SLFRS 16	16,126	-
Deferred tax liabilities recognized during the year	<u>3,863,152</u>	<u>8,137</u>
	<u>3,839,235</u>	<u>(449,992)</u>
Total tax charge to income statement	<u>(2,921,260)</u>	<u>(2,361,307)</u>
14.2 Tax charge to the statement of other comprehensive income		
-Provision for employee benefit	297,390	(106,174)
-Provision for impairment	(1,265,375)	(67,820)
-Fair value adjustments	1,515,086	515,635
-Revaluation of buildings	(220,394)	(69,917)
	<u>326,707</u>	<u>271,724</u>
14.3 Reconciliation between current tax expense and accounting profit		
Accounting profit before taxation	9,893,320	5,644,562
Income tax for the period at 30% (2021- 24%)	2,671,197	1,355,087
Add: Tax effect of expenses that are not deductible for tax purposes	5,032,328	1,321,529
Less: Tax effect of expenses that are deductible for tax purposes	(951,149)	(694,425)
Tax effect on exempt Income and income taxed at reduced rates	(13,529)	(77,673)
Current tax on profit for the year	<u>6,738,847</u>	<u>1,904,518</u>
14.4 Breakdown of Value Added Tax, Nation Building Tax (NBT) and Other Taxes on financial services		
Value Added Tax	(3,373,498)	(2,058,486)
Exchange	-	-
Nation Building Tax (NBT) and Other Taxes on financial services	-	(163,020)
	<u>(3,373,498)</u>	<u>(2,221,506)</u>

- During the 12 months period ended December 2022 the applicable Value Added Tax (VAT) rate has been at 18% (2021 : 15%)

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER

14	Tax expense (Contd.)	2022	2021
		Rs.'000	Rs.'000
14.5	Reconciliation between tax expense and the product of accounting profit		
	Accounting profit before taxation	9,893,320	5,644,561
	Tax effect on accounting profit	9,841,060	(1,355,087)
	Tax effect on deductible income	(11,241,116)	78,468
	Tax effect on non deductible expenses	927,232	(1,623,211)
	Tax effect on deductions claimed	-	547,523
	(Under) / over provision for previous years	(2,636,417)	30,138
	Tax Effect of rate differential	230,880	-
	Other rates (Dividend Tax at 14%, Remittance Tax at 14% ,Capital gain tax at 10%)	(42,899)	(39,138)
	Tax expense	<u>(2,921,260)</u>	<u>(2,361,307)</u>
14.6	Tax Liabilities		
	Balance at the beginning	2,617,115	125,919
	Reclassification of other direct Taxes to Other liabilities	(1,086,781)	
	Current tax charge for the year	6,760,494	1,911,315
	Other Direct Taxes		2,221,506
	Exchange Loss	-	
	Payments made during the year	(841,144)	(1,641,625)
	Balance at the end	<u>7,449,684</u>	<u>2,617,115</u>
14.7	Surcharge Tax		

The government of Sri Lanka imposed a one time, Surcharge tax on companies that earned a taxable income in excess of Rs. 2Bn for the year of assessment of year 2020/21, at the rate of 25%. Surcharge tax deemed to be an expense of financial statements commenced on 1st January 2020. Based on the Surcharge Tax Act requirements and the SoAT on Accounting for Surcharge Tax issued by the Institute of Chartered Accountants of Sri Lanka, the company has recognized the total liability to the Surcharge Tax as an adjustment to the opening retained earnings as at 1st January 2022 amounting to LKR 1.516 Bn.

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

AS AT 31 DECEMBER

15 Analysis of financial instruments by measurement basis

15.1 As at 31 December 2022

	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	-	190,932,418	-	190,932,418
Balances with the Central Bank of Sri Lanka	-	163,595,024	-	163,595,024
Placements with banks	-	-	-	-
Derivative financial instruments	285,614	-	-	285,614
Financial assets measured at fair value through profit or loss	57,230	-	-	57,230
Financial assets at amortised cost – loans and advances	-	227,053,508	-	227,053,508
Financial assets measured at fair value through other comprehensive income	-	-	43,635,387	43,635,387
Financial assets at amortised cost - debt instruments	-	70,283	-	70,283
Acceptances and endorsements	-	18,209,373	-	18,209,373
Total financial assets	342,844	599,860,606	43,635,387	643,838,837
LIABILITIES				
Due to banks	-	34,995,689	-	34,995,689
Derivative financial instruments	126,843	-	-	126,843
Financial liabilities at amortised cost - due to depositors	-	468,266,115	-	468,266,115
Acceptances and endorsements	-	18,209,373	-	18,209,373
Total financial liabilities	126,843	521,471,177	-	521,598,020

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

AS AT 31 DECEMBER

15 Analysis of financial instruments by measurement basis (contd)

15.2 As At 31 December 2021

	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	-	35,459,758	-	35,459,758
Balances with Central Bank	-	31,059,227	-	31,059,227
Placements with banks	-	-	-	-
Derivative financial instruments	38,552	-	-	38,552
Financial assets measured at fair value through profit or loss	151,989	-	-	151,989
Financial Assets at Amortised Cost – Loans and Advances	-	223,667,772	-	223,667,772
Financial assets measured at fair value through other comprehensive income	-	-	137,684,067	137,684,067
Financial assets at amortised cost - debt instruments	-	592,611	-	592,611
Acceptances and endorsements	-	18,196,453	-	18,196,453
Total financial assets	190,541	308,975,821	137,684,067	446,850,429
LIABILITIES				
Due to banks	-	60,784,793	-	60,784,793
Derivative financial instruments	286,459	-	-	286,459
Financial liabilities at amortised cost - due to depositors	-	290,010,108	-	290,010,108
Acceptances and endorsements	-	18,196,453	-	18,196,453
Total financial liabilities	286,459	368,991,354	-	369,277,813

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

AS AT 31 DECEMBER

16	Cash and cash equivalents	2022 Rs.'000	2021 Rs.'000
	Cash in hand	1,638,677	1,039,869
	Balances with other banks	53,258,159	34,419,889
	Placements with banks	136,035,582	-
		190,932,418	35,459,758
17	Balances with the Central Bank of Sri Lanka	2022 Rs.'000	2021 Rs.'000
	Statutory balances with Central bank of Sri Lanka	10,995,024	9,359,227
	Non-statutory balances with central banks		
	- Placements with Central bank of Sri Lanka	152,600,000	21,700,000
		163,595,024	31,059,227
	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 4% as at 31st December 2022 (2021: 4%).		
	Placements with Central bank of Sri Lanka are overnight balances.		
18	Derivative financial instruments	2022 Rs.'000	2021 Rs.'000
	Interest rate options	-	-
	Others	-	-
	Foreign currency derivatives	-	-
	Forward foreign exchange contracts	285,614	38,552
		285,614	38,552
19	Financial assets measured at fair value through profit or loss	2022 Rs.'000	2021 Rs.'000
	Treasury bills	9,468	64,144
	Treasury bonds	47,762	87,845
		57,230	151,989
19.1	Analysis		
	By collateralisation		
	- Unencumbered	57,230	151,989
	By currency		
	- Sri Lankan rupee	57,230	151,989

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20 Financial assets at amortised cost – Loans and advances

	Note	2022 Rs.'000	2021 Rs.'000
Gross loans and advances			
Stage 1		103,844,109	143,906,098
Stage 2		120,933,273	80,574,983
Stage 3		11,581,044	1,368,708
	20.1	<u>236,358,426</u>	<u>225,849,789</u>
Less: Accumulated impairment under;			
Stage 1		(611,648)	(424,076)
Stage 2		(7,961,482)	(943,874)
Stage 3		(731,788)	(814,067)
	20.2	<u>(9,304,918)</u>	<u>(2,182,017)</u>
Net loans and receivables		<u><u>227,053,508</u></u>	<u><u>223,667,772</u></u>

20.1 Analysis

20.1.1 By currency

Sri Lankan Rupee	56,466,835	61,678,066
United States Dollar	171,108,781	158,885,572
Great Britain Pound	470,057	345,041
Others	8,312,753	4,941,110
Gross total	<u>236,358,426</u>	<u>225,849,789</u>

20.1.2 By industry

Agriculture & Fishing	3,038,569	2,702,811
Manufacturing	101,817,941	86,985,844
Tourism	64,290,976	49,965,796
Transport	649,191	4,032,078
Construction	10,729,263	10,283,512
Traders	4,889,693	11,397,472
New Economy	3,494,023	7,949,459
Financial and Business Services	3,477,518	4,048,155
Infrastructure	2	-
Other Services	10,840,688	12,561,821
Credit card	20,435,293	22,496,548
Other	12,695,272	13,426,293
Gross total	<u>236,358,426</u>	<u>225,849,789</u>

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

20.2 Provision for impairment loss	2022	2021
	Rs.'000	Rs.'000
20.2.1 Stage 1		
Opening balance as at 01 January	424,076	589,337
(Write back) to income statement	107,492	(180,658)
Exchange fluctuations and other movements	80,080	15,397
Closing balance as at 31 December	<u>611,648</u>	<u>424,076</u>
20.2.2 Stage 2		
Opening balance as at 01 January	943,874	1,281,289
(Write back) / charge to income statement	5,844,590	(373,160)
Exchange fluctuations and other movements	1,173,018	35,745
Closing balance as at 31 December	<u>7,961,482</u>	<u>943,874</u>
20.2.3 Stage 3		
Opening balance as at 01 January	814,067	1,062,143
(Write back) / charge to income statement	(79,672)	(248,076)
Exchange fluctuations and other movements	(2,607)	-
Closing balance as at 31 December	<u>731,788</u>	<u>814,067</u>
21 Financial assets measured at fair value through other comprehensive income	2022	2021
	Rs.'000	Rs.'000
Treasury bills	236,703	72,200,028
Treasury bonds	43,398,684	65,484,039
	<u>43,635,387</u>	<u>137,684,067</u>
21.1 Analysis		
By collateralisation		
- Unencumbered	<u>43,635,387</u>	<u>137,684,067</u>
	<u>43,635,387</u>	<u>137,684,067</u>
By Currency		
- Sri Lankan Rupees	43,100,194	135,490,228
- United States Dollar	535,193	2,193,839
	<u>43,635,387</u>	<u>137,684,067</u>
21.2 Staging of Financial assets measured at fair value through other comprehensive		
Stage 1	-	137,684,067
Stage 2	43,100,194	-
Stage 3	535,193	-
	<u>43,635,387</u>	<u>137,684,067</u>

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21 Financial assets measured at fair value through other comprehensive income (contd)

21.3 Movements in provision for impairment loss during the year	2022	2021
	Rs.'000	Rs.'000
Opening balance	292,327	732,561
Stage 1		
(Write back) / charge to income statement	(302,605)	(459,662)
Stage 2		
(Write back) / charge to income statement	4,454,261	
Stage 3		
(Write back) / charge to income statement	973,046	
Exchange fluctuations and other movements	80,251	19,428
Closing balance	<u>5,497,280</u>	<u>292,327</u>

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22	Financial assets at amortised cost - debt instruments	2022	2021
		Rs.'000	Rs.'000
	Treasury bonds	109,520	604,214
	Accumulated impairment	(39,237)	(11,603)
		70,283	592,611
22.1	Financial assets at amortised cost - debt instruments		
	By collateralisation		
	- Unencumbered	109,520	604,214
	By currency		
	- Sri Lankan Rupee	109,520	604,214
22.2	Movements in provision for impairment loss during the year		
	Stage 1	Rs.'000	Rs.'000
	Opening balance	11,603	-
	Charge / (write back) to income statement	27,634	11,603
	Closing balance	39,237	11,603
23	Other Assets	Rs.'000	Rs.'000
	Acceptances	18,209,373	18,196,453
	Receivables	10,079,333	3,928,112
	Other miscellaneous not subjected to Impairment	835,722	1,705,062
	(-) Impairment	(571,839)	(11,758)
		28,552,589	23,817,869
23.1	Movements in provision for impairment loss during the year		
	Impairment classification	-	-
	Stage 1		
	Opening balance	11,758	38,483
	Charge / (write back) to income statement*	503,947	(26,725)
	Closing balance	515,705	11,758
	Stage 2		
	Opening balance	-	-
	Charge / (write back) to income statement	56,134	-
	Closing balance	56,134	-
	Total	571,839	11,758

* Includes Impairment provided on balances with Central bank

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	2022 Rs.'000	2021 Rs.'000
24 Off Balance Sheet exposures		
Contingent Assets	338,791,927	275,001,077
	338,791,927	275,001,077
24.1 Movements in provision for impairment loss during the year		
Off BS Exposures		
Stage 1		
Opening balance	43,752	93,946
Charge / (write back) to income statement*	188,883	(50,194)
Closing balance	232,635	43,752
Stage 2		
Opening balance	-	-
Charge / (write back) to income statement*	378,347	-
Exchange	3,752	-
Closing balance	382,099	-
Total	614,734	43,752

25 Total Impairment Movement

	Gross Instrument Value			Total
	Stage 1	Stage 2	Stage 3	
Closing balance as at 31.12.2021	579,320,021	80,574,983	1,368,708	661,263,712
Financial assets Transferred to Stage 2	(30,082,483)	112,812,102	-	82,729,619
Financial assets Transferred to Stage 3	(48,321,324)	(2,494,544)	11,951,174	(38,864,694)
New Financial assets acquired	18,222,952	-	-	18,222,952
Reversals due to Maturities/ Repayments / write offs	(131,264,616)	63,064,178	(1,238,500)	(69,438,938)
Changes in risk parameters (in LGD and PD)	-	-	-	-
Other changes (Off BS, Other assets)	(433,330)	(6,268,578)	33,459	(6,668,449)
Closing balance as at 31.12.2022	387,441,220	247,688,141	12,114,841	647,244,202

	ECL			
	Stage 1	Stage 2	Stage 3	Total
Closing balance as at 31.12.2021	(783,518)	(943,874)	(814,066)	(2,541,458)
Financial assets Transferred to Stage 2	355,176	(12,222,398)	-	(11,867,222)
Financial assets Transferred to Stage 3	4,916	(10,599)	(2,282,195)	(2,287,878)
New Financial assets acquired	(196,174)	-	-	(196,174)
Reversals due to Maturities/ Repayments / write offs	183,704	739,339	1,391,428	2,314,471
Changes in risk parameters (in LGD and PD)	-	-	-	-
Other changes (Off BS, Other assets)	(985,210)	(416,444)	(80,252)	(1,481,906)
Closing balance as at 31.12.2022	(1,421,106)	(12,853,976)	(1,785,085)	(16,060,167)

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26 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 2021	2,665,163	1,615,838	991,667	16,210	158,630	596,665	78,029	65,652	6,187,854
Additions during the year		1,629		23	98	113,931		238,997	354,678
Disposals during the year			(3,311)						(3,311)
Write-off's during the year									-
Transfers during the year									-
Revaluation gain / (loss)	348,000	(37,629)							310,371
Adjustments									-
Closing balance as at 31 December 2021	3,013,163	1,579,838	988,356	16,233	158,728	710,596	78,029	304,649	6,849,592
Balance as at 1 January 2022	3,013,163	1,579,838	988,356	16,233	158,728	710,596	78,029	304,649	6,849,592
Additions during the year		6,404	6,403	9,064	259	44,749	-	181,057	247,936
Disposals during the year									-
Write-off's during the year									-
Transfers during the year		43,282	38,809	8,380	-	143,534	-	(234,005)	0
Revaluation gain / (loss)	(86,688)	(63,000)							(149,688)
Impairment Classification									-
Adjustments			(559)			(7,313)			(7,872)
Balance as at 31st December 2022	2,926,475	1,566,524	1,033,009	33,677	158,987	891,566	78,029	251,701	6,939,969
Accumulated depreciation									
Balance as at 1 January 2021	-	-	665,479	15,794	117,914	474,432	78,029	-	1,351,648
Charge for the year	-	(102,700)	74,501	325	17,161	66,552	-	-	55,839
Reclassified during the year	-	-	-	-	-	-	-	-	-
Revaluation adjustment	-	102,700	-	-	-	-	-	-	102,700
Disposals during the year	-	-	(3,061)	-	-	-	-	-	(3,061)
Adjustments during the year	-	-	-	-	-	-	-	-	-
Balance as at 31 December 2021	-	-	736,919	16,119	135,075	540,984	78,029	-	1,507,126
Balance as at 1 January 2022	-	-	736,919	16,119	135,076	540,984	78,029	-	1,507,127
Charge for the year	-	109,413	83,105	2,033	20,754	86,626	-	-	301,931
Revaluation adjustment	-	(109,413)	-	-	-	-	-	-	(109,413)
Disposals during the year	-	-	-	-	-	-	-	-	-
Adjustments	-	-	-	-	-	7,248	-	-	7,248
Balance as at 31 December 2022	-	-	820,024	18,152	155,830	634,858	78,029	-	1,706,893
Carrying value	2,926,475	1,566,524	212,985	15,525	3,157	256,708	-	251,701	5,233,076
As at 31 December 2021	3,013,163	1,579,838	251,437	114	23,653	169,612	-	304,649	5,342,466
As at 31 December 2022	2,926,475	1,566,524	212,985	15,525	3,157	256,708	-	251,701	5,233,076

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26 Property, plant and equipment (contd)

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

The land and buildings of the Branch as at 31 December 2022 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	Tertius, MBA, Santhana Gopalakrishnan, MBA	Sales Comparison Approach Depreciated Replacement Cost Method Income Capitalization Method (for Commercial)	Rate per square foot	Direct correlation - higher the rate per square foot, higher the market value
			Capitalisation rate	Indirect correlation - higher the rate capitalisation rate, lower the market value
Independence Avenue, Colombo 07	Tertius, MBA, Santhana Gopalakrishnan, MBA	Sales Comparison Approach Depreciated Replacement Cost Method	Sale price per perch	Direct correlation - higher the Sale price per perch, higher the market value
			Cost spent	Direct correlation - higher the cost spent, higher the market value

* Significant unobservable inputs				
Property	LKR/Sq.Ft.Month	Capitalisation rate	Sales price per perch (LKR/Mn)	Cost spent
Sir Baron Jayatilaka Mawatha, Colombo 01	LKR 333	11.5%	21.84	USD 5.91 Mn
Independence Avenue, Colombo 07	NA	NA	17.8	LKR 461.2 Mn

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27	Deferred tax assets / (liabilities)	2022	2021
		Rs.'000	Rs.'000
	Deferred tax assets	5,616,217	1,160,338
	Deferred tax liabilities	(1,260,926)	(970,990)
		4,355,291	189,348

27.1 Temporary differences

Deferred tax assets and liabilities are attributable to the following:

	PPE	Gratuity	Revaluation Reserve	Right of Use Asset	Other	Total
As at 01.01.2021	(32,511)	285,646	(831,210)	72,517	873,174	367,616
Charged/(Credited)						
- to profit or loss	(8,574)	761	-	7,376	(488,598)	(489,035)
-to Other comprehensive income	-	(106,174)	(98,695)	-	447,816	242,947
As at 31.12.2021	(41,085)	180,233	(929,905)	79,893	900,212	189,348
Charged/(Credited)						-
- to profit or loss	33,296	(23,917)	-	16,126	3,813,730	3,839,235
-to Other comprehensive income	-	297,390	(220,393)	-	249,711	326,708
As at 31.12.2022	(7,789)	453,706	(1,150,298)	96,019	4,963,653	4,355,291

Major part of Other consists of Impairment and Financial assets at Fair value through Other comprehensive Income

Deferred tax is computed using the effective tax rate of 2022 -30%, 2021 - 24%. (Refer note 14. Tax Expense)

28	Other assets	2022	2021
		Rs.'000	Rs.'000
	Receivables	10,079,333	3,928,112
	Deposits and prepayments	5,468	62,258
	Sundry debtors	-	-
	Acceptances and endorsements	18,209,373	18,196,453
	Right-of-use assets (Note 28.1)	549,682	1,600,709
	Others	280,572	42,095
	Impairment (Note 23.1)	(571,839)	(11,758)
		28,552,589	23,817,869

28.1 Right-of-use assets and lease liabilities

28.1.1 Amounts recognised in the balance sheet

	2022	2021
	Rs.'000	Rs.'000
Right-of-use assets - Buildings	549,682	1,600,709
Lease liabilities	292,571	593,296

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28 Other assets (contd)		
	2022	2021
28.1 Right-of-use assets and lease liabilities (contd)	Rs.'000	Rs.'000
28.1.2 Amounts recognised in the statement of profit or loss		
Depreciation charges	283,634	336,304
Interest expense	64,764	84,935
Expense relating to short-term leases	11,826	(65,564)
Loss / (Gain) on lease modifications	(95,610)	(12,868)

28.1.3 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 28.1.5.

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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28 Other assets (contd)

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

28.1.4 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.

28.1.5 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.

29 Due to banks	2022	2021
	Rs.'000	Rs.'000
Borrowings	27,809,121	48,117,438
Vostro balances with HSBC offices and other banks	7,186,568	12,667,355
Total	<u>34,995,689</u>	<u>60,784,793</u>

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30 Derivative financial instruments	2022	2021
	Rs.'000	Rs.'000
Forward foreign exchange contracts	<u>126,843</u>	<u>286,459</u>
	126,843	286,459
31 Financial liabilities at amortised cost - due to depositors	2022	2021
	Rs.'000	Rs.'000
Total amount due to other customers (Note 31.1)	<u>468,266,115</u>	<u>290,010,108</u>
31.1 Analysis		
31.1.1 By product		
Demand deposits (current accounts)	100,357,958	79,458,506
Savings deposits	139,896,110	72,606,061
Fixed deposits	196,946,425	125,217,548
Other deposits	31,065,622	12,727,993
Total	<u>468,266,115</u>	<u>290,010,108</u>
31.1.2 By currency		
Sri Lankan Rupees	234,526,685	180,392,017
United States Dollars	208,958,674	94,247,615
Great Britain Pounds	10,084,703	6,929,234
Others	14,696,053	8,441,242
Total	<u>468,266,115</u>	<u>290,010,108</u>
32 Defined benefit (asset) / liability - net	2022	2021
	Rs.'000	Rs.'000
Present value of defined benefit obligations (Note 32.1)	1,512,355	750,972
Fair value of plan assets (Note 32.2)	<u>(998,652)</u>	<u>(974,542)</u>
Defined benefit (asset) / liability - net	<u>513,703</u>	<u>(223,570)</u>
<p>Defined benefit plan of the bank is governed by the requirements of the Payment of Gratuity Act, No.12 of 1983. Bank measures the Present Value of Defined Benefit Obligation (PVDBO) with the advice of an actuary using the Projected Unit Credit Method. The actuarial 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 actuarial valuation as at 31 December 2022, carried out by Messrs. Willis Towers Watson India, actuaries.</p>		
32.1 Movement in the present value of defined benefit obligations		
Opening balance	750,972	1,190,196
Current service cost	3,753	7,614
Interest cost	82,758	89,991
Benefits paid during the year	(100,466)	(88,569)
Actuarial gain / (loss) for the year	775,338	(448,260)
Closing balance	<u>1,512,355</u>	<u>750,972</u>
32.2 Movement in fair value of plan assets		
Opening balance	974,542	944,220
Expected return on plan assets	113,821	73,759
Contribution by employers	15,000	87,642
Benefits paid during the year	(100,466)	(88,569)
Actuarial gain / (loss) for the year	(4,245)	(42,510)
Closing balance	<u>998,652</u>	<u>974,542</u>

Plan assets are invested in Government securities and fixed deposits of state owned banks

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32 Defined benefit (asset)/ liability - net (contd)

32.3 Sensitivity analysis of the defined benefit obligation

	2022	2021
	Rs.'000	Rs.'000
a. Discount rate		
Discount rate*	14.10%	11.70%
1. Effect due to the increase in the discount rate by 1.00% (Rs '000)	(147,832)	(54,764)
2. Effect due to the decrease in the discount rate by 1.00% (Rs '000)	180,544	65,321
b. Increase in salary escalation rate and post retirement pension		
Salary escalation rate		
- Union members	6%	5%
- Non-union members	14%	5%
Post retirement pension		
	10%	1.8%
1. Effect on DBO due to an increase in the salary escalation and post retirement pension rate by 1% p.a. (Rs '000)	164,406	58,592
2. Effect on DBO due to a decrease in the salary escalation and post retirement pension rate by 1% p.a. (Rs '000)	(139,070)	(51,485)
Weighted average duration of defined benefit obligation	6.2 years	8.4 years

* Discount rate used by HSBC Sri Lanka for Defined benefit obligation computation is generally the sovereign bond rate where the tenure is aligned to the weighted average duration of the defined benefit obligation. Given the turn of economic events in Sri Lanka in 2022, Yield of sovereign bond carried a significant premium for credit risk, and the appropriateness of the use of the bond rates as it was questionable. To arrive at a more realistic, long term discount rate, the bank has removed the credit spread from the zero coupon bond rate of 24% and adjusted same to reflect a more normalized credit spread (pre-covid spread). Source for the data for the adjustment is Damodaran Model.

Discount rate based on 28th Dec Yields	24.00% a
Risk Premium to be removed	-14.39% b
Pre covid risk premium to be added	4.50% c
Final discount rate - rounded (d=a-b+c)	14.10% d

33 Other liabilities

	2022	2021
	Rs.'000	Rs.'000
Sundry creditors	506,653	4,979,508
Interest payable	3,553,048	5,802,338
Acceptances and endorsements	18,209,373	18,196,453
Impairment in respect of off-balance sheet credit exposures	614,734	43,752
Lease liabilities	292,571	593,296
Other payables	12,756,680	4,250,475
Value Added Tax, Social Security Contribution levy and Other Taxes	1,503,211	-
	37,436,270	33,865,822

Other payable mainly consist of accruals & deferred income Accounts

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

AS AT 31 DECEMBER

34	Assigned capital	2022	2021
		Rs.'000	Rs.'000
	Assigned Capital	<u>3,152,358</u>	<u>3,152,358</u>
		<u>3,152,358</u>	<u>3,152,358</u>
35	Statutory reserve fund	2022	2021
		Rs.'000	Rs.'000
	Opening balance	2,782,644	2,649,711
	Transferred during the year	<u>214,723</u>	<u>132,933</u>
	Closing balance	<u>2,997,367</u>	<u>2,782,644</u>

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.

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

AS AT 31 DECEMBER

36 Other reserves	2022	2021
	Rs.'000	Rs.'000
Exchange equalisation reserve (Note 36.1)	51,708,239	12,970,357
Fair value through other comprehensive income reserve (Note 36.2)	(550,416)	(1,387,539)
Revaluation reserve (Note 36.3)	2,684,031	2,944,701
IFA reserve (Note 36.4)	-	602,967
Share based payment reserve (Note 36.5)	224,676	193,382
	<u>54,066,530</u>	<u>15,323,868</u>

36.1 Exchange equalisation reserve	2022	2021
	Rs.'000	Rs.'000
Opening balance	12,970,357	10,776,120
Translation Loss on Current Year Loss	(571,773)	73,177
Restatement Gain on Opening FCBU Retained Earnings	37,720,932	103,581
Exchange Variance in FCBU Statutory Reserves	1,588,723	2,017,479
Closing balance	<u>51,708,239</u>	<u>12,970,357</u>

Exchange equalisation of reserve is used to record the restatement gain/loss on FCBU retained earning and profits on account of exchange rates fluctuations.

36.2 Fair value through other comprehensive income reserve	2022	2021
	Rs.'000	Rs.'000
Opening balance	(1,387,539)	764,962
Net movement in revaluation and impairment	837,123	(2,152,501)
Closing balance	<u>(550,416)</u>	<u>(1,387,539)</u>

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.

36.3 Revaluation reserve	2022	2021
	Rs.'000	Rs.'000
Opening balance	2,944,702	2,602,870
Revaluation surplus / (deficit) for the year	(260,671)	341,832
Closing balance	<u>2,684,031</u>	<u>2,944,702</u>

Revaluation reserve is used to record increments and decrements on the revaluation of non-current 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.

36.4 IFA reserve	2022	2021
	Rs.'000	Rs.'000
Opening balance	602,966	2,970,075
Transferred during the year	(602,966)	(2,367,109)
Closing balance	<u>-</u>	<u>602,966</u>

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. These bonds were matured during 2022 and extinguished the IFA reserves balance as at 31.12.2022

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

AS AT 31 DECEMBER

36 Other reserves (contd)

36.5 Share based payment reserve	2022	2021
	Rs.'000	Rs.'000
Opening balance	193,382	175,791
Transferred during the year	31,294	17,591
Closing balance	<u>224,676</u>	<u>193,382</u>

36.6 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.

36.6.1 Restricted share awards - No of shares	2022	2021
Outstanding at the beginning	18,129	17,701
Awards during the year	6,904	18,827
Vested during the year	(13,811)	(18,399)
Outstanding at the end	<u>11,222</u>	<u>18,129</u>

36.6.2 Share-based payments income statement charge	Rs.'000	Rs.'000
Restricted and performance share awards	48,418	29,325
	<u>48,418</u>	<u>29,325</u>

37 Events occurring after the reporting date

Events after the reporting period are those events, favourable and unfavourable, that occur between the reporting date and the date the financial statements are authorised for issue. There are no events occurring after the reporting date which require adjustments to or disclosure in the financial statements.

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
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AS AT 31 DECEMBER

38 Commitments and contingencies

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

	2022	2021
	Rs.'000	Rs.'000
Commitments		
Undrawn loan commitments	226,517,848	189,902,071
Foreign Exchange Contracts	37,778,527	29,804,006
Other contra accounts	43,878,787	33,911,553
Total	<u>308,175,162</u>	<u>253,617,630</u>
Contingencies		
Performance bonds	27,622,849	26,528,825
Letters of credit	32,141,622	26,278,907
Guarantees	114,597,618	84,808,436
Total	<u>174,362,089</u>	<u>137,616,168</u>
Total commitments and contingencies	<u>482,537,251</u>	<u>391,233,798</u>

38.2 Movements in Impairment during the Year

	2022	2021
	Rs.'000	Rs.'000
Opening balance	43,749	93,946
Charge/ (Write back) to income statement	567,230	(89,027)
Exchange rate variance and other adjustments	3,755	38,830
Closing balance	<u>614,734</u>	<u>43,749</u>

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

38.3 Pending litigations against the Branch as at 31 December 2022

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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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

AS AT 31 DECEMBER

38 Commitments and contingencies (contd)

38.3 Pending litigations against the Branch as at 31 December 2022 (contd)

- 5 Case no. 01766/ 2020/ DMR - The case has been filed by Jetwing Pvt Ltd (Customer - Plaintiff). The Customer who has had a relationship with HSBC since 1995 is disputing the validity of certain FX Spot Transactions transacted on the Evolve Platform.
- 6 Law suit instituted by a former staff (Plaintiff) case no: 2369/2016/MR , demanding for compensation for causing him the pain of mind further to his termination from the services of the Bank.
- 7 Case No: DMR 00285/17, has been instituted by M S A Shipping (Pvt) Ltd (The Plaintiff) has filed the action against Mr. Asela Tennakoon - the First Defendant, who has credited 12 cheques, drawn by OPPO Lanka (Pvt) Ltd in favour of “MSA Shipping (Pvt) Ltd or Bearer”, into his personal account with HSBC and also joined HSBC as the Second Defendant on grounds of negligence and breach of duty of care.
- 8 Case no case no -SC SPL LA 225/2020 (appeal of CA WRIT 284/2017) & 226/2020 These are appeals to the Supreme Court by ex CMB staff (Petitioner) against the order of the Court of Appeal in favour of HSBC. Writ was granted in favour of HSBC by the Court of Appeal in CA WRIT 284/2017 and 74/2018 on 17 September 2020. Case No -SC SPL LA 239/2020 (appeal of CA WRIT 284/2017 Attorney General V HSBC) The State has filed an application, under case No: SC/SPL/LA 239/20, with the Supreme Court for Leave to appeal against the recent Judgment of the Court of Appeal delivered for writ matter 284/2017 on 17 September 2020 .
- 9 Case No: 36/2020/SPL HSBC has been named as the 3rd Defendant for a trust related litigation and HSBC has no connection whatsoever to the case. HSBC has been made a party on the alleged claim that money has been routed through the HSBC Accounts which is also incorrect since HSBC has no accounts in the name of the Plaintiff or the 1st and 2nd Defendants (none of these parties are customers of HSBC). It appears from the documentation that this matter is a family dispute between the Plaintiff and the 1st and 2nd Defendants. Plaintiff has instituted action against her husband and step daughter (the 1st and 2nd Defendants).
- 10 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.
- 11 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.

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

AS AT 31 DECEMBER

38 Commitments and contingencies (contd)

38.3 Pending litigations against the Branch as at 31 December 2022 (contd)

12 Mohamed Junaideen Mohamed Nazim (Deceased) , F Fathima Ramza alias Fathima Ramza Deen (Petitioner) Vs HSBC(8 Respondent) & others

- Case number -DTS / 7902- District Court of Kurunegala. Testamentary action by a petitioner on behalf of her demised spouse who is a WPB customer, wherein HSBC Sri Lanka branch(“HSBC”) has been named as the 8th respondent. The petitioner has made HSBC a party for the purpose of obtaining the Bank account balances and to ascertain the outstanding dues of the facilities obtained by the deceased. Hence no compensation is payable by the Bank under this type of litigation. there is a credit card outstanding dues under the deceased customers portfolio and no recovery action has been instituted , therefore we will make a claim for the said amount from the estate of the deceased.

13 LVC. Nishantha & P Wickramasurendra Vs. HSBC(District Court of Colombo - CASE NO: DSP 149/2022) A letter of demand from the plaintiff was served to the Bank owing to the reason for exiting the Banking relationship.

The exit was made based on a request for information received from Inland Revenue Department , the Bank conducted a further review on customer profile and it was revealed that the customer has not fully disclosed his wealth / profit for tax purposes.

On that basis and subject to the prevailing Bank terms and conditions , a decision has been made by the management of the Bank to exit the customer. The plaintiff was informed of the exit decision via letters .

In the interim , the plaintiff has filed litigation against the Bank, thereby obtained an enjoining order from the District Court on 14 March 2022 preventing the Bank from exiting the relationship.

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39 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. All related party transactions have been carried out at normal market terms.

39.1 Transactions with related parties

(a) Interest paid to other HSBC branches and group companies	2022	2021
	Rs.'000	Rs.'000
Other HSBC Branches		
HSBC Hongkong	<u>3,635,182</u>	<u>412,791</u>
	<u>3,635,182</u>	<u>412,791</u>
Group companies		
HSBC London	-	-
HSBC Canada	-	1
HSBC Data Processing Ltd	-	138,466
HSBC Australia	-	17
	<u>-</u>	<u>138,484</u>
(b) Interest received from other HSBC branches and group companies	2022	2022
	Rs.'000	Rs.'000
Other HSBC branches		
HSBC Hongkong	<u>2,265,910</u>	<u>14,342</u>
	<u>2,265,910</u>	<u>14,342</u>
(c) Commission paid to other HSBC branches and group companies	2022	2022
	Rs.'000	Rs.'000
Other HSBC Branches		
HSBC Hongkong	641	351
HSBC Japan	620	430
HSBC New Zealand	390	384
HSBC Singapore	562	281
HSBC Thailand	1,699	1,397
HSBC Australia	6,152	
HSBC China	64	
	<u>10,128</u>	<u>2,843</u>
Group companies		
HSBC London	62	19
HSBC Canada	3,727	2,107
HSBC USA		3,506
HSBC China		76
HSBC Australia		2,297
HSBC Middle East	532	138
HSBC France	50	214
	<u>4,371</u>	<u>8,357</u>

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FOR THE YEAR ENDED 31 DECEMBER

39 Related Party Disclosures (contd)

39.1 Transactions with related parties (contd)

(d) Commission received from other HSBC branches and group companies	2022	2021
	Rs.'000	Rs.'000
Other HSBC branches		
HSBC Hongkong	13,084	33,234
HSBC Japan	2,371	7,729
HSBC Singapore	1,542	8,618
HSBC India	289	7,217
HSBC Vietnam	-	154
HSBC Bangladesh	606	174
HSBC Maldives	-	-
	17,893	57,126
Group companies		
HSBC London	4,357	4,561
HSBC Bank PLC		272
HSBC Canada	-	77
HSBC France	2,358	3,375
HSBC China	13,938	22,671
HSBC Australia		83
HSBC Zurich		1,536
HSBC USA	8,748	2,996
HSBC Data processing Ltd	104	970
HSBC Trinkaus and Burkhardt	17	140
HSBC United Arab Emirates	364	1,231
HSBC Bank Malaysia Berhad		6,370
HSBC Germany		112
HSBC Netherlands	186	30
	30,072	44,424
(e) Other operating income - Other HSBC branches and group companies		
Other HSBC branches		
HSBC Maldives	43,864	35,390
	43,864	35,390
Group companies		
HSBC USA	-	-
HSBC Data processing Ltd - Sri Lanka	-	4,309
	-	4,309

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER

39 Related Party Disclosures (contd)

39.1 Transactions with related parties (contd)

(f) Receivable from other HSBC branches and group companies	2022	2021
	Rs.'000	Rs.'000
Other HSBC branches		
HSBC Hongkong	12,118,017	23,595,301
HSBC New Zealand	44,813	46,429
HSBC Japan	52,674	94,924
HSBC Singapore	154,255	75,478
HSBC India	7,008,155	2,738,521
HSBC Thailand	2,016,282	145
HSBC Maldives	48,527	35,926
	<u>21,442,723</u>	<u>26,586,724</u>
Group companies		
HSBC London	373,723	352,343
HSBC China	49,451	32,456
HSBC Canada	48,981	64,912
HSBC USA	31,047,673	6,924,609
HSBC Data processing Ltd	1,360,014	-
HSBC France	335,208	211,057
HSBC United Arab Emirates	1,733	1,108
HSBC Australia	107,176	65,975
HSBC Bank Mauritius Ltd	27,574,106	
HSBC Bank (Singapore) Limited	108,458,873	
	<u>169,356,938</u>	<u>7,652,460</u>

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

FOR THE YEAR ENDED 31 DECEMBER

39 Related party disclosure (contd)

39.1 Transactions with related parties (contd)

(g) Payable to other HSBC branches and group companies	2022	2021
	Rs.'000	Rs.'000
Other HSBC branches		
HSBC Hongkong	29,831,582	40,637,869
HSBC Japan	1,172	4,134
HSBC Singapore	37,975	27,811
HSBC India	40,650	25,312
HSBC Bangladesh	3,895	23,888
HSBC Maldives	3,765	11,373
HSBC Vietnam	-	-
HSBC Mauritius	311,714	4,948
	<u>30,230,753</u>	<u>40,735,336</u>
Group companies		
HSBC London	352,544	219,336
HSBC Bahrain	792	801
HSBC Canada	12	12
HSBC China (Bank) Co. Ltd	27,124	20,097
HSBC USA	836,471	371,466
HSBC Holdings Head Office	120,408	78,131
HSBC Securities (New York)	6,749	
HSBC Bank Malaysia Berhad	2,158	-
HSBC Bank (Singapore) Limited	50,672	
HSBC Kuwait		
HSBC France	990	1,307
HSBC Qatar	765	1,854
HSBC Vietnam	270	37
HSBC Trinkaus & Burkhardt	5	123
HSBC UAE	2,003	10,949
HSBC Switzerland	139	105
HSBC UK Ring Fenced Bank Limited	19,622	8,796
HSBC Australia	11,440	-
HSBC Continental Europe Netherlands Branch		10
HSBC Data processing Ltd -India	114,207	
HSBC Data processing Ltd	6,377,699	4,541,548
	<u>7,924,070</u>	<u>5,254,573</u>

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

FOR THE YEAR ENDED 31 DECEMBER

39 Related party disclosure (contd)

39.2 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.

(a) Compensation of KMPs	2022	2021
	Rs.'000	Rs.'000
Short term employment benefits	326,718	418,057
Post employment benefits	31,334	45,714
	<u>358,052</u>	<u>463,771</u>
(b) Transactions with KMPs and their close relations	2022	2021
	Rs.'000	Rs.'000
Total deposits	96,408	180,803
Total loans, advances and undrawn facilities granted	219,224	413,549
	<u>315,632</u>	<u>594,352</u>
(c) Direct and indirect accommodation	2022	2021
Direct and indirect accommodation as a percentage of the Branch's Regulatory capital	0.3%	0.6%
(d) Income statement	2022	2021
	Rs.'000	Rs.'000
Interest income	1,657	17,020
Interest expenses	9,778	12,937
Compensation to KMP	358,052	463,771
	<u>369,487</u>	<u>493,728</u>

(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 36.6.1 & 36.6.2

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

39 Financial risk management

39.3 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), Retail Credit Risk, Traded Credit Risk & Market Risk, Funding Risk (including IRRBB) and Operational Risk.

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

39 Financial risk management (contd)

39.3 Risk management framework (contd)

Stress testing (contd)

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.

39.4 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.

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

39 Financial risk management (contd)

39.4 Credit risk (contd)

39.4.1 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 Retail Banking and CEO for Corporate 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 retail businesses, risk is assessed and managed using a wide range of risk models to maintain risk reward balance.

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

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

Impairment assessment

The Branch computes Expected Credit Losses (ECLs) appropriately.

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

39 Financial risk management (contd)

39.4 Credit risk (contd)

39.4.1 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 unlikelihood 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

Impairment and credit risk mitigation

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

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

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

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

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

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.

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

39 Financial risk management (contd)

39.4 Credit risk (contd)

39.4.1 Credit risk management (contd)

Impairment and credit risk mitigation

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

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

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

39 Financial risk management (contd)

39.4 Credit risk (contd)

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

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

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	2022	2021
LKR '000		
Wealth and Personal Banking (WPB)	667,213	994,382
Wholesale Banking (WSB)	-	
	667,213	994,382

Collateral management and valuation

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

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

39 Financial risk management (contd)

39.4 Credit risk (contd)

39.4.1 Credit risk management (contd)

Collateral management and valuation

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

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

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

As at 31 December	2022	2021
LKR 000's		
Balances with Central Bank	163,595,024	31,059,227
Placements with other Banks	136,035,582	-
Balances with other Banks	53,258,159	34,419,889
Derivative financial instruments	285,614	38,552
Financial assets measured at fair value through profit or loss	57,230	151,989
Financial assets at amortised cost - loans and advances	227,053,508	223,667,772
Financial assets measured at fair value through other comprehensive income	43,635,387	136,210,701
Acceptance & endorsements	18,209,373	18,196,453
Total On balance sheet credit exposure	<u>642,129,877</u>	<u>443,744,583</u>
Total Off balance sheet credit exposure	438,043,730	357,278,493

Impairment movement of financial assets

Consolidated	Stage 1	Stage 2	Stage 3	Total
LKR '000				
Opening Balance	753,874	961,911	814,066	2,529,851
Charge to income statement	430,203	10,789,056	893,374	12,112,633
Exchange/other	(215,228)	1,043,123	(2,607)	825,287
	<u>968,849</u>	<u>12,794,090</u>	<u>1,704,833</u>	<u>15,467,771</u>

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

39 Financial risk management (contd)

39.4 Credit risk (contd)

39.4.2 Quantitative Disclosures

Gross Loans and Receivables

Gross loans and receivables, impairment and net loans and receivables from customers are disclosed in Note 20 in the financial Statements. Movements in impairment during the period are disclosed in Note 20.2 in the financial Statements.

Gross loans and receivables - by product

	Gross exposure	Average gross exposure	Gross exposure	Average gross exposure
	2022	2022	2021	2021
	Rs.000	Rs.000	Rs.000	Rs.000
By product - local currency				
Overdrafts	16,159,229	15,699,807	16,627,677	15,816,919
Term loans	19,872,314	22,510,579	22,553,841	23,180,960
Credit cards	20,435,293	21,163,573	22,496,548	21,678,887
Other loans	-	-		
Sub total	<u>56,466,836</u>	<u>59,373,959</u>	61,678,066	60,676,766
By product - foreign currency				
Overdrafts	9,678,559	13,676,640	12,743,577	14,442,894
Term loans	169,844,764	156,104,691	146,442,055	150,254,014
Other loans	368,267	7,156,817	4,986,092	8,311,273
Sub total	<u>179,891,590</u>	<u>176,938,148</u>	164,171,723	173,008,181
Total	<u><u>236,358,426</u></u>	<u><u>236,312,107</u></u>	<u>225,849,789</u>	<u>233,684,947</u>

Gross Loans and Receivables - By Currency

	2022	2021
	Rs.000	Rs.000

By Product - Currency

Sri Lankan Rupee	56,466,835	61,678,066
United States Dollar	171,108,781	158,885,572
Great Britain Pound	470,057	345,041
Others	<u>8,312,753</u>	4,941,110
Total	<u><u>236,358,426</u></u>	<u>225,849,789</u>

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

	Stage 1	Stage 2	Stage 3	Total	Total
	2022	2022	2022	2022	2021
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
WPB	313,917	758,609		1,072,526	1,653,369
WSB	297,732	7,202,873	731,788	8,232,392	528,648
	<u>611,649</u>	<u>7,961,482</u>	<u>731,788</u>	<u>9,304,918</u>	<u>2,182,017</u>

WPB- Wealth and Personal Banking

WSB- Wholesale Banking

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

39 Financial Risk Management (contd)

39.4 Credit risk (contd)

39.4.2 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	2022 Total Rs. 000	2021 Total Rs. 000
Agriculture & Fishing	-	833,487	1,811,150	-	328,248	65,682	-	3,038,567	2,702,813
Manufacturing	1,001,630	48,595,073	7,910,090	-	11,501,767	32,809,381	-	101,817,941	86,985,844
Tourism	-	-	1,437,889	-	-	62,853,087	-	64,290,976	49,965,796
Transport	77,190	-	358,346	-	23,060	190,595	-	649,191	4,032,078
Construction	23,309	-	2,911,567	-	-	7,794,387	-	10,729,263	10,283,512
Traders	67,341	-	1,404,518	-	3,415,014	2,820	-	4,889,693	11,397,472
New Economy	-	-	558,312	-	542,767	2,392,944	-	3,494,023	7,949,459
Financial and Business Services	-	-	656,058	-	1,136,036	1,685,424	-	3,477,518	4,048,155
Infrastructure	-	-	1	-	-	-	-	1	-
Other Services	-	-	2,878,523	-	1,068,886	6,893,279	-	10,840,688	12,561,821
Credit card	-	-	-	20,435,293	-	-	-	20,435,293	22,496,548
Other	-	-	5,911,333	-	-	5,086,821	1,697,118	12,695,272	13,426,293
Total	1,169,470	49,428,560	25,837,787	20,435,293	18,015,778	119,774,420	1,697,118	236,358,426	225,849,789

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

39 Financial Risk Management (contd)

39.4 Credit risk (contd)

39.4.2 Quantitative Disclosures (contd)

Total Gross Loans and receivables including acceptances - Residual contractual maturity

Sector	Less than 7 days	7-30 Days	1-3 Months	3-6 Months	6-12 Months	1-3 Years	3-5 Years	Over 5 years	2022 Total	2021 Total
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs. 000	Rs. 000
Overdrafts	25,837,786	-	-	-	-	-	-	-	25,837,786	29,371,254
Term lending	14,010,136	20,395,250	41,611,884	5,932,621	6,014,241	71,384,938	25,294,126	295,293	184,938,488	163,370,110
Non-eligible bills	268,381	26,487	73,400	-	-	-	-	-	368,268	4,986,090
Money market	-	2,070,000	244,000	750,000	-	-	-	-	3,064,000	3,605,000
Credit card advances	20,435,293	-	-	-	-	-	-	-	20,435,293	22,496,548
Mortgages	224,401	-	7,079	8,044	36,354	136,376	163,464	1,138,873	1,714,591	2,020,787
Total gross loans and receivables	60,775,997	22,491,737	41,936,363	6,690,665	6,050,595	71,521,314	25,457,590	1,434,166	236,358,426	225,849,789
Acceptances and endorsements	5,262,667	5,233,958	6,165,743	1,286,439	259,198	1,367	-	-	18,209,373	18,196,454
Total	66,038,664	27,725,695	48,102,106	7,977,103	6,309,793	71,522,681	25,457,590	1,434,166	254,567,799	244,046,243

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

39 Financial risk management (contd)

39.4 Credit risk (contd)

39.4.2 Quantitative disclosures (contd)

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

Sector	Past due not impaired		Impaired	
	2022 Total Rs. 000	2021 Total Rs. 000	2022 Total Rs. 000	2021 Total Rs. 000
Agriculture and fishing	42,180			
Manufacturing	1,651,945	3,271,650	-	-
Tourism	326,299	154,205	10,457,067	146,660
Transport	77,190	-	-	-
Construction	96,683	2,087	-	-
Traders	-	326,591	-	-
New economy	-	-	-	-
Financial and business services	-	-	-	-
Infrastructure	-	-	-	-
Other services	73,514	613,024	-	87,782
Credit card	-	-	662,551	376,808
Other	910,510	548,885	461,426	757,457
Total	3,178,320	4,916,443	11,581,044	1,368,708

Other Financial Assets -past due not impaired and impaired loans

	Past due not impaired		Impaired	
	2022 Total Rs. 000	2021 Total Rs. 000	2022 Total Rs. 000	2021 Total Rs. 000
International Sovereign Bonds			535,193	-
Total	-	-	535,193	-

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

39 Financial risk management (contd)

39.4 Credit risk (contd)

39.4.2 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	2022 Total Rs. 000	2021 Total Rs. 000
Cash and cash equivalents	14,163,206	40,733,629	-	-	-	-	-	54,896,835	35,459,758
Balances with central banks	163,595,024	-	-	-	-	-	-	163,595,024	31,059,227
Placements with banks	108,467,832	27,567,750	-	-	-	-	-	136,035,582	-
Derivative financial instruments	5,164	84,355	196,095	-	-	-	-	285,614	38,552
Financial assets measured at fair value through profit or loss	57,230	-	-	-	-	-	-	57,230	151,989
Loans and receivables to customers	2,439,583	1,356,827	152,392,929	65,651,817	13,335,752	1,181,518	(9,304,918)	227,053,508	223,667,772
Financial assets measured at fair value through other comprehensive income	43,635,387	-	-	-	-	-	-	43,635,387	137,684,067
Financial assets at amortised cost - debt instruments	109,520	-	-	-	-	-	(39,237)	70,283	592,611
Acceptances	-	-	15,835,675	2,373,699	-	-	-	18,209,374	18,196,453
Total	332,472,946	69,742,561	168,424,699	68,025,516	13,335,752	1,181,518	(9,344,155)	643,838,837	446,850,429

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

39 Financial risk management (contd)

39.4 Credit risk (contd)

39.4.2 Quantitative disclosures (contd)

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

Sector	Contractual residual maturity								Total Rs.000
	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	
2022	8,196,523	75,904	650,630	7,806	348,439	3,741,523	154,246	160,681	13,335,752
2021	3,668,287	1,913	2,757	7,267	487,512	322,013	296,709	129,985	4,916,443

The impairment charges for loans and receivables is disclosed in Note 11. The movement in provision for impairment is disclosed in Note 20.2.

Qualitative disclosures on Collaterals held on past due not

	2022	2021
Quality of the collateral held	A corporate guarantee from the sister company and Property Mortgages	A corporate guarantee from the sister company and Property Mortgages
any significant changes in the quality of that collateral or credit enhancements as a result of deterioration or changes in the collateral policies of the entity during the reporting period	NIL	NIL
Information about financial instruments for which an entity has not recognised a loss allowance because of the collateral	CLT (Call Loans) amounting to LKR 7.5 bn and MLTs (Multi Coupon Loans) amounting to LKR 3.24 bn	`
quantitative information about the collateral held as security and other credit enhancements	Property mortgages where the current Market value is LKR 7.2 bn and Corporate guarantees amounting to LKR 3.96 bn	Property mortgages where the current Market value is LKR 2.3 bn

Collateral held and other credit enhancements and their financial effect

	2022		2021	
	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	227,053,508	79,774,391	223,667,772	103,052,485

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

39 Financial risk management (contd)

39.5 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.

39.5.1 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.

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

39 Financial risk management (contd)

39.5 Liquidity risk (contd)

39.5.1 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	2022 Total Rs. 000	2021 Total Rs. 000
Due to banks	7,186,568	-	21,785,557	609,523	-	5,528,268	-	-	35,109,915	60,798,821
Derivative financial instruments	126,843	-	-	-	-	-	-	-	126,843	286,459
Financial liabilities at amortised cost - due to depositors	313,676,936	59,127,737	39,099,670	30,247,659	22,922,787	3,676,310	3,073,920	-	471,825,019	297,144,504
Acceptances and endorsements	2,052,746	6,223,859	7,599,549	1,774,398	518,395	2,735	-	37,691	18,209,373	18,196,454
Total	323,043,093	65,351,596	68,484,776	32,631,580	23,441,182	9,207,313	3,073,920	37,691	525,271,151	376,426,238

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

39 Financial risk management (contd)

39.5 Liquidity risk (contd)

39.5.1 Management of liquidity and funding risk (contd)

Maturity analysis of financial assets based on undiscounted cash flows

	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	2022 Total Rs. 000	2021 Total Rs. 000
Cash in hand	54,896,835	-	-	-	-	-	-	-	54,896,835	35,459,758
Non-statutory balances with central banks	152,782,365							-	152,782,365	21,700,000
Placements with Banks	136,068,211								136,068,211	-
High Quality Liquid Assets		5,583,283	7,628,163	7,576,073	22,878,726	16,913	9,460	-	43,692,618	137,836,056
Acceptances	2,052,746	6,223,859	7,599,549	1,774,398	518,395	2,735	-	37,691	18,209,373	18,196,453
Total	345,800,157	11,807,142	15,227,712	9,350,471	23,397,121	19,648	9,460	37,691	405,649,402	213,192,267

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

39 Financial risk management (contd)

39.6 Market risk

The risk that movements in market factors, including foreign exchange rates, interest rates and credit spreads, 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.

39.6.1 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.

39.6.2 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.

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

39 Financial risk management (contd)

39.6 Market risk (contd)

39.6.2 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.

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

39 Financial risk management (contd)

39.6 Market risk (contd)

39.6.2 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	441,661	(414,065)	27,596	12,515	(39,225)	(26,710)	575	-	1	526
Pound Sterling	36,629	(46,325)	(9,696)	10,402	(714)	9,688	(48)	-	4	1,128
Euro	39,527	(40,247)	(720)	6,038	(5,322)	716	198	-	(7)	(2,260)
Japanese Yen	14,018	(14,046)	(28)	868	(845)	23	(9)	-	1	353
Indian Rupee								-		
Australian Dollar	29,422	(34,889)	(5,467)	6,496	(1,011)	5,485	23	-	(1)	(611)
Canadian Dollar	13,977	(14,463)	(486)	486	-	486	13	-	2	793
Other currencies	280,491	(291,693)	(11,202)	(4,623)	(8,426)	(13,049)	302	-	2	302
Total exposure	855,725	(855,728)	(2)	32,182	(55,544)	(23,361)	1,054	-	2	232
Total capital funds as per the latest audited financial statements										68,279
Total exposure as a % of total capital funds (Basel III) as per the latest audited financial statements (Should not exceed 30%)										0.3%

* Monitored at the Branch level

*Balances are in LKR Million ("Overall exposure in other respective foreign currency" in respective currency Mn)

Sensitivity Analysis

The impact of changes in exchange rates on Profitability and Equity calculated on Foreign exchange position as at 31-12-2022. 10% shock was applied to assess the potential impact on equity.

	Impact on profitability		Impact on Equity	
	Exchange Rate increase by 10%	Exchange Rate decrease by 10%	Exchange Rate increase by 10%	Exchange Rate decrease by 10%
US Dollars	40.3	(40.3)	40.3	(40.3)
Pound Sterling	(3.4)	3.4	(3.4)	3.4
Euro	13.9	(13.9)	13.9	(13.9)
Japanese Yen	(0.6)	0.6	(0.6)	0.6
Indian Rupee	-	-	-	-
Australian Dollar	1.6	(1.6)	1.6	(1.6)
Canadian Dollar	0.9	(0.9)	0.9	(0.9)
Other currencies	21.1	(21.1)	21.1	(21.1)

* Sensitivity impact is in LKR 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.

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

39 Financial risk management (contd)

39.6 Market risk (contd)

39.6.2 Risk management (contd)

Maturities of assets and liabilities as at 31st December 2022

Figures in LKR'000	Up to 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	2022 Total
Cash and cash equivalent	54,896,837	-	-	-	-	-	-	-	54,896,837
Balances with Central Bank (Gross)	163,595,024	-	-	-	-	-	-	-	163,595,024
Placements with banks (Gross)	136,035,582	-	-	-	-	-	-	-	136,035,582
Derivative financial instruments	285,614	-	-	-	-	-	-	-	285,614
Financial assets measured at fair value through profit or loss	(0)	12,442	(0)	18,361	16,913	9,460	-	-	57,176
Financial assets at amortised cost - loans and advances (Gross)	85,523,156	46,039,867	9,291,079	8,352,248	75,562,800	11,558,804	(148,804)	-	236,179,150
Financial assets measured at fair value through other comprehensive income	5,583,283	13,584,695	7,576,073	16,891,336	(0)	(0)	-	-	43,635,387
Financial assets at amortised cost - debt instruments	-	-	-	-	-	147,751	-	-	147,751
Retirement benefit obligations surplus	-	-	-	-	-	-	-	-	-
Property, plant and equipment	-	-	-	-	-	-	-	5,233,076	5,233,076
Deferred Tax Assets	-	-	-	-	-	-	-	4,355,291	4,355,291
Other assets	12,063,968	6,165,743	1,286,439	259,198	-	-	-	8,777,240	28,552,589
Total assets	457,983,462	65,802,747	18,153,591	31,490,171	75,579,713	13,076,015	(1,508,804)	3,193,524	672,973,476
Due to banks	7,186,566	21,686,630	606,491	-	5,516,002	-	-	-	34,995,689
Derivative financial instruments	126,843	-	-	-	-	-	-	-	126,843
Financial liabilities at amortised cost - due to depositors	370,383,183	38,669,702	29,891,759	22,651,238	3,632,742	3,037,491	-	-	468,266,115
Retirement benefit obligations	-	-	-	-	-	-	513,703	-	513,703
Current tax liability	-	2,483,228	2,483,228	2,483,228	-	-	-	-	7,449,684
Other liabilities	15,487,315	6,165,743	1,286,439	259,198	-	-	-	14,237,575	37,436,270
Equity	-	-	-	-	-	-	-	114,982,116	114,982,116
Total liabilities	393,183,906	69,005,303	34,267,917	25,393,664	9,148,744	3,037,491	513,705	129,219,691	663,770,420
Cumulative gap	64,799,556	(3,202,556)	(16,114,326)	6,096,507	66,430,969	10,038,524	(2,022,509)	(126,026,167)	9,203,056

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.

	Up to 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	4,445,895	3,172,803	6,759,079	7,478,970	5,418,684	347,418	-	27,622,849
Letters of credit	12,863,524	11,435,681	6,323,609	1,518,808	-	-	-	32,141,622
Other contingent items	5,456,447	18,613,821	24,143,219	23,647,000	12,730,873	30,006,257	-	114,597,617
Undrawn loan commitments	226,517,848	-	-	-	-	-	-	226,517,848
Foreign exchange contracts	27,630,242	5,251,213	4,897,072	-	-	-	-	37,778,527
Other contra accounts	43,878,787	-	-	-	-	-	-	43,878,787
	320,792,743	38,473,518	42,122,979	32,644,778	18,149,557	30,353,675	-	482,537,251

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

39 Financial risk management (contd)

39.6 Market risk (contd)

39.6.2 Risk management (contd)

Maturities of assets and liabilities as at 31st December 2021

Figures in LKR'000	Up to 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	2021 Total
Cash and cash equivalent	35,459,758	-	-	-	-	-	-	-	35,459,758
Balances with Central Bank	31,059,227	-	-	-	-	-	-	-	31,059,227
Derivative financial instruments	38,552	-	-	-	-	-	-	-	38,552
Financial assets measured at fair value through profit or loss	62,506	-	-	27,062	47,680	14,740	-	-	151,989
Financial assets at amortised cost - loans and advances	83,373,168	40,122,071	7,431,998	16,728,078	52,592,656	24,119,342	1,482,477	(2,182,017)	223,667,772
Financial assets measured at fair value through other comprehensive income	35,094,892	35,483,486	3,432,454	14,294,552	49,378,682	-	-	-	137,684,067
Financial assets at amortised cost - debt instruments	-	-	-	483,595	-	109,017	-	-	592,611
Retirement benefit obligations	-	-	-	-	-	-	-	223,570	223,570
Property, plant and equipment	-	-	-	-	-	-	-	5,342,466	5,342,466
Deferred Tax Assets	-	-	-	-	-	-	-	189,348	189,348
Other assets	7,691,394	7,564,469	3,266,528	1,172,423	-	1,503	-	4,121,552	23,817,869
Total assets	192,779,498	83,170,025	14,130,981	32,705,710	102,019,018	24,244,601	1,482,477	7,694,919	458,227,229
Due to banks	16,526,839	2,220,130	2,058,666	16,777,633	19,361,384	3,840,141	-	-	60,784,793
Derivative financial instruments	286,459	-	-	-	-	-	-	-	286,459
Financial liabilities at amortised cost - due to depositors	208,021,298	34,653,531	20,868,845	19,252,111	4,370,124	2,844,199	-	-	290,010,108
Current tax liability	-	872,372	872,372	872,372	-	-	-	-	2,617,115
Other liabilities	6,191,532	9,959,831	3,266,528	1,172,423	-	1,503	-	13,274,005	33,865,823
Equity	-	-	-	-	-	-	-	70,662,931	70,662,931
Total liabilities	231,026,129	47,705,864	27,066,411	38,074,539	23,731,508	6,685,842	-	83,936,936	458,227,229
Cumulative gap	(38,246,630)	35,464,162	(12,935,429)	(5,368,829)	78,287,510	17,558,759	1,482,477	(76,242,018)	-

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.

	Up to 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	4,197,016	1,337,654	1,481,808	5,093,051	13,892,698	526,599	-	26,528,825
Letters of credit	8,742,809	9,570,444	6,306,901	1,727,190	-	-	-	26,347,343
Other contingent items	9,749,601	4,639,237	15,325,466	22,598,559	16,302,489	16,124,648	-	84,740,000
Undrawn loan commitments	189,902,071	-	-	-	-	-	-	189,902,071
Foreign exchange contracts	14,971,407	11,932,031	1,904,995	995,573	-	-	-	29,804,006
Other contra accounts	33,911,553	-	-	-	-	-	-	33,911,553
	261,474,456	27,479,366	25,019,169	30,414,372	30,195,187	16,651,248	-	391,233,798

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

39 Financial risk management (contd)

39.6 Market risk (contd)

39.6.2 Risk management (contd)

IBOR Transition

The Bank currently has a number of contracts which reference LIBOR and extend beyond 2022. These contracts are disclosed within the table 1 below. It is currently expected that SOFR (Secured Overnight Financing Rate/IBOR will replace LIBOR In order to transit existing contracts and agreements from LIBOR to IBOR , adjustments for term differences and credit differences might need to be applied to SOFR/ IBOR , to enable the two benchmark rates to be economically equivalent on transition.

Changes to the basis for determining the contractual cash flows required by interest rate benchmark reform are reflected by adjusting their effective interest rate and no immediate gain or loss is recognised.

As of 31.12.2022, changes required to systems, processes and models have been identified and have been implemented. .

The following table contains details of all of the financial instruments that the company holds at 31.12.2022 which reference LIBOR and have not yet transitioned to SOFR or an alternative interest rate benchmark:

Total FCY Loans (gross) as at 31.12.2022	To be transitioned to Alternative Rates
179,891,591	121,261,343

Sensitivity Analysis

The impact of changes in interest rates on Net Interest Income calculated on interest rate risk profile as at 31-12-2022. 1%, 2% and 2.5% shocks were applied and for the sensitivity and assessed the potential impact on NII.

Rate increase by 1%	2,329,575	Rate decrease by 1%	(2,368,239)
Rate increase by 2%	4,628,220	Rate decrease by 2%	(4,736,478)
Rate increase by 2.5%	5,785,275	Rate decrease by 2.5%	(5,920,597)

Impact on Equity	2022		2021	
	Impact on Post Tax Profit	Impact on Post Tax Profit	Impact on Other Components of Equity	Impact on Other Components of Equity
Rate increase by 1%	1,630,703	10,303	(3,692)	(9,308)
Rate increase by 1%	3,239,754	20,606	(7,385)	(18,616)
Rate increase by 2.5%	4,049,693	25,757	(9,231)	(23,270)

For the interest rate sensitivity and impact computations, excess financial assets that are maturing with in the next 12 months have been taken in to account. Statutory income tax of 30% has been used to compute the impacts

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

39 Financial risk management (contd)

39.7 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 Programs/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

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AS AT 31 DECEMBER

39 Financial risk management (contd)

39.7 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 2022 was Rs. 3,722,406.

39.8 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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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

AS AT 31 DECEMBER

39 Financial risk management (contd)

39.8 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 interpretations of Banking Act Directions no.01 on capital requirements under Basel III for licensed commercial 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.

Quantitate disclosures

Composition of regulatory capital (audited)	2022	2021
	Rs'000	Rs'000
Equity capital or stated capital/assigned capital	3,152,358	3,152,358
Reserve fund	2,997,367	2,782,644
Published retained earnings	54,765,861	49,712,612
Accumulated other comprehensive income (OCI)	6,114,026	5,644,396
General and other disclosed reserves	224,676	796,348
Total Common Equity Tier I (CET1) Capital	67,254,288	62,088,358
Deductions to tier 1 capital	4,363,423	(32,360)
Revaluation losses of property, plant and equipment	40,276	-
Net deferred tax assets	4,355,291	-
Intangible assets	5,919	-
Amounts due to head office and branches outside Sri Lanka in Sri Lanka Rupees (-)	(38,063)	(32,360)
	-	-
Total Tier 1 Capital	62,890,865	62,120,717
Components of tier 2 capital		
Revaluation reserves (as approved by CBSL)	1,049,765	1,049,765
General provisions*	4,338,741	1,881,791
Total qualifying tier 2 capital prior to deductions	5,388,506	2,931,556
Total Capital	68,279,371	65,052,273

* Please refer qualitative disclosure on tier 2 capital for explanation

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

AS AT 31 DECEMBER

39 Financial risk management (contd)

39.8 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.

	2022	2021
Capital ratios		
Common Equity Tier 1 Capital Ratio	16.37%	19.68%
Tier 1 ratio	16.37%	19.68%
Total capital ratio	17.78%	20.61%

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40 Fair value of financial assets and liabilities

40.1 Fair value of financial instruments not carried at fair value

Assets	2022		2021	
	Carrying value Rs'000	Fair value Rs'000	Carrying value Rs'000	Fair value Rs'000
Cash and cash equivalents	190,932,418	190,932,418	35,459,758	35,459,758
Balances with Central Bank	163,595,024	163,595,024	31,059,227	31,059,227
Placements with banks	-	-	-	-
Financial assets at amortised cost - loans	227,053,508	231,972,761	223,667,772	229,383,537
Acceptances and endorsements	18,209,373	18,209,373	18,196,454	18,196,454
Liabilities				
Due to banks	34,995,689	34,995,689	60,784,793	60,784,793
Financial liabilities at amortised cost - due to depositors	468,266,115	468,266,115	290,010,108	290,010,108
Acceptances and endorsements	18,209,373	18,209,373	18,196,454	18,196,454

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. For Fair valuation of Loans, level 2 inputs have been used (Base Interest rates available in the open market have been used to arrive at the Fair Value)

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

AS AT 31 DECEMBER

40 Fair value of financial assets and liabilities (contd)

40.2 Fair value of financial instruments carried at fair value

40.2.1 Fair value hierarchy

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

- Level 1 – valuation technique using quoted market price: financial instruments with quoted prices for identical instruments in active markets that the Branch can access at the measurement date.
- Level 2 – valuation technique using observable inputs: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or valued using models where all significant inputs are observable.
in HSBC , all outstanding derivatives are valued using external broker rates on a daily basis. The spot rates and bid-offer swap points are sent by the brokers on a daily basis. For valuation, the mid point of the average broker rates are taken to value the LKR derivatives. For non LKR derivatives, rates are obtain directly from designated third parties expertized in business intelligence services . For Sovereign instruments , secondary market information is used for valuation purposes.
Government Securities are valued using market yeilds of securities which has same maturity period in current market environment
- 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 2022	Level 1 Rs'000	Level 2 Rs'000	Level 3 Rs'000
Assets			
Financial assets measured at fair value through profit or loss	-	57,230	-
Derivatives	17,239	268,375	-
Financial assets measured at fair value through other comprehensive income	-	43,635,387	-
Financial assets at amortised cost - debt instruments	-	-	-
	17,239	43,960,992	-
Liabilities			
Derivatives	6,381	120,462	-
	6,381	120,462	-
As at 31 December 2021			
Assets			
Financial assets measured at fair value through profit or loss	-	151,989	-
Derivatives	2,504	36,048	-
Financial assets measured at fair value through other comprehensive income	-	137,684,067	-
Financial assets at amortised cost - debt instruments	-	-	-
	2,504	137,872,104	4,622,685
Liabilities			
Derivative financial instruments	1,089	285,370	-
	1,089	285,370	-

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

AS AT 31 DECEMBER

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

	2022	
	Assets	Liabilities
	Rs'000	Rs'000
As at 1 January	-	-
Settlements	-	-
As at 31 December	<u>-</u>	<u>-</u>
	<u>-</u>	<u>-</u>
	2021	
	Assets	Liabilities
	Rs'000	Rs'000
As at 1 January	-	-
Total gains recognised in profit or loss	(4,622,685)	-
Settlements	4,622,685	-
As at 31 December	<u>-</u>	<u>-</u>
	<u>-</u>	<u>-</u>

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;

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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)

40.2.2 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 judgmental. 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.

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

41 Economic Downturn 2022

41.1 Liquidity and Funding

Though Locally, the country underwent an extra-ordinary economic stress period, however due to the well reputed International brand name flight to safety in deposits has been triggered by customers and along with other management action taken the bank's Liquidity and Funding positions remains at healthy levels. With the increase of commercial surplus from Dec 21 to Dec 22 mainly due to flight of safety, LKR O/N USD placements were increased by USD 300 M and USD 285M respectively. Further USD 120M AMH Borrowing settlements were made and there were USD 200M in Core Funding limit reduction. On the same line, negative USD LCR limit of USD 95 M was removed during the 2022 ILAA process and USD 100M committed line from AMH was ceased.

41.2 Credit Risk - Mitigation, Recognition and Measurement

In response to the Economical Downturn , Central Bank of Sri Lanka, 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.

Impact On ECL Due to Economic Downturn

CRR downgrade on Sovereign instruments were reflected in the ECL on Loans and Other Financial Assets. Further HSBC Sri Lanka started recognizing impairment on Government securities denominated in LKR from 2022, onwards, as Government securities can no longer be deemed as a Financial assets with Zero counter party credit risk Credit Risk

41.3 Movement in Main Financial Statement line Items Due to Economic Downturn

Due to Increase in CBSL policy rates, there was an improvement in the NII by LKR 24 bn

Due to Sovereign CRR Down grade, there was an Incremental ECL amounting to LKR 20 bn

Due to Depreciation of USD from 201 to 367 , Inter company expense (in FCY) showed an increase of LKR 4 bn

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**OTHER INFORMATION SECTION
(UNAUDITED)**

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Sustainability Disclosure

Overview of Sustainable Finance Policies, Activities and way forward.

HSBC Group's (herein after referred to as 'the Group') ambition is to help its customers transition to net zero and a sustainable future. The most significant contribution the Group can make is by mobilising finance to support its customers to enable decarbonisation in the real economy.

Given the Group's global presence and relationships with clients across industries and client groups, it recognises the role it can play to encourage the global transition to net zero.

Mobilising sustainable finance and investments

The Group continues to identify financing and investing opportunities and prioritizes the themes necessary to support the net-zero transition. These opportunities look to direct capital, financing solutions and resource allocation towards the themes which will maximize climate and commercial impact at scale. They are designed to support clients in their transition journey and to address financing needs to accelerate the infrastructure, technologies, and new business models critical for industries to transition to net zero. The Group offers a broad suite of sustainable finance capabilities across its global businesses, enabling customers to manage risk and pursue ESG-related opportunities.

The Group's sustainable finance and investment progress is set out below, with detailed definitions available in the Group's Sustainable Finance and Investment Data Dictionary (see www.hsbc.com/who-we-are/esg-and-responsible-business/esg-reporting-centre).

Sustainable Finance Related risks and Associated mitigation measures

Greenwashing risk, which arises from the act of knowingly or unknowingly misleading stakeholders regarding the group's strategy relating to climate, the climate impact/benefits of a product or service, or the climate commitments or performance of its customers.

If the group is perceived to mislead stakeholders on its business activities or if it is perceived to fail to achieve its stated net zero ambitions, it could face greenwashing risk resulting in significant regulatory and legal risks.

To support the ongoing management and mitigation of greenwashing, the Compliance sub-function worked across all business lines to enhance the Group's product controls. This improved the Group's ability to identify, assess and manage product-related greenwashing risks throughout the product governance lifecycle.

Management

The Group policies continue to set the Group-wide standards that are required to manage the risk of breaches of its regulatory duty to customers, including those related to climate risk, ensuring fair customer outcomes are achieved. The Group's product and customer lifecycle policies have been enhanced to ensure they take climate into consideration. They are reviewed on a periodic basis to ensure they remain relevant and up to date.

The Compliance sub-function continues to focus on improving the capability of colleagues through training, communications and dedicated guidance, with a particular focus on ensuring colleagues remain up to date with changes in the evolving regulatory landscape.

Aggregation and reporting

The Group has continued to develop its key climate risk-related metrics and indicators, aligned to the broader focus on regulatory compliance risks, to continually improve its risk monitoring capability. This has included the development of a climate-specific risk profile alongside the introduction and improvement of existing metrics and indicators.

Reputational risk

Identification and assessment

The Group implements sustainability risk policies, including the Equator Principles as part of its broader reputational risk framework. The Group focuses on sensitive sectors that may have a high adverse impact on people or the environment, and in which the Group has a significant number of customers. A key area of focus is high-carbon emission sectors, which include oil and gas, power generation, mining, agricultural commodities and forestry.

In 2022, the Group published an updated energy policy, covering oil and gas, power and utilities, hydrogen, renewables, nuclear and biomass. It has also updated its thermal coal phase-out policy after its initial publication in 2021.

Management

As the primary point of contact for customers, the relationship managers are responsible for checking that customers meet policies aimed at reducing carbon emissions. A regional Sustainability Risk team provides a higher level of guidance and is responsible for the oversight of policy compliance and implementation over wholesale banking activities.

Aggregation and reporting

The regional Sustainability Risk Oversight Forum provides a Group-wide forum for senior members of the Group's Risk, Compliance and global business management to support the management of sustainability risks. It also oversees the development and implementation of sustainability risk policies. Cases involving complex sustainability risk issues related to customers, transactions or third parties are managed through the reputational risk and client selection governance process.

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Pillar III disclosures as per Basel III

Key Regulatory Ratios - Capital and Liquidity

Regulatory Capital Adequacy	2022	2021
Common Equity Tier 1, Rs. '000	62,890,865	62,120,718
Tier 1 Capital, Rs. '000	62,890,865	62,120,718
Total Capital, Rs. '000	68,279,371	65,052,274
Credit risk	347,099,308	275,264,999
Market risk	3,988,957	15,547,613
Operational risk	33,032,847	24,871,689
Total risk-weighted assets	384,121,112	315,684,301
Common Equity Tier 1 Capital Ratio, as % of Risk Weighted Assets (Minimum Requirement, 6.5%)	16.37%	19.68%
Tier 1 Capital Ratio, as % of Risk Weighted Assets (Minimum Requirement, 8.0%)	16.37%	19.68%
Total Capital Ratio, as % of Risk Weighted Assets (Minimum Requirement, 12.0%)	17.78%	20.61%

	2022	2021
Regulatory Liquidity		
Statutory Liquid Assets, Rs.'000		
Domestic Banking unit	219,945,305	160,087,130
Off-Shore Banking Unit	184,362,085	35,053,027
Total Bank	404,212,327	195,140,114
Statutory Liquid Assets Ratio,% (Minimum Requirement, 20%)		
Domestic Banking Unit		
Off-Shore Banking Unit	52.23%	58.02%
Total Bank (Minimum Requirement, 20%)	121.47%	29.80%
Liquidity Coverage Ratio (%) - Rupee (Minimum Requirement, 100%)	70.54%	50.26%
Liquidity Coverage Ratio (%) - All currency (Minimum Requirement, 100%)	297.00%	320.57%
Leverage Ratio (%) (Minimum Requirement 3%)	500.40%	356.74%
Net Stable Funding Ratio (%) (Minimum Requirement 100%)	162.79%	149.00%
	8.27%	10.66%

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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	62,890,865
Total Common Equity Tier I (CET1) Capital	67,254,288
Equity capital or stated capital/assigned capital	3,152,358
Reserve fund	2,997,367
Published retained earnings/(accumulated retained losses)	54,765,861
Accumulated other comprehensive income (OCI)	6,114,026
General and other disclosed reserves	224,676
Total Adjustments to CET1 Capital	4,363,423
Revaluation losses of property, plant and equipment	40,276
Deferred tax assets (net)	4,355,291
Intangible Assets	5,919
Amount due to head office & branches outside Sri Lanka in Sri Lanka Rupees	(38,063)
Tier 2 Capital after Adjustments	5,388,506
Total Tier 2 Capital	5,388,506
Revaluation gains	1,049,765
General provisions	4,338,741
Total Adjustments to Tier 2 Capital	-
Total Tier 1 Capital	62,890,865
Total Capital	68,279,371
Total Risk Weighted Assets (RWA)	384,121,112
RWAs for Credit Risk	347,099,308
RWAs for Market Risk	3,988,957
RWAs for Operational Risk	33,032,847
CET1 Capital Ratio (including Capital Conservation Buffer, Countercyclical Capital Buffer & Surcharge on D-SIBs) (%)	16.37%
of which: Capital Conservation Buffer (%)	1.25%
of which: Countercyclical Buffer (%)	
of which: Capital Surcharge on D-SIBs (%)	
Total Tier 1 Capital Ratio (%)	16.37%
Total Capital Ratio (including Capital Conservation Buffer, Countercyclical Capital Buffer & Surcharge on D-SIBs) (%)	17.78%
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	
	2022	2021
Tier 1 Capital	62,890,865	56,642,034
Total Exposures	759,452,225	531,105,298
On Balance Sheet Items (Excluding Derivatives and Securities Financing Transactions, but including Collateral)	668,472,497	460,436,646
Derivative Exposures	928,758	511,231
Securities Financing Transaction Exposures	-	-
Other Off-Balance Sheet Exposures	90,050,970	70,157,421
Basel III Leverage Ratio	8.27%	10.66%

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Capital management (contd.)

Pillar III disclosures as per Basel III (contd.)

Computation of Liquidity Coverage Ratio (All Currency)

Item	Rs.'000		Rs.'000	
	2022		2021	
	Total Un-weighted Value	Total Weighted Value	Total Un-weighted Value	Total Weighted Value
Total Stock of High-Quality Liquid Assets (HQLA)	199,645,387	199,645,387	135,277,146	135,277,146
Total Adjusted Level 1A Assets	199,645,387	199,645,387	135,277,146	135,277,146
Level 1 Assets	199,645,387	199,645,387	135,277,146	135,277,146
Total Adjusted Level 2A Assets	-	-	-	-
Level 2A Assets	-	-	-	-
Total Adjusted Level 2B Assets	-	-	-	-
Level 2B Assets	-	-	-	-
Total Cash Outflows	911,641,807	159,589,408	661,971,714	100,184,907
Deposits	163,377,007	16,337,701	124,397,425	12,439,742
Unsecured Wholesale Funding	313,467,781	125,607,310	177,604,431	70,635,008
Secured Funding Transactions	-	-	-	-
Undrawn Portion of Committed (Irrevocable) Facilities and Other Contingent Funding Obligations	420,107,296	2,954,674	345,714,700	2,854,999
Additional Requirements	14,689,723	14,689,723	14,255,158	14,255,158
Total Cash Inflows	224,506,209	164,432,480	89,836,695	62,264,847
Maturing Secured Lending Transactions Backed by Collateral			-	-
Committed Facilities			-	-
Other Inflows by Counterparty which are Maturing within 30 Days	179,292,461	163,160,231	74,895,484	60,802,967
Operational Deposits	43,775,754	-	12,629,865	-
Other Cash Inflows	1,437,994	1,272,249	2,311,346	1,461,880
Liquidity Coverage Ratio (%) (Stock of High Quality Liquid Assets/Total Net Cash Outflows over the Next 30 Calendar Days) * 100		500.40%		356.74%

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Capital management (contd.)

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	208,050,715	-	208,050,715	-	-	0.00%
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	167,920,676	61,000,237	167,920,676	23,568,899	39,940,556	20.86%
Claims on Financial Institutions	-	-	-	-	-	0.00%
Claims on Corporates	139,271,788	156,008,817	138,863,723	62,633,059	200,626,433	99.57%
Retail Claims	29,703,865	349,901	25,346,958	315,468	19,389,771	75.56%
Claims Secured by Residential Property	2,369,112	-	2,369,112	-	2,369,112	100.00%
Claims Secured by Commercial Real Estate	51,706,928	-	51,706,928	-	51,706,928	100.00%
Non-Performing Assets (NPAs)	11,581,044	-	11,523,571	-	16,776,117	145.58%
Higher-risk Categories	-	-	-	-	-	-
Cash Items and Other Assets	19,109,342	-	19,109,342	-	16,290,390	85.25%
Total	629,713,470	217,358,955	624,891,025	86,517,426	347,099,307	

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

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Capital management (contd.)

Pillar III disclosures as per Basel III (contd.)

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

Description	Rs.'000							Total Credit Exposures Amount
	0%	20%	50%	75%	100%	150%	>150%	
Risk Weight								
Asset classes								
Claims on Central Government and Central Bank of Sri Lanka	208,050,715	-	-	-	-	-	-	208,050,715
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	-	186,255,082	5,089,905	-	144,587	-	-	191,489,574
Claims on Financial Institutions	-	-	-	-	-	-	-	-
Claims on Corporates	-	205,122	1,412,502	-	199,879,158	-	-	201,496,782
Retail Claims	-	-	-	25,090,617	571,809	-	-	25,662,426
Claims Secured by Residential Property	-	-	-	-	2,369,112	-	-	2,369,112
Claims Secured by Commercial Real Estate	-	-	-	-	51,706,928	-	-	51,706,928
Non-Performing Assets (NPAs)	-	-	6,877	-	1,004,725	10,511,969	-	11,523,571
Higher-risk Categories	-	-	-	-	-	-	-	-
Cash Items and Other Assets	1,638,676	1,475,344	-	-	15,995,321	-	-	19,109,341
Total	209,689,391	187,935,548	6,509,284	25,090,617	271,671,640	10,511,969	-	711,408,449

Figures are subjected to credit conversion factors and credit risk mitigation

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Capital management (contd.)

Pillar III disclosures as per Basel III (contd.)

Market risk under standardised measurement method

Item	Rs.'000
(a) RWA for Interest Rate Risk	389,746
General Interest Rate Risk	-
(i) Net Long or Short Position	389,746
(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	108,874
Capital Charge for Market Risk [(a) + (b) + (c)] * CAR	3,988,957

Operational risk under basic indicator approach

	Capital	Gross Income		
	Charge	Rs.'000		
	Factor	1st Year	2nd Year	3rd Year
The Basic Indicator Approach	15%	19,205,536	19,981,034	22,992,653
Capital Charges for Operational Risk (LKR'000)				
The Basic Indicator Approach	4,129,106			
Risk Weighted Amount for Operational Risk (LKR'000)	0			
The Basic Indicator Approach	33,032,847			

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
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Capital management (contd.)

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	190,932,418	190,932,418	169,670,840	-	21,261,578
Balances with Central Banks	163,595,024	163,595,024	163,595,024	-	-
Placements with Banks	-	-	-	-	-
Derivative Financial Instruments	285,614	285,614	-	-	-
Other Financial Assets Held-For-Trading	57,230	57,230	57,230	57,230	25,420
Financial Assets Designated at Fair Value through Profit or Loss	-	-	-	-	-
Loans and Receivables to Banks	-	-	-	-	-
Loans and Receivables to Other Customers	227,053,508	227,053,508	229,810,292	-	4,592,389
Financial assets measured at fair value through other comprehensive income	43,635,387	43,635,387	43,635,387	43,635,387	-
Financial assets at amortised cost - debt instruments	70,283	70,283	70,283	-	-
Investments in Subsidiaries	-	-	-	-	-
Investments in Associates and Joint Ventures	-	-	-	-	-
Property, Plant and Equipment	5,233,076	5,233,076	5,227,157	-	5,919
Investment Properties	-	-	-	-	-
Goodwill and Intangible Assets	-	-	-	-	-
Deferred Tax Assets	4,355,291	4,355,291	-	-	4,355,291
Other Assets	28,552,589	28,552,589	10,377,899	-	-
Liabilities	-	0	0	-	-
Due to Banks	34,995,689	34,995,689	-	-	-
Derivative Financial Instruments	126,843	126,843	-	-	-
Other Financial Liabilities Held-For-Trading	-	-	-	-	-
Financial Liabilities Designated at Fair Value Through Profit or Loss	-	-	-	-	-
Due to Other Customers	468,266,115	468,266,115	-	-	-
Other Borrowings	-	-	-	-	-
Retirement Benefit Obligations	513,705	513,705	-	-	-
Current Tax Liabilities	7,449,684	7,449,684	-	-	-
Deferred Tax Liabilities	-	-	-	-	-
Other Provisions	-	-	-	-	-
Other Liabilities	37,436,268	37,436,268	-	-	-
Due to Subsidiaries	-	-	-	-	-
Subordinated Term Debts	-	-	-	-	-
Off-Balance Sheet Liabilities	-	-	-	-	0
Guarantees	114,597,618	114,597,618	131,119,237	-	387,696
Performance Bonds	27,622,849	27,622,849	27,622,849	-	-
Letters of Credit	32,141,622	32,141,622	32,141,622	-	-
Other Contingent Items	-	-	-	-	-
Undrawn Loan Commitments	226,517,848	226,517,848	226,517,848	-	-
Other Commitments	81,657,314	81,657,314	23,663,731	-	-
Shareholders' Equity	-	-	-	0	0
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	54,066,530	54,066,530	54,765,861	-	-
Accumulated Other Comprehensive Income	0	-	6,114,026	-	-
Statutory reserve fund	2,979,190	2,979,190	2,997,367	-	-
Other Reserves	54,784,038	54,784,038	224,676	-	-
Total Shareholders' Equity	114,982,116	114,982,116	67,254,288	-	-

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 2022 computed based on Banking Act Direction No. 01 of 2016 - Capital requirements under Basel III

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH

AS AT 31 DECEMBER 2022

D-SIB Assessment Exercise

General Information	
Name of the bank	The HongKong and Shanghai Banking Corporation Limited - Sri Lanka Branch

Bank only
Rs.'million

Size Indicator	
Section 1 - Total Exposures	
Total exposures measure	761,533

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)	152,755
(i) Funds deposited	155
(ii) Lending	152,600
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	-
Intra-financial system assets	152,755
Section 3 - Intra-Financial System Liabilities	
a. Funds deposited by or borrowed from other financial institutions (including unused portion of committed lines obtained)	35,036
(i) Funds deposited	35,036
(ii) Borrowings	-
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	8
Intra-financial system liabilities	35,044
Section 4 - Securities Outstanding	
Securities outstanding	-

Substitutability/Financial Institution Infrastructure Indicators	
Section 5 - Payments made in the reporting year (excluding intragroup payments)	
Payments activity	107,784,840
Section 6 - Assets Under Custody	
Assets under custody	70,551
Section 7 - Underwritten Transactions in Debt and Equity Markets	
Underwriting activity	-
Section 8 - Trading Volume	
Trading volume	-

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH

AS AT 31 DECEMBER 2022

D-SIB Assessment Exercise

Complexity indicators	
Section 9 - Notional Amount of Over-the-Counter (OTC) Derivatives	
OTC derivatives	37,779
Section 10 - Level 2 Assets	
Level 2 assets	-
Section 11 - Trading and available for sale (AFS) securities	
Trading and AFS securities	44,346
Section 12 - Cross-Jurisdictional Liabilities	
Foreign liabilities (excluding derivatives and local liabilities in local currency)	6,039
Section 13 - Cross-Jurisdictional Claims	
Foreign claims (excluding derivatives and intragroup claims)	2,779

**THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH**

AS AT 31 DECEMBER 2022

Disclosures in line with Banking Act Directions

**Banking Act no 13 of 2021- Classification , Recognition and measurement of credit facilities in
Licensed banks**

7.1 for the purpose of calculating life-time expected losses under SLFRS 9, at a minimum, if one or more of the prescribed factors/conditions are met, it shall be considered as significant increase in credit risk or as defaulted facilities. The direction outlines 14 SICR criterias.

Licensed bank may rebut one or more criteria listed from 7.1.2 to 7.1.14 in the direction when determining significant increase of credit risk, subject to the following.

1. The KMP heading the Risk Management Function shall recommend such rebuttal criteris to the Board of Directors providing valid rationale and justifications to ensure that such criteria do not result in significant increase of credit risk to the bank, and Board of Directors shall grant approval or reject the proposal after considering the information provided.
2. Disclose the rebutted criteria if any and the estimated impact of such rebuttal on the respective bank's impairment provisions and profitability in their audited annual financial statements.

HSBC Has rebutted the criteria 7.1.3 , which is A two notch downgrade under the internal rating of the licensed bank. Licensed banks are required to map their internal credit risk ratings with the ratings issued by ECAI. For this purpose, licensed banks are required to refer the mapping of external credit ratings given in the Banking Act Directions on capital requirements.

SICR criteria 7.1.3 in CBSL Direction No 13 of 2021 gives rise to an Incremental ECL of 91,315,048. This accounts for 0.37% of the total Impairment provision.

As Permitted by Section 5.5.11 of SLFRS 9 & 7.2 of CBSL Direction No 13 of 2021 , HSBC has rebutted the criteria so referred to given the immateriality of the impact that it gives rise to. (0.37% of total ECL Provision).

As such , ECLs in the Financial Statements as at 31.12.2022 has been reported excluding the incremental ECL of 91,315,048.