



The Hongkong and Shanghai Banking
Corporation Limited

Interim Report 2016

Interim Report 2016

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Certain defined terms

This document comprises the *Interim Report 2016* for The Hongkong and Shanghai Banking Corporation Limited ('the Bank') and its subsidiaries (together 'the group'). References to 'HSBC', 'the Group' or 'the HSBC Group' within this document mean HSBC Holdings plc together with its subsidiaries. Within this document the Hong Kong Special Administrative Region of the People's Republic of China is referred to as 'Hong Kong'. The abbreviations 'HK\$m' and 'HK\$bn' represent millions and billions (thousands of millions) of Hong Kong dollars respectively.

Cautionary statement regarding forward-looking statements

This *Interim Report* contains certain forward-looking statements with respect to the financial condition, results of operations and business of the group.

Statements that are not historical facts, including statements about the Bank'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 undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made, and it should not be assumed that they have been revised or updated in the light of new information or future events.

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

Chinese translation

A Chinese translation of the *Interim Report* is available upon request from: Communications (Asia), Level 32, HSBC Main Building, 1 Queen's Road Central, Hong Kong. The report is also available, in English and Chinese, on the Bank's website at www.hsbc.com.hk.

本《中期業績報告》備有中譯本，如欲查閱可向下列地址索取：香港皇后大道中 1 號滙豐總行大廈 32 樓企業傳訊部（亞太區）。本報告之中英文本亦載於本行之網址 www.hsbc.com.hk。

Financial Highlights

- Profit before tax down 24% to HK\$53,409m (HK\$70,079m in the first half of 2015).
- Attributable profit down 23% to HK\$40,200m (HK\$52,290m in the first half of 2015).
- Return on average shareholders' equity of 13.8% (18.6% in the first half of 2015).
- Total assets up 6% to HK\$7,404bn (HK\$6,954bn at the end of 2015).
- Common equity tier 1 ratio of 16.1% (15.6% at the end of 2015), total capital ratio of 19.2% (18.6% at the end of 2015).
- Cost efficiency ratio of 42.8% (37.7% for the first half of 2015).

Reported results in the first half of 2015 included a gain of HK\$10,636m on the partial disposal of shareholding in Industrial Bank Co., Limited ('Industrial Bank').

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Comment by Stuart Gulliver, Chairman

Economic growth in Asia continued to moderate during the first half of 2016 as demand for exports remained subdued and investment slowed. In mainland China, the domestic economy stabilised as infrastructure investment picked up, housing market activity remained robust and bank lending continued to grow. Hong Kong's economy slowed, as activity in the finance, property, tourism and logistics sectors cooled. However, unemployment remained low and is expected to remain at current levels. In ASEAN, a number of economies are experiencing better economic conditions, notably Indonesia and the Philippines, while India continues to grow strongly and is beginning to institute necessary reforms.

In this environment, The Hongkong and Shanghai Banking Corporation Limited recorded profit before tax in the first half of 2016 of HK\$53,409m, compared with HK\$70,079m in the first half of 2015 which included a gain on partial disposal of Hang Seng Bank Limited's ('Hang Seng') shareholding in Industrial Bank of HK\$10,636m. Excluding this gain, net operating income before loan impairment charges ('Revenue') was 7% lower as customer demand for loans and wealth management services moderated from the high levels seen in 2015, while operating expenses reduced by 6% as we maintained tight control of costs while continuing to invest in growth initiatives. The cost efficiency ratio for the period was 42.8%. Loan impairment charges of HK\$3bn were higher than the first half of 2015, but remained low in relation to both average loans and total income, and overall asset quality continued to be strong.

While reduced demand led to a fall in loans and advances to customers, customer deposits increased, driven by Hong Kong, and net interest income increased by 2%. Non-interest income fell however, principally as equity markets and related revenues were less buoyant than during the first half of 2015. At the end of June 2016, the loans to deposits ratio stood at 57.7%. Our capital position remained strong, with a common equity tier 1 ratio of 16.1% at the end of June 2016.

In Retail Banking and Wealth Management ('RBWM'), we maintained our leading market shares in mortgages and cards in Hong Kong and grew mortgage lending balances with average loan-to-value ratios of 42% on new drawdowns and an estimated 32% on the portfolio as a whole. Our market shares in deposits and mutual fund sales in Hong Kong increased. In July we were awarded 'Asia Pacific International Retail Bank of the Year' by *Asian Banking & Finance*. We are continuing to invest in digital channels and in expanding our business in the Pearl River Delta ('PRD'), and plan to launch credit cards in mainland China during the third quarter of this year.

In Commercial Banking ('CMB'), we continued to focus on supporting our customers through providing an increased share of their banking requirements. Although overall market volumes in trade finance were lower, we increased our market share. Customer advances were lower as a result of repayments and lower trade related lending, but customer deposits grew, and net interest income increased. In the PRD, we continued to invest in infrastructure, people and technology in support of our planned business expansion in the region.

In Global Banking and Markets ('GB&M'), we consolidated our position as the leader in Asia ex-Japan G3 currency bonds and offshore renminbi bonds with increased share in both markets. We ranked first in Merger & Acquisitions in Hong Kong by deal value for the period and were awarded 'Asia's Best Investment Bank' and 'Hong Kong's Best Investment Bank' by *Euromoney*. In the PRD our securities joint venture based in the Qianhai Special Economic Zone will be operational following receipt of regulatory approvals, allowing us to engage in the full spectrum of the securities business in mainland China.

Continued moderate demand is likely to hold back growth in Asia and lead to further policy easing in some economies. Low interest rates and relatively robust financial positions should ensure that financial stability is maintained. We expect mainland China to continue to generate economic growth at around 6.5%, while India should sustain growth of over 7.0%. Most of the region's economies have the capacity to deploy fiscal stimulus through measures including financing infrastructure development. Our strategy remains unchanged and focused on capturing the long-term opportunities in Asia's development as the world's leading economic region. To achieve this, we will continue to serve and support our customers as they invest and grow through the cycle.

Financial Review

Geographical Regions

Profit before tax by geographical region

	Hong Kong HK\$m	Rest of Asia- Pacific HK\$m	Intra-segment elimination HK\$m	Total HK\$m
Period ended 30 June 2016				
Net interest income	28,505	19,171	–	47,676
Net fee income	13,272	6,157	–	19,429
Net trading income	6,926	6,059	–	12,985
Net income from financial instruments designated at fair value ..	327	25	–	352
Gains less losses from financial investments	458	407	–	865
Dividend income	193	8	–	201
Net insurance premium income	24,604	3,600	–	28,204
Other operating income	6,341	1,331	(1,854)	5,818
Total operating income	80,626	36,758	(1,854)	115,530
Net insurance claims and benefits paid and movement in liabilities to policyholders	(26,246)	(4,174)	–	(30,420)
Net operating income before loan impairment charges and other credit risk provisions	54,380	32,584	(1,854)	85,110
Loan impairment charges and other credit risk provisions	(1,109)	(1,860)	–	(2,969)
Net operating income	53,271	30,724	(1,854)	82,141
Operating expenses	(21,870)	(16,420)	1,854	(36,436)
Operating profit	31,401	14,304	–	45,705
Share of profit in associates and joint ventures	100	7,604	–	7,704
Profit before tax	31,501	21,908	–	53,409
Share of profit before tax	59.0%	41.0%	–	100.0%
Cost efficiency ratio	40.2%	50.4%	–	42.8%
Net loans and advances to customers	1,658,091	1,076,143	–	2,734,234
Customer accounts	3,360,663	1,374,433	–	4,735,096
Period ended 30 June 2015				
Net interest income	25,828	21,116	–	46,944
Net fee income	17,718	7,173	–	24,891
Net trading income	8,827	4,900	–	13,727
Net income from financial instruments designated at fair value	3,119	914	–	4,033
Gains less losses from financial investments	11,095	110	–	11,205
Dividend income	170	8	–	178
Net insurance premium income	24,964	3,125	–	28,089
Other operating income	6,773	657	(2,077)	5,353
Total operating income	98,494	38,003	(2,077)	134,420
Net insurance claims and benefits paid and movement in liabilities to policyholders	(28,467)	(3,309)	–	(31,776)
Net operating income before loan impairment charges and other credit risk provisions	70,027	34,694	(2,077)	102,644
Loan impairment charges and other credit risk provisions	(445)	(1,462)	–	(1,907)
Net operating income	69,582	33,232	(2,077)	100,737
Operating expenses	(23,177)	(17,602)	2,077	(38,702)
Operating profit	46,405	15,630	–	62,035
Share of profit in associates and joint ventures	123	7,921	–	8,044
Profit before tax	46,528	23,551	–	70,079
Share of profit before tax	66.4%	33.6%	–	100.0%
Cost efficiency ratio	33.1%	50.7%	–	37.7%
Net loans and advances to customers	1,726,814	1,154,183	–	2,880,997
Customer accounts	3,198,940	1,452,533	–	4,651,473

Financial Review (continued)

Geographical Regions (continued)

Profit before tax by global business – Hong Kong

	Retail Banking and Wealth Management HK\$m	Commercial Banking HK\$m	Global Banking and Markets HK\$m	Global Private Banking HK\$m	Other HK\$m	Intra- segment elimination HK\$m	Total HK\$m
Period ended 30 June 2016							
Net interest income/(expense)	15,120	8,483	5,407	432	(560)	(377)	28,505
Net fee income	7,065	3,588	2,099	415	105	–	13,272
Net trading income/(expense)	57	655	5,788	405	(356)	377	6,926
Net income/(expense) from financial instruments designated at fair value ..	223	(239)	70	–	273	–	327
Gains less losses from financial investments	75	187	189	–	7	–	458
Dividend income	2	–	–	–	191	–	193
Net insurance premium income/ (expense)	22,045	2,583	–	–	(24)	–	24,604
Other operating income	2,550	557	344	5	3,374	(489)	6,341
Total operating income	47,137	15,814	13,897	1,257	3,010	(489)	80,626
Net insurance claims and benefits paid and movement in liabilities to policyholders	(23,579)	(2,667)	–	–	–	–	(26,246)
Net operating income before loan impairment charges and other credit risk provisions	23,558	13,147	13,897	1,257	3,010	(489)	54,380
Loan impairment (charges)/releases and other credit risk provisions	(729)	(352)	(32)	4	–	–	(1,109)
Net operating income	22,829	12,795	13,865	1,261	3,010	(489)	53,271
Operating expenses	(8,856)	(3,487)	(5,230)	(752)	(4,034)	489	(21,870)
Operating profit	13,973	9,308	8,635	509	(1,024)	–	31,401
Share of profit in associates and joint ventures	99	–	1	–	–	–	100
Profit before tax	14,072	9,308	8,636	509	(1,024)	–	31,501
Share of profit before tax	26.3%	17.4%	16.2%	1.0%	(1.9)%	–	59.0%
Net loans and advances to customers	580,403	611,157	384,891	67,800	13,840	–	1,658,091
Customer accounts	1,988,967	906,083	330,397	133,538	1,678	–	3,360,663

Financial Review (continued)Geographical Regions (*continued*)*Profit before tax by global business – Hong Kong*

	Retail Banking and Wealth Management HK\$m	Commercial Banking HK\$m	Global Banking and Markets HK\$m	Global Private Banking HK\$m	Other HK\$m	Intra- segment elimination HK\$m	Total HK\$m
Period ended 30 June 2015							
Net interest income/(expense)	13,435	8,298	5,103	417	(959)	(466)	25,828
Net fee income	10,202	3,933	2,783	694	106	–	17,718
Net trading income/(expense)	754	811	6,505	444	(153)	466	8,827
Net income/(expense) from financial instruments designated at fair value	3,106	(85)	48	–	50	–	3,119
Gains less losses from financial investments	289	136	27	–	10,643	–	11,095
Dividend income	1	–	–	–	169	–	170
Net insurance premium income	22,188	2,776	–	–	–	–	24,964
Other operating income	2,296	241	391	5	4,828	(988)	6,773
Total operating income	52,271	16,110	14,857	1,560	14,684	(988)	98,494
Net insurance claims and benefits paid and movement in liabilities to policyholders	(25,679)	(2,788)	–	–	–	–	(28,467)
Net operating income before loan impairment charges and other credit risk provisions	26,592	13,322	14,857	1,560	14,684	(988)	70,027
Loan impairment (charges)/releases and other credit risk provisions	(627)	(144)	345	(20)	1	–	(445)
Net operating income	25,965	13,178	15,202	1,540	14,685	(988)	69,582
Operating expenses	(9,240)	(3,573)	(5,940)	(779)	(4,633)	988	(23,177)
Operating profit	16,725	9,605	9,262	761	10,052	–	46,405
Share of profit in associates and joint ventures	121	1	1	–	–	–	123
Profit before tax	16,846	9,606	9,263	761	10,052	–	46,528
Share of profit before tax	24.0%	13.7%	13.2%	1.1%	14.4%	–	66.4%
Net loans and advances to customers	566,399	635,554	436,342	71,016	17,503	–	1,726,814
Customer accounts	1,835,941	867,880	347,063	142,057	5,999	–	3,198,940

Financial Review (continued)

Geographical Regions (continued)

Profit before tax by global business – Rest of Asia-Pacific

	Retail Banking and Wealth Management HK\$m	Commercial Banking HK\$m	Global Banking and Markets HK\$m	Global Private Banking HK\$m	Other HK\$m	Intra- segment elimination HK\$m	Total HK\$m
Period ended 30 June 2016							
Net interest income	5,925	5,687	7,089	307	203	(40)	19,171
Net fee income	1,882	1,637	2,448	170	20	–	6,157
Net trading income	263	709	4,760	129	158	40	6,059
Net income/(expense) from financial instruments designated at fair value ..	–	–	(1)	–	26	–	25
Gains less losses from financial investments	(3)	(3)	409	–	4	–	407
Dividend income	5	1	–	–	2	–	8
Net insurance premium income.....	2,302	1,298	–	–	–	–	3,600
Other operating income	655	442	178	6	501	(451)	1,331
Total operating income	11,029	9,771	14,883	612	914	(451)	36,758
Net insurance claims and benefits paid and movement in liabilities to policyholders	(2,628)	(1,546)	–	–	–	–	(4,174)
Net operating income before loan impairment charges and other credit risk provisions	8,401	8,225	14,883	612	914	(451)	32,584
Loan impairment (charges)/releases and other credit risk provisions	(455)	(851)	(572)	–	18	–	(1,860)
Net operating income	7,946	7,374	14,311	612	932	(451)	30,724
Operating expenses	(6,893)	(4,040)	(4,521)	(434)	(983)	451	(16,420)
Operating profit	1,053	3,334	9,790	178	(51)	–	14,304
Share of profit in associates and joint ventures	1,023	5,446	1,135	–	–	–	7,604
Profit before tax	2,076	8,780	10,925	178	(51)	–	21,908
Share of profit before tax	3.9%	16.5%	20.4%	0.3%	(0.1)%	–	41.0%
Net loans and advances to customers	340,841	366,260	328,811	34,196	6,035	–	1,076,143
Customer accounts	458,200	336,670	489,764	79,303	10,496	–	1,374,433

Financial Review (continued)

Geographical Regions (continued)

Profit before tax by global business – Rest of Asia-Pacific

	Retail Banking and Wealth Management HK\$m	Commercial Banking HK\$m	Global Banking And Markets HK\$m	Global Private Banking HK\$m	Other HK\$m	Intra- segment elimination HK\$m	Total HK\$m
Period ended 30 June 2015							
Net interest income	6,166	5,721	8,167	271	565	226	21,116
Net fee income/(expense)	2,418	2,072	2,477	266	(60)	–	7,173
Net trading income	297	685	3,996	141	7	(226)	4,900
Net income/(expense) from financial instruments designated at fair value	906	11	13	–	(16)	–	914
Gains less losses from financial investments	(3)	–	119	–	(6)	–	110
Dividend income	5	–	–	–	3	–	8
Net insurance premium income	2,538	590	–	–	–	(3)	3,125
Other operating income	134	9	253	4	612	(355)	657
Total operating income	12,461	9,088	15,025	682	1,105	(358)	38,003
Net insurance claims and benefits paid and movement in liabilities to policyholders ..	(2,814)	(496)	–	–	–	1	(3,309)
Net operating income before loan impairment charges and other credit risk provisions ...	9,647	8,592	15,025	682	1,105	(357)	34,694
Loan impairment charges and other credit risk provisions	(463)	(960)	(22)	(16)	(1)	–	(1,462)
Net operating income	9,184	7,632	15,003	666	1,104	(357)	33,232
Operating expenses	(7,457)	(4,299)	(4,947)	(471)	(785)	357	(17,602)
Operating profit	1,727	3,333	10,056	195	319	–	15,630
Share of profit in associates and joint ventures	1,033	5,700	1,188	–	–	–	7,921
Profit before tax	2,760	9,033	11,244	195	319	–	23,551
Share of profit before tax	4.0%	12.9%	16.0%	0.3%	0.4%	–	33.6%
Net loans and advances to customers	346,302	400,667	372,248	33,588	1,378	–	1,154,183
Customer accounts	482,199	357,923	531,677	80,245	489	–	1,452,533

Financial Review (continued)

Geographical Regions (continued)

Profit before tax by global business

	Retail Banking and Wealth Management HK\$m	Commercial Banking HK\$m	Global Banking and Markets HK\$m	Global Private Banking HK\$m	Other HK\$m	Intra- segment elimination HK\$m	Total HK\$m
Period ended 30 June 2016							
Net interest income/(expense)	21,045	14,170	12,484	739	(345)	(417)	47,676
Net fee income	8,947	5,225	4,547	585	125	–	19,429
Net trading income/(expense)	320	1,364	10,548	534	(198)	417	12,985
Net income/(expense) from financial instruments designated at fair value	223	(239)	69	–	299	–	352
Gains less losses from financial investments	72	184	598	–	11	–	865
Dividend income	7	1	–	–	193	–	201
Net insurance premium income/(expense) ...	24,347	3,881	–	–	(24)	–	28,204
Other operating income	3,205	999	522	11	3,831	(2,750)	5,818
Total operating income	58,166	25,585	28,768	1,869	3,892	(2,750)	115,530
Net insurance claims and benefits paid and movement in liabilities to policyholders ..	(26,207)	(4,213)	–	–	–	–	(30,420)
Net operating income before loan impairment charges and other credit risk provisions	31,959	21,372	28,768	1,869	3,892	(2,750)	85,110
Loan impairment (charges)/releases and other credit risk provisions	(1,184)	(1,203)	(604)	4	18	–	(2,969)
Net operating income	30,775	20,169	28,164	1,873	3,910	(2,750)	82,141
Operating expenses	(15,749)	(7,527)	(9,751)	(1,186)	(4,973)	2,750	(36,436)
Operating profit	15,026	12,642	18,413	687	(1,063)	–	45,705
Share of profit in associates and joint ventures	1,122	5,446	1,136	–	–	–	7,704
Profit before tax	16,148	18,088	19,549	687	(1,063)	–	53,409
Share of profit before tax	30.2%	33.9%	36.6%	1.3%	(2.0)%	–	100.0%
Net loans and advances to customers	921,244	977,417	713,702	101,996	19,875	–	2,734,234
Customer accounts	2,447,167	1,242,753	820,161	212,841	12,174	–	4,735,096

Financial Review (continued)

Geographical Regions (continued)

Profit before tax by global business

	Retail Banking and Wealth Management HK\$m	Commercial Banking HK\$m	Global Banking and Markets HK\$m	Global Private Banking HK\$m	Other HK\$m	Intra- segment elimination HK\$m	Total HK\$m
Period ended 30 June 2015							
Net interest income/(expense)	19,601	14,019	13,243	688	(367)	(240)	46,944
Net fee income	12,617	6,004	5,263	960	47	–	24,891
Net trading income/(expense)	1,051	1,496	10,501	585	(146)	240	13,727
Net income/(expense) from financial instruments designated at fair value	4,012	(74)	61	–	34	–	4,033
Gains less losses from financial investments	286	136	146	–	10,637	–	11,205
Dividend income	6	–	–	–	172	–	178
Net insurance premium income	24,726	3,366	–	–	–	(3)	28,089
Other operating income	2,430	250	610	9	5,393	(3,339)	5,353
Total operating income	64,729	25,197	29,824	2,242	15,770	(3,342)	134,420
Net insurance claims and benefits paid and movement in liabilities to policyholders ..	(28,493)	(3,284)	–	–	–	1	(31,776)
Net operating income before loan impairment charges and other credit risk provisions	36,236	21,913	29,824	2,242	15,770	(3,341)	102,644
Loan impairment (charges)/releases and other credit risk provisions	(1,090)	(1,104)	323	(36)	–	–	(1,907)
Net operating income	35,146	20,809	30,147	2,206	15,770	(3,341)	100,737
Operating expenses	(16,697)	(7,872)	(10,853)	(1,250)	(5,371)	3,341	(38,702)
Operating profit	18,449	12,937	19,294	956	10,399	–	62,035
Share of profit in associates and joint ventures	1,154	5,701	1,189	–	–	–	8,044
Profit before tax	19,603	18,638	20,483	956	10,399	–	70,079
Share of profit before tax	28.0%	26.6%	29.2%	1.4%	14.8%	–	100%
Net loans and advances to customers	912,701	1,036,221	808,590	104,604	18,881	–	2,880,997
Customer accounts	2,318,140	1,225,803	878,740	222,302	6,488	–	4,651,473

Financial Review (continued)

Hong Kong reported pre-tax profits of HK\$31,501m compared with HK\$46,528m in the first half of 2015, a decrease of 32%, mainly reflecting the non-recurrence of the gain on partial disposal of Hang Seng's shareholding in Industrial Bank of HK\$10,636m in 2015. Excluding this gain, pre-tax profit decreased by HK\$4,391m, driven by lower net fee income.

Revenue decreased by HK\$15,647m, or 22%, mainly reflecting the non-recurring gain mentioned above. Excluding this gain, revenue decreased by HK\$5,011m compared with the first half of 2015, mainly from RBWM and GB&M.

Revenue in RBWM decreased by 11% compared with the first half of 2015, driven by lower net fee income from securities broking and unit trust fees, reflecting weaker investment sentiment in the first half of 2016, compared with a very strong market performance in the first half of 2015. Insurance income also decreased due to weaker equity market performance in the first half of 2016. This was partly offset by higher net interest income, reflecting improved deposit spreads and growth in average deposit balances.

Revenue in GB&M decreased by 6%, mainly from lower Equities income due to lower market turnover, and lower Foreign Exchange ('FX') revenue from reduced client activity, coupled with lower net interest income from Capital Financing. This was partly offset by higher revenue in Balance Sheet Management ('BSM') driven by portfolio growth.

Revenue in CMB decreased by 1%, mainly due to lower net fee income from lower client demand for hedging products, coupled with lower unit trusts and securities broking revenue. This was partly offset by higher net interest income from improved deposit spreads and growth in average deposit balances.

Loan impairment charges increased by HK\$664m compared with the first half of 2015, mainly due to an increase in individually assessed impairment charges in CMB, coupled with the non-recurrence of an impairment release in GB&M in the first half of 2015.

Operating expenses decreased by HK\$1,307m or 6% compared with the first half of 2015, mainly due to lower staff costs and the non-recurrence of charitable donations and other expenses in relation to the 150th anniversary banknotes issuance in 2015.

Financial Review (continued)

Rest of Asia-Pacific reported pre-tax profits of HK\$21,908m compared with HK\$23,551m in the first half of 2015, a decrease of 7% largely due to an unfavourable impact from foreign exchange translation. Excluding this impact, pre-tax profits decreased by 3%, mainly due to lower revenue and higher loan impairment charges, partly offset by lower operating expenses.

Excluding the unfavourable impact from foreign exchange translation, revenue decreased by 2% compared with the first half of 2015, driven by lower revenue in mainland China, partly offset by higher revenue in India and Indonesia.

In mainland China, revenue decreased by 16%, mainly from lower revenue in Rates, Capital Financing and Securities Services in GB&M, coupled with lower income from insurance operations in RBWM.

Elsewhere in Asia, excluding the impact from foreign exchange translation, revenue increased in India due to higher net interest income from growth in lending and deposit balances. Revenue in Indonesia also increased from higher trading income in GB&M, mainly Rates and FX, coupled with higher net interest income from improved lending and deposit spreads, mainly in CMB.

Loan impairment charges increased by HK\$398m compared with the first half of 2015, driven by Australia from higher individually assessed impairment charges in GB&M and CMB, partly offset by lower individually assessed impairment charges in Indonesia in CMB.

Operating expenses decreased by HK\$1,182m, or 7% compared with the first half of 2015, mainly due to the favourable impact from foreign exchange translation. Excluding this impact, operating expenses decreased by 2%, mainly from lower staff costs.

Share of profits in associates and joint ventures decreased by HK\$317m, or 4%, mainly from the impact of foreign exchange translation.

Financial Review (continued)**Net interest income**

	Half-year ended 30 June 2016 HK\$m	Half-year ended 30 June 2015 HK\$m
Net interest income	47,676	46,944
Average interest-earning assets	5,451,257	5,272,723
Net interest spread	1.67%	1.69%
Net interest margin	1.76%	1.80%

Net interest income ('NII') increased by HK\$732m compared with the first half of 2015. Excluding the impact from foreign exchange translation, NII rose by HK\$1,846m, or 4%, mainly in Hong Kong driven by growth in financial investments from increased commercial surplus and insurance fund size, coupled with improved deposit spreads. This was partly offset by lower NII in mainland China due to successive rate cuts by the Central Bank since 2015, coupled with lower average balance sheet from subdued market environment.

Average interest-earning assets increased by HK\$179bn, or 3%, compared with first half of 2015, driven by Hong Kong mainly from an increase in financial investments.

Net interest margin decreased by 4 basis points compared with the first half of 2015, mainly from a change in portfolio mix as the increase in commercial surplus was deployed in relatively lower yielding financial investments, partly offset by improved spreads on customer deposits.

In **Hong Kong**, the net interest margin for the Bank is flat, as improved customer deposit spreads was largely offset by a change in portfolio mix, as the increase in the commercial surplus was deployed in relatively lower yielding financial investments.

At **Hang Seng Bank**, the net interest margin decreased by 8 basis points from compressed customer lending spreads, notably in term lending, and from a change in portfolio mix, partly offset by improved customer deposit spreads.

In the **Rest of Asia-Pacific**, the net interest margin also decreased, notably in mainland China mainly from compressed customer deposit and lending spreads. Decreases were also noted in Australia and in Malaysia, although partly offset by increases in Singapore and in India.

Net fee income

	Half-year ended 30 June 2016 HK\$m	Half-year ended 30 June 2015 HK\$m
Account services	1,570	1,470
Credit facilities	1,480	1,757
Import/export	1,931	2,227
Remittances	1,662	1,682
Securities/broking	3,189	5,376
Cards	3,410	3,493
Insurance	700	774
Unit trusts	2,764	4,014
Funds under management	2,014	2,314
Underwriting	518	617
Other	3,864	4,226
Fee income	23,102	27,950
Fee expense	(3,673)	(3,059)
	19,429	24,891

In 2016, certain expenditure in respect of credit card loyalty programmes previously presented in 'General and administrative expenses' is presented in 'Fee expense' to more appropriately reflect the nature of the expenditure. This accounted for the majority of the increase in fee expense during the period.

Financial Review (continued)**Net trading income**

	Half-year ended 30 June 2016 HK\$m	Half-year ended 30 June 2015 HK\$m
Dealing profits	9,646	10,143
Net interest income on trading assets and liabilities	1,990	2,728
Dividend income from trading securities	1,276	864
Net gain/(loss) from hedging activities	73	(8)
	12,985	13,727

Gains less losses from financial investments

	Half-year ended 30 June 2016 HK\$m	Half-year ended 30 June 2015 HK\$m
Gain on partial disposal of Industrial Bank	–	10,636
Gains on disposal of available-for-sale securities	865	569
	865	11,205

Other operating income

	Half-year ended 30 June 2016 HK\$m	Half-year ended 30 June 2015 HK\$m
Gain on 150 th anniversary banknotes issuance	–	706
Movement in present value of in-force insurance business	3,624	2,075
Gain/(loss) on investment properties	(25)	261
Gain/(loss) on disposal of property, plant and equipment, and assets held for sale	(19)	150
Other	2,238	2,161
	5,818	5,353

Financial Review (continued)**Insurance income**

Included in net operating income are the following revenues earned by the insurance business:

	Half-year ended 30 June 2016 HK\$m	Half-year ended 30 June 2015 HK\$m
Net interest income	5,614	5,045
Net fee income	902	1,057
Net trading loss	(698)	(148)
Net income/(loss) from financial instruments designated at fair value	(15)	3,937
Net insurance premium income	28,204	28,089
Movement in present value of in-force business	3,624	2,075
Other operating income	361	543
	37,992	40,598
Net insurance claims and benefits paid and movement in liabilities to policyholders	(30,420)	(31,776)
Net operating income	7,572	8,822

Net interest income increased by 11% from growth in the debt securities portfolio, reflecting net inflows from new and renewal of life insurance premiums.

Net income from financial instruments designated at fair value decreased, as the gain in the first half of 2015 from the strong market performance was not repeated. To the extent that revaluation is attributable to policyholders, there is an offsetting movement reported under 'Net insurance claims and benefits paid and movement in liabilities to policyholders'.

Net insurance premium income remained stable, as the increase in new business sales was broadly offset by a change in sales mix. The movement in present value of in-force business increased by HK\$1,549m, mainly in Singapore from a decrease in market interest rates, and in Hong Kong from lower investment returns. The effect was partly offset by a corresponding increase in 'Net insurance claims and benefits paid and movement in liabilities to policyholders'.

Other operating income decreased largely due to lower gains on disposal of available-for-sale securities, which resulted in a corresponding decrease in 'Net insurance claims and benefits paid and movements in liabilities to policyholders'.

Loan impairment charges and other credit risk provisions

	Half-year ended 30 June 2016 HK\$m	Half-year ended 30 June 2015 HK\$m
Individually assessed impairment charges	1,589	636
Collectively assessed impairment charges	1,313	1,238
Other credit risk provisions	67	33
Loan impairment charges and other credit risk provisions	2,969	1,907

Individually assessed impairment charges increased compared with the first half of 2015, mainly in Hong Kong from higher impairment charges in CMB, coupled with an impairment release against a GB&M customer in the first half of 2015, and in Australia mainly from impairment charges against a small number of customers. This was partly offset by lower impairment charges in Indonesia. Loan impairment charges as a percentage of average gross customer advances remained low at 0.22% for the first half of 2016 (first half of 2015: 0.13%).

Financial Review (continued)**Operating expenses**

	Half-year ended 30 June 2016 HK\$m	Half-year ended 30 June 2015 HK\$m
Employee compensation and benefits	19,424	21,043
General and administrative expenses	14,050	14,751
Depreciation of property, plant and equipment	2,294	2,165
Amortisation and impairment of intangible assets	668	743
	36,436	38,702
	At 30 June 2016	At 31 December 2015
Staff numbers by region – full-time equivalent		
Hong Kong	28,497	29,356
Rest of Asia-Pacific	36,851	38,196
Total	65,348	67,552

Employee compensation and benefits decreased by HK\$1,619m, reflecting lower performance-related pay and lower headcount, partly offset by the impact from wage inflation.

The decrease in other administrative expenses was largely due to the charitable donations and other expenses in relation to the 150th anniversary banknotes issuance in 2015.

Financial Review (continued)

Capital adequacy

The following tables show the capital ratios, risk-weighted assets and capital base as contained in the 'Capital Adequacy Ratio' return required to be submitted to the Hong Kong Monetary Authority ('HKMA') by the Bank on a consolidated basis that is specified by the HKMA under the requirements of section 3C(1) of the Banking (Capital) Rules.

The group uses the advanced internal ratings-based approach to calculate its credit risk for the majority of its non-securitisation exposures and the internal ratings-based (securitisation) approach to determine credit risk for its banking book securitisation exposures. For market risk, the group uses an internal models approach to calculate its general market risk for the risk categories of interest rate exposures, foreign exchange (including gold) exposures, and equity exposures. The group also uses an internal models approach to calculate its market risk in respect of specific risk for interest rate exposures and equity exposures. The group uses the standardised (market risk) approach for calculating other market risk positions as well as trading book securitisation exposures, and the standardised (operational risk) approach to calculate its operational risk.

The Bank and its banking subsidiaries maintain a regulatory reserve to satisfy the provisions of the Hong Kong Banking Ordinance and local regulatory requirements for prudential supervision purposes. At 30 June 2016, the effect of this requirement is to restrict the amount of reserves which can be distributed to shareholders by HK\$25,273m (31 December 2015: HK\$27,819m). There are no relevant capital shortfalls in any of the group's subsidiaries at 30 June 2016 (31 December 2015: Nil) which are not included in its consolidation group for regulatory purposes.

The basis of consolidation for the calculation of capital ratios for regulatory purposes is different from that for accounting purposes. Further information on the regulatory consolidation basis is set out in the Supplementary Notes that will be posted in the Regulatory Disclosures section of our website www.hsbc.com.hk.

A detailed breakdown of the group's common equity tier 1 ('CET1') capital, additional tier 1 ('AT1') capital, tier 2 capital and regulatory deductions and a full reconciliation between the group's accounting and regulatory balance sheets can be viewed in the Supplementary Notes Appendices that will be posted in the Regulatory Disclosures section of our website www.hsbc.com.hk.

	At 30 June 2016 %	At 31 December 2015 %
Capital ratios		
CET1 capital	16.1	15.6
Tier 1 capital	17.3	16.6
Total capital	19.2	18.6
Risk-weighted assets by risk type	HK\$m	HK\$m
Credit risk	1,975,263	1,942,430
Counterparty credit risk	162,995	176,764
Market risk	99,175	101,551
Operational risk	301,658	298,662
	2,539,091	2,519,407

The following table sets out the composition of the group's capital base under Basel III at 30 June 2016. The position at 30 June 2016 benefitted from transitional arrangements which will be phased out.

Financial Review (continued)**Capital adequacy** (continued)

<i>Capital base</i>	At 30 June 2016 HK\$m	At 31 December 2015 HK\$m
Common equity tier 1 ('CET1') capital		
Shareholders' equity	544,448	514,078
Shareholders' equity per balance sheet	621,182	584,201
Revaluation reserve capitalisation issue	(1,454)	(1,454)
Other equity instruments	(14,737)	(14,737)
Unconsolidated subsidiaries	(60,543)	(53,932)
Non-controlling interests	22,105	22,352
Non-controlling interests per balance sheet	49,603	51,685
Non-controlling interests in unconsolidated subsidiaries	(6,253)	(5,717)
Surplus non-controlling interests disallowed in CET1	(21,245)	(23,616)
Regulatory deductions to CET1 capital	(158,233)	(142,611)
Valuation adjustments	(1,950)	(1,845)
Goodwill and intangible assets	(14,208)	(14,032)
Deferred tax assets net of deferred tax liabilities	(2,408)	(1,863)
Cash flow hedging reserve	97	(51)
Changes in own credit risk on fair valued liabilities	(1,611)	(940)
Defined benefit pension fund assets	(28)	(40)
Significant capital investments in unconsolidated financial sector entities	(55,756)	(39,524)
Property revaluation reserves ¹	(57,096)	(56,497)
Regulatory reserve	(25,273)	(27,819)
Total CET1 capital	408,320	393,819
Additional tier 1 ('AT1') capital		
Total AT1 capital before regulatory deductions	48,044	50,826
Perpetual subordinated loans	14,737	14,737
Perpetual non-cumulative preference shares	25,240	25,213
Allowable non-controlling interests in AT1 capital	8,067	10,876
Regulatory deductions to AT1 capital	(16,831)	(25,887)
Significant capital investments in unconsolidated financial sector entities	(16,831)	(25,887)
Total AT1 capital	31,213	24,939
Total tier 1 capital	439,533	418,758
Tier 2 capital		
Total Tier 2 capital before regulatory deductions	66,884	79,164
Perpetual cumulative preference shares	1,552	3,100
Cumulative term preferences shares	–	8,138
Perpetual subordinated debt	3,104	6,204
Term subordinated debt	21,669	21,603
Property revaluation reserves ¹	26,347	26,079
Impairment allowances and regulatory reserve eligible for inclusion in Tier 2 capital	14,212	14,040
Regulatory deductions to Tier 2 capital	(20,003)	(29,059)
Significant capital investments in unconsolidated financial sector entities	(20,003)	(29,059)
Total tier 2 capital	46,881	50,105
Total capital	486,414	468,863

1. Includes the revaluation surplus on investment properties which is reported as part of retained profits and adjustments made in accordance with the Banking (Capital) Rules issued by the HKMA.

Financial Review (continued)**Capital adequacy** (continued)

The following table shows the pro-forma Basel III end point basis position once all transitional arrangements have been phased out, based on the Transition Disclosures Template. It should be noted that the pro-forma Basel III end point basis position takes no account of, for example, any future profits or management actions. In addition, the current regulations or their application may change before full implementation. Given this, the final impact on the group's capital ratios may differ from the pro-forma position, which is a mechanical application of the current rules to the balance sheet at 30 June 2016; it is not a projection. On this pro-forma basis, the group's CET1 ratio is 14.8%, which is above the Basel III minimum requirement plus expected regulatory capital buffer requirements.

Reconciliation of regulatory capital from transitional basis to a pro-forma Basel III end point basis

	At 30 June 2016 HK\$m	At 31 December 2015 HK\$m
CET1 capital on a transitional basis	408,320	393,819
Transitional provisions:		
Significant capital investments in unconsolidated financial sector entities	(33,662)	(51,774)
CET1 capital end point basis	374,658	342,045
AT1 capital on a transitional basis	31,213	24,939
Grandfathered instruments:		
Perpetual non-cumulative preference shares	(25,240)	(25,213)
Transitional provisions:		
Allowable non-controlling interests in AT1 capital	(6,784)	(9,494)
Significant capital investments in unconsolidated financial sector entities	16,831	25,887
AT1 capital end point basis	16,020	16,119
Tier 2 capital on a transitional basis	46,881	50,105
Grandfathered instruments:		
Perpetual cumulative preference shares	(1,552)	(3,100)
Cumulative term preference shares	–	(8,138)
Perpetual subordinated debt	(3,104)	(6,204)
Term subordinated debt	(1,651)	(1,607)
Transitional provisions:		
Significant capital investments in unconsolidated financial sector entities	16,831	25,887
Tier 2 capital end point basis	57,405	56,943

Principal risks and uncertainties

The group continuously monitors and identifies risks. This process, which is informed by its risk factors and the results of its stress testing programme, gives rise to the classification of certain principal risks. Changes in the assessment of principal risks may result in adjustments to the group's business strategy and potentially, its risk appetite.

Our principal banking risks are credit risk, liquidity and funding risk, market risk, operational risk, compliance risk, reputational risk and insurance risk. There is no material change in the principal risks and uncertainties for the remaining six months of the financial year, the description of which can be found in the risk report of the Bank's *Annual Report and Accounts 2015*.

Statement of Directors' Responsibilities

The Directors, the names of whom are set out below, confirm to the best of their knowledge that:

- the condensed consolidated financial statements have been prepared in accordance with Hong Kong Accounting Standard ('HKAS') 34 'Interim Financial Reporting'; and
- the interim report includes a fair review of the information required by DTR4.2.7R of the Disclosure Rules and Transparency Rules issued by the UK Financial Conduct Authority, being an indication of important events that have occurred during the first six months of the financial year ending 31 December 2016 and their impact on the condensed consolidated financial statements; and a description of the principal risks and uncertainties for the remaining six months of the financial year.

Stuart Gulliver (Chairman); Peter Tung Shun Wong (Deputy Chairman & Chief Executive);
Laura May Lung Cha*, GBS (Deputy Chairman); Zia Mody* (Deputy Chairman); Graham John Bradley*;
Dr Christopher Wai Chee Cheng*, GBS, OBE; Dr Raymond Kuo Fung Ch'ien*, GBS, CBE;
Irene Yun-lien Lee*; Rose Wai Mun Lee; Jennifer Xinzhe Li*; Victor Tzar Kuoi Li[#]; John Robert Slosar*;
Dr Rosanna Yick-ming Wong*, DBE; Marjorie Mun Tak Yang*, GBS; Tan Sri Dr Francis Sock Ping Yeoh*, CBE

* *independent non-executive Director*

[#] *non-executive Director*

On behalf of the Board
Stuart Gulliver, *Chairman*
3 August 2016

Condensed Consolidated Financial Statements (unaudited)

Consolidated Income Statement

	<i>Note</i>	Half-year ended 30 June 2016 HK\$m	Half-year ended 30 June 2015 HK\$m
Interest income		60,954	62,819
Interest expense		(13,278)	(15,875)
Net interest income		47,676	46,944
Fee income		23,102	27,950
Fee expense		(3,673)	(3,059)
Net fee income		19,429	24,891
Net trading income		12,985	13,727
Net income from financial instruments designated at fair value		352	4,033
Gains less losses from financial investments		865	11,205
Dividend income		201	178
Net insurance premium income		28,204	28,089
Other operating income		5,818	5,353
Total operating income		115,530	134,420
Net insurance claims and benefits paid and movement in liabilities to policyholders		(30,420)	(31,776)
Net operating income before loan impairment charges and other credit risk provisions		85,110	102,644
Loan impairment charges and other credit risk provisions	2	(2,969)	(1,907)
Net operating income		82,141	100,737
Employee compensation and benefits		(19,424)	(21,043)
General and administrative expenses		(14,050)	(14,751)
Depreciation of property, plant and equipment		(2,294)	(2,165)
Amortisation and impairment of intangible assets		(668)	(743)
Total operating expenses		(36,436)	(38,702)
Operating profit		45,705	62,035
Share of profit in associates and joint ventures		7,704	8,044
Profit before tax		53,409	70,079
Tax expense	4	(10,164)	(10,177)
Profit for the period		43,245	59,902
Profit attributable to shareholders of the parent company		40,200	52,290
Profit attributable to non-controlling interests		3,045	7,612

Condensed Consolidated Financial Statements (unaudited) (continued)**Consolidated Statement of Comprehensive Income**

	Half-year ended 30 June 2016 HK\$m	Half-year ended 30 June 2015 HK\$m
Profit for the period	43,245	59,902
Other comprehensive income/(expense)		
Items that will be reclassified subsequently to the income statement when specific conditions are met:		
Available-for-sale investments:		
– fair value changes taken to equity	7,760	66
– fair value changes transferred to the income statement on disposal	(865)	(15,330)
– fair value changes transferred to the income statement on hedged items	(2,482)	(247)
– income taxes	(724)	137
Cash flow hedges:		
– fair value changes taken to equity	(12,372)	1,138
– fair value changes transferred to the income statement	12,132	(789)
– income taxes	35	(117)
Share of other comprehensive income of associates and joint venture	249	197
Exchange differences	(1,029)	(3,647)
Items that will not be reclassified subsequently to the income statement:		
Property revaluation:		
– fair value changes taken to equity	1,570	3,889
– income taxes	(266)	(661)
Remeasurement of defined benefit:		
– before income taxes	(899)	(490)
– income taxes	153	103
Other comprehensive income/(expense) for the period, net of tax	3,262	(15,751)
Total comprehensive income for the period, net of tax	46,507	44,151
Total comprehensive income for the period attributable to:		
– shareholders of the parent company	43,769	41,576
– non-controlling interests	2,738	2,575
	46,507	44,151

Condensed Consolidated Financial Statements (unaudited) (continued)**Consolidated Balance Sheet**

	<i>Note</i>	At 30 June 2016 HK\$m	At 31 December 2015 HK\$m
ASSETS			
Cash and sight balances at central banks		213,600	151,103
Items in the course of collection from other banks		34,119	25,020
Hong Kong Government certificates of indebtedness		225,094	220,184
Trading assets		442,244	302,626
Derivatives		451,500	380,955
Financial assets designated at fair value		101,152	99,095
Reverse repurchase agreements - non-trading		274,266	212,779
Placings with and advances to banks		461,611	421,221
Loans and advances to customers	5	2,734,234	2,762,290
Financial investments		1,768,537	1,716,046
Amounts due from Group companies		266,674	244,396
Interests in associates and joint ventures	8	123,099	122,438
Goodwill and intangible assets		53,739	49,568
Property, plant and equipment		110,460	110,064
Deferred tax assets		2,280	1,836
Other assets	9	141,562	134,062
Total assets		7,404,171	6,953,683
LIABILITIES			
Hong Kong currency notes in circulation		225,094	220,184
Items in the course of transmission to other banks		44,680	30,753
Repurchase agreements - non-trading		37,298	16,158
Deposits by banks		236,400	148,294
Customer accounts	10	4,735,096	4,640,076
Trading liabilities		219,299	191,851
Derivatives		480,606	369,419
Financial liabilities designated at fair value		52,424	50,770
Debt securities in issue		38,230	40,859
Retirement benefit liabilities		6,167	5,809
Amounts due to Group companies		148,713	110,073
Other liabilities and provisions	11	86,551	86,920
Liabilities under insurance contracts		362,624	340,820
Current tax liabilities		7,346	2,456
Deferred tax liabilities		20,913	18,799
Subordinated liabilities		5,054	8,003
Preference shares		26,891	36,553
Total liabilities		6,733,386	6,317,797
EQUITY			
Share capital		114,359	96,052
Other equity instruments		14,737	14,737
Other reserves		99,317	93,031
Retained profits		392,769	380,381
Total shareholders' equity		621,182	584,201
Non-controlling interests		49,603	51,685
Total equity		670,785	635,886
Total equity and liabilities		7,404,171	6,953,683

Consolidated Statement of Changes in Equity

	Half- year ended 30 June 2016										
	Share capital HK\$m	Other equity instruments HK\$m	Retained profits and proposed dividend HK\$m	Other reserves				Total shareholders' equity HK\$m	Non-controlling interests HK\$m	Total equity HK\$m	
				Property revaluation reserve HK\$m	Available-for-sale investment reserve HK\$m	Cash flow hedge reserve HK\$m	Foreign exchange reserve HK\$m				Other ¹ HK\$m
At 1 January 2016	96,052	14,737	380,381	52,099	4,880	(35)	(16,991)	53,078	584,201	51,685	635,886
Profit for the period	-	-	40,200	-	-	-	-	-	40,200	3,045	43,245
Other comprehensive income (net of tax)	-	-	(657)	1,340	3,965	(199)	(920)	40	3,569	(307)	3,262
Available-for-sale investments	-	-	-	-	3,750	-	-	-	3,750	(61)	3,689
Cash flow hedges	-	-	-	-	-	(199)	-	-	(199)	(6)	(205)
Property revaluation	-	-	(123)	1,340	-	-	-	-	1,217	87	1,304
Actuarial losses on defined benefit plans	-	-	(528)	-	-	-	-	-	(528)	(218)	(746)
Share of other comprehensive income of associates and joint ventures	-	-	(6)	-	215	-	-	40	249	-	249
Exchange differences	-	-	-	-	-	-	(920)	-	(920)	(109)	(1,029)
Total comprehensive income for the period	-	-	39,543	1,340	3,965	(199)	(920)	40	43,769	2,738	46,507
Shares issued	18,307	-	-	-	-	-	-	-	18,307	-	18,307
Dividends paid	-	-	(25,565)	-	-	-	-	-	(25,565)	(4,705)	(30,270)
Movement in respect of share-based payment arrangements	-	-	166	-	-	-	-	187	353	2	355
Other movements	-	-	117	10	-	(10)	-	-	117	(117)	-
Transfers ²	-	-	(1,873)	(728)	-	-	-	2,601	-	-	-
At 30 June 2016	114,359	14,737	392,769	52,721	8,845	(244)	(17,911)	55,906	621,182	49,603	670,785

For footnotes, see page 26.

Consolidated Statement of Changes in Equity (continued)

	Half- year ended 31 December 2015										
	Share capital HK\$m	Other equity instruments HK\$m	Retained profits and proposed dividend HK\$m	Other reserves					Total shareholders' equity HK\$m	Non-controlling interests HK\$m	Total equity HK\$m
				Property revaluation reserve HK\$m	Available-for-sale investment reserve HK\$m	Cash flow hedge reserve HK\$m	Foreign exchange reserve HK\$m	Other ¹ HK\$m			
At 1 July 2015	96,052	14,737	367,214	50,670	6,822	60	(1,736)	43,862	577,681	50,625	628,306
Profit for the period	-	-	37,243	-	-	-	-	-	37,243	2,838	40,081
Other comprehensive income (net of tax)	-	-	(335)	2,148	(1,942)	(95)	(15,255)	107	(15,372)	(198)	(15,570)
Available-for-sale investments	-	-	-	-	(2,106)	-	-	-	(2,106)	(188)	(2,294)
Cash flow hedges	-	-	-	-	-	(95)	-	-	(95)	(5)	(100)
Property revaluation	-	-	(121)	2,148	-	-	-	-	2,027	245	2,272
Actuarial losses on defined benefit plans	-	-	(211)	-	-	-	-	-	(211)	41	(170)
Share of other comprehensive income of associates and joint ventures	-	-	(3)	-	164	-	-	102	263	-	263
Exchange differences	-	-	-	-	-	-	(15,255)	5	(15,250)	(291)	(15,541)
Total comprehensive income for the period	-	-	36,908	2,148	(1,942)	(95)	(15,255)	107	21,871	2,640	24,511
Dividends paid	-	-	(15,655)	-	-	-	-	-	(15,655)	(1,592)	(17,247)
Movement in respect of share-based payment arrangements	-	-	3	-	-	-	-	313	316	3	319
Other movements	-	-	(3)	1	-	-	-	(10)	(12)	9	(3)
Transfers ²	-	-	(8,086)	(720)	-	-	-	8,806	-	-	-
At 31 December 2015	96,052	14,737	380,381	52,099	4,880	(35)	(16,991)	53,078	584,201	51,685	635,886

For footnotes, see page 26.

Consolidated Statement of Changes in Equity (continued)

	Half- year ended 30 June 2015										
	Share capital HK\$m	Other equity instruments HK\$m	Retained profits and proposed dividend HK\$m	Other reserves					Total shareholders' equity HK\$m	Non-controlling interests HK\$m	Total equity HK\$m
				Property revaluation reserve HK\$m	Available-for-sale investment reserve HK\$m	Cash flow hedge reserve HK\$m	Foreign exchange reserve HK\$m	Other ¹ HK\$m			
At 1 January 2015	96,052	14,737	339,061	48,481	16,537	(166)	1,872	41,261	557,835	50,511	608,346
Profit for the period	-	-	52,290	-	-	-	-	-	52,290	7,612	59,902
Other comprehensive income (net of tax)	-	-	(594)	2,998	(9,715)	226	(3,608)	(21)	(10,714)	(5,037)	(15,751)
Available-for-sale investments	-	-	-	-	(9,926)	-	-	-	(9,926)	(5,448)	(15,374)
Cash flow hedges	-	-	-	-	-	226	-	-	226	6	232
Property revaluation	-	-	(117)	2,998	-	-	-	-	2,881	347	3,228
Actuarial losses on defined benefit plans	-	-	(479)	-	-	-	-	-	(479)	92	(387)
Share of other comprehensive income of associates and joint ventures	-	-	2	-	211	-	-	(16)	197	-	197
Exchange differences	-	-	-	-	-	-	(3,608)	(5)	(3,613)	(34)	(3,647)
Total comprehensive income for the period	-	-	51,696	2,998	(9,715)	226	(3,608)	(21)	41,576	2,575	44,151
Dividends paid	-	-	(21,750)	-	-	-	-	-	(21,750)	(2,461)	(24,211)
Movement in respect of share-based payment arrangements	-	-	4	-	-	-	-	32	36	1	37
Other movements	-	-	(1)	(15)	-	-	-	-	(16)	(1)	(17)
Transfers ²	-	-	(1,796)	(794)	-	-	-	2,590	-	-	-
At 30 June 2015	96,052	14,737	367,214	50,670	6,822	60	(1,736)	43,862	577,681	50,625	628,306

1 The other reserves mainly comprise the share-based payment reserve account, purchase premium arising from transfer of business within the HSBC Group and other non-distributable reserves. The share-based payment reserve account is used to record the amount relating to share options granted to employees of the group directly by HSBC Holdings plc.

2 The movement from Retained profits to Other reserves mainly includes the relevant transfers in an associate according to local regulatory requirements as applicable.

Condensed Consolidated Financial Statements (unaudited) (continued)**Consolidated Cash Flow Statement**

	Half-year ended 30 June 2016 HK\$m	Half-year ended 30 June 2015 HK\$m
Operating activities		
Cash generated from operations	197,867	173,685
Interest received on financial investments	8,810	7,683
Dividends received on financial investments	276	233
Dividends received from associates	82	79
Taxation paid	(3,695)	(4,376)
Net cash inflow from operating activities	203,340	177,304
Investing activities		
Purchase of financial investments	(311,105)	(270,772)
Proceeds from sale or redemption of financial investments	237,050	265,324
Purchase of property, plant and equipment	(1,097)	(1,853)
Proceeds from sale of property, plant and equipment and assets held for sale	5	343
Purchase of other intangible assets	(815)	(741)
Net cash inflow from the sale of interests in business portfolios	–	4,001
Net cash outflow from investing activities	(75,962)	(3,698)
Net cash inflow before financing activities	127,378	173,606
Financing activities		
Issue of ordinary share capital	18,307	–
Repayment of subordinated liabilities	(3,110)	–
Redemption of preference shares	(9,692)	–
Ordinary dividends paid	(25,565)	(21,750)
Dividends paid to non-controlling interests	(4,705)	(2,461)
Interest paid on preference shares	(669)	(550)
Interest paid on subordinated liabilities	(392)	(510)
Net cash outflow from financing activities	(25,826)	(25,271)
Increase in cash and cash equivalents	101,552	148,335
Changes in cash and cash equivalents		
	2016	2015
	HK\$m	HK\$m
At 1 January	658,397	679,670
Net cash inflow before the effect of foreign exchange movements	101,552	148,335
Effect of foreign exchange movements	20,839	(11,052)
At 30 June	780,788	816,953

Notes on the Condensed Consolidated Financial Statements (unaudited)

1. Basis of preparation

a Compliance with Hong Kong Financial Reporting Standards

The Condensed Consolidated Financial Statements ('Financial Statements') of the group have been prepared in accordance with HKAS 34 'Interim Financial Reporting' as issued by the Hong Kong Institute of Certified Public Accountants ('HKICPA'). The Financial Statements should be read in conjunction with the Bank's *Annual Report and Accounts 2015* which have been prepared in accordance with Hong Kong Financial Reporting Standards issued by the HKICPA.

Standards applied during the half year to 30 June 2016

There were no new standards applied during the half year to 30 June 2016.

During the half year to 30 June 2016, the group applied a number of amendments to standards which had an insignificant effect on the Financial Statements.

b Use of estimates and judgements

Management believes that the group's critical accounting estimates and judgements are those which relate to impairment of loans and advances, goodwill impairment, the valuation of financial instruments, deferred tax assets, provisions for liabilities and interests in associates. There was no change in the current period to the critical accounting estimates and judgements applied in 2015, which are stated in note 2 of the Bank's *Annual Report and Accounts 2015*.

c Composition of group

There were no material changes in the composition of the group in the half year to 30 June 2016.

d Future accounting developments

Information on future accounting developments and their potential effect on the Financial Statements of the group are provided in note 1 of the Bank's *Annual Report and Accounts 2015*.

In addition, in May 2016, the HKICPA issued HKFRS 16 'Leases'. The standard is effective for annual periods beginning on or after 1 January 2019 with early application permitted. The group is currently assessing the impact of this standard but it is not practicable to quantify the effect as at the date of the publication of this Interim Report.

e Going concern

The Financial Statements are prepared on a going concern basis, as the Directors are satisfied that the group has the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows and capital resources.

f Accounting policies

The accounting policies and methods of computation applied by the group for the Financial Statements are consistent with those described in note 3 of the Bank's *Annual Report and Accounts 2015*. The methods of computation applied by the group for the Financial Statements are consistent with those applied for the Bank's *Annual Report and Accounts 2015*.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**2. Loan impairment charges and other credit risk provisions**

	Half-year ended 30 June 2016 HK\$m	Half-year ended 30 June 2015 HK\$m
Individually assessed impairment charges:		
New charges	2,411	1,716
Releases	(765)	(964)
Recoveries	(57)	(116)
	1,589	636
Collectively assessed impairment charges	1,313	1,238
Other credit risk provisions	67	33
Loan impairment charges and other credit risk provisions	2,969	1,907

There were no impairment losses or provisions against held-to-maturity or available-for-sale debt investments (2015: nil).

3. Dividends

	Half-year ended 30 June 2016		Half-year ended 30 June 2015	
	HK\$ per share	HK\$m	HK\$ per share	HK\$m
Ordinary dividends paid				
– fourth interim dividend in respect of the previous financial year approved and paid during the half-year	0.44	17,065	0.37	14,250
– first interim dividend paid	0.20	8,500	0.20	7,500
	0.64	25,565	0.57	21,750

The Directors have declared a second interim dividend in respect of the half-year ended 30 June 2016 of HK\$0.19 per ordinary share (HK\$8,500m) (half-year ended 30 June 2015 of HK\$0.20 per ordinary share (HK\$7,500m)).

4. Tax expense

The tax expense in the consolidated income statement comprises:

	Half-year ended 30 June 2016 HK\$m	Half-year ended 30 June 2015 HK\$m
Current income tax		
– Hong Kong taxation	4,625	5,409
– Overseas taxation	4,504	4,482
Deferred taxation	1,035	286
	10,164	10,177

The effective tax rate for the first half of 2016 was 19.03%, compared with 14.5% for the first half of 2015, as the non-taxable gains from disposal of available-for-sale investments were significantly higher in 2015.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**5. Loans and advances to customers**

	At 30 June 2016 HK\$m	At 31 December 2015 HK\$m
Gross loans and advances to customers	2,746,964	2,773,819
Impairment allowances:		
– Individually assessed	(7,862)	(7,040)
– Collectively assessed	(4,868)	(4,489)
	<u>(12,730)</u>	<u>(11,529)</u>
Net loans and advances to customers	<u>2,734,234</u>	<u>2,762,290</u>
Allowances as a percentage of gross loans and advances to customers:		
– Individually assessed	0.29%	0.25%
– Collectively assessed	0.18%	0.16%
Total allowances	<u>0.47%</u>	<u>0.41%</u>

6. Impairment allowances against loans and advances to customers

	Individually assessed HK\$m	Collectively assessed HK\$m	Total HK\$m
At 1 January 2016	7,040	4,489	11,529
Amounts written off	(793)	(1,406)	(2,199)
Recoveries of loans and advances written off in previous years	57	462	519
Net charge to income statement	1,589	1,313	2,902
Unwinding of discount of loan impairment	(156)	(33)	(189)
Exchange and other adjustments	125	43	168
At 30 June 2016	<u>7,862</u>	<u>4,868</u>	<u>12,730</u>
At 1 January 2015	6,299	4,221	10,520
Amounts written off	(246)	(1,595)	(1,841)
Recoveries of loans and advances written off in previous years	117	489	606
Net charge to income statement	636	1,238	1,874
Unwinding of discount of loan impairment	(100)	(36)	(136)
Exchange and other adjustments	(116)	(70)	(186)
At 30 June 2015	<u>6,590</u>	<u>4,247</u>	<u>10,837</u>

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**7. Analysis of loans and advances to customers based on categories used by the HSBC Group**

The following analysis of loans and advances to customers is based on categories used by the HSBC Group, including The Hongkong and Shanghai Banking Corporation Limited and its subsidiaries, to manage associated risks.

	Hong Kong HK\$m	Rest of Asia-Pacific HK\$m	Total HK\$m
At 30 June 2016			
Residential mortgages	475,011	272,210	747,221
Credit card advances	53,088	22,778	75,866
Other personal	133,924	85,920	219,844
Total personal	662,023	380,908	1,042,931
Commercial, industrial and international trade	408,348	377,234	785,582
Commercial real estate	180,833	63,616	244,449
Other property-related lending	199,991	71,468	271,459
Government	14,196	2,136	16,332
Other commercial	115,168	143,298	258,466
Total corporate and commercial	918,536	657,752	1,576,288
Non-bank financial institutions	79,546	45,246	124,792
Settlement accounts	2,140	813	2,953
Total financial	81,686	46,059	127,745
Gross loans and advances to customers	1,662,245	1,084,719	2,746,964
Individually assessed impairment allowances	(2,314)	(5,548)	(7,862)
Collectively assessed impairment allowances	(1,840)	(3,028)	(4,868)
Net loans and advances to customers	1,658,091	1,076,143	2,734,234
At 31 December 2015			
Residential mortgages	472,324	260,901	733,225
Credit card advances	56,791	22,180	78,971
Other personal	132,234	84,092	216,326
Total personal	661,349	367,173	1,028,522
Commercial, industrial and international trade	419,589	405,594	825,183
Commercial real estate	186,463	64,420	250,883
Other property-related lending	207,448	65,412	272,860
Government	6,292	2,484	8,776
Other commercial	133,718	145,632	279,350
Total corporate and commercial	953,510	683,542	1,637,052
Non-bank financial institutions	64,050	42,414	106,464
Settlement accounts	1,099	682	1,781
Total financial	65,149	43,096	108,245
Gross loans and advances to customers	1,680,008	1,093,811	2,773,819
Individually assessed impairment allowances	(2,165)	(4,875)	(7,040)
Collectively assessed impairment allowances	(1,979)	(2,510)	(4,489)
Net loans and advances to customers	1,675,864	1,086,426	2,762,290

Gross loans and advances to customers in Hong Kong decreased by HK\$18bn, or 1%, during the first half of 2016, largely from a decrease in corporate and commercial lending of HK\$35bn, partly offset by an increase in financial lending of HK\$17bn.

In the Rest of Asia-Pacific, gross loans and advances to customers decreased by HK\$9bn, or 1%, including favourable foreign exchange translation effects of HK\$23bn. Excluding this impact, the underlying decrease of HK\$32bn was mainly from a decrease in corporate and commercial lending of HK\$34bn, mainly in Singapore, mainland China and Malaysia.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**8. Interests in associates and joint ventures****Bank of Communications Co., Limited ('BoCom')***Impairment testing*

At 30 June 2016, the fair value of the group's investment in BoCom had been below the carrying amount for approximately 50 months, apart from a short period in 2013 and briefly during the first half of 2015. As a result, the group performed an impairment test on the carrying amount of the investment in BoCom. The test confirmed that there was no impairment at 30 June 2016.

	At 30 June 2016			At 31 December 2015		
	VIU HK\$bn	Carrying Value HK\$bn	Fair Value HK\$bn	VIU HK\$bn	Carrying Value HK\$bn	Fair Value HK\$bn
BoCom	125.7	120.1	69.1	132.1	119.5	77.0

Basis of recoverable amount

The impairment test was performed by comparing the recoverable amount of BoCom, determined by a value-in-use ('VIU') calculation, with its carrying amount. The VIU calculation uses discounted cash flow projections based on management's estimates of earnings. Cash flows beyond the short to medium-term are then extrapolated in perpetuity using a long-term growth rate. An imputed capital maintenance charge ('CMC') is calculated to reflect expected regulatory capital requirements, and is deducted from forecast cash flows. The principal inputs to the CMC calculation include estimates of asset growth, the ratio of risk-weighted assets to total assets, and the expected regulatory capital requirements. Management judgement is required in estimating the future cash flows of BoCom.

Key assumptions in VIU calculation

Long-term profit growth rate: the growth rate used was 5% (2015: 5%) for periods after 2019 and does not exceed forecast GDP growth in mainland China.

Long-term asset growth rate: the growth rate used was 4% (2015: 4%) for periods after 2019 and this is the rate of growth required for an assumed 5% long-term growth rate in profit.

Discount rate: the discount rate of 13% (2015: 13%) is derived from a range of values obtained by applying a Capital Asset Pricing Model ('CAPM') calculation for BoCom, using market data. Management supplements this by comparing the rates derived from the CAPM with discount rates available from external sources, and the group's discount rate for evaluating investments in mainland China. The discount rate used is within the range of 10.1% to 15.0% (2015: 10.1% to 14.2%) indicated by the CAPM and external sources.

Loan impairment charge as a percentage of customer advances: the ratio used ranges from 0.76% to 0.83% (2015: 0.71% to 0.78%) in the short to medium-term and are based on the forecasts disclosed by external analysts. For periods after 2019, the ratio is 0.7% (2015: 0.7%), slightly higher than the historical average.

Risk-weighted assets as a percentage of total assets: the ratio used was 67% for all forecast periods (2015: 67%). This is consistent with the forecasts disclosed by external analysts.

Cost-income ratio: the ratio used was 41% (2015: 41%) in the short to medium-term. The ratios were consistent with the short to medium-term range forecasts of 40.2% to 42.4% (2015: 40.3% to 40.7%) disclosed by external analysts.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**8. Interests in associates and joint ventures** (continued)

The following table shows the changes to each key assumption which, in isolation, would reduce the headroom to nil:

Key assumption	Changes to key assumption to reduce headroom to nil
• Long-term profit growth rate	• Decrease by 27 basis points
• Long-term asset growth rate	• Increase by 29 basis points
• Discount rate	• Increase by 34 basis points
• Loan impairment charge as a percentage of customer advances	• Increase by 6 basis points
• Risk-weighted assets as a percentage of total assets	• Increase by 205 basis points
• Cost-income ratio	• Increase by 121 basis points

9. Other assets

	At 30 June 2016 HK\$m	At 31 December 2015 HK\$m
Current tax assets	662	1,013
Assets held for sale	258	159
Prepayments and accrued income	9,790	3,881
Accrued interest receivable	17,628	17,305
Acceptances and endorsements	29,151	31,480
Bullion	47,366	47,105
Other	36,707	33,119
	141,562	134,062

'Other' includes other financial assets and insurance debtors.

10. Customer accounts

	At 30 June 2016 HK\$m	At 31 December 2015 HK\$m
Current accounts	953,808	949,169
Savings accounts	2,753,691	2,645,151
Other deposit accounts	1,027,597	1,045,756
	4,735,096	4,640,076

11. Other liabilities and provisions

	At 30 June 2016 HK\$m	At 31 December 2015 HK\$m
Accruals and deferred income	20,873	25,425
Provisions for liabilities and charges	938	1,203
Acceptances and endorsements	29,173	31,480
Share-based payment liability to HSBC Holdings plc	2,001	1,769
Other liabilities	33,566	27,043
	86,551	86,920

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**12. Contingent liabilities and commitments**

	At 30 June 2016 HK\$m	At 31 December 2015 HK\$m
Contract amount:		
Contingent liabilities	268,913	257,932
Commitments	2,243,629	2,131,992
	2,512,542	2,389,924

The above analysis discloses the nominal principal amounts of commitments, excluding capital commitments, guarantees and other contingent liabilities, which are mainly credit-related instruments including both financial and non-financial guarantees and commitments to extend credit.

13. Segmental analysis

The basis of identifying segments and measuring segmental results is set out in note 45 'Segmental Analysis' of the Bank's *Annual Report and Accounts 2015*. There have been no material changes to the segments since 31 December 2015.

Geographical regions	Hong Kong HK\$m	Rest of Asia- Pacific HK\$m	Intra-segment elimination HK\$m	Total HK\$m
Half-year ended 30 June 2016				
Total operating income	80,626	36,758	(1,854)	115,530
Profit before tax	31,501	21,908	–	53,409
Total assets	5,140,101	2,726,376	(462,306)	7,404,171
Total liabilities	4,794,963	2,400,729	(462,306)	6,733,386
Half-year ended 30 June 2015				
Total operating income	98,494	38,003	(2,077)	134,420
Profit before tax	46,528	23,551	–	70,079
Total assets	4,955,249	2,771,602	(559,186)	7,167,665
Total liabilities	4,638,322	2,460,223	(559,186)	6,539,359
Half-year ended 31 December 2015				
Total operating income	67,179	36,255	(1,909)	101,525
Profit before tax	26,344	20,856	–	47,200
Total assets	4,934,662	2,588,062	(569,041)	6,953,683
Total liabilities	4,613,757	2,273,081	(569,041)	6,317,797

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**14. Fair values of financial instruments carried 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 following table provides an analysis of the basis for the valuation of financial instruments carried at fair value:

	Valuation techniques			Third party total HK\$m	Amounts with HSBC entities ² HK\$m	Total HK\$m
	Quoted market price Level 1 HK\$m	Using observable inputs Level 2 HK\$m	With significant unobservable inputs Level 3 HK\$m			
At 30 June 2016						
Assets						
Trading assets ¹	261,767	179,785	692	442,244	–	442,244
Derivatives	7,539	323,296	1,018	331,853	119,647	451,500
Financial assets designated at fair value	67,558	30,821	2,773	101,152	–	101,152
Available-for-sale investments	1,004,262	514,618	6,061	1,524,941	–	1,524,941
	1,341,126	1,048,520	10,544	2,400,190	119,647	2,519,837
Liabilities						
Trading liabilities ¹	67,395	145,281	6,623	219,299	–	219,299
Derivatives	6,146	348,448	1,636	356,230	124,376	480,606
Financial liabilities designated at fair value	–	52,167	257	52,424	–	52,424
	73,541	545,896	8,516	627,953	124,376	752,329
At 31 December 2015						
Assets						
Trading assets ¹	158,173	143,611	842	302,626	–	302,626
Derivatives	6,914	271,230	1,181	279,325	101,630	380,955
Financial assets designated at fair value	65,883	30,766	2,446	99,095	–	99,095
Available-for-sale investments	1,015,065	466,129	6,253	1,487,447	–	1,487,447
	1,246,035	911,736	10,722	2,168,493	101,630	2,270,123
Liabilities						
Trading liabilities ¹	56,291	128,102	7,458	191,851	–	191,851
Derivatives	5,773	253,647	1,682	261,102	108,317	369,419
Financial liabilities designated at fair value	–	50,770	–	50,770	–	50,770
	62,064	432,519	9,140	503,723	108,317	612,040

¹ Amounts with HSBC Group entities are not reflected here.

² Derivatives balances with HSBC Group entities are largely under 'Level 2'.

Details of the control framework, fair values determined using valuation techniques, fair value adjustments, and the approach used to calculate the fair value of each type of financial instrument are included in note 48 of the Bank's *Annual Report and Accounts 2015*.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**14. Fair values of financial instruments carried at fair value** (continued)

The table below sets out quantitative information about significant unobservable inputs used in measuring financial instruments with Level 3 valuations.

Valuation technique	Key unobservable inputs	Assets- fair value HK\$m	Liabilities- fair value HK\$m	Range of inputs	
				Lower	Higher
At 30 June 2016					
Structured notes and deposits					
Option model	Equity correlation	–	880	0.35	0.94
Option model	Equity volatility	–	4,521	12%	46%
Option model	Interest rate correlation	–	486	0.43	0.99
Option model	Foreign exchange volatility	–	662	4%	25%
Corporate bonds					
Market comparable approach	Bid quotes	920	–	100.06	100.19
Private equity including strategic investments					
Market comparable approach	Multiples	3,267	–	0.55	33.78
Net asset value	Equity valuation	582	–	n/a	n/a
Net asset value	Fund valuation	2,940	–	n/a	n/a
Broker pricing	Bid quotes	794	–	0.58	0.61
Other		2,041	1,967		
		10,544	8,516		
At 31 December 2015					
Structured notes and deposits					
Option model	Equity correlation	–	1,110	0.35	0.93
Option model	Equity volatility	–	4,602	12%	55%
Option model	Interest rate correlation	–	869	0.43	0.99
Option model	Foreign exchange volatility	–	725	5%	27%
Corporate bonds					
Market comparable approach	Bid quotes	1,289	–	99.52	100.54
Private equity including strategic investments					
Market comparable approach	Multiples	3,373	–	0.72	37.04
Net asset value	Equity valuation	656	–	n/a	n/a
Net asset value	Fund valuation	2,559	–	n/a	n/a
Broker pricing	Bid quotes	555	–	0.41	0.42
Other		2,290	1,834		
		10,722	9,140		

For descriptions of the key unobservable inputs and the inter-relationships between key unobservable inputs used in fair value measurement, please refer to note 48 of the Bank's *Annual Report and Accounts 2015*.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**14. Fair values of financial instruments carried at fair value** (continued)

Movement in Level 3 financial instruments

	Assets				Liabilities		
	Available-for-sale HK\$m	Held for trading HK\$m	Designated at fair value through profit or loss HK\$m	Derivatives HK\$m	Held for trading HK\$m	Designated at fair value through profit or loss HK\$m	Derivatives HK\$m
At 1 January 2016	6,253	842	2,446	1,181	7,458	–	1,682
Total gains/(losses) recognised in profit or loss	(7)	10	157	243	(439)	–	402
– Trading income excluding net interest income	–	10	–	243	(439)	–	402
– Net income from other financial instruments designated at fair value ..	–	–	157	–	–	–	–
– Gains less losses from financial investments	(7)	–	–	–	–	–	–
Total gains/(losses) recognised in other comprehensive income ¹	184	2	2	1	59	–	–
– Available-for-sale investments: fair value gains	134	–	–	–	–	–	–
– Exchange differences	50	2	2	1	59	–	–
Purchases	33	827	299	–	–	–	–
Issues	–	–	–	–	1,058	–	–
Sales	(14)	(989)	(2)	–	–	–	–
Deposits/settlements	(388)	–	(119)	(4)	(627)	–	(22)
Transfers out	–	–	(12)	(403)	(886)	–	(454)
Transfers in	–	–	2	–	–	257	28
At 30 June 2016	6,061	692	2,773	1,018	6,623	257	1,636
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 30 June 2016 ¹	–	10	156	13	(3)	–	(50)
– Trading income excluding net interest income	–	10	–	13	(3)	–	(50)
– Net income from other financial instruments designated at fair value ..	–	–	156	–	–	–	–

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**14. Fair values of financial instruments carried at fair value** (continued)

	Assets				Liabilities	
	Available-for-sale HK\$m	Held for trading HK\$m	Designated at fair value through profit or loss HK\$m	Derivatives HK\$m	Held for trading HK\$m	Derivatives HK\$m
At 1 January 2015	6,712	165	1,911	785	12,153	1,108
Total gains/(losses) recognised in profit or loss	4	4	137	191	(829)	349
– Trading income excluding net interest income	–	4	–	191	(829)	349
– Net income from other financial instruments designated at fair value	–	–	137	–	–	–
– Gains less losses from financial investments	4	–	–	–	–	–
Total gains/(losses) recognised in other comprehensive income ¹	61	–	(1)	(1)	(163)	(2)
– Available-for-sale investments: fair value gains	96	–	–	–	–	–
– Exchange differences	(35)	–	(1)	(1)	(163)	(2)
Purchases	527	283	1,283	–	–	–
Issues	–	–	–	–	3,312	–
Sales	(41)	(19)	(45)	–	–	–
Deposits/settlements	–	–	(368)	(69)	(821)	(62)
Transfers out	–	(31)	(314)	(147)	(3,698)	(153)
Transfers in	–	–	–	–	373	–
At 30 June 2015	<u>7,263</u>	<u>402</u>	<u>2,603</u>	<u>759</u>	<u>10,327</u>	<u>1,240</u>
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 30 June 2015 ¹	–	5	136	116	–	(18)
– Trading income excluding net interest income	–	5	–	116	–	(18)
– Net income from other financial instruments designated at fair value	–	–	136	–	–	–

1 The amount has been reported on a net basis, after taking into consideration the total gains or losses arising from those transactions where the risk has been backed out to other HSBC entities.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**14. Fair values of financial instruments carried at fair value** (continued)

The fair values of financial instruments are, in certain circumstances, measured using valuation models that incorporate assumptions that are not supported by prices from observable current market transactions in the same instrument and are not based on observable market data. The following table shows the sensitivity of these fair values to reasonably possible alternative assumptions:

	Reflected in income statement		Reflected in other comprehensive income	
	Favourable changes HK\$m	Unfavourable changes HK\$m	Favourable changes HK\$m	Unfavourable changes HK\$m
At 30 June 2016				
Derivatives/trading assets/trading liabilities	163	(148)	–	–
Financial assets/liabilities designated at fair value	139	(139)	–	–
Financial investments: available-for-sale	–	–	385	(385)
	302	(287)	385	(385)
At 31 December 2015				
Derivatives/trading assets/trading liabilities	193	(177)	–	–
Financial assets/liabilities designated at fair value	122	(122)	–	–
Financial investments: available-for-sale	–	–	401	(401)
	315	(299)	401	(401)

Details of the sensitivity of fair values to reasonably possible alternative assumptions, by Level 3 instrument type, are included in note 48 of the Bank's *Annual Report and Accounts 2015*.

Transfers between levels of the fair value hierarchy are deemed to occur at the end of the reporting period.

15. Fair values of financial instruments not carried at fair value

The accounting policies which determine the classification of financial instruments, and the use of assumptions and estimation in valuing them, are described in note 3 of the Bank's *Annual Report and Accounts 2015*.

	At 30 June 2016		At 31 December 2015	
	Carrying amount HK\$m	Fair value HK\$m	Carrying amount HK\$m	Fair value HK\$m
Assets				
Reverse repurchase agreements – non-trading	274,266	274,603	212,779	212,866
Placings with and advances to banks	461,611	461,751	421,221	421,431
Loans and advances to customers	2,734,234	2,726,158	2,762,290	2,753,271
Financial investment debt securities	243,596	259,981	228,599	235,919
Liabilities				
Repurchase agreements – non-trading	37,298	37,298	16,158	16,158
Deposits by banks	236,400	236,471	148,294	148,294
Customer accounts	4,735,096	4,735,064	4,640,076	4,640,626
Debt securities in issue	38,230	38,296	40,859	40,898
Subordinated liabilities	5,054	3,799	8,003	6,865
Preference shares	26,891	27,051	36,553	36,863

Details of how the fair values of financial instruments that are not carried at fair value on the balance sheet are calculated can be found in note 49 of the Bank's *Annual Report and Accounts 2015*.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**16. Legal and regulatory matters**

The group is party to legal proceedings and regulatory matters in a number of jurisdictions arising out of its normal business operations. Apart from the matters described below, the Bank considers that none of these matters are material. The recognition of provisions is determined in accordance with the accounting policies set out in note 3(v) of the Bank's *Annual Report and Accounts 2015*. While the outcome of legal proceedings and regulatory matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of these matters as at 30 June 2016. Any provision recognised does not constitute an admission of wrongdoing or legal liability. It is not practicable to provide an aggregate estimate of potential liability for our legal proceedings and regulatory matters as a class of contingent liabilities.

Anti-money laundering and sanctions-related matters

In October 2010, HSBC Bank USA entered into a consent order with the Office of the Comptroller of the Currency (the 'OCC') and the indirect parent of that company, HSBC North America Holdings Inc. ('HNAH'), entered into a consent order with the Federal Reserve Board (together the 'Orders'). These Orders required improvements to establish an effective compliance risk management programme across HSBC's US businesses, including risk management related to the US Bank Secrecy Act ('BSA') and anti-money laundering ('AML') compliance. HSBC Bank USA is not currently in compliance with the OCC Order. Steps are being taken to address the requirements of the Orders.

In December 2012, HSBC Holdings plc, HNAH and HSBC Bank USA entered into agreements with US and UK government agencies regarding past inadequate compliance with the BSA, AML and sanctions laws. Among those agreements, HSBC Holdings plc and HSBC Bank USA entered into a five-year deferred prosecution agreement with , among others, the US Department of Justice ('DoJ') (the 'US DPA'); and HSBC Holdings plc consented to a cease-and-desist order and HSBC Holdings plc and HNAH consented to a civil money penalty order with the Federal Reserve Board. HSBC Holdings plc also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions, as well as an undertaking with the UK Financial Conduct Authority to comply with certain forward-looking AML and sanctions-related obligations. In addition, HSBC Bank USA entered into civil money penalty orders with the Financial Crimes Enforcement Network ('FinCEN') of the US Treasury Department and the OCC.

Under these agreements, HSBC Holdings plc and HSBC Bank USA made payments totalling \$1.9bn to US authorities and undertook various further obligations, including, among others, to continue to cooperate fully with the DoJ in any and all investigations, not to commit any crime under US federal law subsequent to the signing of the agreement, and to retain an independent compliance monitor (the 'Monitor'). In January 2016, the Monitor delivered his second annual follow-up review report. Through his country-level reviews, the Monitor identified potential anti-money laundering and sanctions compliance issues that the DoJ and HSBC are reviewing further.

HSBC Bank USA also entered into two consent orders with the OCC. These required HSBC Bank USA to correct the circumstances noted in the OCC's report and to adopt an enterprise-wide compliance programme, and imposed restrictions on acquiring control of, or holding an interest in, any new financial subsidiary, or commencing a new activity in its existing financial subsidiary, without the OCC's prior approval.

These settlements with US and UK authorities have led to private litigation, and do not preclude further private litigation related to HSBC's compliance with applicable BSA, AML and sanctions laws or other regulatory or law enforcement actions for BSA, AML, sanctions or other matters not covered by the various agreements.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**16. Legal and regulatory matters** (continued)*Tax investigations*

The Bank continues to cooperate with the relevant US and other authorities, including with respect to US-based clients of the Bank in India.

In addition, various tax administration, regulatory and law enforcement authorities around the world, including in India, are conducting investigations and reviews of HSBC Swiss Private Bank and other HSBC companies in connection with allegations of tax evasion or tax fraud, money laundering and unlawful cross-border banking solicitation. The Indian tax authority issued a summons and request for information to the Bank in India.

The Bank and other HSBC companies are cooperating with the relevant authorities. There are many factors that may affect the range of outcomes, and the resulting financial impact, of these investigations and reviews, which could be significant.

In light of the media attention regarding these matters, it is possible that other tax administration, regulatory or law enforcement authorities will also initiate or enlarge similar investigations or regulatory proceedings.

Mossack Fonseca & Co

HSBC has received requests for information from various regulatory and law enforcement authorities around the world concerning persons and entities believed to be linked to Mossack Fonseca & Co, a service provider of personal investment companies. HSBC is cooperating with the relevant authorities.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of this matter, including the timing or any possible impact on HSBC, which could be significant.

Singapore Interbank Offered Rate ('SIBOR') and/or Singapore Swap Offer Rate ('SOR')

In July 2016, the Bank, other HSBC companies and other panel banks were named as defendants in a putative class action filed in the New York District Court on behalf of persons who transacted in products related to SIBOR and/or SOR. The complaint alleges, among other things, misconduct related to SIBOR and/or SOR in violation of US antitrust and racketeering laws and US state law. This matter is at an early stage.

There are many factors that may affect the range of outcomes, and the resulting financial impact, of this lawsuit, which could be significant.

Foreign exchange rate investigations

Various regulators and competition and law enforcement authorities around the world, including in South Korea, are conducting investigations and reviews into trading by HSBC and others on the foreign exchange markets. The Bank and other HSBC companies are cooperating with these investigations and reviews.

There are many factors that may affect the range of outcomes and the resulting financial impact of these investigations, which could be significant.

Hiring practices investigation

The US Securities and Exchange Commission (the 'SEC') is investigating multiple financial institutions, including HSBC Holdings plc, in relation to hiring practices of candidates referred by or related to government officials or employees of state-owned enterprises in Asia Pacific. HSBC has received various requests for information and is cooperating with the SEC's investigation.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of this matter, including the timing or any possible impact on HSBC, which could be significant.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)

17. Additional information

Supplementary Notes relating to the period ended 30 June 2016, prepared in accordance with the Banking (Disclosure) Rules made under section 60A of the Banking Ordinance, will be made available on our website: www.hsbc.com.hk. A press release will be issued to announce the availability of this information.

18. Interim Report 2016 and statutory accounts

The financial information relating to the year ended 31 December 2015 that is included in this interim report does not constitute the Bank's statutory annual consolidated accounts for that year but is extracted from those financial statements which have been delivered to the Registrar of Companies and the Hong Kong Monetary Authority.

The auditor has reported on those financial statements in their report dated 22 February 2016. The auditor's report was unqualified; did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying its report; and did not contain a statement under sections 406(2), 407(2) or (3) of the Hong Kong Companies Ordinance (Cap. 622).

19. Ultimate holding company

The Hongkong and Shanghai Banking Corporation Limited is an indirectly-held, wholly-owned subsidiary of HSBC Holdings plc, which is incorporated in England.

Report on Review of Interim Financial Information to the Board of Directors of The Hongkong and Shanghai Banking Corporation Limited

Introduction

We have reviewed the interim financial information set out on pages 21 to 42, which comprises the condensed consolidated balance sheet of The Hongkong and Shanghai Banking Corporation Limited (the 'Bank') and its subsidiaries (together, the 'group') as at 30 June 2016 and the related condensed consolidated statements of income, comprehensive income, changes in equity and cash flows for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes. The directors of the Bank are responsible for the preparation and presentation of this interim financial information in accordance with Hong Kong Accounting Standard ('HKAS') 34 'Interim Financial Reporting' issued by the Hong Kong Institute of Certified Public Accountants and the Disclosure Rules and Transparency Rules of the United Kingdom's Financial Conduct Authority. Our responsibility is to express a conclusion on this interim financial information based on our review and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the United Kingdom's Auditing Practices Board. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the interim financial information is not prepared, in all material respects, in accordance with HKAS 34 'Interim Financial Reporting' and the Disclosure Rules and Transparency Rules of the United Kingdom's Financial Conduct Authority.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong
3 August 2016