HSBC PRIVATE BANK (UK) LIMITED

# Financial Statements
# 31 December 2012

Registered No. 499482



RESTRICTED

HSBC PRIVATE BANK (UK) LIMITED

# Financial Statements
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**Contents**

# Directors' report for the year ended 31 December 2012

## Principal activities

The Company is an authorised bank under the Financial Services and Markets Act 2000 and regulated by the Financial Services Authority The Company's principal activity is private banking No change in the Company's activities is anticipated

## Performance

The Company's results for the year under review are as detailed in the income statement shown in these accounts on page 8

Profit for the year in 2012 of £64,388,000 was 36 0% higher than the equivalent figure in 2011 (£47,328,000) In comparison to prior year the main highlights on performance were higher net interest income from the Company's loan portfolio on improved loan margins only partially offset by reduced loan volumes, a decrease in impairment charges against client lending and lower expenditure

Total assets of the Company reduced by £596 million to £8,832 million at 31 December 2012 (31 December 2011 £9,428 million) This primarily resulted from a reduction in the loan portfolio and reduced holdings of liquid assets held to satisfy the FSA's liquidity requirements Where the Company does not fund its activities through its customer deposit base it does so through contractual funding arrangements with other HSBC entities

Total equity of the Company increased by £65 million to £653 million at 31 December 2012 (31 December 2011 £588 million)

## Business Review

### Business Development

The last twelve months have been characterised by continuing economic uncertainty, in the UK and overseas, as governments struggle with budget deficits and a continuing lack of growth in the major western economies The eurozone crisis continues to be the dominant driver of uncertainty, and there is still some risk of one or more countries leaving the euro, although the situation improved in 2012 Even if the eurozone does not split, the currency will remain very vulnerable to market perception Banks in some countries remain very fragile and the rest of the European banking industry could be affected through its exposure to the weakest countries In the current context of very low growth due to austerity measures, this could further aggravate the economic crisis and could push European countries into a vicious circle of economic crisis and sovereign difficulties Although the Company's exposure to the peripheral eurozone countries is relatively limited, the Company is exposed to counterparties in the core European countries which could be affected by any sovereign or currency crisis The Company's eurozone exposures are described in more detail on page 35

Against this backdrop the Company delivered a successful financial performance in a challenging economic environment during 2012 The Company grew its income, mainly in Net Interest Income, whilst a reduced credit appetite led to a decrease in its lending operations Competition for cash deposits in the UK market continues to be challenging as the low interest rate environment causes clients to actively pursue enhanced interest rates, especially from those institutions that the UK Government possesses a financial investment in

The Company decreased its cost basis primarily due to lower staff costs, driven by a decrease in the number of employees, and lower Legal and Professional fees as litigation costs from 2011 were not repeated in 2012 In addition, the level of impairments decreased during the year compared to prior year, although the Company continues to maintain enhanced oversight of this area The level of impairments during the year was 6 6% of total revenue (2011 10%)

The result of the highlights above was a marked increase in Profit before Tax

During 2012 the Company also made a number of strategic decisions as it sought to restructure, simplify and grow its business These included the sale of its subsidiary Property Vision Holdings to the management of Property Vision and the closure of its branch operations in Dublin The financial impacts of these decisions are included in the financial result of 2012

As part of this strategy the ownership of HSBC Private Bank (UK) Ltd changed from HSBC Private Bank (Holdings) Suisse to HSBC Bank plc on 1st October 2012

# Directors' report for the year ended (continued) 31 December 2012

Total Assets under Management (including cash deposits) increased by £502 million to £14,697 million at 31 December 2012 (31 December 2011 £14,195 million), due to new investment inflows from customers and market appreciation of client balances

Although difficult financial markets are likely to continue in 2013, the Company is well positioned to benefit from any opportunities for business growth that arise

**Key performance indicators**

The Directors use KPIs to monitor the business As well as the income statement and the balance sheet, these indicators include measures to identify the returns on different categories of assets and the risks to which the Company is exposed

Financial KPIs monitored include 'pre-tax return on risk-weighted assets', 'cost efficiency', 'core tier 1 capital' and 'advances to core funding ratio'

Non-financial KPIs monitored include employee engagement measuring employees' emotional and intellectual commitment to the Company

**Risk management**

The principal risks and uncertainties facing the Company, together with its financial risk management objectives and policies, and an analysis of the exposure to such risks, are set out in note 21 of the financial statements

The most important non-financial types of risk are operational risk, reputational risk and regulatory risk The Directors have put in place procedures to monitor and manage these risks

Operational risk is relevant to every aspect of the Company's business and covers a wide spectrum of issues Losses arising from fraud, unauthorised activities, errors omission, inefficiency, systems failure or from external events all fall within the definition of operational risk The objective of the Company's operational risk management is to manage and control operational risk in a cost effective manner within targeted levels of operational risk consistent with the Company's risk appetite, as defined by the Risk Management Committee

All employees must safeguard the reputation of the Company by maintaining the highest standards of conduct at all times and by being aware of issues, activities or associations that pose a threat to the reputation of the Company The long term success of the Company is closely linked to the confidence of its stakeholders Safeguarding and building upon the Company's reputation is the responsibility of every employee Any lapse in standards of integrity, compliance, customer service or operating efficiency represents a potential reputational risk The company always aspires to the highest standards of conduct and, as a matter of routine, takes account of reputational risks to its business

In respect of regulatory risk, the UK regulators may take actions that could result in changes in industry practices, sales and pricing The Company maintains a strong compliance culture and monitors the regulatory environment closely to react proactively to changes and reduce risks to the business

**Future developments**

The financial services industry in the UK remains closely regulated Regulatory changes are likely to affect the Company's activities including the implementation of the 'Basel III' measures through national regulations and, in the EU, through CRD IV, and changing standards for the conduct of business There is also continued risk of further changes to regulation relating to remuneration and taxes

It is the intention of the Directors, that in 2013, the Company will continue to grow its principal business activity Achievement of this objective will be partly dependent on the impact of the UK and global economy on the Company's clients and any adjustments to the Company's risk appetite

**Dividends**

The Directors do not recommend the payment of a dividend in respect of the year ended 31 December 2012, as per prior year, as early repayment of subordinated liabilities is under consideration

# Directors' report for the year ended (continued) 31 December 2012

**Going concern basis**

As set out in note 21, the financial statements are prepared on a going concern basis, as the Directors are satisfied that the Company 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

**Directors**

The Directors who served during the year were as follows

| Name | Appointed | Resigned |
|---|---|---|
| A Zeller | | 10th February 2012 |
| S T Brown | | 14th December 2012 |
| W J R Gething | | 31st July 2012 |
| R B Janvrin | | |
| F Morra | 21st May 2012 | |
| C D Allen | 20th August 2012 | |
| M J Mount | | 29th June 2012 |
| D K Sheehan | | 8th June 2012 |
| P Tremble | 27th March 2012 | |
| C Streule | | 8th June 2012 |

The Articles of Association of the Company provide that in certain circumstances the Directors are entitled to be indemnified out of the assets of the Company against claims from third parties in respect of certain liabilities arising in connection with the performance of their functions, in accordance with the provisions of the UK Companies Act 2006 Indemnity provisions of this nature have been in place during the financial year but have not been utilised by the Directors

**Financial instruments**

The financial risk management objectives and policies of the Company, including the policy for hedging each major type of forecasted transaction for which hedge accounting is used, together with an analysis of the exposure to such risks, as required under Part 1 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, are set out in note 21 of the Notes to the Financial Statements

**Employment of disabled persons**

The Company is committed to providing equal opportunities to employees The employment of disabled persons is included in this commitment and the recruitment, training, career development and promotion of disabled persons is based on the aptitudes and abilities of the individual Should employees become disabled during employment, every effort would be made to continue their employment and, if necessary, appropriate training would be provided

**Employment policy**

The Company continues to regard communication with its employees as a key aspect of its policies Information is given to employees about employment matters and about the financial and economic factors affecting the Company's performance through management channels, in-house magazines and by way of attendance at internal seminars and training programmes Employees are encouraged to discuss operational and strategic issues with their line management and to make suggestions aimed at improving performance The involvement of employees in the performance of the Company is further encouraged through a profit participation scheme

**Capital management**

The Company defines capital as total shareholders' equity It is HSBC's objective to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times There were no changes to the Company's approach to capital management during the year

Pillar 3 of Basel II is related to market discipline and aims to make firms more transparent by requiring them to publish specific details of their risks, capital and risk management under the Basel II framework Separate Pillar 3 disclosures are not required for the Company as the Company is included in the consolidated Pillar 3 disclosures of HSBC Bank plc These disclosures are published as a separate document on HSBC Bank plc's website

# Directors' report for the year ended (continued) 31 December 2012

The Company is regulated by the UK Financial Services Authority ("FSA") The FSA's General Prudential sourcebook ("GENPRU") provides rules for calculating the actual capital and minimum capital resources requirements of the Company The Company is expected to maintain capital at above the minimum requirement at all times

The calculation of actual capital is shown below

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Shareholders' equity | 653,034 | 588,327 |
| Regulatory adjustments to the accounting basis | (791) | 4,215 |
| Unrealised (gains) / losses on available-for-sale debt securities | (791) | 4,383 |
| Reserves arising from unrealised (gains) on available-for-sale equities | - | (168) |
| Deduction 50% of excess expected losses over impairment allowances | - | (463) |
| **Core tier 1 capital** | 652,243 | 592,079 |
| Total qualifying tier 2 capital before deductions | 101,889 | 126,114 |
| Reserves arising from unrealised gains on available-for-sale equities | - | 168 |
| 100% of surplus impairment allowances over expected losses | 2,521 | - |
| Collective impairment allowances | 6,403 | 5,907 |
| Term subordinated debt (note 14) | 92,965 | 120,039 |
| Total deductions other than from tier1 capital | - | (15 552) |
| 50% of excess expected losses over impairment allowances | - | (464) |
| Unconsolidated investments | - | (15,088) |
| **Total regulatory capital** | 754,132 | 702,641 |
| Minimum capital requirements | (350,640) | (389,983) |
| Surplus | 403,492 | 312,658 |
| **Risk-weighted assets (Unaudited)** | | |
| Credit and counterparty risk | 3,989,902 | 4,504,138 |
| Market risk | 25,502 | 5,534 |
| Operational risk | 346,705 | 325,039 |
| Total | 4,362,109 | 4,834,711 |
| **Capital ratios (Unaudited)** | | |
| Core tier 1 ratio | 15 0 | 12 2 |
| Total capital ratio | 17 3 | 14 5 |

The Company held capital resources above the minimum requirement throughout the year

### Supplier payment policy

The Company does not currently subscribe to any code or standard on payment practice It is the Company's policy, however, to settle the terms of payment with suppliers when agreeing the terms of each transaction, to ensure that suppliers are made aware of the terms of payment and to abide by the terms of payment

It is Company practice to organise payment to its suppliers through a central accounts payable function operated by HSBC Bank plc The payment performance of this unit is incorporated within the results of that company

### Disclosure of information to auditor

Each person who is a Director at the date of approval of this report confirms that so far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware, and the Director has taken all the steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information This confirmation is given pursuant to section 418 of the Companies Act 2006 and should be interpreted in accordance therewith

# Directors' report for the year ended (continued) 31 December 2012

### Auditor

KPMG Audit Plc are deemed to be reappointed in accordance with an elective resolution made under section 386 of the Companies Act 1985 which continues in force under the Companies Act 2006

### Statement of Directors' responsibilities in respect of the Directors' report and financial statements

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations

Company law requires the Directors to prepare financial statements for each financial year Under that law they have elected to prepare the financial statements in accordance with IFRSs as adopted by the EU and applicable law

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period

In preparing these financial statements, the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether they have been prepared in accordance with IFRSs as adopted by the EU, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006

They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities

By order of the Board

C D Allen

*Director*

Dated 20th March 2013

Registered Office
8 Canada Square
London
E14 5HQ

# Independent Auditor's Report to the Members of HSBC Private Bank (UK) Limited

We have audited the financial statements of HSBC Private Bank (UK) Limited for the year ended 31 December 2012 set out on pages 8 to 41 The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed

**Respective responsibilities of Directors and Auditor**

As explained more fully in the Directors' Responsibilities Statement set out on page 6, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit, and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors

**Scope of the audit of the financial statements**

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's web-site at www frc org uk/auditscopeukprivate

**Opinion on financial statements**

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2012 and of its profit for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the EU, and
- have been prepared in accordance with the requirements of the Companies Act 2006

**Opinion on other matter prescribed by the Companies Act 2006**

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

**Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of Directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit

Matthew Davies (Senior Statutory Auditor)
For and on behalf of KPMG Audit Plc, Statutory Auditor
*Chartered Accountants*
London

20th March 2013

# Financial Statements

## Income statement for the year ended 31 December 2012

| | Notes | 2012 £'000 | 2011 £'000 |
|---|---|---|---|
| Interest income | | 246,073 | 253,103 |
| Interest expense | | (72,854) | (88,399) |
| **Net interest income** | | 173,219 | 164,704 |
| Fee income | | 79,954 | 86,301 |
| Fee expense | | (10,749) | (12,808) |
| **Net fee income** | | 69,205 | 73,493 |
| Net trading income / (expense) | 3 | 2,191 | (289) |
| Dividend income | | 284 | 56 |
| Other operating (expense) / income | 3 | (4 685) | 1,446 |
| **Total operating income** | | 240,214 | 239,410 |
| Loan impairment charges and other credit risk provisions | | (21,363) | (33,951) |
| **Net operating income** | | 218,851 | 205,459 |
| Employee compensation and benefits | 4 | (86,055) | (93,982) |
| General and administrative expense | 6 | (33,199) | (44,459) |
| Amortisation and impairment of investment in subsidiaries | | (9,365) | - |
| **Profit before tax** | | 90,232 | 67,018 |
| **Tax expense** | 7 | (25,844) | (19,690) |
| **Profit for the year** | | 64,388 | 47,328 |

The notes on pages 12 to 41 form an integral part of these financial statements

## Statement of comprehensive income for the year ended 31 December 2012

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Profit/(loss) for the year | 64,388 | 47,328 |
| **Other comprehensive income/(expense)** | | |
| Available-for-sale investments | | |
| – fair value gains / (losses) | 5,690 | (4,353) |
| – permanent impairment / disposal of AFS investments | (684) | (1,208) |
| – income taxes | (1,268) | 1,161 |
| Other comprehensive income / (expense) for the year, net of tax | 3,738 | (4,400) |
| Total comprehensive income for the year | 68 126 | 42,928 |

# Financial Statements (continued)

## Statement of financial position as at 31 December 2012

| | Notes | 2012 £'000 | 2011 £'000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and cash equivalents | | 991 | 1,184 |
| Derivatives | *19* | 18,016 | 25,384 |
| Loans and advances to banks | | 240,372 | 562,407 |
| Loans and advances to customers | *8* | 7,311,585 | 7,874,005 |
| Financial investments | | 1,105,185 | 798,609 |
| Other assets | | 66,981 | 57,996 |
| Prepayments and accrued income | | 84,924 | 86,154 |
| Investments in subsidiaries | *9* | - | 15,088 |
| Property, plant and equipment | *11* | 23 | 23 |
| Deferred tax assets | *10* | 4,177 | 7,194 |
| Total assets | | 8,832,254 | 9,428,044 |
| **LIABILITIES AND EQUITY** | | | |
| Deposits by banks | | 2,349,478 | 2,856,299 |
| Customer accounts | | 5,439,746 | 5,605,226 |
| Derivatives | *19* | 138,266 | 112,839 |
| Other financial liabilities | *12* | 12,895 | 16,909 |
| Current tax liabilities | | 10,641 | 7,082 |
| Accruals and deferred income | | 79,107 | 87,093 |
| Provisions | *13* | 937 | 2,992 |
| Subordinated liabilities | *14* | 148,150 | 151,277 |
| Total liabilities | | 8,179,220 | 8,839,717 |
| **Equity** | | | |
| Called up share capital | *15* | 176,910 | 176,910 |
| Share premium account | | 3,277 | 3,277 |
| Other reserves | | 690 | (3,048) |
| Retained earnings | | 472,157 | 411,188 |
| Total shareholders' equity | | 653,034 | 588,327 |
| Total equity and liabilities | | 8,832,254 | 9,428,044 |

The notes on pages 12 to 41 form an integral part of these financial statements

These financial statements were approved by the Board of Directors on 20th March 2013 and were signed on its behalf by

**C D Allen**
Director

Company Registered Number 499482

# Financial Statements (continued)

## Statement of cash flows for the year ended 31 December 2012

| | Notes | 2012 £'000 | 2011 £'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit before tax | | 90,232 | 67,018 |
| Adjustments for | | | |
| - Non-cash items included in net profit | *16(a)* | 31,545 | 43,309 |
| - Change in operating assets | *16(b)* | 560,680 | (163,693) |
| - Change in operating liabilities | *16(c)* | (1,004,131) | 488,224 |
| - Tax paid | | (20,535) | (16,117) |
| - Elimination of exchange differences | | 2,324 | (1,018) |
| Net cash (used) / generated from operating activities | | (339,885) | 417,723 |
| **Cash flows from investing activities** | | | |
| - Proceeds on disposal of subsidiary | | 471 | - |
| - (Purchase) / sale of financial investments | | (302,667) | 708,570 |
| Net cash (used) / generated from investing activities | | (302,196) | 708,570 |
| **Cash flows from financing activities** | | | |
| (Outflow) / proceeds from borrowings | | 336,680 | (647,904) |
| Dividends paid | | - | - |
| Net cash generated / (used) from financing activities | | 336,680 | (647,904) |
| **Net (decrease) / increase in cash and cash equivalents** | | (305,401) | 478,389 |
| Cash and cash equivalents brought forward | | 536,259 | 56,654 |
| Effect of exchange rate changes on cash and cash equivalents | | (5,451) | 1,216 |
| Cash and cash equivalents carried forward | *16(d)* | 225 407 | 536,259 |

The notes on pages 12 to 41 form an integral part of these financial statements

# Financial Statements (continued)

## Statement of changes in equity for the year ended 31 December 2012

| | Called up share capital | Share premium | Retained earnings | Other reserves: Available-for-sale fair value reserve | Total shareholders' equity |
|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 |
| **2012** | | | | | |
| At 1 January 2012 | 176,910 | 3,277 | 411,188 | (3,048) | 588,327 |
| Profit for the year | - | - | 64,388 | - | 64,388 |
| Other comprehensive income for the year, net of tax | - | - | - | 3,738 | 3,738 |
| Total comprehensive income for the year | - | - | 64,388 | 3,738 | 68,126 |
| Net impact of equity-settled share-based payments | - | - | (3,419) | - | (3,419) |
| Dividends to shareholders | - | - | - | - | - |
| At 31 December 2012 | 176,910 | 3,277 | 472,157 | 690 | 653,034 |

| | Called up share capital | Share premium | Retained earnings | Other reserves: Available-for-sale fair value reserve | Total shareholders' equity |
|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 |
| **2011** | | | | | |
| At 1 January 2011 | 176,910 | 3,277 | 360,844 | 1,352 | 542,383 |
| Profit for the year | - | - | 47,328 | - | 47,328 |
| Other comprehensive expense for the year, net of tax | - | - | - | (4,400) | (4,400) |
| Total comprehensive income/(expense) for the year | - | - | 47,328 | (4,400) | 42,928 |
| Net impact of equity-settled share-based payments | - | - | 3,016 | - | 3,016 |
| Dividends to shareholders | - | - | - | - | - |
| At 31 December 2011 | 176,910 | 3,277 | 411,188 | (3,048) | 588 327 |

The notes on pages 12 to 41 form an integral part of these financial statements

Shareholders' equity is wholly attributable to equity shareholders of HSBC Bank plc

# Notes on the Financial Statements (continued)

## 1 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the EU EU-endorsed IFRSs may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU

At 31 December 2012, there were no unendorsed standards effective for the year ended 31 December 2012 affecting these financial statements, and there was no significant difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the Company Accordingly, the Company's financial statements for the year ended 31 December 2012 are prepared in accordance with IFRSs as issued by the IASB

IFRSs comprise accounting standards issued by the IASB and its predecessor body as well as interpretations issued by the IFRS Interpretations Committee ('IFRIC') and its predecessor body

These financial statements present information about the Company as an individual undertaking and not about its group The Company is not required to prepare consolidated financial statements by virtue of the exemption conferred by Section 400 of the Companies Act 2006

The results of the Company are included within the consolidated financial statements of HSBC Holdings plc

The Company's financial statements are presented in its functional currency, Sterling

(b) Future accounting developments

At 31 December 2012, a number of standards and interpretations, and amendments thereto, had been issued by the IASB, which are not effective for the Company's financial statements as at 31 December 2012 In addition to the projects to complete financial instrument accounting, the IASB is continuing to work on projects on revenue recognition, which together with the standards described below, will represent widespread and significant changes to accounting requirements from 2013

**Standards and Interpretations issued by the IASB**

**Standards applicable in 2013**

In May 2011, the IASB issued IFRS 13 'Fair Value Measurement' ('IFRS 13') This standard is effective for annual periods beginning on or after 1 January 2013 and early adoption has not been taken IFRS 13 is required to be applied prospectively from the beginning of the first annual period in which it is applied The disclosure requirements of IFRS 13 do not require comparative information to be provided for periods prior to initial application

IFRS 13 establishes a single source of guidance for all fair value measurements required or permitted by IFRSs The standard clarifies the definition of fair value as an exit price, which is defined as a price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions, and enhances disclosures about fair value measurement

In December 2011, the IASB issued amendments to IFRS 7 'Disclosures – Offsetting Financial Assets and Financial Liabilities' which requires the disclosures about the effect or potential effects of offsetting financial assets and financial liabilities and related arrangements on an entity's financial position The amendments are effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods The amendments are required to be applied retrospectively

## 2 Summary of significant accounting policies

(a) Interest income and expense

Interest income and expense for all financial instruments except for those classified as held-for-trading or designated at fair value are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method

# Notes on the Financial Statements (continued)

(b) Non interest income

**Fee income** is earned from a diverse range of services provided by the Company to its customers Fee income is accounted for as follows

i income earned on the execution of a significant act is recognised as revenue when the act is completed,

ii income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees), and

iii income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and recorded in 'Interest income' (Note 2(a))

**Net trading income** comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with related interest income, expense and dividends

**Net income from financial instruments designated at fair value** includes all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value through profit or loss Interest income and expense arising on those financial instruments are recognised in 'Interest income and expense' (Note 2(a))

(c) Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated by the Company which are not classified as designated at fair value Loans and advances are recognised when cash is advanced to borrowers They are derecognised when either the borrower repays its obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment losses Where exposures are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment for the hedged risk only

Changes in the fair value adjustment are recorded as "Trading Income" (Note 3)

(d) Impairment of loans and advances to Customers

Losses for impaired loans are recognised promptly when there is objective evidence that impairment of a loan or portfolio of loans has occurred Impairment losses are calculated on individual loans and on groups of loans assessed collectively Impairment losses are recorded as charges to the income statement

Impairment losses on individual loans are calculated by discounting the expected future cash flows of a loan at its original effective interest rate, and comparing the resultant present value with the loan's current carrying amount and charging the amount of any loss to the income statement

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss This reflects impairment losses that the Company has incurred as a result of events occurring before the balance sheet date, which the Company is not able to identify on an individual loan basis, and that can be reliably estimated
Losses expected as a result of future events, no matter how likely, are not recognised

**Renegotiated loans**

Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or should be considered past due The carrying amount of loans that have been classified as renegotiated retain this classification until maturity or derecognition Interest is recorded on renegotiated loans taking into account the new contractual terms following renegotiation A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument

# Notes on the Financial Statements (continued)

(e) Financial Investments

Treasury bills, debt securities and equity shares intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale Financial investments are recognised on trade date, when the Company enters into contractual arrangements with counterparties to purchase securities, and are normally derecognised when either the securities are sold or the borrowers repay their obligations

Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income in "Available-for-sale investments – fair value gains/ (losses)" until the financial assets are either sold or become impaired When available-for-sale financial assets are sold, cumulative gains or losses previously recognised in other comprehensive income are recognised in the income statement as 'Other operating income'

Interest income is recognised on available-for-sale debt securities using the effective interest method, calculated over the asset's expected life Premiums and/or discounts arising on the purchase of dated investment securities are included in the calculation of their effective interest rates

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the income statement, is removed from other comprehensive income and recognised in the income statement

Impairment losses for available-for-sale debt securities are recognised within 'Loan impairment charges and other credit risk provision' in the income statement and impairment losses for available-for-sale equity securities are recognised within 'Other operating income'

(f) Derivatives and hedge accounting

Derivatives are recognised initially, and are subsequently remeasured, at fair value Fair values of exchange traded derivatives are obtained from quoted market prices Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models

The method of recognising fair value gains or losses depends on whether derivatives are held for trading or are designated as hedging instruments, and if the latter, the nature of the risks being hedged All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement When derivatives are designated as hedges, the Company classifies them as hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedges') Hedge accounting is applied to derivatives designated as hedging instruments in a fair value hedge provided certain criteria are met

**Hedge accounting**

At the inception of a hedging relationship, the Company documents the relationship between the hedging instruments and hedged items, its risk management objective and its strategy for undertaking the hedge The Company also requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments, primarily derivatives, that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair value of the hedged items Interest on designated qualifying hedges is included in 'Net interest income'

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement, along with changes in the fair value of the hedged assets, liabilities or group thereof that are attributable to the hedged risk

If a hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment to the carrying amount of the hedged item is amortised to the income statement based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised, in which case it is released to the income statement immediately

**Hedge effectiveness testing**

To qualify for hedge accounting, the Company requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness) and demonstrate actual effectiveness (retrospective effectiveness) on an ongoing basis

# Notes on the Financial Statements (continued)

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed For prospective effectiveness the hedging instrument must be expected to be highly effective in offsetting changes in fair value attributable to the hedged risk during the period for which the hedge is designated For actual effectiveness to be achieved, the changes in fair value must offset each other in the range of 80 per cent to 125 per cent Hedge ineffectiveness is recognised in the income statement in 'Net trading income'

**Derivatives that do not qualify for hedge accounting**

All gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in the income statement in 'Net trading income'

(g) Property, plant and equipment

Tangible assets relate to artworks owned by the company, which are not depreciated

(h) Income tax

Income tax comprises current tax and deferred tax Income 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 which case it is recognised in the same statement in which the related item appears

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantively enacted by the balance sheet date, and any adjustment to tax payable in respect of previous years Current tax assets and liabilities are offset when the group intends to settle on a net basis and the legal right to offset exists

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts attributed to such assets and liabilities for tax purposes Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised

Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled based on tax rates and laws enacted, or substantively enacted, by the balance sheet date Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when the group has a legal right to offset

Deferred tax relating to share-based payment transactions is recognised directly in other comprehensive income to the extent that the amount of the estimated future tax deduction exceeds the amount of the related cumulative remuneration expense Deferred tax relating to fair value remeasurements of available for-sale investments which are charged or credited directly to other comprehensive income, is also credited or charged directly to other comprehensive income and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement

(i) Foreign currencies

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the balance sheet date Any resulting exchange differences are included in the income statement Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined

(j) Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation, which has arisen as a result of past events, and for which a reliable estimate can be made of the amount of the obligation

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the Company, or are present obligations that have arisen from past events but are not recognised because it not

## Notes on the Financial Statements (continued)

probable that settlement will require outflow of economic benefits, or because the amount of the obligations cannot be reliably measured Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote

(k) Debt securities in issue and deposits by banks and customers

Financial liabilities are recognised when the Company enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at fair value, which is normally the proceeds received net of directly attributable transaction costs incurred Subsequent measurement of financial liabilities, other than those measured at fair value through profit or loss, is at amortised cost, using the effective interest rate method to amortise the difference between proceeds received, net of directly attributable transaction costs incurred, and the redemption amount over the expected life of the instrument

(l) Share-based payments and discretionary cash bonuses

The cost of 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 'Retained Earnings' The vesting period is the period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately

A cancellation that occurs during the vesting period is treated as an acceleration of vesting, and recognised immediately for the amount that would otherwise have been recognised for services over the vesting period

HSBC Holdings plc is the grantor of its equity instrument for all share awards and share options across the group The credit to 'Retained earnings' over the vesting period on expensing an award represents the effective capital contribution from HSBC Holdings plc To the extent the Company will be, or has been, required to fund a share-based payment arrangement, this capital contribution is reduced and the fair value of shares expected to be released to employees is recorded within 'Other liabilities'

(m) Significant judgments

In preparing the financial statements, the Directors are required to make judgements where uncertainty exists at the balance sheet date

In the following cases, the balance sheet value at the reporting date is influenced by significant judgements

- Impairment of loans and advances to customers (note 2d),
- Impairment of Available for sale investments (note 2e), and
- Provisions (note 13)

(n) Determination of fair value

All financial instruments are recognised initially at fair value In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (that is, the fair value of the consideration given or received) In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates

Subsequent to initial recognition, the fair values of financial instruments measured at fair value that are traded on active markets are based on those active quoted prices When independent prices are not available, fair values are determined by using valuation techniques which refer to observable market data These include comparison with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants

(o) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value Such investments are normally those with less than one months' maturity from the date of acquisition, and include cash and balances at central banks and loans and advances to banks

# Notes on the Financial Statements (continued)

## 3 Net Operating income

Net operating income is stated after the following items of income, expense, gains and losses

| | 2012 | 2011 |
|---|---|---|
| | £'000 | £'000 |
| Foreign exchange | 4,859 | 5,759 |
| Interest expense on forward foreign exchange | (186) | (1,592) |
| Change in fair value of hedging instruments (note 20) | (23,656) | (70,561) |
| Change in fair value of hedged items (note 20) | 22,432 | 69,751 |
| Change in fair value of derivatives held for trading | | |
| - fair value | 891 | (1,003) |
| - interest expense | (2,149) | (2,643) |
| **Net trading income** | 2,191 | (289) |
| | | |
| Loss on sale of Property Vision Holdings Limited | (5,164) | - |
| Other | 479 | 1,446 |
| **Other operating (expense) / income** | (4 685) | 1,446 |

## 4 Employee compensation and benefits

| | 2012 | 2011 |
|---|---|---|
| | £'000 | £'000 |
| Wages and salaries including share - based payments (see below) | 73,422 | 80,457 |
| Social security costs | 8,177 | 8,837 |
| Post employment benefits | 4,456 | 4 688 |
| | 86,055 | 93,982 |

| The average number of persons employed by the Company during the year was | Number | Number |
|---|---|---|
| – Directors | 6 | 8 |
| – Other | 751 | 836 |
| | 757 | 844 |

a) Post-employment benefit plans

The Company's employees are members of various schemes

The HSBC Bank (UK) Pension Scheme, which is the principal scheme, covers employees of HSBC Bank plc, its UK subsidiaries (including the Company) and certain other employees of the Group This scheme, assets of which are held in a separate trust fund, comprises a funded defined benefit section, which is closed, and a defined contribution section, which was established on 1 July 1996 for new employees

Individual subsidiaries within the Group, whose employees participate in the defined benefit section, are not able to identify their share of the underlying assets and liabilities of the scheme and account for the scheme as a defined contribution scheme For this reason, the Company has not disclosed the details of the defined benefit section required under IAS 19, "Employee Benefits"

Full disclosure of the principal actuarial financial assumptions used to calculate the defined benefit pension plans at 31 December 2012, of which employees of the Company are members, are disclosed in the statutory accounts of HSBC Bank plc The Company makes a regular payment to HSBC Bank plc, for HSBC Bank plc to invest in the various schemes on behalf of the Company's employees The Company has not been asked to contribute to any scheme deficit, except through amendments to its regular payments

## Notes on the Financial Statements (continued)

In 2012, the pension cost for defined contribution plans which cover 70% of the Company's employees was £4,456,000 (2011 £4,688,000) The Company expects to make £4,388,000 of contributions to the defined contribution plans during 2013

b) Share-based payments

The ultimate parent company, HSBC Holdings plc, operates share option schemes and share award schemes, in which employees of HSBC Private Bank (UK) Ltd participate

Included in 'Wages and salaries' is a charge of £5,411,000 (2011 £8,995,000) in respect of equity-settled share-based payment transactions

Share awards

Share awards are made to eligible employees for recruitment and retention purposes or as part of deferral of annual bonus The awards vest between one and three years from the date of the award

The total number of shares outstanding at 31 December 2012 was 1,319,241 (2011 3,414,881) Total shares awarded in 2012 were 416,646 The weighted average fair value of share awards granted outstanding was £6 28 (2011 £4 97)

Share options

The Save-As-You-Earn ("SAYE") share option scheme, invites eligible employees to enter into savings contracts to save up to £250 per month, with the option to use the savings to acquire shares in HSBC Holdings plc The HSBC Holdings Group Share Option Plan was a long term incentive plan under which certain employees between 2000 and 2005 were awarded share options Employees of the Company have participated in both the HSBC Holdings plc "SAYE" share option scheme and HSBC Holdings Group Share Option Plan

Movement on HSBC share option plans

| | SAYE share option plans | | HSBC Holdings Group share option plan | |
|---|---|---|---|---|
| | Number | WAEP* £ | Number | WAEP* £ |
| At 1 January 2012 | 1,440,687 | 3 66 | 607,058 | 6 99 |
| Granted during the year | 438,545 | 4 46 | - | - |
| Exercised during the year | (537,336) | 2 14 | (1,911) | 6 38 |
| Forfeited and expired during the year | (200,639) | 4 50 | (187,807) | 7 28 |
| At 31 December 2012 | 1,141,257 | 3 99 | 417,340 | 6 87 |

| | SAYE share option plans | | HSBC Holdings Group share option plan | |
|---|---|---|---|---|
| | Number | WAEP* £ | Number | WAEP* £ |
| At 1 January 2011 | 1,454,875 | 3 61 | 811,237 | 7 12 |
| Granted during the year | 141,371 | 5 06 | - | - |
| Exercised during the year | (28,600) | 1 83 | (8 033) | 6 67 |
| Forfeited and expired during the year | (126,959) | 4 31 | (196,146) | 7 99 |
| At 31 December 2011 | 1,440,687 | 3 66 | 607,058 | 6 99 |

* Weighted average exercise price

The weighted average fair value of share options outstanding, which is calculated when transactions are contracted, was £1 23 (2011 £1 40)

Full details of all HSBC Share Awards / Options, and the calculation of the fair values of share options, are included in the Annual Report and Accounts of HSBC Holdings plc

# Notes on the Financial Statements (continued)

## 5 Remuneration of Directors

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Directors' emoluments | | |
| Short term employee benefits | 1,970 | 2,455 |
| Post-employment benefits | 120 | 77 |
| Termination benefits | 280 | 274 |
| Deferred cash awards | - | 610 |
| Share-based payments | 441 | 954 |
| | 2,811 | 4,370 |

The emoluments of certain Directors are borne by other Companies owned by the ultimate parent company and are not included within the disclosures provided The emoluments of certain Directors that are employed by the Company but are disclosed in the financial statements of any parent of the Company are not disclosed

The aggregate of emoluments and amounts received under long term incentive schemes of the highest paid Director was £710,000 (2011 £958,000), including contributions to a defined contribution pension scheme of £20,000 (2011 £20,000) made by the Company in respect of services The highest paid Director did not exercise any share options over HSBC Holdings plc ordinary shares during the year

| | 2012 No | 2011 No |
|---|---|---|
| Retirement benefits are accruing to the following number of directors under | | |
| – Defined contribution schemes | 2 | 3 |
| – Defined benefit schemes | 1 | - |
| The number of directors in respect of whose qualifying service shares were received/receivable under long term incentive schemes | 5 | 7 |
| The number of directors who exercised share options over HSBC Holdings plc ordinary shares | 1 | 2 |

## 6 Auditor's remuneration

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Auditor' remuneration | | |
| – Audit of these financial statements pursuant to legislation | 91 | 96 |
| – Other audit-related services pursuant to such legislation | 34 | 42 |
| – Tax advisory services provided to the company | 5 | 17 |
| – Other services provided to the company | 12 | 9 |
| | 142 | 164 |

# Notes on the Financial Statements (continued)

## 7 Tax expense

| | Notes | 2012 £'000 | 2011 £'000 |
|---|---|---|---|
| **Current tax** | | | |
| UK Corporation tax | | | |
| – on current year profit | | (22,777) | (18,347) |
| – adjustments in respect of prior years | | (50) | (153) |
| Total current tax | | (22,827) | (18,500) |
| **Deferred tax** | *10* | | |
| Origination and reversal of temporary differences | | (2 614) | (580) |
| Effect of changes in tax rates | | (378) | (590) |
| Adjustment in respect of prior years | | (25) | (20) |
| Total deferred tax | | (3,017) | (1,190) |
| Tax expense | | (25,844) | (19,690) |

The UK corporation tax rate applying to the Company was 24 5% (2011 26 5%)

The following table reconciles the tax expense

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Taxation at UK corporation tax rate of 24 5% (2011 26 5%) | (22,107) | (17,844) |
| Adjustments in respect of prior period liabilities | (75) | (173) |
| Amounts not deductible for tax purposes | (3,676) | (500) |
| Gain less losses from financial investments | 63 | 320 |
| Temporary differences between accounting and tax allocations | | |
| – Adjustment in respect of share-based payments | 329 | (903) |
| – Impact due to changes in tax rates | (378) | (590) |
| Overall tax expense | (25,844) | (19,690) |

The UK Government has announced that the main rate of corporation tax for the year beginning 1 April 2012 will reduce from 26 per cent to 24 per cent, to be followed by further 1 per cent reductions per annum to 22 per cent for the year beginning 1 April 2014 While the reduction in the corporate tax rate to 23% has already been enacted, the further announced reductions are expected to be enacted through the [2012 and 2013] Finance Acts This results in a weighted average rate of 24 5 per cent for 2012 (2011 26 5 per cent) It is not expected that the proposed future rate changes will have a significant effect on the net UK deferred tax position

# Notes on the Financial Statements (continued)

## 8 Loans and advances to customers

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Gross loans and advances to customers | 7,400,300 | 7,947,709 |
| Impairment allowances (Note 21 (a) V) | (102,069) | (90,231) |
| Fair value adjustment to loans hedged by designated swaps | 13,354 | 16,527 |
| Loans and advances to customers | 7,311,585 | 7,874,005 |

## 9 Investments in Subsidiaries

The Company had no subsidiary undertakings at 31 December 2012

In the first half of 2012 initial discussions were entered into in respect of the sale of Property Vision Holdings Limited and an impairment of investment in subsidiary of £9,365,000 was taken in recognition of the preliminary consideration amounts discussed On the 12th October 2012, the Company sold 100 per cent of the share capital of Property Vision Holdings Limited to PV Acquisition Limited for a cash consideration of £942,000, resulting in a loss on sale of £5,164,145

On the 26th September 2012 all assets of HSBC Private Trustee (UK) Limited were assigned to its parent HSBC Private Bank (UK) Limited and an application was made to strike off HSBC Private Trustee (UK) Limited from the 'Register of Companies'

# Notes on the Financial Statements (continued)

## 10 Deferred tax assets

| | 2012 | 2011 |
|---|---|---|
| | £'000 | £'000 |
| At 1 January | 7,194 | 8,384 |
| Income statement credit/(debit) | | |
| - Property plant and equipment | (23) | (22) |
| - Share-based payments | (1,997) | (82) |
| - IFRS transitional adjustments and provisions | (997) | (1,086) |
| At 31 December | 4,177 | 7,194 |

The amount of deferred taxation accounted for in the Balance Sheet

| | 2012 | 2011 |
|---|---|---|
| | £'000 | £'000 |
| **Deferred tax assets** | | |
| Property plant and equipment | 93 | 116 |
| Share-based payments | 1,550 | 3,547 |
| IFRS transitional adjustments and provisions | 2,534 | 3,531 |
| | 4,177 | 7,194 |

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts attributable to such assets and liabilities for tax purposes Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent it is probable that future taxable profits will be available against which deductible temporary differences can be utilised

# Notes on the Financial Statements (continued)

## 11 Property, plant and equipment

| | Equipment, fixtures & fittings £ | Total £ |
|---|---|---|
| **2012** | | |
| **Cost or fair value** | | |
| At 1 January 2012 | 23 | 23 |
| Additions | - | - |
| Disposals | - | - |
| At 31 December 2012 | 23 | 23 |
| **Accumulated depreciation and impairment** | | |
| At 1 January 2012 | - | - |
| Charge for the year | - | - |
| Movement in impairment provisions | - | - |
| Disposals | - | - |
| At 31 December 2012 | - | - |
| Net carrying amount 31 December 2012 | 23 | 23 |
| **2011** | | |
| **Cost or fair value** | | |
| At 1 January 2011 | 23 | 23 |
| Additions | - | - |
| Disposals | - | - |
| At 31 December 2011 | 23 | 23 |
| **Accumulated depreciation and impairment** | | |
| At 1 January 2011 | - | - |
| Charge for the year | - | - |
| Movement in impairment provisions | - | - |
| Disposals | - | - |
| At 31 December 2011 | - | - |
| Net carrying amount 31 December 2011 | 23 | 23 |

# Notes on the Financial Statements (continued)

## 12 Other financial liabilities

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Share-based payment liabilities | 7,853 | 14,105 |
| Other liabilities | 5,042 | 2,804 |
| | 12,895 | 16,909 |

## 13 Provisions

| | Provisions for liabilities and charges £'000 | Premises related provisions £'000 | Total £'000 |
|---|---|---|---|
| At 1 January 2012 | 2,900 | 92 | 2,992 |
| Additional provisions/increase in provisions | 937 | - | 937 |
| Provisions utilised | (943) | - | (943) |
| Amounts reversed | (1,957) | (92) | (2,049) |
| At 31 December 2012 | 937 | - | 937 |

| | Provisions for liabilities and charges £'000 | Premises related provisions £'000 | Total £'000 |
|---|---|---|---|
| At 1 January 2011 | - | 92 | 92 |
| Additional provisions/increase in provisions | 2,900 | - | 2,900 |
| Provisions utilised | - | - | - |
| Amounts reversed | - | - | - |
| At 31 December 2011 | 2,900 | 92 | 2,992 |

A provision of £2,900,000 raised in 2011 for the possible cost of redress relating to the sale of certain personal pension plans and advice was partially utilised in settlement of individual claims to the extent of £943,000 in 2012 The residual provision of £1,957,000 was reversed in 2012 with no further claims anticipated

A provision of £937,000 (2011 Nil) has been made for a possible tax charge in respect of hedge fund services previously treated as VAT exempt which are currently under review in respect of their VAT status

# Notes on the Financial Statements (continued)

## 14 Subordinated liabilities

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Loans from fellow subsidiary undertaking | | |
| Dated subordinated loan capital | | |
| US$45,000,000 variable rate subordinated loan maturing 2013 | 27,841 | 29,065 |
| GB£27,000,000 variable rate subordinated loan maturing 2014 | 27 000 | 27 000 |
| GB£15,000,000 variable rate subordinated loan maturing 2015 | 15,000 | 15,000 |
| GB£35,000,000 variable rate subordinated loan maturing 2016 | 35,000 | 35,000 |
| US$30,000,000 variable rate subordinated loan maturing 2016 | 18,561 | 19,377 |
| US$40,000,000 variable rate subordinated loan maturing 2018 | 24,748 | 25,835 |
| | 148,150 | 151,277 |

Subordinated loan capital is repayable at par on maturity but may be repayable prior to maturity at the option of the borrower, generally with the consent of the Financial Services Authority The interest rate is related to interbank offered rates

## 15 Called up share capital

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| **Issued, alloted and fully paid up** | | |
| **17,691,000 Ordinary shares of £10 each** | | |
| As at 1 January and 31 December | 176 910 | 176,910 |
| **Authorised** | | |
| **19,500,000 Ordinary shares of £10 each** | | |
| As at 1 January and 31 December | 195,000 | 195 000 |

# Notes on the Financial Statements (continued)

## 16 Reconciliation of profit before tax to net cash flow from operating activities

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| a) Non-cash items included in profit and loss | | |
| Amortisation and items recognised in equity | 5,278 | 7,789 |
| Loan impairment changes | 21,363 | 33,951 |
| Loans written off net of recoveries | (8,513) | (1,331) |
| Impairment / loss on disposal of subsidiary | 14,529 | - |
| Provision (released) / raised for liabilities and charges | (1,112) | 2,900 |
| | 31,545 | 43,309 |
| b) Change in operating assets | | |
| Change in prepayments and accrued income | 1,230 | 39,037 |
| Change in loans and advances to banks | 11,376 | (21,237) |
| Change in loans and advances to customers | 549,570 | (249,999) |
| Change in financial assets designated at fair value | 7,368 | 46,666 |
| Change in other assets | (8,864) | 21,840 |
| | 560,680 | (163,693) |
| c) Change in operating liabilities | | |
| Change in accruals and deferred income | (7,986) | 17,536 |
| Change in deposits by banks | (843,501) | 264,013 |
| Change in customer accounts | (165,480) | 201,801 |
| Change in financial liabilities designated at fair value | 25,427 | 10,168 |
| Change in other liabilities | (12 591) | (5,294) |
| | (1 004,131) | 488,224 |
| d) Cash and cash equivalents comprise | | |
| Cash and balances at central banks | 991 | 1,184 |
| Loans and advances to banks of one month or less | 224 416 | 535 075 |
| | 225,407 | 536,259 |

# Notes on the Financial Statements (continued)

## 17 Contingent liabilities and contractual commitments

The bank is party to legal proceedings, investigations 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 is material, either individually or in the aggregate The bank recognises a provision for a liability in relation to these matters when it is probable that an outflow of economic benefits will be required to settle an obligation which has arisen as a result of past events, and for which a reliable estimate can be made of the amount of the obligation While the outcome of these matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of legal proceedings as at 31 December 2012 There are outstanding investigations pending in respect of pension transfer advice cases, which are not able to be reliably quantified

The following table gives the nominal principal amounts of off-balance sheet transactions

Contingent liabilities and commitments are credit-related instruments, which include acceptances, guarantees and commitments to extend credit The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements

| | 2012 | 2011 |
|---|---|---|
| | Contract Amount | Contract Amount |
| | £'000 | £'000 |
| Contingent liabilities | | |
| Guarantees and assets pledged as collateral security | 138,336 | 224,085 |
| Commitments | | |
| Undrawn formal standby facilities, credit lines and other commitments to lend | 466,557 | 515,124 |

# Notes on the Financial Statements (continued)

## 18 Analysis of financial assets and liabilities by measurement basis

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost The significant accounting policies in note 2 describe how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised

Fair values of the financial investments are determined directly by reference to published price quotations in an active market The following table analyses the financial assets and liabilities in the Balance Sheet by the class of financial instrument to which they are assigned, and therefore by the measurement basis

| At 31 December 2012 | Held for trading | Financial assets and liabilities designated at fair value | Loans and receivables | Available-for-sale securities | Financial assets and liabilities at amortised cost | Derivatives designated as fair value hedging instruments | Total |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Assets** | | | | | | | |
| Cash and cash equivalents | - | - | - | - | 991 | - | 991 |
| Derivatives | 18,016 | - | - | - | - | - | 18,016 |
| Loans and advances to banks | - | - | 240,372 | - | - | - | 240,372 |
| Loans and advances to customers | - | 384,747 | 6,926,838 | - | - | - | 7,311,585 |
| Financial investments | - | - | - | 1,105,185 | - | - | 1,105,185 |
| Shares in Group undertakings | - | - | - | - | - | - | - |
| Other assets | - | - | - | - | 66,981 | - | 66,981 |
| Accrued income | - | - | - | - | 84,924 | - | 84,924 |
| Total financial assets | 18,016 | 384,747 | 7,167,210 | 1,105,185 | 152,896 | - | 8,828,054 |
| Total non financial assets | | | | | | | 4,200 |
| Total assets | | | | | | | 8,832,254 |
| **Liabilities** | | | | | | | |
| Deposits by banks | - | - | - | - | 2,349,478 | - | 2,349,478 |
| Customer accounts | - | 96,310 | - | - | 5,343,436 | - | 5,439,746 |
| Derivatives | 23,097 | - | - | - | - | 115,169 | 138,266 |
| Other financial liabilities | - | - | - | - | 23 536 | - | 23,536 |
| Accruals | - | - | - | - | 66,915 | - | 66,915 |
| Subordinated liabilities | - | - | - | - | 148,150 | - | 148,150 |
| Total financial liabilities | 23 097 | 96,310 | - | - | 7 931,515 | 115 169 | 8,166,091 |
| Total non financial liabilities | | | | | | | 13 129 |
| Total liabilities | | | | | | | 8 179 220 |

## Notes on the Financial Statements (continued)

| At 31 December 2011 | Held for trading £'000 | Financial assets and liabilities designated at fair value £'000 | Loans and receivables £'000 | Available-for-sale securities £'000 | Financial assets and liabilities at amortised cost £'000 | Derivatives designated as fair value hedging instruments £'000 | Total £'000 |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and cash equivalents | - | - | - | - | 1,184 | - | 1,184 |
| Derivatives | 25,309 | - | - | - | - | 75 | 25,384 |
| Loans and advances to banks | - | - | 562,407 | - | - | - | 562,407 |
| Loans and advances to customers | - | 434,462 | 7,439,543 | - | - | - | 7,874,005 |
| Financial investments | - | - | - | 798,609 | - | - | 798,609 |
| Shares in Group undertakings | - | - | - | - | 15,088 | - | 15,088 |
| Other assets | - | - | - | - | 57,996 | - | 57,996 |
| Accrued income | - | - | - | - | 86,154 | - | 86,154 |
| Total financial assets | 25,309 | 434,462 | 8,001,950 | 798,609 | 160,422 | 75 | 9,420,827 |
| Total non financial assets | | | | | | | 7,217 |
| Total assets | | | | | | | 9 428,044 |
| **Liabilities** | | | | | | | |
| Deposits by banks | - | - | - | - | 2,856,299 | - | 2,856,299 |
| Customer accounts | - | 82,843 | - | - | 5,522,383 | - | 5,605,226 |
| Derivatives | 19,278 | - | - | - | - | 93,561 | 112,839 |
| Other financial liabilities | - | - | - | - | 23,991 | - | 23,991 |
| Accruals | - | - | - | - | 76,933 | - | 76,933 |
| Subordinated liabilities | - | - | - | - | 151,277 | - | 151,277 |
| Total financial liabilities | 19,278 | 82,843 | - | - | 8 630 883 | 93,561 | 8,826,565 |
| Total non financial liabilities | | | | | | | 13,152 |
| Total liabilities | | | | | | | 8,839,717 |

For all financial instruments, the fair value is equal to the carrying value in the Balance Sheet, except as analysed below Fair value is assumed to equal carrying value for all balances repricing in less than six months Where repricing is greater than six months using discounted cash flow, each loan or deposit is valued using a LIBOR-based discount curve applied to the expected cash flows

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Loans and advances to customers | 7,412,860 | 7,926,814 |
| Customer accounts | 5,479,019 | 5,649,911 |

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments In many cases, it would not be possible to realise immediately the estimated fair values given the size of the portfolios measured Accordingly, these fair values do not represent the value of these financial instruments to the Company as a going concern

# Notes on the Financial Statements (continued)

## 19 Derivatives

Derivatives are carried at fair value and shown in the Balance Sheet as separate totals of assets and liabilities Asset values represent the cost to the Company of replacing all transactions with a fair value in the Company's favour assuming that all the Company's relevant counterparties default at the same time, and that transactions can be replaced instantaneously Liability values represent the cost to the Company's counterparties of replacing all their transactions with the Company with a fair value in their favour if the Company were to default Changes in the values of derivatives are recognised in 'Trading income' (note 2c)

The Company transacts derivatives primarily to manage and hedge the Company's own risks For accounting purposes, derivative instruments are classified as held either for trading or hedging Derivatives that are held, and qualify as hedging instruments, are formally designated as hedges as defined in IAS 39 All other derivative instruments are classified as held-for-trading The held-for-trading category includes derivatives managed in conjunction with financial instruments designated at fair value

Contract amounts of derivatives held-for-trading purposes by product type

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Exchange rate | 2,251,746 | 2,352,820 |
| Interest rate | 262,163 | 367,202 |
| Precious metals | - | 28,356 |
| Total derivatives | 2,513 909 | 2,748,378 |

Fair values of derivative open positions by type of product contract

| | At 31 December 2012 | | At 31 December 2011 | |
|---|---|---|---|---|
| | Assets £'000 | Liabilities £'000 | Assets £'000 | Liabilities £'000 |
| Exchange rate | 13,474 | 15,166 | 15,432 | 5,610 |
| Interest rate | 4,542 | 123,100 | 9,408 | 106,685 |
| Precious metals | - | - | 544 | 544 |
| Total | 18,016 | 138 266 | 25,384 | 112 839 |
| Netting | - | - | - | - |

of which the following are third party

| | At 31 December 2012 | | At 31 December 2011 | |
|---|---|---|---|---|
| | Assets £'000 | Liabilities £'000 | Assets £'000 | Liabilities £'000 |
| Exchange rate | 2,868 | 774 | 927 | 1 548 |
| Interest rate | 720 | 1,101 | 718 | 4,431 |
| Precious metals | - | - | 58 | 486 |
| Total | 3,588 | 1,875 | 1,703 | 6,465 |
| Netting | - | - | - | - |

# Notes on the Financial Statements (continued)

## 20 Hedging instruments

The Company uses derivatives (interest rate swaps) for hedging purposes in the management of its own asset and liability portfolios This enables the Company to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities All derivatives qualifying as hedging instruments are fair value hedges as defined under IAS 39

Contract amounts of derivatives held-for-hedging purposes by product type

| | 2012<br>£'000 | 2011<br>£'000 |
|---|---|---|
| Interest rate contracts | | |
| - pay fixed swaps | 1 215,993 | 1,077,952 |

The notional or contractual amounts of interest rate contracts indicate the nominal value of transactions outstanding at the balance sheet date, they do not represent amounts at risk

The Company's fair value hedges consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term loans to customers due to movements in market interest rates For qualifying fair value hedges, all changes in the fair value of the derivative and in the fair value of the item in relation to the risk being hedged are recognised in "Trading income" If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortised to income as a yield adjustment over the remainder of the hedging period

The fair values of outstanding derivatives designated as fair value hedges at the end of the reporting period, were assets of £Nil (2011 £75,000) and liabilities of £115,169,000 (2011 £93,561,000)

| | 2012<br>£'000 | 2011<br>£'000 |
|---|---|---|
| Gain or losses arising from the change in fair value of fair value hedges | | |
| - on hedging instruments | (23,656) | (70,561) |
| - on hedged items attributable to the hedged risks | 22,432 | 69,751 |
| | (1,224) | (810) |

# Notes on the Financial Statements (continued)

## 21 Management of financial risk

All of the Company's activities involve analysis, evaluation and management of some degree of risk or combination of risks The most important types of risk include financial risk, which comprises credit risk, liquidity risk and market risk The management of financial risk and consideration of profitability, cash flows and capital resources form a key element in the Directors' assessment of the Company as a going concern

### a) Credit risk management

Credit risk is the risk that a customer or counterparty of the Company will be unable or unwilling to meet a commitment that it has entered into with the Company It is managed within limits approved by the board and delegated to individuals as appropriate

Within the overall framework of the HSBC Group policy, the Company has an established risk management process encompassing credit approvals, the control of exposures, credit policy direction to the business, and the monitoring and reporting of exposures

The management of the Company is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality Regular reviews are undertaken to assess and evaluate levels of risk concentration

The Company employs a sophisticated and granular methodology, with an internal ratings-based ("IRB") approach for part of it's portfolios for calculating the Company's minimum capital requirement under Basel II

#### I. Maximum exposure to credit risk

**Maximum exposure at 31 December**

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Derivatives | 18,016 | 25,384 |
| Loans and advances to banks | 240 372 | 562,407 |
| Loans and advances to customers | 7,400,300 | 7,947,709 |
| Off-balance sheet | | |
| - guarantees and assets pledged as collateral security | 138,336 | 224,085 |
| - undrawn formal standby facilities, credit lines and other commitments to lend | 466,557 | 515,124 |
| | 8,263,581 | 9,274,709 |

#### II. Collateral and other credit enhancements

The Company follows guidelines as to the acceptability of specific classes of collateral or credit risk mitigation Whilst collateral is important in mitigating credit risk, it is the Company's policy to establish that loans are within the customer's capacity to repay rather than place significant reliance on security The principal collateral types are as follows

- In the personal sector, mortgages over residential properties, cash and securities,
- In the commercial sector, charges over business assets such as premises, stock and receivables,
- In the commercial real estate sector, charges over the properties being financed, and
- In the financial sector, charges over financial instruments such as debt securities, bank guarantees and equities in support of trading facilities

# Notes on the Financial Statements (continued)

A summary of the loan book analysed by collateral type is provided below

| At 31 December | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Residential property | 2,812,901 | 2,983,717 |
| Other property | 3,451,455 | 3,500,853 |
| Bank guaranteed | 40,890 | 74,077 |
| Cash backed | 530,754 | 647,034 |
| Other * | 420,999 | 560,619 |
| Unsecured | 143,301 | 181,409 |
| Gross loan and advances to customers | 7,400,300 | 7,947,709 |

* Other collateral includes charges over marketable investments such as stocks, shares and bonds, hold covered guarantees and charges over music rights and other assets

## III. Credit quality

The four classifications below describe the credit quality of the Company's lending and derivatives These categories each encompass a range of more granular, internal credit rating grades assigned to corporate and personal lending business

- Strong exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss Personal accounts operate within product parameters and only exceptionally show any period of delinquency
- Medium exposures require closer monitoring, with low to moderate default risk Personal accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes
- Sub-standard exposures show varying degrees of special attention and default risk is of greater concern Personal portfolio segments show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes
- Impaired exposures have been assessed, individually as impaired

| | Strong £'000 | Medium £'000 | Sub-Standard £'000 | Impaired £'000 | Impairment Allowances £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| **At 31 December 2012** | | | | | | |
| Derivatives | 14,428 | 3,588 | - | - | - | 18,016 |
| Loans and advances to banks | 240,372 | - | - | - | - | 240,372 |
| Loans and advances to customers | 310,990 | 6,554,092 | 293,966 | 254,606 | (102,069) | 7,311,585 |
| **At 31 December 2011** | | | | | | |
| Derivatives | 23,681 | 1,703 | - | - | - | 25,384 |
| Loans and advances to banks | 562,407 | - | - | - | - | 562,407 |
| Loans and advances to customers | 573,634 | 6,819,547 | 325,535 | 245,520 | (90,231) | 7,874,005 |

## Notes on the Financial Statements (continued)

### IV. Loans and advances to customers and banks – net total credit risk

Loans and advances against which the Company had legally enforceable rights to offset with financial liabilities were as follows

| | 2012 Gross Book Value £'000 | 2012 Amount for which the Company has a legally enforceable right to offset £'000 | 2012 Net total credit risk £'000 | 2011 Gross Book Value £'000 | 2011 Amount for which the Company has a legally enforceable right to offset £'000 | 2011 Net total credit risk £'000 |
|---|---|---|---|---|---|---|
| Loans and advances to banks | 240,372 | - | 240,372 | 562,407 | - | 562,407 |
| Loans and advances to customers | 7,400,300 | 517,327 | 6,882,973 | 7,947,709 | 645,122 | 7,302,587 |
| | 7 640,672 | 517 327 | 7,123,345 | 8,510,116 | 645 122 | 7,864 994 |

### V. Impairment allowances

Where impairment losses occur, the Company reduces the carrying amount of loans and advances to customers through the use of an allowance account The following is an analysis of the movement in individually and collectively assessed impairment provisions

| | 2012 Individually assessed £'000 | 2012 Collectively assessed £'000 | 2011 Individually assessed £'000 | 2011 Collectively assessed £'000 |
|---|---|---|---|---|
| At 1 January | 66,107 | 24,124 | 43,284 | 15,797 |
| Amounts written off | (8,513) | - | (1,331) | - |
| Recoveries of amounts written off in previous years | - | - | - | - |
| Charge to income statement | 19,668 | 1,695 | 25,624 | 8,327 |
| Exchange and other movements | (1,012) | - | (1,470) | - |
| At 31 December | 76,250 | 25,819 | 66,107 | 24,124 |

In 2012, interest of £536,000 (2011 £442,000) was accrued on loans for which individually assessed impairment provisions existed

### VI Renegotiated loans and forbearance

The Company may renegotiate the terms and conditions of a loan for a number of reasons which include changing market conditions, customer retention and other reasons not related to the credit condition of a customer Under certain circumstances, the Company may renegotiate the terms and conditions of a loan in response to actual or perceived financial difficulties of a customer, this practice of renegotiation for credit purposes is known as loan forbearance

A range of forbearance strategies are employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default, foreclosure or repossession The policies and practices are based on criteria which, in the judgement of local management, indicate that repayment is likely to continue

Forbearance strategies include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, debt consolidations, the deferral of foreclosure, and other forms of loan modifications and re-ageing These management policies and practices typically provide the customer with terms and

## Notes on the Financial Statements (continued)

conditions that are more favourable than those provided initially Such arrangements could include cases where an account is brought up-to-date without full repayment of all arrears

Loan forbearance is only granted in situations where the customer has showed a willingness to repay the borrowing and is expected to be able to meet the revised obligations From this point forward, the Company discloses loan forbearance as 'renegotiated loans', which represent concessions granted which the Company would not normally consider as a result of financial difficulties of a customer

The following table shows the Company's holdings of renegotiated loans and advances to customers by industry sector and credit quality classification

| | At 31 December 2012 | | | | At 31 December 2011 | | | |
|---|---|---|---|---|---|---|---|---|
| | Neither past due nor impaired | Past due but not impaired | Impaired | Total | Neither past due nor impaired | Past due but not impaired | Impaired | Total |
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Retail | 90,244 | 41,885 | 66,754 | 198,883 | 116,047 | 44,159 | 68,790 | 228,996 |
| Residential Mortgages | 79,664 | 39,187 | 54,833 | 173,684 | 84,868 | 38,182 | 53 761 | 176,811 |
| Other personal | 10,580 | 2 698 | 11 921 | 25,199 | 31,179 | 5,977 | 15,029 | 52,185 |
| Commercial real estate | 197,780 | 38,667 | 78,436 | 314,883 | 103,074 | 5,152 | 43,797 | 152,023 |
| Corporate and commercial | 77 | - | 4 449 | 4,526 | 9,996 | 99 | 5,852 | 15 947 |
| Financials | 7 | - | - | 7 | 3,480 | | - | 3,480 |
| Other | - | 615 | - | 615 | 2,096 | | - | 2,096 |
| | 288,108 | 81,167 | 149,639 | 518,914 | 234,693 | 49,410 | 118,439 | 402,542 |

### VII. Sovereign Debt Exposure

For the purpose of this disclosure, eurozone countries are members of the EU and part of the euro single currency bloc The eurozone countries identified as peripheral exhibited during the period levels of market volatility which exceeded other eurozone countries and demonstrated fiscal or political uncertainty which may persist through 2013 In addition, certain of these countries exhibit high sovereign debt to GDP ratios, short to medium-term maturity concentration of their liabilities, or have sought bailout funding They include Greece, Ireland, Italy, Portugal and Spain

The risk of a split of the eurozone receded during 2012 largely due to the support given by the ECB and to the first steps taken to improve the eurozone coherence This was however obtained with the condition of the implementation of austerity measures in almost all countries and notably in the eurozone periphery As a result the region entered in recession by mid-2012 and this is expected to continue during the first part of 2013 All European countries, including Germany and other Northern countries are affected by the lower demand and global deleveraging although Germany is expected to come out of the crisis more rapidly than other countries due to the fact that it has already implemented structural reforms in past years

The following analysis of the Company's exposures to selected European countries is made voluntarily to reflect developments in best practice disclosure

| | Greece | Ireland | Italy | Portugal | Spain | Total |
|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Loans and advances | 42 | 52,683 | 1,025 | 1,223 | 7 | 54,980 |
| Gross | 42 | 89,630 | 1,025 | 1,223 | 7 | 91,927 |
| Impairment allowances | - | (36,947) | - | - | - | (36 947) |
| Off- balance sheet exposures - commitments | 212 | 143 | 253 | - | 8 | 616 |

# Notes on the Financial Statements (continued)

**b) Liquidity risk management**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due

Approximately 86% of the bank's asset base is sterling-based with the remainder mostly denominated in Euros and US Dollars The Company funds its sterling asset base from a combination of capital resources, customer accounts and short term borrowings from its intermediate parent company, HSBC Bank plc Surplus balances in other currencies are usually placed with HSBC Bank plc or other HSBC Group entities In order to adhere to the FSA's requirements on liquidity the Company maintains the requisite liquid assets buffer

For risk monitoring purposes, management monitor the ratio of net liquid assets to customer accounts Net liquid assets are defined as the difference between liquid assets and liabilities falling due within three months Target and trigger liquidity ratios are set for the Company by HSBC Bank plc

The following is an analysis of assets and liabilities by remaining contractual maturities at the balance sheet date

**31 December 2012:**

| | On demand | Due within 3 months | Due between 3-12 months | Due between 1-5 years | Due after 5 years | Undated | Total |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Assets** | | | | | | | |
| Cash and cash equivalents | 991 | - | - | - | - | - | 991 |
| Derivatives | - | 12,421 | 1,129 | 1,471 | 2,995 | - | 18,016 |
| Loans and advances to banks | 58,641 | 166,065 | 13,686 | 1,980 | - | - | 240,372 |
| Loans and advances to customers | 682,087 | 1,651,862 | 1,624,016 | 3,234,193 | 221,496 | (102,069) | 7,311,585 |
| Financial investments | - | 99,926 | - | 456,999 | 548,260 | - | 1,105,185 |
| Property, plant and equipment | - | - | - | - | - | 23 | 23 |
| Other assets | - | 3,828 | - | - | - | 67,330 | 71,158 |
| Prepayments and accrued income | - | 73,071 | - | - | - | 11,853 | 84,924 |
| **Total as at 31 December 2012** | 741,719 | 2,007,173 | 1,638,831 | 3,694,643 | 772,751 | (22,863) | 8,832,254 |

| | On demand | Due within 3 months | Due between 3-12 months | Due between 1-5 years | Due after 5 years | Undated | Total |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Liabilities and Equity** | | | | | | | |
| Deposit by banks | 74,218 | 180,000 | 1,695,260 | 400,000 | - | - | 2,349 478 |
| Customer accounts | 3,367,503 | 1,177,431 | 567,409 | 203,608 | 123,795 | - | 5,439,746 |
| Derivatives | - | 12,106 | 4,431 | 30,577 | 91,152 | - | 138,266 |
| Other liabilities | - | 10,641 | - | - | - | 12,895 | 23,536 |
| Accruals and deferred income | - | 79,004 | - | - | - | 103 | 79,107 |
| Provisions for liabilities and charges | - | - | - | - | - | 937 | 937 |
| Subordinated liabilities | - | - | 27,841 | 95,561 | 24,748 | - | 148,150 |
| Equity | - | - | - | - | - | 653,034 | 653,034 |
| **Total as at 31 December 2012** | 3,441,721 | 1,459,182 | 2,294,941 | 729,746 | 239,695 | 666,969 | 8,832,254 |

**31 December 2011:**

# Notes on the Financial Statements (continued)

| | On demand | Due within 3 months | Due between 3-12 months | Due between 1-5 years | Due after 5 years | Undated | Total |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Assets** | | | | | | | |
| Cash and cash equivalents | 1,184 | - | - | - | - | - | 1,148 |
| Derivatives | - | 14,472 | 1,522 | 7,352 | 2,038 | - | 25,384 |
| Loans and advances to banks | 92,453 | 450,255 | 8,488 | 11,211 | - | - | 562,407 |
| Loans and advances to customers | 720,271 | 1,710,528 | 1 525,681 | 3,683,249 | 324,506 | (90,230) | 7,874,005 |
| Financial investments | - | - | - | 268,029 | 529,315 | 1,265 | 798,609 |
| Shares in Group undertakings | - | - | - | - | - | 15 088 | 15,088 |
| Property, plant and equipment | - | - | - | - | - | 23 | 23 |
| Other assets | - | 42 | - | - | - | 65,148 | 65,190 |
| Prepayments and accrued income | - | 71 650 | - | - | - | 14 504 | 86 154 |
| **Total as at 31 December 2011** | 813,908 | 2,246,947 | 1,535,691 | 3,969,841 | 855,859 | 5,798 | 9,428,044 |

| | On demand | Due within 3 months | Due between 3-12 months | Due between 1-5 years | Due after 5 years | Undated | Total |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Liabilities and Equity** | | | | | | | |
| Deposit by banks | 162,669 | - | 1,052,110 | 1,641,520 | - | - | 2 856,299 |
| Customer accounts | 3,598,493 | 1,248,167 | 354,591 | 197,273 | 206,702 | - | 5,605,226 |
| Derivatives | - | 5,729 | 1,260 | 33,962 | 71,888 | - | 112,839 |
| Other liabilities | - | 7,082 | - | - | - | 16,909 | 23,991 |
| Accruals and deferred income | - | 74,003 | - | - | - | 13 060 | 87,093 |
| Provisions for liabilities and charges | - | - | - | - | - | 2,992 | 2,992 |
| Subordinated liabilities | - | - | - | 125,442 | 25,835 | - | 151,277 |
| Equity | - | - | - | - | - | 588,327 | 588,327 |
| **Total as at 31 December 2011** | 3,761,162 | 1,335,011 | 1,407,961 | 1,998,197 | 304,425 | 621,288 | 9,428,044 |

The following is an analysis of undiscounted cash flows payable under various financial liabilities by remaining contractual maturities at the balance sheet date

| | On demand | Due within 3 months | Due between 3-12 months | Due between 1-5 years | Due after 5 years | Total |
|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **At 31 December 2012** | | | | | | |
| Deposit by banks | 74,745 | 184 425 | 1,709,639 | 417,253 | - | 2 386,062 |
| Customer accounts | 3,367,503 | 1,185,361 | 577,681 | 223,653 | 142,743 | 5,496,941 |
| Subordinated liabilities | - | 437 | 29,153 | 101,242 | 25,624 | 156 456 |
| | 3,442,248 | 1,370,223 | 2 316,473 | 742 148 | 168,367 | 8 039,459 |

| | On demand | Due within 3 months | Due between 3-12 months | Due between 1-5 years | Due after 5 years | Total |
|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **At 31 December 2011** | | | | | | |
| Deposit by banks | 162,425 | 9,088 | 1,082 113 | 1,740 911 | - | 2,994,537 |
| Customer accounts | 3,598,492 | 1,257,377 | 365,035 | 226,938 | 244,649 | 5,692,491 |
| Subordinated liabilities | - | 567 | 1,701 | 134,514 | 26 999 | 163,781 |
| | 3,760 917 | 1,267 032 | 1,448 849 | 2,102,363 | 271,648 | 8,850,809 |

**c) Market risk management**

## Notes on the Financial Statements (continued)

Market risk is the risk that interest rates, foreign exchange rates or equity and commodity prices will move and result in profits or losses to the Company

The Company manages market risk through risk limits approved by the HSBC Group Executive Committee and adopted by the Company's Board An independent risk unit develops risk management policies and measurement techniques, and reviews limit utilisation on a daily basis

Disclosures on interest rate risk and foreign exchange risk are provided below

**Interest rate risk**

Interest rate risk is managed internally by monitoring the sensitivity of the fair value of the Company's assets and liabilities to a 0 01% shift in yield curves (the present value of a basis point or 'PVBP') At 31 December 2012 the Company's risk as measured by PVBP was £4,129 (2011 £30,241) PVBP is the change in the present value of future cash flows and not an immediate gain or loss in the Income Statement

The PVBP of Interest Rate Swaps which have not qualified as Fair Value Hedges for the purposes of IAS39 (note 20) at 31 December 2012 was £12,326 (2011 £18,821)

The table below discloses the mismatch of the dates on which interest on financial assets and financial liabilities are next reset to market rate on a contractual basis or, if earlier, the dates on which the instruments mature as at 31 December 2012 Actual reset dates may differ from contractual dates owing to prepayments and the exercise of options In addition, contractual terms may not be representative of the behaviour of financial assets and liabilities

**31 December 2012:**

| | Not more than three months | More than three months but not more than six months | More than six months but not more than one year | More than one year but not more than five years | More than five years | Non-interest bearing | Total |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Assets** | | | | | | | |
| Loans & advances to banks | 224,706 | 5,027 | 1,816 | 1,980 | - | 6,843 | 240,372 |
| Loans & advances to customers | | | | | | | |
| - Fair value risk | 112 | 5 584 | 55,350 | 307,517 | 16,184 | - | 384,747 |
| - Cash flow risk | 6,047 622 | 269,009 | 34,853 | 282,169 | 106,553 | 53 530 | 6,793,736 |
| - Neither | 41,217 | 2,700 | 6,790 | 70 292 | 12,103 | - | 133,102 |
| Other assets | 99,926 | - | - | 456,999 | 548,260 | 175,112 | 1,280,297 |
| **Total Assets** | 6 413 583 | 282,320 | 98,809 | 1,118,957 | 683,100 | 235,485 | 8,832,254 |
| **Liabilities** | | | | | | | |
| Deposits by banks | 1,715,739 | 633,739 | - | - | - | - | 2,349,478 |
| Customer accounts | 4,550,423 | 171,176 | 396,233 | 203,608 | 118,306 | - | 5,439,746 |
| Other liabilities | - | - | - | - | - | 241,846 | 241,846 |
| Subordinated liabilities | 24,748 | 123,402 | - | - | - | - | 148,150 |
| Shareholders' equity | - | - | - | - | - | 653,034 | 653,034 |
| **Total equity and liabilities** | 6,290,910 | 928,317 | 396,233 | 203 608 | 118,306 | 894,880 | 8 832 254 |
| **Notional value** | | | | | | | |
| Interest rate swaps | 1,282 692 | (5,455) | (59,863) | (736 991) | (480,383) | - | - |
| **Interest rate sensitivity gap** | 1 405 365 | (651,452) | (357,287) | 178,358 | 84,411 | (659,395) | - |
| **Cumulative interest rate sensitivity gap** | 1,405,365 | 753 913 | 396 626 | 574,984 | 659 395 | - | - |

**31 December 2011:**

# Notes on the Financial Statements (continued)

| | Not more than three months | More than three months but not more than six months | More than six months but not more than one year | More than one year but not more than five years | More than five years | Non-interest bearing | Total |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Assets** | | | | | | | |
| Loans & advances to banks | 542,708 | - | 1 250 | 11,211 | - | 7,238 | 562,407 |
| Loans & advances to Customers | | | | | | | |
| - Fair value risk | 67 | 12,906 | 17,867 | 376,766 | 26,856 | - | 434,462 |
| - Cash flow risk | 6,612,996 | 106,048 | 35,627 | 48,777 | 4,646 | 34,000 | 6,842,094 |
| - Neither | 130,539 | 1,555 | 16,055 | 255,214 | 194,086 | - | 597,449 |
| Other assets | - | - | - | 268,029 | 529,315 | 194,288 | 991,632 |
| **Total Assets** | 7,286,310 | 120,509 | 70 799 | 959,997 | 754,903 | 235,526 | 9,428,044 |
| **Liabilities** | | | | | | | |
| Deposits by banks | 2,564,189 | 220,000 | 72,110 | - | - | - | 2,856,299 |
| Customer accounts | 4,846,660 | 253,622 | 100,969 | 197,273 | 206,702 | - | 5,605,226 |
| Other liabilities | - | - | - | - | - | 226,915 | 226,915 |
| Subordinated liabilities | 25,835 | 125,442 | - | - | - | - | 151,277 |
| Shareholders' equity | - | - | - | - | - | 588,327 | 588,327 |
| **Total equity and liabilities** | 7,436,684 | 599,064 | 173,079 | 197 273 | 206,702 | 815,242 | 9 428 044 |
| **Notional value** | | | | | | | |
| Interest rate swaps | 1,157,096 | (6 146) | (31,239) | (623,785) | (495,926) | - | - |
| **Interest rate sensitivity gap** | 1,006,722 | (484,701) | (133,519) | 138,939 | 52,275 | (579,716) | - |
| **Cumulative interest rate sensitivity gap** | 1,006,722 | 522,021 | 388 502 | 527,441 | 579 716 | - | - |

A positive interest rate sensitivity gap exists where more assets than liabilities re-price during a given period Although a positive gap position tends to benefit net interest income in a rising interest rate environment, the actual effect will depend on a number of factors, including the extent to which repayments are made earlier or later than the contracted date and variations in interest rates within re-pricing periods and among currencies Similarly, a negative interest rate sensitivity gap exists where more liabilities than assets re-price during a given period In this case, a negative gap position tends to benefit net interest income in a declining interest rate environment, but again the actual effect will depend on the same factors as for positive interest rate gaps, as described above

### Foreign exchange risks

The table below shows an analysis of assets and liabilities between balances denominated in sterling and those denominated in other currencies

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Denominated in sterling | 7,638,326 | 8,254,426 |
| Denominated in currencies other than sterling | 1,193,928 | 1,173 618 |
| Total assets | 8 832,254 | 9,428,044 |
| Denominated in sterling | 6,569,072 | 6,979,512 |
| Denominated in currencies other than sterling | 2,263,182 | 2,448,532 |
| Total equity and liabilities | 8,832,254 | 9,428 044 |

## 22 Related party transactions

# Notes on the Financial Statements (continued)

a) Transactions, arrangements and agreements involving Directors and connected persons and Companies controlled by them

| | 2012 Number of Directors | 2012 £'000 | 2011 Number of Directors | 2011 £'000 |
|---|---|---|---|---|
| Loans (including housing loans) to, and guarantees on behalf of | 1 | 1,000 | 1 | 925 |

The maximum amount of loans for Directors outstanding during the year was £1,125,166 (2011 £ 1,301,862)

b) Compensation to the Board of Directors, as executives of the Company, is disclosed in note 5 to the accounts

c) Summary of aggregate balances of transactions with other related parties of HSBC Private Bank (UK) Limited

**Group Companies**

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| **Assets** | | |
| Derivatives | 14,428 | 23,681 |
| Loans and advances to banks | 232,491 | 554,321 |
| **Liabilities** | | |
| Deposits by banks | 2,349,478 | 2,856,299 |
| Derivatives | 136,391 | 106,374 |
| Subordinated liabilities | 148,150 | 151,277 |
| **INCOME STATEMENT** | | |
| Interest income | 6,537 | 12,428 |
| Interest expense | 34 526 | 44,870 |
| Fee income | 15,002 | 19 400 |
| Fee expense | 7,956 | 10,207 |
| Dividend income | 284 | 56 |
| General and administrative expenses | 16,795 | 15,682 |
| **OFF BALANCE SHEET** | | |
| Contract amount of derivatives | 3,510,672 | 3,449,637 |

The above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees The transactions did not involve more than the normal risk of repayment or present other unfavourable features

# Notes on the Financial Statements (continued)

## 23 Parent undertakings

On the 1st October 2012 the Company was sold by its immediate parent, HSBC Private Banking Holdings (Suisse) SA to HSBC Bank plc The ultimate parent company and the parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the Company is a member is HSBC Holdings plc The parent of the smallest such group is HSBC Bank plc

HSBC Bank plc, is the Company's direct controlling party and HSBC Holdings plc is the Company's ultimate controlling party

Copies of the group financial statements of HSBC Holdings plc may be obtained from

HSBC Holdings plc
8 Canada Square
London
E14 5HQ
www hsbc com