THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED SRI LANKA BRANCH

FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2023

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH

FOR THE YEAR ENDED 31 DECEMBER 2023

CONTENTS

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Independent auditor's report

To the Branch management of Hongkong & Shanghai Banking Corporation Limited Sri Lanka Branch

Report on the audit of the financial statements

Our opinion

We have audited the financial statements of Hongkong & Shanghai Banking Corporation Limited Sri Lanka Branch ("the Branch"). The financial statements of the Branch comprise:

- the statement of financial position as at 31 December 2023;
- the income statement and statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the cash flows statement for the year then ended; and
- the notes to the financial statements, which include a summary of Material accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Branch as at 31 December 2023, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

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

Branch Management is responsible for the other information. The other information comprises the sustainability disclosures, supplemental Basel III disclosures and disclosures in line with Banking Act no 13 of 2021- classification, recognition and measurement of credit facilities in Licensed banks but does not include the financial statements and our auditor's report thereon.

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

In connection with our audit of the financial statements, our responsibility is to read the other information 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 Branch management and those charged with governance for the financial statements

Branch 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 Branch 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, Branch 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 Branch 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 judgement 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.

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

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

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

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

We communicate with the Branch Management 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.

Deloitte Partners

CHARTERED ACCOUNTANTS

COLOMBO
30 May 2024

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

FOR THE YEAR ENDED 31 DECEMBER	**Note**	**2023 Rs.'000**	2022 Rs.'000
Interest income		**44,656,669**	45,487,641
Interest expenses		**(9,853,680)**	(11,861,847)
Net interest income	**6**	**34,802,989**	33,625,794
Fee and commission income		**7,613,886**	6,627,143
Fee and commission expenses		**(1,891,541)**	(1,753,299)
Net fee and commission income	**7**	**5,722,345**	4,873,844
Net gain from trading	**8**	**9,125,014**	4,684,987
Net fair value gains from financial instruments at fair value thorugh profit and loss	**9**	**22,608**	(9,467)
Other operating income (net)	**10**	**102,578**	220,390
Total operating income		**49,775,534**	43,395,548
Impairment (charge) / reversal for loans and other losses	**11**	**7,781,165**	(12,480,098)
Net operating income		**57,556,699**	30,915,450
Personnel expenses	**12**	**(5,808,132)**	(5,567,739)
Other expenses	**13**	**(13,800,594)**	(12,194,188)
Operating profit before Value Added Tax and Other Taxes on Financial Services		**37,947,973**	13,153,523
Value Added Tax and Other Taxes on Financial Services	**14.4**	**(7,325,781)**	(3,260,203)
Profit before tax		**30,622,192**	9,893,320
Income tax expense	**14.1**	**(10,472,659)**	(2,921,260)
Profit for the year		**20,149,533**	6,972,060

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 97, 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**	**2023 Rs.'000**	2022 Rs.'000
Profit for the year		**20,149,533**	6,972,060
Other comprehensive income / (expenses)			
Items that may be reclassified to profit or loss in subsequent periods			
Net gains/ (losses) on investments in debt instruments measured at fair value through other comprehensive income (Net of tax)		**834,137**	837,123
Net gains/ (losses) from the financial statements of foreign currency operation		**(11,124,633)**	38,737,882
Net other comprehensive income that may be reclassified to profit or loss in subsequent periods		**(10,290,496)**	39,575,005
Items that may not be reclassified to profit or loss in subsequent periods			
Remeasurement of post-employment benefit obligations (Net of Tax)		**498,560**	(482,193)
Net gains/ (losses) on revaluation of land and buildings (Net of Tax)		**285,783**	(260,670)
Net other comprehensive gain / (loss) that may not be reclassified to profit or loss in subsequent periods		**784,343**	(742,863)
Net other comprehensive income		**(9,506,153)**	38,832,142
Total comprehensive income for the year		**10,643,380**	45,804,202

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 97, 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	2023 Rs.'000	2022 Rs.'000
ASSETS			
Cash and cash equivalents	16	218,142,715	190,916,870
Balances with the Central Bank of Sri Lanka	17	88,040,714	163,152,431
Placements with banks	18	11,337,397	-
Derivative financial instruments	19	1,010,959	285,614
Financial assets measured at fair value through profit or loss	20	23,759	57,230
Financial assets at amortised cost – Loans and advances	21	210,213,522	227,053,508
Financial assets measured at fair value through other comprehensive income	22	19,661,971	43,635,387
Financial assets at amortised cost - debt instruments	23	93,575	70,283
Retirement benefit obligations surplus	30	85,970	-
Property, plant and equipment	25	5,518,045	5,233,077
Deferred tax asset	26	1,285,651	4,355,291
Other assets	27	31,012,381	29,010,731
Total assets		586,426,659	663,770,422
LIABILITIES			
Due to banks	28	38,358,732	34,995,689
Derivative financial instruments	29	228,622	126,843
Financial liabilities at amortised cost - due to depositors	30	372,447,510	468,266,115
Current tax liabilities	14	6,348,598	7,449,684
Retirement benefit obligations deficit	31	-	513,703
Other liabilities	32	46,493,026	37,436,272
Total liabilities		463,876,488	548,788,306
EQUITY			
Assigned capital	33	3,152,358	3,152,358
Statutory reserve fund	34	3,152,358	2,997,367
Other reserves	35	44,006,117	54,066,530
Retained earnings		72,239,338	54,765,861
Total equity		122,550,171	114,982,116
Total equity and liabilities		586,426,659	663,770,422
Contingent liabilities and commitments	38	442,170,056	482,537,251
Memorandum Information			
Number of employees		747	884
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 97, 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.

....
Mark Surgenor
Chief Executive Officer
30th May 2024
Colombo

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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 2022	3,152,358	12,970,357	602,967	(1,387,539)	193,382	2,782,644	2,944,702	49,404,061	70,662,932
Restated balance as at 1 January 2022	3,152,358	12,970,357	602,967	(1,387,539)	193,382	2,782,644	2,944,702	49,404,061	70,662,932
Surcharge Tax 2022	-	-	-	-	-	-	-	(1,516,311)	(1,516,311)
Adjusted opening balance as at 1 January 2022 after the surcharge tax	3,152,358	12,970,357	602,967	(1,387,539)	193,382	2,782,644	2,944,702	47,887,750	69,146,621
Profit for the year	-		-		-	-		6,972,060	6,972,060
Other comprehensive income (net of tax)	-	38,737,882	-	837,123	-	-	(260,671)	(482,193)	38,832,141
Total comprehensive income for the year	-	38,737,882	-	837,123	-	-	(260,671)	6,489,867	45,804,201
Transactions with non equity holders, recognised directly in equity									
Depreciation on revaluation reserve	-	-	-	-	-	-			-
Deferred tax on revaluation	-	-		-	-	-			-
Transactions with equity holders, recognised directly in equity									
Transfers to reserves during the year	-	-	-	-	31,294	**214,723**	-	(214,723)	31,294
Restricted shares	-	-	-	-	-	-	-		-
Transfer to IFA reserve	-	-	-	-	-	-			-
Transfer to IFA reserve	-	-	-	-	-	-	-		-
Impairment on FVOCI	-	-	-	-	-				-
Transfer from IFA reserve	-	-	(602,967)	-	-	-	-	602,967	
Profit transferred to head office									-
Total transactions with equity holders	-	-	(602,967)	-	31,294	214,723	-	388,244	31,294
Balance as at 31 December 2022	3,152,358	51,708,239	-	(550,416)	224,676	2,997,367	2,684,031	54,765,861	114,982,116
Balance as at 1 January 2023	**3,152,358**	**51,708,239**	**-**	**(550,416)**	**224,676**	**2,997,367**	**2,684,031**	**54,765,861**	**114,982,116**
Profit for the year	**-**	-	-	-	-	**-**	**-**	**20,149,533**	**20,149,533**
Other comprehensive income (net of tax)	**-**	**(11,124,633)**	**-**	**834,137**	**-**	**-**	**285,783**	**498,560**	**(9,506,153)**
Total comprehensive income for the year	**-**	**(11,124,633)**	**-**	**834,137**	**-**	**-**	**285,783**	**20,648,093**	**10,643,380**
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	**-**	**-**	**-**	**-**	**(55,700)**	**154,991**	**-**	**(154,991)**	**(55,700)**
Profit transferred to head office	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(3,019,625)**	**(3,019,625)**
Transfer from IFA reserve	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total transactions with equity holders	**-**	**-**	**-**	**-**	**(55,700)**	**154,991**	**-**	**(3,174,616)**	**(3,075,325)**
Balance as at 31 December 2023	**3,152,358**	**40,583,606**	**-**	**283,721**	**168,976**	**3,152,358**	**2,969,814**	**72,239,338**	**122,550,171**

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 97, 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**	**2023 Rs.'000**	2022 Rs.'000
Cash flow from operating activities			
Interest received		**45,462,794**	44,511,949
Interest paid		**(11,123,915)**	(12,896,678)
Fees and commission received		**5,722,345**	4,873,845
Net receipts from trading activities		**8,437,951**	4,680,130
Payments to employees		**(5,589,302)**	(5,210,546)
VAT and NBT on financial services		**(6,281,621)**	(2,957,069)
Receipts from other operating activities		**118,216**	730,341
Payments to other operating activities		**(13,276,087)**	(10,957,925)
Operating profit before changes in operating assets and liabilities		**23,470,381**	22,774,047
(Increase) / decrease in operating assets			
Balances with Central Bank of Sri Lanka		**75,522,459**	(132,535,797)
Financial assets at amortised cost - loans and advances		**19,504,159**	3,190,524
Treasury bills and bonds		**29,579,018**	87,038,569
Other assets		**(13,741,004)**	(2,258,213)
		110,864,632	(44,564,917)
Increase / (decrease) in operating liabilities			
Financial liabilities at amortised cost - due to depositors		**(95,818,606)**	178,256,008
Financial liabilities at amortised cost - due to other borrowers		**3,363,043**	(25,789,105)
Other liabilities		**6,159,867**	(9,858,607)
		(86,295,695)	142,608,296
Net cash generated from operating activities before income tax		**48,039,318**	120,817,426
Income tax paid		**(9,198,458)**	(2,937,713)
Net cash generated from operating activities		**38,840,859**	117,879,713
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		**(324,890)**	(247,938)
Net cash used in investing activities		**(324,890)**	(247,938)
Cash flow from financing activities		**-**	-
Lease payments in lieu of leases with >1 year contract period		**(147,626)**	(333,845)
Profit transferred to Head Office		**-**	-
Net cash used in financing activities		**(147,626)**	(333,845)
Net increase in cash and cash equivalents		**38,368,343**	117,297,930
Cash and cash equivalents at the beginning of period *	**16**	**190,932,418**	35,459,758
Exchange difference in respect of cash and cash equivalents		**(11,124,633)**	38,174,730
Cash and cash equivalents at the end of the period *	**16**	**218,176,128**	190,932,418

* Cash and cash equivalent balances are presented gross of impairment
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 97, which form an integral part of the financial statements of the Branch. The Report of the Auditors is given on pages 1 to 3.

1. CORPORATE INFORMATION

1.1 Domicile and legal form

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

1.2 Principal activities and nature of operations

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

1.3 Parent company and ultimate parent company

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

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

2. SUMMARY OF MATERIAL 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.

2. SUMMARY OF MATERIAL 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 material to the Branch financial statements are disclosed in note 4.

2.1.4 Changes in accounting standards

The following amendments to the Sri Lanka Accounting Standards that are relevant for the preparation of 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 2023 (ie year ending 31 December 2023) and (b) forthcoming requirements, being standards and amendments that will become effective on or after 1 January 2024.

(a) New accounting standards, amendments and interpretations – applicable 1 January 2023

The Branch has applied the following standards and amendments for the first time for their financial reporting periods commencing 1 January 2021:

i. Amendments to LKAS 1 Presentation of Financial Statements and IFRS Practice Statement 2 Making Materiality Judgements— Disclosure of Accounting Policies
ii. Amendments to LKAS 12 Income Taxes—Deferred Tax related to Assets and Liabilities arising from a Single Transaction
iii. Amendments to LKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors—Definition of Accounting Estimates

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.

2. SUMMARY OF MATERIAL ACCOUNTING POLICIES (CONTD)

2.1 Basis of preparation (contd)

i. Amendments to LKAS 1 Presentation of Financial Statements and IFRS Practice Statement 2 Making Materiality Judgements— Disclosure of Accounting Policies

The Branch has adopted the amendments to IAS 1 for the first time in the current year. The amendments change the requirements in IAS 1 with regard to disclosure of accounting policies. The amendments replace all instances of the term 'significant accounting policies' with 'material accounting policy information'. Accounting policy information is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements.

The supporting paragraphs in IAS 1 are also amended to clarify that accounting policy information that relates to immaterial transactions, other events or conditions is immaterial and need not be disclosed. Accounting policy information may be material because of the nature of the related transactions, other events or conditions, even if the amounts are immaterial. However, not all accounting policy information relating to material transactions, other events or conditions is itself material.

This amendment is effective for the annual periods beginning on or after 1 January 2023.

ii. Amendments to LKAS 12 Income Taxes—Deferred Tax related to Assets and Liabilities arising from a Single Transaction

The Branch has adopted the amendments to LKAS 12 for the first time in the current year. The amendments introduce a further exception from the initial recognition exemption. Under the amendments, an entity does not apply the initial recognition exemption for transactions that give rise to equal taxable and deductible temporary differences. Depending on the applicable tax law, equal taxable and deductible temporary differences may arise on initial recognition of an asset and liability in a transaction that is not a business combination and affects neither accounting profit nor taxable profit.

Following the amendments to LKAS 12, an entity is required to recognise the related deferred tax asset and liability, with the recognition of any deferred tax asset being subject to the recoverability criteria in IAS 12.

This amendment is effective for the annual periods beginning on or after 1 January 2023.

iii. Amendments to LKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors— Definition of Accounting Estimates

The Branch has adopted the amendments to LKAS 8 for the first time in the current year. The amendments replace the definition of a change in accounting estimates with a definition of accounting estimates. Under the new definition, accounting estimates are "monetary amounts in financial statements that are subject to measurement uncertainty". The definition of a change in accounting estimates was deleted.

2. SUMMARY OF MATERIAL ACCOUNTING POLICIES (CONTD)

2.1 Basis of preparation (contd)

(b) New standards and amendments but not adopted in 2023

At the date of authorisation of these financial statements, the Branch has not applied the following new and revised SLFRS Accounting Standards that have been issued but are not yet effective.

(i) Classification of Liabilities as Current or Non-current – Amendments to LKAS 1

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

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

2.1.5 Rounding of amounts

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

3. MATERIAL ACCOUNTING POLICIES

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

3.1 Foreign currency translation

(i) Functional and presentation currency

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

(ii) Transactions and balances

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

3. MATERIAL 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.

3. MATERIAL ACCOUNTING POLICIES (CONTD)

3.2 Revenue recognition (contd)

(ii) **Fees and commissions**

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

(ii) Fees and commissions (contd)

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

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

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

3. MATERIAL ACCOUNTING POLICIES (CONTD)

3.3 Taxation

Current tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the 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.

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.

3. MATERIAL 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.

3. MATERIAL ACCOUNTING POLICIES (CONTD)

3.4 Financial assets and financial liabilities (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).

3. MATERIAL ACCOUNTING POLICIES (CONTD)

3.5 Financial assets and financial liabilities (contd)

3.5.3 Measurement

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.

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. MATERIAL ACCOUNTING POLICIES (CONTD)

3.5 Financial assets and financial liabilities (contd)

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

3.5.3.3 Financial assets measured at fair value through other comprehensive income

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

3.5.3.4 Financial instruments designated at fair value through profit or loss

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

3.5.3.5 Derivatives

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

3.5.3.6 Equity instruments

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

3. MATERIAL 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 1000 ~~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.

3. MATERIAL 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 2021.

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 within income statement.

3.8 Cash and cash equivalents

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

3. MATERIAL ACCOUNTING POLICIES (CONTD)

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. With effect from 01 September 2021, the reserve should be maintained for an amount equal to 4% of the total of such rupee deposit liabilities (up to 31 August 2021, this ratio was maintained as 2%).

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. MATERIAL ACCOUNTING POLICIES (CONTD)

3.11 Financial guarantees

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

3.12 Employee benefits

3.12.1 Pension fund

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

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

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 contributes 8% of the gross salary. Bank is required to apply interest at a rate or rates higher than five percentum (5%) per annum on the provident fund account. If there is any shortfall in the overall Fund income, the bank shall meet the deficit and recognize it in the Fund accounts.

3.12.3 Trust fund

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

3. MATERIAL 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.

3. MATERIAL 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 MATERIAL 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. MATERIAL 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. MATERIAL 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.

4. MATERIAL MANAGEMENT ESTIMATES AND JUDGEMENTS (CONTD)

Renegotiation (contd)

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

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

Loan modifications that are not credit impaired

Loan modifications that are not identified as 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.

4. MATERIAL MANAGEMENT ESTIMATES AND JUDGEMENTS (CONTD)

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 24.1 to the financial statements.

Useful Life Time 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. Amendments to LKAS 12 Income Taxes—International Tax Reform—Pillar Two Model Rules

The Branch has adopted the amendments to LKAS 12 for the first time in the current year. The IASB amends the scope of LKAS 12 to clarify that the Standard applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules published by the OECD, including tax law that implements qualified domestic minimum top up taxes described in those rules. The amendments introduce a temporary exception to the accounting requirements for deferred taxes in LKAS 12, so that an entity would neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes. Following the amendments, the Branch is required to disclose that it has applied the exception and to disclose separately its current tax expense (income) related to Pillar Two income taxes. Pillar Two income taxes introduce a minimum effective tax rate of at least 15%, calculated based on a specific rule set. Groups with an effective tax rate below the minimum in any jurisdiction would be required to pay top-up tax to their head office location. The tax would be applied to groups with revenue of at least EUR 750 million. HSBC Sri Lanka's effective tax rate is at 34% hence the adoption has not had any material impact on the disclosures or on the amounts reported in these financial statements.

FOR THE YEAR ENDED 31 DECEMBER

6 Net interest income

	2023	2022
	Rs.'000	Rs.'000
Interest income		
Cash and cash equivalents*	**9,935,468**	2,176,408
Balances with central bank	**7,954,727**	12,785,158
Call placements with banks	**20,122**	257,553
Financial assets measured at fair value through profit or loss	**19,386**	6,862
Financial assets at amortised cost		
- loans and advances	**24,789,312**	20,514,019
- debt and other instruments	**12,014**	1,456,252
Financial assets measured at fair value through other comprehensive income	**1,925,640**	8,291,389
Total interest income	**44,656,669**	45,487,641
Interest expenses		
Due to banks	**(63,500)**	(66,062)
Financial liabilities at amortised cost		
- due to depositors	**(9,370,916)**	(10,784,856)
- due to repo holders	**-**	-
Interest expense on lease liabilities	**(43,747)**	(64,764)
Interest expense on deposits/ borrowings from group companies	**(556,791)**	(807,135)
Interest expenses related to other	**181,274**	(139,030)
Total interest expenses	**(9,853,680)**	(11,861,847)
	34,802,989	33,625,794

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

6.1 Net interest income from Sri Lanka Government Securities

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

	2023	2022
	Rs.'000	Rs.'000
Interest income	**1,957,040**	9,754,502
Less: Interest expenses	**-**	-
Net interest income from Sri Lanka Government Securities	**1,957,040**	9,754,502

FOR THE YEAR ENDED 31 DECEMBER

		2023	2022
7	**Net fee and commission income**	**2023**	2022
		Rs.'000	Rs.'000
	Fee and commission income	**7,613,886**	6,627,143
	Fee and commission expenses	**(1,891,541)**	(1,753,299)
		5,722,345	4,873,844
7.1	**Comprising**		
	Loans and advances	**34,942**	32,088
	Credit cards	**3,652,593**	3,393,580
	Trade and remittance transactions	**990,752**	817,743
	Deposits accounts	**85,957**	90,688
	Off Balance sheet activities	**2,507,196**	1,921,493
	Others	**342,446**	371,551
	Fee and commission income	**7,613,886**	6,627,143
	Fee expense		
	Credit cards	**1,574,398**	1,533,422
	Other	**317,143**	219,877
		1,891,541	**1,753,299**
	Net Fee and commission income	**5,722,345**	4,873,844

8	**Net gain from trading**	**2023**	2022
		Rs.'000	Rs.'000
	Foreign exchange		
	- Gains/(losses) from transactions with customers	**115,614**	12,112
	- Gains from transactions with others	**2,162**	4,280
	Other trading income	**9,007,238**	4,668,595
		9,125,014	4,684,987

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).

FOR THE YEAR ENDED 31 DECEMBER

		2023	2022
9	**Net fair value gains from financial instruments at fair value through Profit and Loss**	**2023**	2022
		Rs.'000	Rs.'000
	Net gains (Losses) on financial assets at fair value through profit and loss	**22,608**	**(9,467)**

10	**Other operating income (net)**	**2023**	2022
		Rs.'000	Rs.'000
	Loss on sale of property, plant and equipment	**(15,638)**	-
	Other income from intercompany transactions /dividend from mandatory shares	**118,216**	220,390
		102,578	220,390

11	**Impairment charges / (reversals) and other losses**	**2023**	2022
		Rs.'000	Rs.'000
11.1	**Financial assets at amortised cost - loans and advances (Note 21.1)**		
	Stage 1	**(84,918)**	107,492
	Stage 2	**(4,917,317)**	5,844,590
	Stage 3	**250,101**	(79,672)
		(4,752,134)	5,872,410
11.2	**Financial assets at amortised cost – debt instruments (Note 23.2)**		
	Stage 1	**-**	-
	Stage 2	**(63,261)**	34,262
	Stage 3	**-**	-
		(63,261)	34,262
11.3	**Financial assets measured at fair value through other comprehensive income (Note 22.3)**		
	Stage 1	**-**	(302,605)
	Stage 2	**(4,258,954)**	4,454,261
	Stage 3	**-**	973,046
		(4,258,954)	5,124,702
11.4	**Contingent liabilities and commitments (Note 38.2)**		
	Stage 1	**255,135**	185,004
	Stage 2	**12,765**	382,226
	Stage 3	**-**	-
		267,900	567,230

		2023	2022
11	**Impairment charges / (reversals) and other losses**	**Rs.'000**	Rs.'000
11.5	**Others**		
	Stage 1	**(35,573)**	440,313
	Stage 2	**(79,477)**	73,717
	Stage 3	**-**	-
	Other	**-**	-
		(115,050)	514,030
11.5.1	**Others**		
	Stage 1		
	Acceptances	**273,647**	66,976
	Balances with Banks	**(100,553)**	330,971
	Balances with Central Bank	**(208,667)**	42,366
		(35,573)	440,313
	Stage 2		
	Acceptances	**(55,931)**	56,041
	Balances with Banks	**(23,546)**	17,676
		(79,477)	73,717
	Total	**(115,050)**	514,030
11.6	**Write-off's, recoveries and other**	**1,140,334**	367,464
		(7,781,165)	12,480,098
		-	-

FOR THE YEAR ENDED 31 DECEMBER

12	**Personnel expenses**	**2023**	2022
		Rs.'000	Rs.'000
	Salary and bonus	**(3,637,803)**	(3,220,290)
	Contributions to defined benefit obligation	**(83,804)**	27,310
	Contributions to defined contribution plans / other benefit plans	**(404,451)**	(480,586)
	Others	**(1,682,074)**	(1,894,173)
		(5,808,132)	(5,567,739)

* Others mainly include allowances paid to the employees amounting to LKR1.3 Billion (2022: LKR 1.4 Billion).

13	**Other expenses**	**2023**	2022
		Rs.'000	Rs.'000
	Auditors’ remuneration	**(6,312)**	(5,413)
	Non-audit fees to auditors	**(5,491)**	(4,375)
	Professional and legal expenses	**(152,455)**	(159,857)
	Depreciation of property, plant and equipment	**(361,409)**	(301,931)
	Depreciation on right of use assets	**(163,860)**	(283,634)
	Office administration and establishment expenses	**(1,892,696)**	(2,033,741)
	Short-term lease expenses	**(43,550)**	(19,749)
	Donations	**-**	-
	Others	**(11,174,821)**	(9,385,488)
		(13,800,594)	(12,194,188)

Main component of expenses classified as 'Others' are payable in lieu of services rendered by the inter companies, out of which Regionally Allocated charges (RAC)payable to the regional Head office is 1,373 Mn (2022:2,950 Mn) .

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 and current taxes at at the rate of 30% which is the statutory tax rate. Current Tax of 2022 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 .

		2023	2022
14	**Tax expense (contd)**	**Rs.'000**	Rs.'000
14.1	**Current tax expense**		
	Current tax on profit for the year (Note 14.3)	**(8,097,372)**	(6,738,847)
	Over provision for the previous year	-	-
	Exchange	-	20,669
	Remittance tax	-	(42,317)
		(8,097,372)	(6,760,495)
	Deferred tax expenses		
	-Provision for employee benefit	-	(23,917)
	- Owned assets	-	-
	-Allowances for expected credit losses	**(2,501,891)**	-
	-SLFRS 16	-	-
	-Accelerated depreciation of Property Plant & Equipment	-	-
	Deferred tax assets derecognised during the year	**(2,501,891)**	(23,917)
	- Provision for employee benefit	**28,992**	-
	-Accelerated depreciation of Property Plant & Equipment	**75,330**	-
	- Owned assets	-	33,296
	-Allowance for Expected Credit Loss	-	3,813,730
	-SLFRS 16	**22,283**	16,126
	Deferred tax liabilities recognized during the year	**126,605**	3,863,152
		(2,375,286)	3,839,235
	Total tax charge to income statement	**(10,472,659)**	(2,921,260)
14.2	**Tax charge to the statement of other comprehensive income**		
	-Provision for employee benefit	**(178,940)**	297,390
	-Provision for impairment	**1,292,068**	(1,265,375)
	-Fair value adjustments	**(1,685,004)**	1,515,086
	-Revaluation of buildings	**(122,479)**	(220,394)
		(694,355)	326,707
14.3	**Reconciliation between current tax expense and accounting profit**		
	Accounting profit before taxation	**30,622,192**	9,893,320
	Income tax for the period at 30%	**9,186,658**	2,671,197
	Add: Tax effect of expenses that are not deductable for tax purposes	**415,198**	5,032,328
	Less: Tax effect of expenses that are deductable for tax purposes	**(836,335)**	(951,149)
	Tax effect on exempt Income and income taxed at reduced rates	**(668,149)**	(13,529)
	Current tax on profit for the year	**8,097,372**	6,738,847

-During 12 months ended December 2023, applicable income tax rate has been 30% for both current tax and deferred tax computations. Income tax has been increased from 24% to 30% in year 2022, which resulted in two tax rates being applicable for the year 2022.

		2023	2022
14.4	**Breakdown of Value Added Tax and Other Taxes on financial services**		
	Value Added Tax	**(6,432,394)**	(3,164,653)
	SSCL on financial services	**(893,387)**	(95,551)
		(7,325,781)	(3,260,204)

- During the 12 month period ended December 2023 the applicable Value Added Tax (VAT) rate has been at 18% (2022 : 15%) and Social security Contribution Lecy (SSCL) has been at 2.5% (2022 October Onwards : 2.5%).

14 Tax expense (contd)

		2023 Rs.'000	2022 Rs.'000
14.5	**Reconciliation between tax expense and the product of accounting profit**		
	Accounting profit before taxation	**30,622,192**	9,893,320
	Tax effect on accounting profit	**(9,186,658)**	(2,671,196)
	Tax effect on deductible income	**668,149**	12,988
	Tax effect on non deductible expenses	**(2,406,312)**	(1,894,953)
	Tax effect on deductions claimed	**452,107**	1,345,017
	(Under) / over provision for previous years	**-**	-
	Tax Effect of rate differential	**439**	329,785
	Other rates (Dividend Tax at 14%, Remittance Tax at 14% ,Capital gain tax at 10%)	**(384)**	(42,899)
	Tax expense	**(10,472,659)**	(2,921,260)
14.6	**Tax Liabilities**		
	Balance at the beginning	**7,449,684**	2,617,115
	Reclassification of other direct Taxes to Other liabilities	**-**	(1,086,781)
	Current tax charge for the year	**8,097,372**	6,760,494
	Exchange Loss	**-**	-
	Payments made during the year	**(9,198,458)**	(841,144)
	Balance at the end	**6,348,598**	7,449,684

AS AT 31 DECEMBER

15 Analysis of financial instruments by measurement basis

15.1 As at 31 December 2023

	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	-	218,142,715	-	218,142,715
Balances with the Central Bank of Sri Lanka	-	88,040,714	-	88,040,714
Placements with banks	-	11,337,397	-	11,337,397
Derivative financial instruments	1,010,959	-	-	1,010,959
Financial assets measured at fair value through profit or loss	23,759	-	-	23,759
Financial assets at amortised cost – loans and advances	-	210,213,522	-	210,213,522
Financial assets measured at fair value through other comprehensive income	-	-	19,661,971	19,661,971
Financial assets at amortised cost - debt instruments	-	93,575	-	93,575
Acceptances and endorsements	-	24,265,096	-	24,265,096
Total financial assets	**1,034,718**	**552,093,019**	**19,661,971**	**572,789,708**
LIABILITIES				
Due to banks	-	38,358,732	-	38,358,732
Derivative financial instruments	228,622	-	-	228,622
Financial liabilities at amortised cost - due to depositors	-	372,447,510	-	372,447,510
Acceptances and endorsements	-	24,524,578	-	24,524,578
Total financial liabilities	**228,622**	**435,330,820**	**-**	**435,559,442**

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15 Analysis of financial instruments by measurement basis (contd)

15.2 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	-	190,916,870	-	190,916,870
Balances with Central Bank	-	163,152,431	-	163,152,431
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	-	18,095,676	-	18,095,676
Total financial assets	**342,844**	**599,288,768**	**43,635,387**	**643,266,999**
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**

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16 Cash and cash equivalents

	2023	2022
	Rs.'000	Rs.'000
Cash in hand	**1,791,560**	1,638,677
Balances with other banks	**8,078,288**	53,258,159
Money at call and at short notice	**208,306,280**	136,035,582
Less: Impairment related to cash and cash equivalent	**(33,413)**	(15,548)
	218,142,715	190,916,870

17 Balances with the Central Bank of Sri Lanka

	2023	2022
	Rs.'000	Rs.'000
Statutory balances with Central bank of Sri Lanka	**2,872,565**	10,995,024
Placements with Central bank of Sri Lanka	**85,200,000**	152,600,000
Less: Impairment related to Balances with Central Bank of Sri Lanka	**(31,851)**	(442,593)
	88,040,714	163,152,431

As required by the provisions of Section 93 of the Monetary Law Act, a cash balance is maintained with the Central Bank of Sri Lanka. The minimum cash reserve requirement on Rupee deposit liabilities was 2% as at 31st December 2023 (2022: 4%).

18 Placements with Banks

	2023	2022
	Rs.'000	Rs.'000
Placements with Banks	11,338,600	-
Less: Impairment related to Placements with Banks	(1,203)	-
	11,337,397	-

19 Derivative financial instruments

	2023	2022
	Rs.'000	Rs.'000
Currency Swaps	**348,589**	-
Forward foreign exchange contracts	**662,370**	285,614
	1,010,959	285,614

20 Financial assets measured at fair value through profit or loss

	2023	2022
	Rs.'000	Rs.'000
Treasury bills	**-**	9,468
Treasury bonds	**23,759**	47,762
	23,759	57,230

20.1 Analysis

By collateralisation		
- Unencumbered	**23,759**	57,230
By currency		
- Sri Lankan rupee	**23,759**	57,230

AS AT 31 DECEMBER

21 Financial assets at amortised cost – Loans and advances

	Note	2023 Rs.'000	2022 Rs.'000
Gross loans and advances			
Stage 1		**149,163,057**	103,844,109
Stage 2		**57,581,552**	120,933,273
Stage 3		**8,310,041**	11,581,044
		215,054,650	236,358,426
Less: Accumulated impairment under;			
Stage 1		**(745,497)**	(611,648)
Stage 2		**(2,983,652)**	(7,961,482)
Stage 3		**(1,111,979)**	(731,788)
		(4,841,128)	(9,304,918)
Net loans and receivables		**210,213,522**	227,053,508

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

		2023	2022
21.1	**Provision for impairment loss**	**Rs.'000**	Rs.'000
21.1.1	**Stage 1**		
	Opening balance as at 01 January	**611,648**	424,076
	(Write back) to income statement	**(84,918)**	107,492
	Exchange fluctuations and other movements	**218,767**	80,080
	Closing balance as at 31 December	**745,497**	611,648
21.1.2	**Stage 2**		
	Opening balance as at 01 January	**7,961,482**	943,874
	(Write back) / charge to income statement	**(4,917,317)**	5,844,590
	Exchange fluctuations and other movements	**(60,513)**	1,173,018
	Closing balance as at 31 December	**2,983,652**	7,961,482
21.1.3	**Stage 3**		
	Opening balance as at 01 January	**731,788**	814,067
	(Write back) / charge to income statement	**250,101**	(79,672)
	Exchange fluctuations and other movements	**130,090**	(2,607)
	Closing balance as at 31 December	**1,111,979**	731,788

		2023	2022
22	**Financial assets measured at fair value through other comprehensive income**	**Rs.'000**	Rs.'000
	Treasury bills	**19,190,275**	236,703
	Treasury bonds/ International Soverign Bonds	**471,696**	43,398,684
		19,661,971	43,635,387
22.1	**Analysis**		
	By collateralisation		
	- Unencumbered	**19,661,971**	43,635,387
		19,661,971	43,635,387
	By Currency		
	- Sri Lankan Rupees	**19,190,275**	43,100,194
	- United States Dollar	**471,696**	535,193
		19,661,971	43,635,387
22.2	**Staging of Financial assets measured at fair value through other comprehensive**		
	Stage 1	**-**	-
	Stage 2	**19,190,275**	43,100,194
	Stage 3	**471,696**	535,193
		19,661,971	**43,635,387**

22 Financial assets measured at fair value through other comprehensive income

22.3 Movements in provision for impairment loss during the year

	2023	2022
	Rs.'000	Rs.'000
Opening balance	**5,497,280**	292,327
Stage 1		
(Write back) / charge to income statement	**-**	(302,605)
Stage 2		
(Write back) / charge to income statement	**(4,258,954)**	4,454,261
Stage 3		
(Write back) / charge to income statement	**-**	973,046
Exchange fluctuations and other movements	**(130,655)**	80,251
Closing balance	**1,107,671**	5,497,280

AS AT 31 DECEMBER

		2023	2022
23	**Financial assets at amortised cost - debt instruments**	**2023**	2022
		Rs.'000	Rs.'000
	Treasury bonds	**110,020**	109,520
	Accumulated impairment	**(16,445)**	(39,237)
		93,575	70,283
23.1	**Financial assets at amortised cost - debt instruments**		
	By collateralisation		
	- Unencumbered	**110,021**	109,520
	By currency		
	- Sri Lankan Rupee	**110,021**	109,520
23.2	**Movements in provision for impairment loss during the year**		
	Stage 2	**Rs.'000**	Rs.'000
	Opening balance	**39,237**	11,603
	Charge / (write back) to income statement	**(63,261)**	34,262
	Other Movement	**40,469**	(6,628)
	Closing balance	**16,445**	39,237
24	**Other Assets**	**Rs.'000**	Rs.'000
	Acceptances	24,524,578	18,209,373
	(-) Impairment	(259,482)	(113,697)
		24,265,096	**18,095,676**
24.1	**Movements in provision for impairment loss during the year**		
	Impairment classification - Other Assets	**2023**	2022
		Rs.'000	Rs.'000
	Stage 1		
	Opening balance	3,222	3,065
	Charge / (write back) to income statement	273,647	56,041
	Other Movement	(53,875)	(55,884)
	Closing balance	**222,994**	**3,222**
	Stage 2		
	Opening balance	110,475	1,533
	Charge / (write back) to income statement	(55,931)	66,976
	Other movement	(18,056)	41,966
	Closing balance	**36,488**	**110,475**
	Total	**259,482**	**113,697**

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24.2 Off Balance Sheet exposures

	2023 Rs.'000	2022 Rs.'000
Contingent Assets	362,080,440	399,760,995
Stage 1		
Opening balance	228,756	43,752
Charge / (write back) to income statement	255,135	185,004
Other movement	(138,311)	-
Closing balance	**345,580**	**228,756**
Stage 2		
Opening balance	385,978	-
Charge / (write back) to income statement	12,765	382,226
Other movement	(98,171)	3,752
Closing balance	**300,572**	**385,978**
Total	**646,152**	**614,734**

24.3 Total Impairment Movement

	Gross Instrument Value			
	Stage 1	Stage 2	Stage 3	Total
Closing balance as at 31 December 20	387,441,220	247,688,141	12,116,237	647,245,598
Financial assets Transferred to Stage 2	(23,398,337)	33,855,404	(9,132,799)	1,324,268
Financial assets Transferred to Stage 3	-	(1,689,139)	7,284,668	5,595,529
New Financial assets acquired	400,460,711	33,930,575	-	434,391,286
Reversals due to Maturities/ Repayments / write offs	(206,389,335)	(164,580,224)	(1,422,872)	(372,392,431)
Changes in risk parameters (in LGD and PD)	42,956,324	(42,956,324)	-	-
Other changes (Off BS, Other assets)	-	-	(63,497)	(63,497)
Closing balance as at 31 December 2023	601,070,583	106,248,433	8,781,737	716,100,753

	ECL			
	Stage 1	Stage 2	Stage 3	Total
Closing balance as at 31 December 20	(1,421,106)	(12,853,976)	(1,785,085)	(16,060,167)
Financial assets Transferred to Stage 2	(33,455)	1,632,205	(852,564)	746,186
Financial assets Transferred to Stage 3	(257,389)	280,161	(281,953)	(259,181)
New Financial assets acquired	183,821	(1,352,022)	-	(1,168,201)
Reversals due to Maturities/ Repayments / write offs	253,619	7,762,714	1,884,654	9,900,987
Changes in risk parameters (in LGD and PD)	(206,446)	920,608	(1,130,329)	(416,167)
Other changes (Off BS, Other assets)	138,311	98,171	82,716	319,198
Closing balance as at 31 December 20	(1,342,645)	(3,512,139)	(2,082,561)	(6,937,345)

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25 Property, plant and equipment

	Land	Freehold buildings and improvements	Office 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
Cost/revalued Amount								
Balance as at 1 January 2022	3,013,163	1,579,838	1,004,589	158,728	710,596	78,029	304,648	6,849,591
Additions during the year	-	6,404	15,467	259	44,749	-	181,057	247,936
Disposals during the year	-	-	-	-	-	-	-	-
Write-off's during the year	-	-	-	-	-	-	-	-
Transfers during the year	-	43,282	47,189	-	143,534	-	(234,005)	-
Revaluation gain / (loss)	(86,688)	(63,000)	-	-	-	-	-	(149,688)
Adjustments	-	-	(557)	-	(7,313)	-	-	(7,870)
Closing balance as at 31 December 2022	2,926,475	1,566,524	1,066,688	158,987	891,566	78,029	251,700	6,939,969
Balance as at 1 January 2023	**2,926,475**	**1,566,524**	**1,066,688**	**158,987**	**891,566**	**78,029**	**251,700**	**6,939,969**
Additions during the year	**-**	**-**	**67,746**	**53,071**	**41,066**	**-**	**163,007**	**324,890**
Disposals during the year	**-**	**-**	**(50,315)**	**-**	**(4,258)**	**-**	**-**	**(54,573)**
Write-off's during the year	-	-	-	-	-	-	-	-
Transfers during the year	-	**14,184**	**98,262**	**-**	**88,158**	**-**	**(200,604)**	-
Revaluation gain / (loss)	**(214,475)**	**497,266**	**-**	**-**	**-**	**-**	**-**	**282,791**
Impairment Classification	-	-	-	-	-	-	-	-
Adjustments	-	-	**(65,900)**	-	-	-	-	**(65,900)**
Balance as at 31st December 2023	**2,712,000**	**2,077,974**	**1,116,481**	**212,058**	**1,016,532**	**78,029**	**214,103**	**7,427,177**
Accumulated depreciation								
Balance as at 1 January 2022	-	-	753,038	135,075	540,984	78,029	-	1,507,126
Charge for the year	-	109,413	85,138	20,754	86,626	-	-	301,931
Reclassified during the year	-	-	-	-	-	-	-	-
Revaluation adjustment	-	(109,413)	-	-	-	-	-	(109,413)
Disposals during the year	-	-	-	-	-	-	-	-
Adjustments during the yer	-	-	-	-	7,248	-	-	7,248
Balance as at 31 December 2022	-	-	838,176	155,829	634,858	78,029	-	1,706,892
Balance as at 1 January 2023	**-**	**-**	**838,176**	**155,829**	**634,858**	**78,029**	**-**	**1,706,892**
Charge for the year	**-**	**125,471**	**161,074**	**25,515**	**49,350**	**-**	**-**	**361,410**
Revaluation adjustment	**-**	**(125,471)**	-	**-**	-	**-**	**-**	**(125,471)**
Disposals during the year	**-**	**-**	**(36,361)**	**-**	**(2,574)**	**-**	**-**	**(38,935)**
Adjustments	**-**	**-**	**5,236**	**-**		**-**	**-**	**5,236**
Balance as at 31 December 2023	**-**	**-**	**968,125**	**181,344**	**681,634**	**78,029**	**-**	**1,909,132**
Carrying value	**2,712,000**	**2,077,974**	**148,356**	**30,714**	**334,898**	**-**	**214,103**	**5,518,045**
As at 31 December 2022	2,926,475	1,566,524	228,512	3,158	256,708	-	251,700	5,233,077
As at 31 December 2023	**2,712,000**	**2,077,974**	**148,356**	**30,714**	**334,898**	**-**	**214,103**	**5,518,045**

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25 Property, plant and equipment (contd)

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

The land and buildings of the Branch as at 31 December 2023 have been revalued and the revalued amounts have been incorporated in the financial statements for the year. This is considered as a level 3 valuation and the details of the valuation are given below.

Property	Name and Qualifications of the independent valuer	Valuation Technique	Significant unobservable inputs *	Inter-relationship between key unobservable inputs and fair value measurement
Sir Baron Jayatilaka Mawatha, Colombo 01	1. Harsha Hareendran MPlan 4 years experience 2. Tertius MBA 10 years experience 3. Somy Thomas MBA 16 years experience	Summation approach of “Income capitalisation” and “Depreciated Replacement Cost” approach	Rate per square foot	Direct correlation - higher the rate per square foot, higher the market value
Independence Avenue, Colombo 07	1. Harsha Hareendran MPlan 4 years experience 2. Tertius MBA 10 years experience 3. Somy Thomas MBA 16 years experience	Direct Sale Comparable approach and Depreciated Replacement Cost Method	Sale price per perch Cost spent	Direct correlation - higher the cost spent, higher the market value

* Significant unobservable inputs			
Estimated price per perch	Estimated price	Estimated discount rate	Correlation to Fair Value
21.48 Mn	1,203	NA	NA
20 Mn	1,579	NA	NA

Sensitivity analysis

In order to illustrate the significance of the unobservable inputs used in the valuation as at 31 December 2023, a sensitivity analysis was carried out as follows.

Property	Description	Change in assumption	Present value of the property		Submitted Value
			Increase in assumption (LKR million)	Decrease in assumption	
Colombo 01	Rate per sq ft	10%	1323	1,083	1,203
Colombo 01	Yield rate	1%	2849	2,393	2,601
Colombo 07	Sale price per perch	10%	2175	1,859	2,017

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26 Deferred tax assets / (liabilities)

	2023	2022
	Rs.'000	Rs.'000
Deferred tax assets	**2,558,428**	5,616,217
Deferred tax liabilities	**(1,272,777)**	(1,260,926)
	1,285,651	4,355,291

26.1 Temporary differences

Deferred tax assets and liabilities are attributable to the following:

	PPE	Gratuity	Revaluation Reserve	Right of Use Asset	Other	Total
As at 01.01.2022	**(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**
Charged/(Credited)						
- to profit or loss	75,330	28,992	-	22,285	(2,501,891)	(2,375,285)
-to Other comprehensive income	-	(178,940)	(122,479)	-	(392,937)	(694,356)
As at 31.12.2023	**67,541**	**303,757**	**(1,272,777)**	**118,304**	**2,068,825**	**1,285,650**

Major part of other, consists of deferred taxes on impairment and fair value movement Financial assets at Fair value through other comprehensive Income.

Deferred tax is computed using the statutory tax rate of 2023 -30%, 2022 - 30%.

27 Other assets

	2023	2022
	Rs.'000	Rs.'000
Receivables	**5,948,228**	10,079,333
Deposits and prepayments	**7,522**	5,468
Acceptances and endorsements	**24,524,578**	18,209,373
Right-of-use assets (Note 27.1)	**539,164**	549,682
Others	**252,371**	280,572
Impairment (Note 23.1)	**(259,482)**	**(113,697)**
	31,012,381	**29,010,731**

27.1 Right-of-use assets and lease liabilities

	-	-
27.1.1 Amounts recognised in the balance sheet	**Rs.'000**	Rs.'000
Right-of-use assets - Land & Buildings	**539,164**	549,682
Lease liabilities	**220,559**	**292,571**

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27 Other assets (contd)

	2023	2022
27.1 Right-of-use assets and lease liabilities (contd)	**Rs.'000**	Rs.'000

27.1.2 Amounts recognised in the statement of profit or loss

Depreciation charges	163,860	283,634
Interest expense	43,747	64,764
Expense relating to short-term leases	43,550	19,749
Loss / (Gain) on lease modifications	337	(95,610)

27.1.3 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.

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.

27 Other assets (contd)

27.1.3 The group’s leasing activities and how these are accounted for; (contd)

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.

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.

27.1.4 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.

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.

28 Due to banks

	2023	2022
	Rs.'000	Rs.'000
Borrowings	**28,566,161**	27,809,121
Securities sold under repurchase (repo) agreements	**-**	-
Vostro balances with HSBC offices and other banks	**9,792,571**	7,186,568
	38,358,732	34,995,689

29 Derivative financial instruments

	2023	2022
	Rs.'000	Rs.'000
Forward foreign exchange contracts	228,622	126,843
	228,622	126,843

		2023	2022
30	**Financial liabilities at amortised cost - due to depositors**	Rs.'000	Rs.'000
	Total amount due to other customers (Note 30.1)	372,447,510	468,266,115
30.1	**Analysis**		
30.1.1	By product		
	Demand deposits (current accounts)	100,979,759	103,925,951
	Savings deposits	112,587,336	151,082,825
	Fixed deposits	155,493,455	197,026,247
	Other deposits	3,386,960	16,231,093
	Total	372,447,510	468,266,116
30.1.2	By currency		
	Sri Lankan Rupees	184,258,698	234,526,685
	United States Dollars	164,848,671	208,958,674
	Great Britain Pounds	9,823,874	10,084,703
	Others	13,516,267	14,696,053
	Total	372,447,510	468,266,115

		2023	2022
31	**Net defined benefit (asset) / liability**	Rs.'000	Rs.'000
	Present value of defined benefit obligations (Note 31.1)	1,012,526	1,512,355
	Fair value of plan assets (Note 31.2)	(1,098,496)	(998,652)
	Defined benefit (asset) / liability - net	(85,970)	513,703

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 acturial valuation involves making assumptions about discount rates, future salary increases and mortality rates. Due to long term nature of these plans, such estimates are subject to significant uncertainty. All assumptions are reviewed at each reporting date. Accordingly, the employee benefits obligation is based on the acturial valuation as at 31 December 2023, carried out by Messrs Willis Towers Watson India, actuaries.

		2023	2022
31.1	**Movement in the present value of defined benefit obligations**		
	Opening balance	1,512,355	750,972
	Current service cost	9,564	3,753
	Interest cost	205,453	82,758
	Benefits paid during the year	(118,379)	(100,466)
	Actuarial gain / (loss) for the year	(596,467)	775,338
	Closing balance	1,012,526	1,512,355
31.2	**Movement in fair value of plan assets**		
	Opening balance	998,652	974,542
	Expected return on plan assets	131,213	113,821
	Contribution by employers	5,977	15,000
	Benefits paid during the year	(118,379)	(100,466)
	Actuarial gain / (loss) for the year	81,033	(4,245)
	Closing balance	1,098,496	998,652

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

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31 Defined benefit liability - net (contd)

31.3 Sensitivity analysis of the defined benefit obligation

	2023 Rs.'000	2022 Rs.'000
a. Discount rate		
Discount rate	**13.00%**	**14.10%**
1. Effect due to the increase in the discount rate by 1.00% (Rs '000)	**(75,627)**	**(147,832)**
2. Effect due to the decrease in the discount rate by 1.00% (Rs '000)	**88,946**	**180,544**
b. Increase in salary escalation rate and post retirement pension		
Salary escalation rate		
- Union members	**8%**	**6%**
- Non-union members	**5%**	**14%**
Post retirement pension	**5%**	10%
1. Effect on DBO due to an increase in the salary escalation and post retirement pension rate by 1% p.a. (Rs '000)	**83,057**	**164,406**
2. Effect on DBO due to a decrease in the salary escalation and post retirement pension rate by 1% p.a. (Rs '000)	**(72,687)**	**(139,070)**
Weighted average duration of defined benefit obligation	**6 years**	6.2 years

32 Other liabilities

	2023 Rs.'000	2022 Rs.'000
Sundry creditors	**-**	506,653
Interest payable	**2,282,814**	3,553,048
Acceptances and endorsements	**24,524,578**	18,209,373
Impairment in respect of off-balance sheet credit exposures	**646,152**	614,734
Lease liabilities	**220,559**	292,571
Accrued Expenses	**2,119,938**	2,062,965
Payable to Group Entities	**7,168,237**	2,178,655
Other payables	**6,983,378**	8,515,062
Value Added Tax, Social Security Contribution levy and Other Taxes	**2,547,370**	1,503,211
	46,493,026	37,436,272

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

33 Assigned capital

	2023 Rs.'000	2022 Rs.'000
Assigned Capital	**3,152,358**	3,152,358
	3,152,358	3,152,358

34 Statutory reserve fund

	2023 Rs.'000	2022 Rs.'000
Opening balance	**2,997,367**	2,782,644
Transferred during the year	**154,991**	214,723
Closing balance	**3,152,358**	2,997,367

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. Statutory reserve fund was built up untill it reaches the assigned capital, hence no further transfers are required from 2024 onwards.

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35 Other reserves

	2023	2022
	Rs.'000	Rs.'000
Exchange equalisation reserve (Note 35.1)	**40,583,606**	51,708,239
Fair value through other comprehensive income reserve (Note 35.2)	**283,721**	(550,416)
Revaluation reserve (Note 35.3)	**2,969,814**	2,684,031
Share based payment reserve (Note 35.5)	**168,976**	224,676
	44,006,117	54,066,530

35.1 Exchange equalisation reserve

	2023	2022
	Rs.'000	Rs.'000
Opening balance	**51,708,239**	12,970,357
Movement for the period	(11,124,633)	38,737,882
Closing balance	**40,583,606**	51,708,239

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

35.2 Fair value through other comprehensive income reserve

	2023	2022
	Rs.'000	Rs.'000
Opening balance	**(550,416)**	(1,387,539)
Net movement in revaluation and impairment	**834,137**	837,123
Closing balance	**283,721**	(550,416)

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.

35.3 Revaluation reserve

	2023	2022
	Rs.'000	Rs.'000
Opening balance	**2,684,031**	2,944,702
Net Revaluation surplus / (deficit) for the year	**285,783**	(260,671)
Closing balance	**2,969,814**	2,684,031

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.

35 Other reserves (Contd)

35.4 IFA reserve

	2023	2022
	Rs.'000	Rs.'000
Opening balance	-	602,967
Transferred during the year	-	(602,967)
Closing balance	-	-

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.

35 Other reserves (contd)

35.5 Share based payment reserve

	2023	2022
	Rs.'000	Rs.'000
Opening balance	224,676	193,382
Transferred during the year	(55,700)	31,294
Closing balance	168,976	224,676

35.6 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.

35.6.1 Restricted share awards - No of shares

	2023	2022
Outstanding at the beginning	11,222	18,129
Awards during the year	2,460	6,904
Vested during the year	(5,550)	(13,811)
Outstanding at the end	8,132	11,222

35.6.2 Share-based payments income statement charge

	Rs.'000	Rs.'000
Restricted and performance share awards	(19,599)	48,418
	(19,599)	48,418

36 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.

37 Comparative figures

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

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38 Commitments and contingencies

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

	2023	2022
	Rs.'000	Rs.'000
Commitments		
Undrawn loan commitments	**238,563,687**	226,517,848
Foreign Exchange Contracts	**61,148,720**	37,778,527
Other contra accounts	**18,940,896**	44,997,729
Total	**318,653,303**	309,294,104
Contingencies		
Performance bonds	**84,841,503**	128,463,213
Letters of credit	**30,200,442**	34,430,023
Guarantees	**8,474,808**	10,349,911
Total	**123,516,753**	173,243,147
Total commitments and contingencies	**442,170,056**	482,537,251

38.2 Movements in Impairment during the Year

	2023	2022
	Rs.'000	Rs.'000
Opening balance	**614,734**	43,749
Charge/ (Write back) to income statement	**267,900**	567,230
Exchange rate variance and other adjustments	**(236,482)**	3,755
Closing balance	**646,152**	614,734

38.3 Pending litigations against the Branch as at 31 December 2023

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 (new case No LT/2/1121/2021), 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.

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38 Commitments and contingencies (contd)

38.3 Pending litigations against the Branch as at 31 December 2023 (contd)

4. Case no. CHC/66/2023 /MR-Commercial High Courts of Colombo - The case has been filed by Jetwing Pvt Ltd (Customer - Palintiff). 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.

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

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

7. 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 .

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

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

38 Commitments and contingencies (contd)

38.3 Pending litigations against the Branch as at 31 December 2023 (contd)

10. 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.

11. Case no: DSP 493/2023, District Court Of Colombo - A staff member filed litigation against Bank, before the District Court of Colombo seeking relief in form of an interim injuction to prevent the Bank holding the Domestic Inquiry as a part of its disciplinary proceedings.

38.4 Pending Tax Cases

Interpretation of section 79 of Inland revenue act no 24 of 2017- Head office expenses

Based on the literal meaning of Section 79 of the Inland Revenue Act No. 24 of 2017 IRD has taken an unfavorable position on how the Head office expense should be treated for the income tax computation of the branches. aggrieved by the decision HSBC management has taken steps to escalate same at Tax Appeals Commission. Currently the bank awaits the determination from TAC or recourse from IRD in line with the administrative procedure under the new Inland revenue act no, 24 of 2017 and amendments there to.

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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.

39.1 Transactions with related parties

(a) Interest paid to other HSBC branches and group companies	2023	2022
	Rs.'000	Rs.'000
Other HSBC Branches		
HSBC Hongkong	**401,096**	668,651
	401,096	668,651
Group companies		
HSBC London	**-**	-
HSBC Canada	**87**	1
HSBC Data Processing Ltd	**154,369**	138,466
HSBC Australia	**50**	17
HSBC Singapore	**1,189**	-
	155,695	138,484

(b) Interest received from other HSBC branches and group companies	2023	2022
	Rs.'000	Rs.'000
Other HSBC branches		
HSBC Hongkong	**478,052**	463,175
HSBC China	**530**	-
	478,582	463,175
Group companies		
HSBC Singapore	**7,454,721**	1,662,225
HSBC Data Processing Ltd	**282,867**	140,510
HSBC Mauritius	**645,640**	-
HSBC Malaysia	**1,073,042**	-
	9,456,270	1,802,735

FOR THE YEAR ENDED 31 DECEMBER

39 Related party disclosures

39.1 Transactions with related parties

(c) Commission paid to other HSBC branches and group companies	2023 Rs.'000	2022 Rs.'000
Other HSBC Branches		
HSBC Hongkong	**704**	641
HSBC Japan	**500**	620
HSBC New Zealand	**272**	390
HSBC Singapore	**594**	562
HSBC Thailand	**1,485**	1,699
HSBC Australia	**5,369**	6,152
HSBC China	**-**	64
	8,924	10,128
Group companies		
HSBC London	**-**	**62**
HSBC Canada	**2,705**	**3,727**
HSBC China	**92**	-
HSBC Middle East	**-**	**532**
HSBC France	**-**	50
HSBC UAE	**534**	-
HSBC UK	**90**	-
HSBC Continental Europe	**148**	-
	3,569	4,371

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

	2023	2022
	Rs.'000	Rs.'000
Other HSBC branches		
HSBC Hongkong	**6,925**	13,084
HSBC Japan	**5,843**	2,371
HSBC Singapore	**17,276**	1,542
HSBC India	**13,831**	289
HSBC Bangladesh	**-**	606
HSBC Maldives	**-**	-
	43,875	17,892
Group companies		
HSBC London	**9,898**	4,357
HSBC Vietnam	**85**	-
HSBC Canada	**82**	-
HSBC France	**-**	2,358
HSBC China	**16,971**	13,938
HSBC Australia	**90**	-
HSBC Zurich	**1,578**	-
HSBC USA	**-**	8,748
HSBC Data processing Ltd	**10,437**	104
HSBC Trinkaus and Burkhardt	**-**	17
HSBC United Arab Emirates	**1,227**	364
HSBC Bank Malaysia Berhad	**2,841**	-
HSBC Germany	**-**	-
HSBC Netherlands	**-**	186
HUSI Indonesia	**149**	-
HSBC Continental Europe	**7,333**	-
HSBC Mauritius	**157**	-
HUSI North America	**3,280**	-
	54,128	30,072

(e) Other operating income - Other HSBC branches and group companies

Other HSBC branches		
HSBC Maldives	**87,895**	43,771
	87,895	**43,771**
Group companies		
HSBC Data processing Ltd - Sri Lanka	**5,009**	5,067
	5,009	**5,067**

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	**2023**	2022
	Rs.'000	Rs.'000
Other HSBC branches		
HSBC Hongkong *	**26,170,185**	12,118,017
HSBC New Zealand	**73,238**	44,813
HSBC Japan	**52,966**	52,674
HSBC Singapore	**91,798**	154,255
HSBC India	**63,540**	7,008,155
HSBC Thailand	**55,780**	2,016,282
HSBC Maldives	**2,496**	48,527
	26,510,003	21,442,723
Group companies		
HSBC London	**2,005,741**	373,723
HSBC China	**170,107**	49,451
HSBC Canada	**48,058**	48,981
HSBC USA	**-**	31,047,673
HSBC Data processing Ltd	**1,262,250**	1,360,014
HSBC France	-	335,208
HSBC United Arab Emirates	**4,898**	1,733
HSBC Australia	**97,140**	107,176
HSBC Bank Mauritius Ltd	**-**	27,574,106
HSBC Bank (Singapore) Limited	**129,881,429**	108,458,873
HSBC Bank Malaysia Berhad	**65,331,255**	-
HSBC Continental Europe	**80,679**	-
HUSI North America	**5,246,762**	-
	204,128,319	169,356,938

* This balance includes placements with HSBC Hongkong

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39 Related party disclosure (contd)

39.1 Transactions with related parties (contd)

(g) Payable to other HSBC branches and group companies	**2023**	2022
	Rs.'000	Rs.'000
Other HSBC branches		
HSBC Hongkong *	**30,671,807**	29,831,582
HSBC Japan	**1,259**	1,172
HSBC Singapore	**146,893**	37,975
HSBC India	**44,224**	40,650
HSBC Bangladesh	**3,168**	3,895
HSBC Maldives	**10,279**	3,765
HSBC Vietnam	**-**	-
HSBC Mauritius	**562**	311,714
	30,878,192	**30,230,753**
Group companies		
HSBC London	**278,525**	352,544
HSBC Baharain	**1,352**	792
HSBC Canada	**12**	12
HSBC China (Bank) Co. Ltd	**4,394**	27,124
HSBC USA	**-**	836,471
HSBC Holdings Head Office	**-**	120,408
HSBC Securities (New York)	**-**	6,749
HSBC Bank Malaysia Berhad	**11,139**	2,158
HSBC Bank (Singapore) Limited	**9,265**	50,672
HSBC Kuwait	**-**	-
HSBC France	**-**	990
HSBC Qatar	**-**	765
HSBC Vietnam	**153**	270
HSBC Trinkaus & Burkhardt	**-**	5
HSBC UAE	**42,093**	2,003
HSBC Switzerland	**-**	139
HSBC UK Ring Fenced Bank Limited	**-**	19,622
HSBC Australia	**387**	11,440
HSBC Continental Europe Netherlands Branch	**-**	
HSBC Data processing Ltd -India	**196,922**	114,207
HSBC Data processing Ltd	**6,762,692**	6,377,699
HBAP Philippines	**324**	-
HBAP Thailand	**486**	-
HBEU Branch Zurich	**167**	-
HBME - Qatar	**1,280**	-
HSBC Continental Europe	**163,297**	-
HSBC Global Services (UK) Limited	**1,503,148**	-
HSBC Software Dev (Guangdong)Ltd	**795,577**	-
HSBC Software Develop (India) Pvte Ltd	**70,898**	-
HSBC UK Bank plc	**14,102**	-
HUSI North America	**383,301**	-
	10,239,514	7,924,070

* This balance includes borrowings from HSBC Hongkong

39 Related party disclosure (contd)

39.1 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	**2023**	2022
	Rs.'000	Rs.'000
Short term employment benefits	**724,670**	326,718
Post employment benefits	**52,811**	31,334
	777,481	**358,052**

(b) Transactions with KMPs and their close relations	**2023**	2022
	Rs.'000	Rs.'000
Total deposits	**107,368**	96,408
Total loans, advances and undrawn facilities granted	**246,136**	219,224
	353,504	315,632

(c) Direct and indirect accommodation	**2023**	2022
Direct and indirect accommodation as a percentage of the Branch's Regulatory capital	**0.3%**	0.3%

(d) Income statement	**2023**	2022
	Rs.'000	Rs.'000
Interest income	**12,944**	1,657
Interest expenses	**5,858**	9,778
Compensation to KMP	**777,481**	358,052
	796,283	369,487

(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 35.5 and 35.6.

40 Financial risk management

40.1 Risk management framework

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

The Branch’s Risk Function consists of Wholesale Credit & Market Risk, Wealth & Personal Banking (WPB) Risk, Operational and Resilience Risk, and CRO & Administration which encapsulates Treasury risk Risk Strategy, and Enterprise Wide Risks. The HSBC Group provides overall written policies and procedures on Risk management covering specific areas such as Credit risk, Treasury risk, Market risk Operational and Resilience risk and Climate risk. The Local Management through the Executive Committee and the Risk Management Meeting 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, Thematic & Emerging Risks 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 Meeting held at an agreed frequency for the year with ad-hoc meetings held in between as appropriate with the Regional Risk Appetite and Governance team providing oversight. The bank’s actual performance is reported monthly against the approved RAS to the Risk Management Meeting ('RMM'), enabling senior management to monitor the risk profile and guide business activities to balance risk and return. This reporting allows risks to be promptly identified, mitigated and drive a strong risk culture. Risk Appetite and tolerance thresholds are decided by respective Risk Stewards in collaboration with respective business lines.

Stress testing

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

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

40 Financial risk management (contd)

40.1 Risk management framework (contd)

Stress testing (contd)

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

HSBC Sri Lanka performs EWST under three stress scenarios with ascending levels of severity, i.e minor, medium and major. The approach for 2023 is to leverage on the HSBC Group Internal Stress Testing (GIST) scenarios. The severity of the GIST scenario (adjusted but largely the equivalent of the major scenario) are scaled down to 50% and 10% respectively to arrive at the medium and mild scenarios.

Stress Testing results are reviewed by both local and regional subject matter experts before being presented for approval to the "Design Authority (DA)" consisting of CFO, & CRO. 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.

40.2 Credit risk

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

Credit risk

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

• 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.

40 Financial risk management (contd)

40.2 Credit risk (Contd)

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

The principle objectives of our credit risk management are;

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

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

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

Credit Quality of Financial Instruments

Branch's credit risk rating systems and processes are designed to differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. Within Branch's WPB businesses, risk is assessed and managed using a wide range of risk models and strategies to maintain risk reward balance.

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

HSBC Group and regional credit review 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.

40 Financial risk management (contd)

40.2 Credit risk (contd)

40.2.1 Credit risk management

Credit impaired loans

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

- contractual payments of either principal or interest are past due for more than 90 days;
- there are other indications that the borrower is unlikely to pay, such as when a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and
- the loan is otherwise considered to be in default. If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due. Therefore, the definitions of credit impaired and default are aligned as far as possible so that stage 3 represents all loans that are considered defaulted or otherwise credit impaired.

Impairment and credit risk mitigation

The existence of collateral has an impact when calculating ECLs on stage 3 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 backed by collateral, the current net realizable value of the collateral will be taken into account when assessing the need for individually assessed ECLs.

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

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

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

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

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

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

40 Financial risk management (contd)

40.2 Credit risk (contd)

40.2.1 Credit risk management (contd)

Impairment and credit risk mitigation

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

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

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

An assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. The assessment explicitly or implicitly compares the risk of default occurring at the reporting date compared with that at initial recognition, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. The assessment is unbiased, probability-weighted, and to the extent relevant, uses forward-looking information consistent with that used in the measurement of ECL. The analysis of credit risk is multifactor. The determination of whether a specific factor is relevant and its weight compared with other factors depends on the type of product, the characteristics of the financial instrument and the borrower. Therefore, it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk and these criteria will differ for different types of lending, particularly between WSB and WPB. However, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when 30 days past due. In addition, wholesale loans that are individually assessed, typically WSB customers and included on a watch or worry list, are included in stage 2. Details of rebuttals pertaining to the SICR criteria stipulated in the Banking Direction No. 13 of 2021 issued by Central Bank of Sri Lanka, will be disclosed, together with the estimated expected credit loss impact in the annual audited financial statements in line with the with the regulatory requirement

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

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

40 Financial risk management (contd)

40.2 Credit risk (contd)

40.2.1 Credit risk management (contd)

Write off of loans and receivables

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

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

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

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

As at 31 December	**2023**	2022
LKR '000		
Wealth and Personal Banking (WPB)	**967,020**	667,213
Wholesale Banking (WSB)	**-**	-
	967,020	667,213

Collateral management and valuation

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

The secured facilities extended to WPB customers consist of home loans (at present his product is limited only to Bank staff), facilities against shares and cash back facilities.

40 Financial risk management (contd)

40.2 Credit risk (contd)

40.2.1 Credit risk management (contd)

Collateral management and valuation (Contd)

Accordingly, the nature of collateral relating to WPB facilities consist of property, vehicles, shares (Colombo Stock Exchange) and cash for respective facilities.
Depending on its form, collateral can have a significant financial effect in mitigating our exposure to credit risk.

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

As at 31 Decemeber	**2023**	2022
LKR 000's		
Balances with Central Bank	**88,040,714**	163,152,431
Placements with other Banks	**219,611,493**	136,024,503
Balances with other Banks	**8,077,060**	54,892,367
Derivative financial instruments	**1,010,959**	285,614
Financial assets measured at fair value through profit or loss	**23,759**	57,230
Financial assets at amortised cost - loans and advances	**210,213,522**	227,053,508
Financial assets measured at fair value through other comprehensive income	**19,661,971**	43,635,387
Acceptance & endorsements	**24,265,096**	18,095,676
Total On balance sheet credit exposure	**570,904,574**	643,196,716
Total Off balance sheet credit exposure	422,583,007	436,924,788

Impairment movement of financial assets/ liabilities

Consolidated				
LKR '000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Opening Balance	**1,421,106**	**12,853,976**	**1,785,085**	**16,060,167**
Charge to income statement	**134,644**	**(9,306,243)**	**250,101**	**(8,921,498)**
Exchange/other	**(213,106)**	**(35,594)**	**47,376**	**(201,323)**
	1,342,644	**3,512,139**	**2,082,562**	**6,937,346**

40 Financial risk management (contd)

40.2 Credit risk (contd)

40.2.2 Quantitative Disclosures

Gross Loans and Receivables

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

Gross loans and receivables - by product

	Gross exposure 2023 Rs.000	**Average gross exposure 2023 Rs.000**	Gross exposure 2022 Rs.000	Average gross exposure 2022 Rs.000
By product - local currency				
Overdrafts	**41,378,313**	**27,958,286**	16,159,229	15,699,807
Term loans	**45,312,868**	**34,786,744**	19,872,314	22,510,579
Credit cards	**21,088,689**	**20,123,832**	19,942,100	21,163,573
Trade Loans	**536,768**	**767,397**	493,193	
Sub total	**108,316,638**	**83,636,259**	56,466,836	59,373,959
By product - foreign currency				
Overdrafts	**7,420,549**	**8,459,527**	9,678,559	13,676,640
Term loans	**63,056,347**	**80,152,856**	111,189,901	156,104,691
Trade Loans	**36,261,116**	**39,126,889**	59,023,130	7,156,817
Sub total	**106,738,012**	**127,739,272**	179,891,590	176,938,148
Total	**215,054,650**	**211,375,531**	236,358,426	236,312,107

Gross Loans and Receivables - By Currency	**2023 Rs.000**	2022 Rs.000
By Product - Currency		
Sri Lankan Rupee	**108,316,638**	56,466,835
United States Dollar	**99,907,505**	171,108,781
Great Britain Pound	**348,477**	470,057
Others	**6,482,030**	8,312,753
Total	**215,054,650**	236,358,426

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

	Stage 1 2023 Rs.000	**Stage 2 2023 Rs.000**	**Stage 3 2023 Rs.000**	**Total 2023 Rs.000**	Total 2022 Rs.000
WPB	223,306	420,031	833,585	**1,476,922**	1,072,526
WSB	522,191	2,563,621	278,394	**3,364,206**	8,232,392
	745,497	**2,983,652**	**1,111,979**	**4,841,128**	9,304,918

WPB- Wealth and Personal Banking
WSB- Wholesale Banking

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

40 Financial Risk Management (contd)

40.2 Credit risk (contd)

40.2.2 Quantitative Disclosures (contd)

Gross Loans and Receivables - Sector wise analysis

Sector	Import lending Rs.000	Export lending Rs.000	Overdrafts Rs.000	Credit Cards Rs.000	Short term loans Rs.000	Medium and long term loans Rs.000	Mortgages Rs.000	2023 Total Rs. 000	2022 Total Rs. 000
Agriculture & Fishing	-	477,251	3,341,629	-	-	794,306	-	**4,613,186**	3,026,469
Manufacturing	1,048,395	35,272,238	8,959,690	-	3,886,188	9,132,334	-	**58,298,846**	98,696,692
Tourism	-	-	385,890	-	-	22,716,108	-	**23,101,998**	34,655,858
Transport		-	545,805	-	95,011	5,391,927	-	**6,032,743**	5,353,967
Construction	-	-	368,647	-	-	6,606,508	-	**6,975,155**	10,063,520
Traders			2,886,022		2,667,635	5,583,037		**11,136,694**	7,819,702
Financial and Business Services	-	-	754,831	-		1,500,000	-	**2,254,831**	2,068,341
Infrastructure	-	-	-	-	-	9,100,000	-	**9,100,000**	145,119
Other Services			22,406,112		218,382	11,636,389		**34,260,883**	38,161,328
Credit card	-	-	-	21,088,689	-	-	-	**21,088,689**	20,435,293
Other	-	-	9,150,237	-	-	26,929,039	2,112,350	**38,191,626**	15,932,137
Total	**1,048,395**	**35,749,489**	**48,798,863**	**21,088,689**	**6,867,216**	**99,389,648**	**2,112,350**	**215,054,650**	236,358,426

40 Financial Risk Management (contd)

40.2 Credit risk (contd)

40.2.2 Quantitative Disclosures (contd)

Total Gross Loans and receivables including acceptances - Residual contractual maturity

Sector	Less than 7 days Rs.000	7-30 Days Rs.000	1-3 Months Rs.000	3-6 Months Rs.000	6-12 Months Rs.000	1-3 Years Rs.000	3-5 Years Rs.000	Over 5 years Rs.000	2023 Total Rs. 000	2022 Total Rs. 000
Overdrafts	48,798,862	-	-	-	-	-	-	-	**48,798,862**	25,837,786
Term lending	5,247,658	18,121,277	29,498,176	5,393,743	15,983,504	42,259,970	23,839,932	2,407,967	**142,752,227**	184,938,488
Non-eligible bills	302,522	-	-	-	-	-	-	-	**302,522**	368,268
Money market placements	-	-	-	-	-	-	-	-	**-**	3,064,000
Credit card advances	21,088,689	-	-	-	-	-	-	-	**21,088,689**	20,435,293
Mortgages	1,180	970	140	702	5,746	50,171	80,340	1,973,101	**2,112,350**	1,714,591
Total gross loans and receivables	**75,438,911**	**18,122,247**	**29,498,316**	**5,394,445**	**15,989,250**	**42,310,141**	**23,920,272**	**4,381,068**	**215,054,650**	236,358,426
Acceptances and endorsements	2,927,573	6,744,401	11,161,893	2,343,459	1,344,842	2,410	-	-	**24,524,578**	18,209,373
Total	**78,366,484**	**24,866,648**	**40,660,209**	**7,737,904**	**17,334,092**	**42,312,551**	**23,920,272**	**4,381,068**	**239,579,228**	254,567,799

40 Financial risk management (contd)

40.2 Credit risk (contd)

40.2.2 Quantitative disclosures (contd)

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

Sector	Past due not impaired		Impaired	
	2023 Total Rs. 000	2022 Total Rs. 000	**2023 Total Rs. 000**	2022 Total Rs. 000
Agriculture and fishing	**-**	42,180		
Manufacturing	**1,696,142**	1,651,945	**-**	-
Tourism	**3,131,192**	326,299	**696,952**	10,457,067
Transport	**559,970**	77,190	**-**	-
Construction	**-**	96,683	**-**	-
Traders	**180,150**	-	**-**	-
New economy	**-**	-	**-**	-
Financial and business services	**-**	-	**-**	-
Infrastructure	**-**	-	**-**	-
Other services	**25,000**	73,514	**-**	-
Credit card	**-**	-	**321,315**	662,551
Other	**4,428,138**	910,510	**704,283**	461,426
Total	**10,020,592**	3,178,321	**1,722,550**	11,581,044

Other Financial Assets -past due not impaired and impaired loans

	Past due not impaired		Impaired	
	2023 Total Rs. 000	2022 Total Rs. 000	**2023 Total Rs. 000**	2022 Total Rs. 000
International Sovereign Bonds	-	-	471,696	535,193
Total	-	-	**471,696**	**535,193**

40 Financial risk management (contd)

40.2 Credit risk (contd)

40.2.2 Quantitative Disclosures (contd)

Distribution of financial instruments by credit quality

Sector	Strong Rs.000	Good Rs.000	Satisfactory Rs.000	Sub Standard Rs.000	Past due but not impaired Rs.000	Impaired Rs.000	Impairment Allowance Rs.000	2023 Total Rs. 000	2022 Total Rs. 000
Cash and cash equivalents	9,869,848		-	-	-	-	(1,228)	**9,868,620**	54,892,367
Balances with central banks	88,072,565	-	-	-	-	-	(31,851)	**88,040,714**	163,152,431
Placements with banks	219,644,880	-	-	-	-	-	(33,387)	**219,611,493**	136,024,503
Derivative financial instruments	-	921,423	89,536	-	-	-	-	**1,010,959**	285,614
Financial assets measured at fair value through profit or loss	23,759	-	-	-	-	-	-	**23,759**	57,230
Loans and receivables to customers	2,352,621	827,153	155,749,267	44,382,466	10,020,592	1,722,550	(4,841,128)	**210,213,522**	227,053,508
Financial assets measured at fair value through other comprehensive income	19,190,275	-	-	-	-	471,696	-	**19,661,971**	43,635,387
Financial assets at amortised cost - debt instruments	110,020	-	-	-	-	-	(16,445)	**93,575**	70,283
Acceptances	-	-	23,079,618	1,444,960	-	-	(259,482)	**24,265,096**	18,095,676
Total	**339,263,968**	**1,748,576**	**178,918,421**	**45,827,426**	**10,020,592**	**2,194,246**	**(5,183,521)**	**572,789,708**	643,266,999

40 Financial risk management (contd)

40.2 Credit risk (contd)

40.2.2 Quantitative disclosures (contd)

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

Sector	Contractual residual maturity								Total
	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	Rs.000
2023	**1,819,919**	**2,345,058**	**335,771**	**353,316**	**222,646**	**2,268,306**	**37,317**	**2,638,259**	**10,020,592**
2022	**8,196,523**	**75,904**	650,630	7,806	348,439	3,741,523	154,246	160,681	13,335,752

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

Qualitative disclosures on Collaterals held on past due not impaired

	2023	**2022**
Quality of the collateral held	Corporate guarantees from the two Joint Venture partners and Property Mortgage.	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	Loan Facility Amounting to LKR 6.6 Bn	Loan Facilities Amounting to LKR 10.49 Bn
Quantitative information about the collateral held as security and other credit enhancements	Property mortgage with a market value ofLKR 7.8 Bn and Corporate guarantees of LKR 6.8 Bn	Property mortgages where the current Market value is LKR 7.2 bn and Corporate guarantees amounting to LKR 3.96 bn

Collateral held and other credit enhancements and their financial effect

	2023		2022	
	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	**210,213,522**	**69,991,284**	227,053,508	79,774,391

40 Financial risk management (contd)

40.3 Liquidity risk

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

Liquidity and funding risk is:

- 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.

40.3.1 Management of liquidity and funding risk

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

40 Financial risk management (contd)

40.3 Liquidity risk (contd)

40.3.1 Management of liquidity and funding risk (contd)

NSFR
This ratio monitors if the bank has sufficient stable funding to its illiquid assets. The equity and liability side of the balance sheet is considered to "provide" stable funding while on and off balance sheet assets are considered to be "requiring" stable funding.
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.

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**	**2023 Total Rs. 000**	2022 Total Rs. 000
Due to banks	9,874,819	18,936,958	6,570,085	372,434	2,877,900	-	-	-	**38,632,196**	35,109,915
Derivative financial	228,622	-	-	-	-	-	-	-	**228,622**	126,843
Financial liablities at amortised cost - due to depositors	244,229,482	42,305,199	44,958,629	22,641,157	16,959,291	2,810,860	4,090,693	-	**377,995,311**	471,825,019
Acceptances and endorsements	2,927,573	6,744,401	11,161,893	2,343,459	1,344,842	2,410	-	-	**24,524,578**	18,209,373
Total	**257,260,496**	**67,986,558**	**62,690,607**	**25,357,050**	**21,182,033**	**2,813,270**	**4,090,693**	-	**441,380,707**	525,271,150

	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**	**2023 Total Rs. 000**	2022 Total Rs. 000
Cash in hand	9,869,848	-	-	-	-	-	-	-	**9,869,848**	54,896,835
Non-statutory balances with	85,221,008							-	**85,221,008**	152,782,365
Placements with Banks	209,687,176	11,587,946							**221,275,122**	136,068,211
Governemnt Securities	1,398,408	3,050,000	15,010,500	5,892	4,499	5,009	115,525	2,535	**19,592,368**	43,692,618
Acceptances	2,927,573	6,744,401	11,161,893	2,343,459	1,344,842	2,410	-	-	**24,524,578**	18,209,373
Total	**309,104,013**	**21,382,347**	**26,172,393**	**2,349,351**	**1,349,341**	**7,419**	**115,525**	**2,535**	**360,482,924**	405,649,402

40 Financial risk management (contd)

40.4 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 retail and commercial banking assets and liabilities, financial investments designated as available for sale.

40.4.1 Monitoring and limiting market risk exposures

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

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

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

40.4.2 Risk management

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

40 Financial risk management (contd)

40.4 Market risk (contd)

40.4.2 Risk management (contd)

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

The historical simulation models used incorporate the following features:

•Historical market rates and prices are calculated with reference to foreign exchange rates, interest rates 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.

40 Financial risk management (contd)

40.4 Market risk (contd)
40.4.2 Risk management (contd)

Foreign exchange position

Currency (LKR' million)	Spot			Forward			Net Open Position	Net position in other exchange contracts	Overall exposure in other respective foreign currency	Overall exposure in Sri Lankan Rupees
	Assets	Liabilities	Net	Assets	Liabilities	Net				
US Dollars	334,375	(295,927)	38,448	21,761	(58,656)	(36,895)	3,706	-	11	3,706
Pound Sterling	36,294	(45,581)	(9,287)	17,394	(8,118)	9,276	719	-	3	719
Euro	31,152	(32,754)	(1,602)	5,733	(4,133)	1,599	1,179	-	4	1,179
Japanese Yen	10,645	(10,652)	(7)	73	(73)	-	235	-	1	235
Australian Dollar	26,169	(30,397)	(4,228)	5,569	(1,344)	4,225	32	-	0	32
Canadian Dollar	12,591	(13,011)	(420)	469	(73)	395	(24)	-	(0)	(24)
Other currencies	179,076	(201,996)	(22,920)	(8,020)	(8,426)	(16,445)	1,919	-	2	1,919
Total exposure	**630,302**	**(630,318)**	**(16)**	**42,979**	**(80,823)**	**(37,845)**	**7,766**	**-**	**21**	**7,766**
Total capital funds as per the latest audited financial statements										**89,332**
Total exposure as a % of total capital funds (Basel III) as per the latest audited financial statements (Should not exceed 30%)										**8.7%**

* Monitored at the Branch level
*Balances are in LKR Million (Column 10 in respective currency Mn)

Sensitivity Analysis
The impact of changes in exchange rates on Equity calculated on Foreign exchange position as at 31-12-2023. 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	259.4	(259.4)	259.4	(259.4)
Pound Sterling	50.3	(50.3)	50.3	(50.3)
Euro	82.5	(82.5)	82.5	(82.5)
Japanese Yen	16.5	(16.5)	16.5	(16.5)
Australian Dollar	2.2	(2.2)	2.2	(2.2)
Canadian Dollar	(1.6)	1.6	(1.6)	1.6
Other currencies	134.3	(134.3)	134.3	(134.3)

* Sensitivity impact is in LKR Mn

Interest Rate risk in the Banking Book (IRRBB)
HSBC Sri Lanka has a comprehensive interest rate risk management process where interest rate risk generated at the business level is transferred to Markets Treasury to manage centrally. Markets Treasury has the required expertise to manage and hedge interest rate risk of the Bank. Interest rate risk transfer to Markets Treasury is carried out through the Interest Rate Risk Transfer Pricing mechanism and the Interest Rate Risk Behaviouralization policy, which are reviewed and approved annually by Asset and Liability Management Committee (ALCO).

The interest rate risk in the banking book is transferred to Markets Treasury through a specialized system which provides the visibility on the interest rate risk exposures with real time data on the transferred balances, rates and any mismatches that are prevalent. In addition, the market limit monitoring systems available at HSBC allows Markets Treasury to have an up to date view on the PVBP (Present Value of Basis Point) movement. These mechanisms and systems enable Markets Treasury to actively manage the IRRBB of HSBC Sri Lanka. Furthermore, from a reporting standpoint ALCO also has oversight to the monthly Net Interest Margin monitoring tool, which gives visibility of the overall NII (Net Interest Income) of the bank and at customer group level and product level. With this tool, NII is analyzed in detail and action taken to correct any issues.

40 Financial risk management (contd)

40.4 Market risk (contd)

40.4.2 Risk management (contd)

Maturities of assets and liabilities as at 31st December 2023

Figures in LKR'000	Upto 1 month	Between 1 - 3 months	Between 3 - 6 months	Between 6 - 12 months	1 - 3 years	3 - 5 years	5 years and above	Non financial assets & liabilities	2023 Total
Cash and cash equivalent	9,869,848	-	-	-	-	-	-	(1,228)	**9,868,620**
Balances with Central Bank	88,072,565	-	-	-	-	-	-	(31,851)	**88,040,714**
Placements with banks	167,811,280	40,495,000	11,338,600	-	-	-	-	(33,387)	**219,611,493**
Derivative financial instruments	1,010,959	-	-	-	-	-	-	-	**1,010,959**
Financial assets measured at fair value through profit or loss	319	-	5,892	4,499	5,009	5,506	2,535	-	**23,759**
Financial assets at amortised cost - loans and advances	93,561,158	29,498,316	5,394,445	15,989,250	42,310,141	23,920,272	4,381,068	(4,841,128)	**210,213,521**
Financial assets measured at fair value through other comprehensive income	4,431,456	14,758,819	-	-	-	-	-	471,696	**19,661,971**
Financial assets at amortised cost - debt instruments	-	-	-	-	-	110,020	-	(16,445)	**93,574**
Retirement benefit obligations surplus							85,970	-	**85,970**
Property, plant and equipment	-	-	-	-	-	-	-	5,518,045	**5,518,045**
Deferred Tax Assets								1,285,651	**1,285,651**
Other assets	9,671,975	11,161,893	2,343,459	1,344,842	2,410	-	-	6,487,803	**31,012,382**
Total assets	**374,429,560**	**95,914,027**	**19,082,396**	**17,338,590**	**42,317,560**	**24,035,797**	**4,469,573**	**8,839,155**	**586,426,659**
Due to banks	28,664,499	6,479,200	345,557	2,869,476	-	-	-	-	**38,358,732**
Derivative financial instruments	228,622	-	-	-	-	-	-	-	**228,622**
Financial liablities at amortised cost - due to depositors	287,075,765	42,920,279	21,468,477	16,230,017	2,122,198	2,630,774	-	-	**372,447,510**
Retirement benefit obligations	-	-	-	-	-	-	-	-	**-**
Current tax liability	-	2,116,199	2,116,199	2,116,199	-	-	-	-	**6,348,598**
Other liabilities	9,643,954	11,179,768	2,376,068	1,394,190	87,224	63,933	-	21,747,889	**46,493,026**
Equity	-	-	-	-	-	-	-	122,550,172	**122,550,172**
Total liabilities	**325,612,839**	**62,695,447**	**26,306,302**	**22,609,881**	**2,209,422**	**2,694,707**	**-**	**144,298,061**	**586,426,659**
Cumulative gap	**48,816,721**	**33,218,581**	**(7,223,906)**	**(5,271,291)**	**40,108,138**	**21,341,090**	**4,469,573**	**(135,458,906)**	**-**

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

	Upto 1 month	Between 1 - 3 months	Between 3 - 6 months	Between 6 - 12 months	1 - 3 years	3 - 5 years	5 years and above	Total
Performance bonds	2,989,232	18,909,906	11,869,379	14,182,429	16,790,920	11,968,241	8,131,396	**84,841,503**
Letters of credit	12,781,979	15,450,090	1,772,405	195,968	-	-	-	**30,200,442**
Other contingent items	536,429	1,478,745	1,123,112	4,200,369	611,932	-	524,222	**8,474,808**
Undrawn loan commitments	238,563,687	-	-	-	-	-	-	**238,563,687**
Foreign exchange contracts	7,578,362	16,349,772	9,561,992	27,658,594	-	-	-	**61,148,720**
Other contra accounts	18,940,896	-	-	-	-	-	-	**18,940,896**
	281,390,585	**52,188,513**	**24,326,888**	**46,237,360**	**17,402,852**	**11,968,241**	**8,655,618**	**442,170,056**

40 Financial risk management (contd)

40.4 Market risk (contd)

40.4.2 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	-	-	-	-	-	-	(4,470)	**54,892,367**
Balances with Central Bank (Gross)	163,595,024	-	-	-	-	-	-	(442,593)	**163,152,431**
Placements with banks (Gross)	136,035,582	-	-	-	-	-	-	(11,079)	**136,024,503**
Derivative financial instruments	285,614	-	-	-	-	-	-	-	**285,614**
Financial assets measured at fair value through profit or loss	-	12,442	-	18,361	16,913	9,514	-	-	**57,230**
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	30,472	(9,304,918)	**227,053,508**
Financial assets measured at fair value through other comprehensive income	5,583,283	13,584,695	7,576,073	16,891,336	-	-	-	-	**43,635,387**
Financial assets at amortised cost - debt instruments	-	-	-	-	-	109,520	-	(39,237)	**70,283**
Retirement benefit obligations surplus									**-**
Property, plant and equipment	-	-	-	-	-	-	-	5,233,077	**5,233,077**
Deferred Tax Assets	-	-	-	-	-	-	-	4,355,291	**4,355,291**
Other assets	12,063,968	6,165,743	1,286,439	259,197	-	-	-	9,235,383	**29,010,731**
Total assets	**457,983,464**	**65,802,747**	**18,153,591**	**25,521,142**	**75,579,713**	**11,677,838**	**30,472**	**9,021,454**	**663,770,422**
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	-	-	-	14,237,576	**37,436,271**
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**	**663,770,422**
Cumulative gap	**64,799,558**	**(3,202,556)**	**(16,114,325)**	**127,478**	**66,430,969**	**8,640,347**	**(483,233)**	**(120,198,238)**	**-**

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	83,852,436	1,093,638	3,541,554	6,177,419	15,423,190	8,675,584	9,699,393	**128,463,213**
Letters of credit	34,430,023	-	-	-	-	-	-	**34,430,023**
Other contingent items	9,779,837	27,071	1,729	-	840	-	540,434	**10,349,911**
Undrawn loan commitments	226,517,848	-	-	-	-	-	-	**226,517,848**
Derivatives- principal amount	27,630,242	5,251,213	4,897,072	-	-	-	-	**37,778,527**
Other contra accounts	44,997,729	-	-	-	-	-	-	**44,997,729**
	427,208,115	**6,371,923**	**8,440,354**	**6,177,419**	**15,424,030**	**8,675,584**	**10,239,827**	**482,537,251**

40 Financial risk management (contd)

40.5 Operational risk

The objective of our Non-Financial Risk management is to manage risks consistent with our risk appetite, through informed decision making and controlled risk taking.

A formal governance structure provides oversight over the management of Non-Financial Risk. A country level Risk Management Meeting (RMM) is held on a bi-monthly basis (ad-hoc meetings may be held in-between as appropriate) to discuss key risk issues and review the effective implementation of our 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.

Some of the key action taken in the management of Non-Financial Risks include the following:

Risk and Control Assessment process is in place that facilitates the assessment of material risks and the associated control environment faced by the bank. Risk and Control Assessments are established and maintained by Risk Owners in consultation with Control Owners and Risk Stewards.

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.

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. 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.

Third Party Risk management (inclusive of Internal Third Parties) entails the identification, assessment and management of risks when engaging with such Third parties. In addition, 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 the 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.

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

40 Financial risk management (contd)

40.5 Operational risk (contd)

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 regulations 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 system of record in in place for the reporting of material Risks, Event management and Issues/Actions. Risk and Control Assessments are input and maintained by Risk Owners. To ensure that loss events are consistently reported and monitored at HSBC Group level, all branches are required to report losses, inclusive of individual material losses in excess of a particular threshold which are monitored against risk appetites set.

40.6 Capital management

Qualitative disclosures

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

Tier 1 Capital – Core Capital

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

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40 Financial risk management (contd)

40.6 Capital management (contd)

Tier 2 Capital – Supplementary capital

Revaluation gains and general provision are the only constituents of supplementary capital for the Branch. As per the CBSL regulations a prudential revaluation is done reflecting the full possibility of price fluctuations and forced sale, with prior approval from CBSL, which is then subject to a discount of 50%. According to explanatory note no. 03 of 2019 on 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.

Quantative disclosures

Composition of regulatory capital (audited)	**2023**	2022
	Rs'000	Rs'000
Equity capital or stated capital/assigned capital	**3,152,358**	**3,152,358**
Reserve fund	**3,152,358**	**2,997,367**
Published retained earnings	**72,239,339**	**54,765,861**
Accumulated other comprehensive income (OCI)	**7,871,302**	**6,114,026**
General and other disclosed reserves	**168,976**	**224,676**
Total Common Equity Tier I (CET1) Capital	**86,584,333**	**67,254,288**
Deductions to tier 1 capital	**1,331,944**	**4,363,423**
Revaluation losses of property, plant and equipment	**49,000**	**40,276**
Net deferred tax assets	**1,285,650**	**4,355,291**
Intangible assets	**25,394**	**5,919**
Defined benefit pension fund assets	**85,970**	**-**
Amounts due to head office and branches outside Sri Lanka in Sri Lanka Rupees (-)	**(114,070)**	**(38,063)**
	-	-
Total Tier 1 Capital	**85,252,389**	**62,890,865**
Components of tier 2 capital		
Revaluation reserves (as approved by CBSL)	**1,049,765**	**1,049,765**
General provisions*	**3,030,170**	**4,520,882**
Total qualifying tier 2 capital prior to deductions	**4,079,935**	**5,570,647**
Total Capital	**89,332,324**	**68,461,512**

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

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40 Financial risk management (contd)

40.6 Capital management(contd)

Capital adequacy

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

Growth measures as targeted in the Annual Operating Plan (AOP) are reviewed in line with impact to Capital Adequacy Ratio (CAR) limits set by CBSL. Any remittance of profit to Regional offices is evaluated in terms of impact to CAR. Further, potential exchange rate fluctuations too are taken into account when forecasting CAR, which is carried out periodically. HSBC Sri Lanka will ensure that business growth and profit remittances are carried out in full compliance with the prudential limits set by CBSL. This is operationalised by managing the CAR against an internally set risk appetite, which is well above the minimum capital requirements set by CBSL.

	2023	2022
Capital ratios		
Common Equity Tier 1 Capital Ratio	**23.43%**	**15.77%**
Tier 1 ratio	**23.43%**	**15.77%**
Total capital ratio	**24.55%**	**17.17%**

Audited Capital Adequacy Ratio (2022) - 17.78%, Amended CAR post to the statutory audit (2022) - 17.17%

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41 Fair value of financial assets and liabilities

41.1 Fair value of financial instruments not carried at fair value

	2023		2022	
Assets	**Carrying value Rs'000**	**Fair value Rs'000**	Carrying value Rs'000	Fair value Rs'000
Cash and cash equivalents	**9,868,620**	**9,868,620**	54,892,367	54,892,367
Balances with Central Bank	**88,040,714**	**88,040,714**	163,152,431	163,152,431
Placements with banks	**219,611,493**	**219,611,493**	136,024,503	136,024,503
Financial assets at amortised cost - loans	**210,213,522**	**218,635,192**	227,053,508	231,972,761
Acceptances and endorsements	**24,265,096**	**24,265,096**	18,095,676	18,095,676
Liabilities				
Due to banks	**38,358,732**	**38,358,732**	34,995,689	34,995,689
Financial liablities at amortised cost - due to depositors	**372,447,510**	**372,447,510**	468,266,115	468,266,115
Acceptances and endorsements	**24,524,578**	**24,524,578**	18,209,373	18,209,373

Note:

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

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41 Fair value of financial assets and liabilities (contd)

41.2 Fair value of financial instruments carried at fair value

41.2.1 Fair value hierarchy

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

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

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

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

Financial instruments carried at fair value and bases of valuation

As at 31 December 2023	**Level 1 Rs'000**	**Level 2 Rs'000**	**Level 3 Rs'000**
Assets			
Financial assets measured at fair value through profit or loss	**-**	**23,759**	**-**
Derivatives	**11,446**	**999,513**	**-**
Financial assets measured at fair value through other comprehensive income	**-**	**19,661,971**	**-**
Financial assets at amortised cost - debt instruments	-	-	-
	11,446	**20,685,243**	**-**
Liabilities			
Derivatives	**11,252**	**217,370**	**-**
	11,252	**217,370**	**-**
As at 31 December 2022			
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			
Derivative financial instruments	6,381	120,462	-
	6,381	**120,462**	**-**

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41 Fair value of financial assets and liabilities (contd)

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

41.2.1 Fair value hierarchy (contd)

Movement in Level 3 financial instruments	**2023**	
	Assets	**Liabilities**
	Rs'000	**Rs'000**
As at 1 January	-	-
Settlements	-	-
As at 31 December	**-**	**-**

	2022	
	Assets	Liabilities
	Rs'000	Rs'000
As at 1 January	-	-
Total gains recognised in profit or loss	-	-
Settlements	-	-
As at 31 December	-	-

41.2.2 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;

41 Fair value of financial assets and liabilities (contd)

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

41.2.2 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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Basel III - Disclosures Under Pillar 3 as per the Banking Act Direction No.01 of 2016

Key Regulatory Ratios - Capital and Liquidity

	2023 (Audited) **As at 31 December**	2022.00 As at 31 December
Regulatory Capital Adequacy		
Common Equity Tier 1, Rs.'Mn	85,252	62,891
Tier 1 Capital, Rs.'Mn	85,252	62,891
Total Capital, Rs.'Mn	89,332	68,462
Common Equity Tier 1 Capital Ratio, as % of Risk Weighted Assets (Minimum Requirement, 7%)	23.43%	15.77%
Tier 1 Capital Ratio, as % of Risk Weighted Assets (Minimum Requirement, 8.5%)	23.43%	15.77%
Total Capital Ratio, as % of Risk Weighted Assets (Minimum Requirement, 12.5%)	24.55%	17.17%

Note- Audited Capital Adequacy ratio (2022) - 17.78%, Amended CAR post to the statutory audit (2022)- 17.17%

	2023 **As at 31 December**	2022 As at 31 December
Regulatory Liquidity		
Statutory Liquid Assets, Rs.'Mn		
Domestic Banking unit	132,648	219,945
Off-Shore Banking Unit	188,341	184,362
Total Bank	322,416	404,212
Statutory Liquid Assets Ratio,%		
Domestic Banking Unit	49.96%	52.23%
Off-Shore Banking Unit	109.40%	121.47%
Total Bank (Minimum Requirement, 20%)	73.00%	70.54%
Liquidity Coverage Ratio (%) - Rupee (Minimum Requirement 2023- 100% , 2022 - 90%)	163.00%	297.00%
Liquidity Coverage Ratio (%) - All currency (Minimum Requirement 2023- 100% , 2022 - 90%)	251.85%	500.40%
Net Stable Funding Ratio (%)	144.43%	163%
(Minimum Requirement 2023- 100% , 2022 - 90%)	0.00%	
Leverage Ratio (%)	13.14%	8.27%
(Minimum Requirement 3%)	0.00%	

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Basel III - Disclosures Under Pillar 3 as per the Banking Act Direction No.01 of 2016

Basel III Computation of Capital Adequacy Ratio

Item	As at 31st December 2023 Rs.'Mn
Common Equity Tier I (CETI) Capital after Adjustments	**85,252**
Total Common Equity Tier I (CET1) Capital	**86,584**
Equity capital or stated capital/assigned capital	3,152
Reserve fund	3,152
Published retained earnings/(accumulated retained losses)	72,239
Accumulated other comprehensive income (OCI)	7,871
General and other disclosed reserves	169
Total Adjustments to CET1 Capital	**1,332**
Revaluation losses of property, plant and equipment	49
Other intangible assets (net)	25
Deferred tax assets (net)	1,286
Defined benefit pension fund assets	86
Amount due to head office & branches outside Sri Lanka in Sri Lanka Rupees	(114)
Tier 2 Capital after Adjustments	**-**
Total Tier 2 Capital	**-**
Revaluation gains	1,050
General provisions	3,030
Total Adjustments to Tier 2 Capital	**4,080**
Total Tier 1 Capital	**89,332**
Total Capital	**86,584**
Total Risk Weighted Assets (RWA)	**363,868**
RWAs for Credit Risk	310,350
RWAs for Market Risk	5,150
RWAs for Operational Risk	48,368
CET1 Capital Ratio (including Capital Conservation Buffer, Countercyclical Capital Buffer & Surcharge on D-SIBs) (%)	**23.43%**
of which: Capital Conservation Buffer (%)	
of which: Countercyclical Buffer (%)	-
of which: Capital Surcharge on D-SIBs (%)	-
Total Tier 1 Capital Ratio (%)	**23.43%**
Total Capital Ratio (including Capital Conservation Buffer, Countercyclical Capital Buffer & Surcharge on D-SIBs) (%)	**24.55%**
of which: Capital Conservation Buffer (%)	
of which: Countercyclical Buffer (%)	-
of which: Capital Surcharge on D-SIBs (%)	-

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
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Basel III - Disclosures Under Pillar 3 as per the Banking Act Direction No.01 of 2016

Computation of Leverage Ratio

Item	As at 31st December 2023 Rs.'Mn	As at 31 December 2022 Rs.'Mn
Tier 1 Capital	**85,252**	62,891
Total Exposures	**648,511**	759,452
On Balance Sheet Items (Excluding Derivatives and Securities Financing Transactions, but including Collateral)	**588,860**	668,472
Derivative Exposures	**2,271**	929
Securities Financing Transaction Exposures	**-**	-
Other Off-Balance Sheet Exposures	**57,379**	90,051
Basel III Leverage Ratio	**13.14%**	8.27%

Basel III Computation of Liquidity Coverage Ratio (All Currency)

Item	As at 31st December 2023 Rs'Mn		As at 31 December 2022 Rs'Mn	
	Total Un-weighted Value	Total Weighted Value	Total Un-weighted Value	Total Weighted Value
Total Stock of High-Quality Liquid Assets (HQLA)	**106,206**	**106,206**	**199,645**	**199,645**
Total Adjusted Level 1A Assets	**106,206**	**106,206**	**199,645**	**199,645**
Level 1 Assets	**106,206**	**106,206**	**199,645**	**199,645**
Total Adjusted Level 2A Assets	-	-	-	-
Level 2A Assets	-	-	-	-
Total Adjusted Level 2B Assets	-	-	-	-
Level 2B Assets	-	-	-	-
Total Cash Outflows	**793,402**	**168,683**	**911,642**	**159,590**
Deposits	143,387	14,339	163,377	16,338
Unsecured Wholesale Funding	256,869	120,638	313,468	125,607
Secured Funding Transactions	-	-	-	-
Undrawn Portion of Committed (Irrevocable) Facilities and Other Contingent Funding Obligations	362,080	2,640	420,107	2,955
Additional Requirements	31,066	31,066	14,690	14,690
Total Cash Inflows	**201,211**	**179,752**	**224,506**	**164,432**
Maturing Secured Lending Transactions Backed by Collateral	-	-	-	-
Committed Facilities	-	-	-	-
Other Inflows by Counterparty which are Maturing witl	190,362	179,087	179,292	163,160
Operational Deposits	10,184	-	43,776	-
Other Cash Inflows	665	665	1,438	1,272
Liquidity Coverage Ratio (%) (Stock of High Quality Liquid Assets/Total Net Cash Outflows over the Next 30 Calendar Days) * 100		**251.85%**		**500.40%**

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
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Basel III - Disclosures Under Pillar 3 as per the Banking Act Direction No.01 of 2016

Credit Risk under Standardised Approach - Credit Risk Exposures and Credit Risk Mitigation (CRM) Effects

Asset Class	As at 31st December 2023					
	Exposures before Credit Conversion Factor (CCF) and CRM		Exposures post CCF and CRM		RWA and RWA Density (%)	
	On-Balance Sheet Amount Rs.'Mn	Off-Balance Sheet Amount Rs.'Mn	On-Balance Sheet Amount Rs.'Mn	Off-Balance Sheet Amount Rs.'Mn	RWA Rs.'Mn	RWA Density(ii) Rs.'Mn
Claims on Central Government and CBSL	107,397	-	107,397	-	-	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	201,219	64,098	201,219	11,923	43,201	20.27%
Claims on Financial Institutions	1,500	-	1,500	-	300	20.00%
Claims on Corporates	134,351	273,674	134,351	46,820	162,795	89.86%
Retail Claims	30,059	75,080	23,602	34	17,803	75.32%
Claims Secured by Residential Property	1,978	-	1,540	-	1,540	100.00%
Claims Secured by Commercial Real Estate	37,883	-	37,883	-	37,883	100.00%
Non-Performing Assets (NPAs)	7,680	-	7,668	-	10,967	143.02%
Higher-risk Categories	-	-	-	-	-	-
Cash Items and Other Assets	39,337	-	39,337	-	35,861	91.16%
Total	**561,404**	**412,852**	**554,497**	**58,777**	**310,350**	-

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

Market Risk under Standardised Measurement Method

As at 31st December 2023	RWA Amount Rs.'Mn
(a) RWA for Interest Rate Risk	**30**
General Interest Rate Risk	-
(i) Net Long or Short Position	30
(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	**613**
Capital Charge for Market Risk [(a) + (b) + (c)] * CAR	**5,150**

Operational Risk under Basic Indicator Approach

	Capital Charge	Gross Income For the period ending 30 September 2023		
	Factor	1st Year Rs.'Mn	2nd Year Rs.'Mn	3rd Year Rs.'Mn
The Basic Indicator Approach	15%	57,571	43,396	19,954
Capital Charges for Operational Risk (LKR'Mn)				
The Basic Indicator Approach	6,046			
Risk Weighted Amount for Operational Risk (LKR'Mn)				
The Basic Indicator Approach	48,368			

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH

Basel III - Disclosures Under Pillar 3 as per the Banking Act Direction No.01 of 2016

Credit Risk under Standardised Approach
Exposures by Asset Classes and Risk Weights (Post CCF & CRM)

Description	**Amount (LKR'000) as at 31 December 2023 (Post CCF & CRM)**							
Asset classes\ Risk Weight	**0%**	**20%**	**50%**	**75%**	**100%**	**150%**	**>150%**	**Total Credit Exposures Amount**
Claims on Central Government and Central Bank of Sri Lanka	107,397	-	-	-	-	-	-	**107,397**
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	-	212,377	421	-	-	343	-	**213,142**
Claims on Financial Institutions	-	1,500	-	-	-	-	-	**1,500**
Claims on Corporates	-	22,951	28	-	158,191	-	-	**181,170**
Retail Claims	-	-	-	23,334	302	-	-	**23,636**
Claims Secured by Residential Property	-	-	-	-	1,540	-	-	**1,540**
Claims Secured by Commercial Real Estate	-	-	-	-	37,883	-	-	**37,883**
Non-Performing Assets (NPAs)	-	-	10	-	1,051	6,607	-	**7,668**
Higher-risk Categories	-	-	-	-	-	-	-	**-**
Cash Items and Other Assets	1,792	2,106	-	-	35,439	-	-	**39,337**
Total	**109,189**	**238,934**	**459**	**23,334**	**234,406**	**6,950**	**-**	**613,273**

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
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Basel III - Disclosures Under Pillar 3 as per the Banking Act Direction No.01 of 2016

Differences between Accounting and Regulatory Scopes and Mapping of Financial Statement Categories with Regulatory Risk Categories – Bank

Item	As at 31st December 2023				
	a Carrying Values as Reported in Published Financial Statements Rs'Mn	b Carrying Values under Scope of Regulatory Reporting Rs'Mn	c Subject to Credit Risk Framework Rs'Mn	d Subject to Market Risk Framework Rs'Mn	e Not subject to Capital Requirements or Subject to Deduction from Capital Rs'Mn
Assets					
Cash and Cash Equivalents	218,143	218,143	191,591	-	26,551
Balances with Central Banks	88,041	88,041	88,041	-	-
Placements with banks	11,337	11,337	11,337	-	-
Derivative Financial Instruments	1,011	1,011	-	1,011	-
Other Financial Assets Held-For-Trading	24	24	-	24	-
Loans and Receivables to Other Customers	210,214	210,214	210,214	-	-
Financial Investments - Fair value through other comprehensive income	19,662	19,662	19,662	-	-
Financial Investments - Amortised cost	94	94	94	-	-
Retirement benefit obligations surplus	86	86	-	-	86
Investments in Associates and Joint Ventures	-	-	-	-	-
Property, Plant and Equipment	5,518	5,518	5,493	-	25
Investment Properties	-	-	-	-	-
Goodwill and Intangible Assets	-	-	-	-	-
Deferred Tax Assets	1,286	1,286	-	-	1,286
Other Assets	31,012	31,012	31,012	-	-
Liabilities					
Due to Banks	38,359	38,359	-	-	-
Derivative Financial Instruments	229	229	-	-	-
Other Financial Liabilities Held-For-Trading	-	-	-	-	-
Financial Liabilities Designated at Fair Value Through Profit or Loss	-	-	-	-	-
Due to Other Customers	372,448	372,448	-	-	-
Other Borrowings	-	-	-	-	-
Retirement Benefit Obligations	-	-	-	-	-
Current Tax Liabilities	6,349	6,349	-	-	-
Deferred Tax Liabilities	-	-	-	-	-
Other Provisions	-	-	-	-	-
Other Liabilities	46,493	46,493	-	-	-
Due to Subsidiaries	-	-	-	-	-
Subordinated Term Debts	-	-	-	-	-
Off-Balance Sheet Liabilities					
Guarantees	8,475	8,475	8,475	-	-
Performance Bonds	84,842	84,842	84,842	-	-
Letters of Credit	30,200	30,200	30,200	-	-
Other Contingent Items	-	-	-	-	-
Undrawn Loan Commitments	238,564	238,564	238,564	-	-
Other Commitments	80,090	80,090	80,090	-	-
Shareholders' Equity					
Equity Capital (Stated Capital)/Assigned Capital	3,152	3,152	-	-	-
of which Amount Eligible for CET1	-	-	-	-	-
of which Amount Eligible for AT1	-	-	-	-	-
Retained Earnings	72,239	72,239	-	-	-
Accumulated Other Comprehensive Income	-	-	-	-	-
Statutory reserve fund	3,152	3,152	-	-	-
Other Reserves	44,006	44,006	-	-	-
Total Shareholders' Equity	**122,550**	**122,550**	**-**	**-**	**-**

42 Sustainability Disclosure

42.1 Cautionary Statements Regarding Forward-Looking Statements

This Annual Report and Accounts 2023 contains certain forward-looking statements with respect to the financial condition, environmental, social and governance ('ESG') related matters, results of operations and business of the group, including the strategic priorities; financial, investment and capital targets; and the group's ability to contribute to the Group's ESG targets, commitments and ambitions described herein.

Statements that are not historical facts, including statements about the group's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential' and 'reasonably possible', variations of these words and similar expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore no undue reliance should be placed on them. Forward-looking statements apply only as of the date they are made. The group makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statement.

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors, including ESG related factors, could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward-looking statement.

42.2 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 Group aims to help customers transition to net zero and a sustainable future by providing and facilitating between $750bn and $1tn of sustainable finance and investment by 2030. The Group's sustainable finance and investment ambition aims to help promote green, sustainable and socially-focused business and sustainable investment products and solutions.

To help achieve the scale and speed of change required to transition to net zero, the Group acknowledges the need of supporting customers not just with finance, but with the services, insights and tools to help them to transition.

In 2023, the Group continued to focus on providing customers with products, services and initiatives to help enable emissions reduction in the real economy. In 2023, the Group introduced an internal briefing series called Net Zero in Practice to support this objective, which covers new technologies relevant to the net zero transition, drawing on expertise from across the organization and highlighting financing opportunities and case studies.

Continued progress towards achieving the Group's sustainable finance and investment ambition is dependent on market demand for the products and services set out in the Group's Sustainable Finance and Investment Data Dictionary 2023, see www.hsbc.com/who-we-are/esg-and-responsible-business/esgreporting-centre .

The Group's sustainability risk policies comprise core net zero-aligned policies – thermal coal phase-out and energy – and broader sustainability risk policies covering: agricultural commodities, chemicals, forestry, mining and metals, and World Heritage Sites and Ramsar-designated wetlands. The Group also applies the Equator Principles when financing relevant projects.

42 Sustainability Disclosure (contd)

42.2 Overview of Sustainable Finance Policies, Activities, and way forward (contd)

The Group Risk and Compliance function has specialists who review and support implementation of sustainability risk policies. The Group's relationship managers are the primary point of contact for many of its business customers and are responsible for managing customers' adherence to the sustainability risk policies. They are supported by sustainability risk managers across the Group who have local or regional responsibility for advising on, and overseeing, the management of risks as outlined in the policies. Where considered appropriate, policy matters are escalated to relevant internal governance committees.

42.3 Sustainable Finance Related risks and Associated mitigation measures

Climate risk relates to the financial and non-financial impacts that may arise as a result of climate change and the move to a net zero economy. The Group manages climate risk across all businesses and are incorporating climate considerations within traditional risk types in line with Group-wide risk management framework. The Group's material exposure to climate risk relates to wholesale and retail client financing activity within banking portfolio.

Climate risk can impact the Group either directly or through relationships with clients. These include the potential risks arising as a result of the Group's net zero ambition, which could lead to reputational concerns, and potential legal and/or regulatory action if is perceived to mislead stakeholders on business activities or if the Group fails to achieve stated net zero targets.

The Group's climate risk approach identifies two primary drivers of climate risk:

– physical risk, which arises from the increased frequency and severity of extreme weather events, such as hurricanes and floods, or chronic gradual shifts in weather patterns or rises in the sea level; and
– transition risk, which arises from the process of moving to a net zero economy, including changes in government policy and legislation, technology, market demand, and reputational implications triggered by a change in stakeholder expectations, action or inaction.

The Group has identified the following thematic issues related to climate risk which are most likely to materialise in the form of reputational, regulatory compliance and litigation risks:

– net zero alignment risk, which arises from the risk of the Group failing to meet its net zero commitments or failing to meet external expectations related to net zero, because of inadequate ambition and/or plans, poor execution, or inability to adapt to changes in external environment.
– the risk of greenwashing, which arises from the act of knowingly or unknowingly making inaccurate, unclear, misleading or unsubstantiated claims regarding sustainability to the Group's stakeholders.

42 Sustainability Disclosure (contd)

42.3 Sustainable Finance Related risks and Associated mitigation measures (contd)

Wholesale credit risk

The Group has metrics in place to monitor the exposure of its wholesale corporate lending portfolio to six high transition risk sectors. The sector classifications are based on internal HSBC definitions and can be judgmental in nature . The sector classifications are subject to the remediation of ongoing data quality challenges. This data will be enhanced and refined in future years.

The Group's relationship managers engage with the Group's key wholesale customers through a transition engagement questionnaire to gather information and assess the alignment of the Group's wholesale customers' business models to net zero and their exposure to physical and transition risks. The Group uses the responses to the questionnaire to create a climate risk score for the Group's key wholesale customers.

The Group's credit policies require that relationship managers comment on climate risk factors in credit applications and annual credit reviews. Credit policies also require manual credit risk rating overrides if climate is deemed to have a material impact on credit risk under 12 months if not already captured under the original credit risk rating.

Regulatory compliance risk

The Groups policies set the standards that are required to manage the risk of breaches of regulatory duty to customers, including those related to climate risk, ensuring fair customer outcomes are achieved. To make sure responsibilities are met in this regard, the Group's policies are subject to continuous review and enhancement. There is also focus on the ongoing development and improvement of monitoring capabilities, ensuring appropriate alignment to the broader focus on regulatory compliance risks.

The Group is particularly focused on mitigating climate risks inherent to the product lifecycle. To support this, it has enhanced a number of processes including:

- ensuring risk oversight and review of new product marketing materials with any reference to climate, sustainability and ESG;
- developing the Group's product marketing controls to ensure climate claims are robustly evidenced and substantiated within product marketing materials; and
- clarifying and improving product marketing framework, procedures and associated guidance, to ensure product-related marketing materials comply with both internal and external standards, and are subject to robust governance.

Regulatory Compliance operates an ESG and Climate Risk Working Group to track and monitor the integration and embedding of climate risk management into the functions' activities, while monitoring regulatory and legislative changes across the ESG and climate risk agenda .

42 Sustainability Disclosure (contd)

Reputational risk
The Group manages the reputational impact of climate risk through the Group's broader reputational risk framework, supported by the Group's sustainability risk policies and metrics.

The Group's sustainability risk policies set out the Group's appetite for financing activities in certain sectors. Its thermal coal phase-out and energy policies aim to drive down greenhouse gas emissions while supporting a just transition.

The Group's global network of sustainability risk managers provides local policy guidance to relationship managers for the oversight of policy compliance and in support of implementation across the Group's wholesale banking activities.

42.4 Banks approach towards sustainable finance activities and way forward

The Group seeks to collaborate with a range of partners to develop a supportive environment for achieving net zero and mobilising finance for climate action and nature-based solutions. Partnerships vary in scope and form depending on the sector and geography, as well as its presence in local markets. The Group acts independently and voluntarily in decision making, based on own business interests, priorities and objectives, and in accordance with the laws and regulations of the markets in which it operates.

The Central Bank of Sri Lanka issued Banking Act Directions on "Sustainable Finance Activities of Licensed Banks" in June 2022, to promote sustainable financing initiatives and cater to the need for a Governance and Risk Management framework for licensed banks in respect of sustainable finance activities. HSBC Sri Lanka is currently in progress of implementing the regulation with each facet of the regulation tasked and overseen by the respective business lines and functions. The sustainable financing initiatives of HSBC Sri Lanka are formally governed by its Executive Committee Meetings with senior management oversight.

42.5 Additional cautionary statement regarding ESG data, metrics and forward-looking statements

The Annual Report and Accounts 2023 contains a number of forward-looking statements (as defined above) with respect to the Group's (including the group's) ESG targets, commitments, ambitions, climate-related pathways, processes and plans, and the methodologies and scenarios the Group (including the group) uses, or intends to use, to assess the Group's (including the group's) progress in relation to these ('ESG-related forward-looking statements').

42 Sustainability Disclosure (contd)

42.5 Additional cautionary statement regarding ESG data, metrics and forward-looking statements (contd)

In preparing the ESG-related information contained in the Annual Report and Accounts 2023, the group has relied on a number of key judgements, estimations and assumptions of the Group and the processes and issues involved are complex. The Group has used ESG (including climate) data, models and methodologies that it considers, as of the date on which they were used, to be appropriate and suitable to understand and assess climate change risk and its impact, to analyse financed emissions - and operational and supply chain emissions, to set ESG-related targets and to evaluate the classification of sustainable finance and investments. However, these data, models and methodologies are often new, are rapidly evolving and are not of the same standard as those available in the context of other financial information, nor are they subject to the same or equivalent disclosure standards, historical reference points, benchmarks or globally accepted accounting principles. In particular, it is not possible to rely on historical data as a strong indicator of future trajectories in the case of climate change and its evolution. Outputs of models, processed data and methodologies are also likely to be affected by underlying data quality, which can be hard to assess and the Group expects industry guidance, market practice, and regulations in this field to continue to change. The Group (including the group) also face challenges in relation to its ability to access data on a timely basis, lack of consistency and comparability between data that is available and its ability to collect and process relevant data. Consequently, the ESG-related forward-looking statements and ESG metrics disclosed in the Annual Report and Accounts 2023 carry an additional degree of inherent risk and uncertainty.

Due to the unpredictable evolution of climate change and its future impact and the uncertainty of future policy and market response to ESG-related issues and the effectiveness of any such response, the Group (including the group) may have to re-evaluate its progress towards its ESG ambitions, commitments and targets in the future, update the methodologies it uses or alter its approach to ESG (including climate) analysis and may be required to amend, update and recalculate its ESG disclosures and assessments in the future, as market practice and data quality and availability develop.

No assurance can be given by or on behalf of the group as to the likelihood of the achievement or reasonableness of any projections, estimates, forecasts, targets, commitments, ambitions, prospects or returns contained herein. Readers are cautioned that a number of factors, both external and those specific to the Group (including the group), could cause actual achievements, results, performance or other future events or conditions of the group to differ, in some cases materially, from those stated, implied and/or reflected in any ESG-related forward-looking statement or metric due to a variety of risks, uncertainties and other factors (including without limitation those referred to below):

42 Sustainability Disclosure (contd)

42.5 Additional cautionary statement regarding ESG data, metrics and forward-looking statements (contd)

- Climate change projection risk: this includes, for example, the evolution of climate change and its impacts, changes in the scientific assessment of climate change impacts, transition pathways and future risk exposure and limitations of climate scenario forecasts;

- ESG projection risk: ESG metrics are complex and are still subject to development. In addition, the scenarios employed in relation to them, and the models that analyse them have limitations that are sensitive to key assumptions and parameters, which are themselves subject to some uncertainty, and cannot fully capture all of the potential effects of climate, policy and technology-driven outcomes;
- Changes in the ESG regulatory landscape: this involves changes in government approach and regulatory treatment in relation to ESG disclosures and reporting requirements, and the current lack of a single standardised regulatory approach to ESG across all sectors and markets;
- Variation in reporting standards: ESG reporting standards are still developing and are not standardised or comparable across all sectors and markets, new reporting standards in relation to different ESG metrics are still emerging;
- Data availability, accuracy, verifiability and data gaps: the Group's (including the group's) disclosures are limited by the availability of high-quality data in some areas and the Group's (including the group's) own ability to timely collect and process such data as required. Where data is not available for all sectors or consistently year on year, there may be an impact to the Group's (including the group's) data quality scores. While the Group (including the group) expects its data quality scores to improve over time, as companies continue to expand their disclosures to meet growing regulatory and stakeholder expectations, there may be unexpected fluctuations within sectors year on year, and/or differences between the data quality scores between sectors. Any such changes in the availability and quality of data over time, or the Group's (including the group's) ability to collect and process such data, could result in revisions to reported data going forward, including on financed emissions, meaning that such data may not be reconcilable or comparable year-on year;
- Developing methodologies and scenarios: the methodologies and scenarios the Group (including the group)uses to assess financed emissions and set ESG-related targets may develop over time in line with market practice, regulation and/or developments in science, where applicable. Such developments could result in revisions to reported data, including on financed emissions or the classification of sustainable finance and investments, meaning that data outputs may not be reconcilable or comparable year-on year; and

- Risk management capabilities: global actions, including the Group's (and the group's) own actions, may not be effective in transitioning to net zero and in managing relevant ESG risks, including in particular climate, nature-related and human rights risks, each of which can impact the Group (including the group) both directly and indirectly through its customers, and which may result in potential financial and non-financial impacts to the Group (including the group). In particular:

42 Sustainability Disclosure (contd)

42.5 Additional cautionary statement regarding ESG data, metrics and forward-looking statements (contd)

– the Group (including the group) may not be able to achieve its ESG targets, commitments and ambitions (including with respect to the positions set forth in the Group's thermal coal phase-out policy and its energy policy, and its targets to reduce its on-balance sheet financed emissions and, where applicable, facilitated emissions in its portfolio of selected high-emitting sectors), which may result in the Group's (including the group's) failure to achieve some or all of the expected benefits of its strategic priorities; and

– the Group (including the group) may not be able to develop sustainable finance and ESG-related products consistent with the evolving expectations of its regulators, and its capacity to measure the environmental and social impacts from its financing activity may diminish (including as a result of data and model limitations and changes in methodologies), which may affect its ability to achieve its ESG targets, commitments and ambitions, including its net zero ambition, its targets to reduce its on-balance sheet financed emissions and, where applicable, facilitated emissions in its portfolio of selected high-emitting sectors and the positions set forth in its thermal coal phase-out policy and energy policy, and increase the risk of greenwashing.

Any forward-looking statements made by or on behalf of the Group (including the group) speak only as of the date they are made. The Group (including the group) expressly disclaims any obligation to revise or update these ESG forward-looking statements, other than as expressly required by applicable law.

Written and/or oral ESG-related forward-looking statements may also be made in the Group's (including the group's) periodic reports to its regulators, public offering or disclosure documents, press releases and other written materials, and in oral statements made by the Group's (including the group's) Directors, officers or employees to third parties, including financial analysts.

The Group's data dictionaries and methodologies for preparing the above ESG-related metrics and third-party limited assurance reports can be found on: www.hsbc.com/who-we-are/esg-and-responsible-business/esg-reporting-centre.

Annex I

D-SIBs Assessment Exercise*

Rs. Million

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

SIZE	
Section 1 - Total exposure	
Total exposure measure	649,978.16
INTERCONNECTEDNESS	
Section 2 - Intra-financial system assets	
a. Funds deposited with or lent to other financial institutions (including unused portion of committed lines extendec	382.48
i) Funds deposited	382.48
ii) Lending	-
b. Holdings of securities issued by other financial institutions	-
c. Net positive current exposure of securities financing transactions (SFTs) with other financial institution:	-
d. Over-the-counter (OTC) derivatives with other financial institutions that have a net positive mark to mark value	368.14
Intra-financial system assets	750.61
Section 3 - Intra-financial system liabilities	
a. Funds deposited by or borrowed from other financial institutions (including unused portion of committed lines obtainec	9,418.98
i) Funds deposited	9,418.98
ii) Borrowings	-
b. Net negative current exposure of securities financing transactions with other financial institution:	-
c. Over-the-counter derivatives with other finacial institutions that have a net negative mark to mark value	0.20
Intra-financial system liabilities	9,419.18
Section 4 - Securities outstanding	
Securities outstanding	-
SUSTAINABILITY/FINANCIAL INSTITUTION INFRASTRUCTURE	
Section 5 - Payments made in the reporting year (excluding intragroup payments)	
Payment activity	152,315,519.30
Section 6 - Assets under custody	
Assets under custody	154,309.71
Section 7 - Underwritten transactions	
Underwritten transactions	-
Section 8 - Trading volume	
Trading volume	-
COMPLEXITY	
Section 9 - Notional amount of over-the-counter (OTC) derivatives	
OTC derivatives	61,268.94
Section 10 - Level 2 assets	
Level 2 assets	-
Section 11 - Trading and available for sale (AFS) securities	
Trading and AFS securities	19,685.73
Section 12 - Cross-jurisdictional liabilities	
Foreign liabilities (excluding derivatives and intragroup liabilities	42,325.07
Section 13 - Cross-jurisdictional claims	
Foreign claims (excluding derivatives and intragroup claims)	46,421.34

* As per the Banking Act Direction No. 10 of 2019 - Framework for Dealing with Domestic Systemically Important Banks. Please refer Annex I(A) for the guidelines.

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
SRI LANKA BRANCH

AS AT 31 DECEMBER 2023

Disclosures in line with Banking Act Directions
Banking Act no 13 of 2021- Classification , Recognition and measurement of credit facilities in Licensed bank

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 criteria.

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 criteria 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.

SICR criteria 7.1.3 in CBSL Direction No 13 of 2021 gives rise to an Incremental ECL of USD 443. This accounts for 0.003% of the total Impairment provision.

As Permitted by Section 7.2 of CBSL Direction No 13 of 2021, HSBC has rebutted the criteria so referred to, and the impact and the ECLs in the Financial Statements as at 31.12.2023 has been reported excluding the incremental ECL of USD 443.