HSBC Private Bank (UK) Limited

Registration No: 499482

Annual Report and Financial Statements for the year ended 31 December 2018

HSBC

Annual Report and Financial Statements for the year ended 31 December 2018

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Strategic Report

Principal activities

HSBC Private Bank (UK) Limited ('the Entity') is a private company incorporated in England and Wales, United Kingdom. Its trading address is 8 Canada Square, Londong E14 5HQ.

HSBC Private Bank (UK) Limited is an authorised bank under the Financial Services and Markets Act 2000, authorised by the Prudential Regulation Authority ('PRA') and regulated by the Financial Conduct Authority ('FCA'). The Entity's principal activity is private banking.

Ring-fenced bank

The UK Financial Services (Banking Reform) Act 2013 and associated secondary legislation and regulatory rules required UK deposit-taking banks with more than £25m of 'core deposits' (broadly from individuals and small to medium-sized businesses) to separate their UK retail banking activities from their other wholesale and investment banking activities by 1 January 2019. The resulting UK ring fenced bank entities need to be legally distinct, operationally separate and economically independent from the non-ring-fenced bank entities.

The Entity is a subsidiary of HSBC UK Bank plc ('HSBC UK'), HSBC's UK ring fenced bank, which also includes Retail Banking and Wealth Management ('RBWM') and Commercial Banking ('CMB'). These businesses were transferred from HSBC Bank plc on 1 July 2018, following the court approval of the ring-fenced transfer scheme to meet the regulatory ring-fencing requirements in accordance with the Financial Services (Banking Reform) Act 2013 and related legislation.

The primary means of transferring the Entity's qualifying customers to the ring fenced bank was through a court approved ring-fencing scheme ('RFTS') as provided for in Part VII, section 106 of the Financial Services and Market Act 2000 (as amended) ('FSMA'). In addition to these transfers, certain items were transferred through other legal arrangements.

Divisionalisation

Supporting the Group's strategy to streamline legal structures, the Entity is proposing to transfer its business into HSBC UK, in 2019. Such transfer can be effected pursuant to a Banking Business Transfer Scheme under Part VII of the UK Financial Services and Markets Act 2000 (a Part VII Scheme). A Part VII Scheme is a court approved business transfer scheme. The Entity's business would be transferred to HSBC UK by operation of law pursuant to an order of the English High Court and subject to a scheme document, which would set out the full terms of the transfer.

For the purposes of the laws of jurisdictions within the United Kingdom, the Entity's assets, rights, obligations and liabilities (contractual or otherwise) will transfer so as to substitute HSBC UK for the Entity. As a result, counterparty consent is not required to effect the transfer of the Entity's business as a matter of the laws of the jurisdictions within the United Kingdom. In the case of arrangements which are not governed by laws of the jurisdictions within the United Kingdom, further steps may be necessary to transfer such arrangement, such as contractual assignments or novations. This will depend on the governing law involved, as certain jurisdictions do not recognise the enforceability of a Part VII Scheme.

It is planned to transfer the assets and liabilities of the Entity to HSBC UK at book value on the date of transfer.

Review of the Entity's business

As part of the HSBC Group the Entity leverages the group's network of business and countries. The Entity's key strategy is to serve private banking clients who are business owners and are served as corporate clients by CMB. At the same time, the Entity targets wealthy private individuals served by RBWM, in order to provide them with a seamless wealth proposition, and executives of Global Banking & Markets' (GBM) institutional clients. In 2018 there has been an above plan performance in referrals from existing HSBC Group clients.

The Entity works closely with its clients to provide solutions to grow, manage and preserve wealth. Its products and services include:

- Discretionary and brokerage service;
- Credit advisory (overdrafts/lending);
- Deposit products;
- Foreign exchange;
- Investment management and advice (both advisory and discretionary services); and
- Private wealth solutions and planning, including trust and estate planning.

The Entity no longer contains asset management capabilities, as these have been transferred to the RBWM business in HSBC UK.

During 2018, the Entity continued to make satisfactory progress in delivering its strategy to:

- deliver an enhanced banking and wealth management proposition to clients to help them grow and protect their wealth;
- be the private bank of choice for HSBC Group's most valuable clients and connect them to the best of HSBC Group's capabilities;
- deliver increasing profits and capital efficient returns to the Group; and
- focus on being the bank of choice for business owners and entrepreneurs.

Key enablers of the strategic plan are the replacement of the Global Platform via the Global Platform Replacement project. All other strategic areas are supported by Global Private Bank's global programmes.

Performance

The Entity's results for the year under review are as detailed in the income statement shown on page 11 of these financial statements.

The profit for 2018 is £31,507,000, 70% higher than in 2017 due to lower expected credit losses and other credit impairment charges ('ECLs'), higher net interest income ('NII') and lower operating expenses.

Revenue in 2018 decreased by £23,043,000 (13%) mainly due to the by the Entity no longer incurring and recharging head office costs for non ring-fenced Global Private Bank entities. Client revenue relating to net interest income (NII) is £3,001,000 higher than 2017 primarily driven by the impact of the Bank of England interest rate rise and higher liquidity premiums on client assets, partially offset by lower lending NII due to increased repayments and margin compression in 2018.

Operating expenses decreased by £29,917,000 (21%) due to lower head office recharges as noted above and the implementation of a revised cost share agreement with HSBC Private Bank Channel Islands, which was required following the introduction of MIFID II in 2018.

Loan impairments charges are £605,000 in 2018 versus £10,431,000 in 2017. Whilst impairments were in line with previous periods, these were offset by three large recoveries and the implementation of the Entity specific Probability of Default (PD) model in 2018. On the transition to IFRS9 the Entity adopted the UK corporate PD model as a tactical solution to calculate Expected Credit Losses (ECL), until the Entity's PD model was deployed. Whilst the entity is exposed to broadly similar UK systematic risks, the default rates were more conservative. In 2017 there was a single significant loan impairment related to a legacy lending relationship within the portfolio that is being exited.

Business position

Assets decreased by 9% from £7,011,119,000 in December 2017 to £6,404,241,000 in December 2018. This was due to reduced loans and advances with banks, as a consequence of reduced client accounts. Liabilities decreased between December 2017 and 2018, from £6,407,362,000 to £ 5,790,173,000, a 10% decrease. This reduction is primarily due to a 12% decline in customer accounts caused by the low interest rates offered on deposit products and client liquidity events.

Total equity of the Entity increased by £10,311,000 to £614,068,000 at 31 December 2018 (31 December 2017: £603,757,000).

Total Assets under management (including cash deposits) decreased to £8,583,068,964 at 31 December 2018 (31 December 2017: £9,080,113,000). This decrease is primarily driven by client caution due to market uncertainty, client liquidity events and the Entity's strategy to build a more balanced portfolio of wealth management products.

Key performance indicators

The Directors use Key Performance Indicators ('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 Entity is exposed.

Financial KPIs

	Target	2018	2017
Profit before tax (£'000)	36,932	42,439	25,739
Pre-tax return on risk-weighted assets (%)	2	2	1
Common equity tier 1 (%)	26	29	28
Cost efficiency ratio (%)	73	73	79

Profit before tax of £42,439,000 in 2018 was 65% higher than in 2017 and 15% higher than target. The significant increase in profitability has been driven by the increase in interest rates on customer accounts and lower loan impairment charges in 2018.

Pre-tax return on average risk-weighted assets is measured as pre-tax profit divided by average risk weighted assets. The increase from 1% in 2017 to 2% in 2018 was driven by profitability, as risk-weighted assets remained broadly flat, consistent with the loans and advances to customers.

Capital has remained very stable through the period. The Entity's capital comprises Common Equity Tier 1 (CET1) only, which is the highest quality form of capital, consisting of shareholders' equity and non-controlling interest less regulatory deductions and adjustments. The Entity increased its capital base to 29% in 2018. The Entity's approach to managing its capital is to ensure it exceeds current regulatory requirements and has sufficient capital to meet future expected regulatory changes and support the development of its business.

Cost efficiency is measured as total operating expenses divided by operating income before loan impairment charges and other credit risk provisions. Performance has improved year on year due to the change in treatment of intergroup costs and heightened cost management.

Principal risks and uncertainties

The principal financial risks and uncertainties facing the Entity are credit risk, market risk and liquidity risk. These risks, the exposure to such risks and management of risk are set out in Note 28 of the financial statements.

The most important non-financial types of risk are operational risk, legal, conduct and regulatory risk, including financial crime compliance, reputational risk and cyber risk. The Directors have put in place procedures to monitor and manage these risks.

Operational risk is relevant to every aspect of the Entity'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 Entity'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 Entity's risk appetite, as proposed by the Risk Management Committee set by the Board.

In July 2015 and November 2015 respectively, two actions were brought by individuals against the Entity in the High Court of England and Wales seeking damages on various alleged grounds, including breach of duty to the claimants, in connection with their participation in certain Ingenious film finance schemes.

In December 2018, a further action was brought against the Entity in the High Court of England and Wales by multiple claimants seeking damages for alleged unlawful means conspiracy and dishonest assistance in connection with lending provided by the Entity to third parties in respect of certain Ingenious film finance schemes in which the claimants participated. In February 2019, the Entity received a letter before claim by investors in Eclipse film finance schemes asserting various claims against the Entity and others in connection with their roles in facilitating the design, promotion and operation of such schemes. These matters are at very early stages.

It is possible that additional actions or investigations will be initiated against the Entity as a result of its historic involvement in the provision of certain film finance related services.

In February 2019, various HSBC companies, including the Entity, were named as defendants in a claim issued in the High Court of England and Wales that alleges foreign exchange-related misconduct.

Based on the facts currently known, it is not practicable to estimate the resolution of these matters, including the timing or possible aggregate impact on the Entity, which could be significant.

Regulators in the UK and other countries have continued to increase their focus on 'conduct' matters relating to fair outcomes for customers and orderly/transparent markets, including, for example, attention to sales processes and incentives, products and investment suitability, product governance, employee activities and accountabilities.

In the UK, the FCA is making increasing use of existing and new powers of intervention and enforcement, including powers to consider past business undertaken and implement customer compensation and redress schemes or other, potentially significant, remedial work. The FCA is also regulating areas of activity not previously regulated by them, such as consumer credit, and considering competition issues in the markets they regulate. Additionally, the FCA increasingly takes actions in response to customer complaints or where they see poor customer outcomes and/or market abuses, either specific to an institution or more generally in relation to a particular product.

Financial service providers face increasingly stringent and costly regulatory and supervisory requirements, particularly in the areas of capital and liquidity management, conduct of business, operational structures and the integrity of financial services delivery. Increased government intervention and control over financial institutions may significantly alter the competitive landscape.

The Entity maintains a strong compliance culture and monitors the regulatory environment closely to react proactively to changes and reduce risks to the business.

Like other public and private organisations, the Entity continues to be a target of cyber-attacks, which in some cases, the intention of these attacks are to disrupt services including the availability of the Entity's external facing websites, compromise organisations and customer information or expose security weaknesses. Management of cyber risks is coming under increased regulatory scrutiny.

The security of the Entity's information and technology infrastructure is crucial for maintaining the Entity's banking application process and protecting the Entity's customers and the HSBC brand.

The UK is due to formally leave the EU in March 2019. However, there is no certainty on the future relationship between the UK and the EU or indeed an implementation period. This creates market volatility and economic risk, particularly in the UK. While there may be some changes to the provision of products and services for our clients and employees based in the UK, we are taking mitigating actions to help minimise any potential disruption. Our priority is to ensure we continue to support our clients through this period of uncertainty, and help them minimise the impact of these potential risks. We continue to stay very close to our clients, via proactive communications and dedicated channels to respond to customer queries. Through sectorial analysis, portfolio reviews and stress-testing scenarios, we have developed a range of contingency plans to ensure we continue to support our clients and minimise potential disruption. For further information, please refer to Note 32 on page 49.

On behalf of the Board

Charles Boulton
Director
19 February 2019

8 Canada Square
Londong E14 5HQ

Report of the Directors

Directors

The Directors of the Entity who were in office during the year and up to the date of signing the financial statements were as follows:

Name	Appointed	Resigned
C Boulton	15 May 2018	
J Coyle	12 December 2018	
D W Lister	12 December 2018	
J F Trueman	01 April 2013	
D Stewart	02 June 2016	
C Allen	20 August 2012	12 December 2018
P Boyles	18 April 2016	12 December 2018
J Paterson	03 October 2016	12 December 2018
P Tremble	27 March 2012	12 December 2018

The Articles of Association of the Entity provide that in certain circumstances the Directors are entitled to be indemnified out of the assets of the Entity 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. All Directors have the benefit of Directors' and officers' liability insurance.

Dividends

A dividend was declared by the Directors during the year ended 31 December 2018 for £18,000,000 (2017: £128,000,000)

Significant events since the end of the financial year

No significant events affecting the Entity have occurred since the end of the financial year.

Future developments

The Entity's activities are expected to be divisionalised into HSBC UK plc in 2019.

Going concern basis

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the Entity 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.

Subject to internal and regulatory approvals, in support of the Group's strategy to streamline legal structures and operations, the Entity is proposing to transfer its business at book value to its parent undertaking, HSBC UK Bank plc. Divisionalisation is planned to take place in the last quarter of 2019, but the financial statements will continue to be prepared on a going concern basis, until the decision has been taken to liquidate the Entity.

Financial risk management

The financial risk management objectives and policies of the Entity, 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 28 of the Notes on the financial statements.

Employment of people with a disability

The Entity is committed to providing equal opportunities to employees. The employment of people with a disability is included in this commitment. The recruitment, training, career development and promotion of people with a disability are based on the aptitudes and abilities of the individual. Should employees become disabled during employment with us, efforts are made to continue their employment and, if necessary, appropriate training, reasonable equipment and facilities are provided.

Employment policy

The Entity 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 Entity's performance through management channels, oral communication 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 Entity is further encouraged through a profit participation scheme.

Capital management [Audited]

The Entity defines capital as total shareholders' equity. It is the Entity'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 Entity's approach to capital management during the year.

The Entity manages it's capital within the context of an annual capital plan which determines the optimal amount and mix of capital required to support planned business growth and meet local regulatory capital requirements.

All regulatory capital requirements were met in 2018.

Pillar 3 of the Basel regulatory framework is related to market discipline and aims to make firms more transparent by requiring them to publish specific details of their risks and capital, and how these are managed. Separate Pillar 3 disclosures are not required for the Entity as the Entity is included in the consolidated Pillar 3 disclosures of HSBC UK Bank plc. These disclosures are published as a separate document on www.hsbc.com.

The PRA is the supervisor of the Entity. The PRA sets capital requirements and receives information on the capital adequacy of the Entity. The Entity complied with the PRA's capital adequacy requirements throughout 2018. Since 1 January 2014, our capital is calculated under CRD IV and supplemented by the PRA Rulebook to effect the transposition of CRD IV directive requirements. The Basel III framework, similarly to Basel II, is structured around three 'pillars': minimum capital requirements, supervisory review process and market discipline. Basel III also introduces a number of capital buffers, including the Capital Conservation Buffer ('CCB'), Countercyclical Capital Buffer ('CCyB'), and other systemic buffers such as the Globally/Other Systemically Important Institutions ('G-SII'/'O-SII') buffer. CRD IV legislation implemented Basel III in the EU, and in the UK, the 'PRA Rulebook' for CRR firms transposed the various discretions under CRD IV legislation into UK requirements.

Regulatory capital

The Entity's capital base is divided into two main categories namely common equity tier 1 and tier 2, depending on the degree of permanency and loss absorbency exhibited.

- Common equity tier 1 capital is the highest quality form of capital, comprising shareholders' equity. Under CRD IV various capital deductions are treated differently for the purposes of capital adequacy - these include negative amounts resulting from the calculation of expected loss amounts under IRB.
- Tier 2 comprises subordinated loans. Currently the Entity has no tier 2 capital.

Calculation of actual capital

	2018 £'000	2017 £'000
Tier 1 capital		
Shareholders' equity	**614,068**	603,757
Regulatory adjustments to the accounting basis		
Deductions		
- Excess expected losses over impairment allowances	**(19,237)**	(18,387)
Common equity tier 1 capital	**594,831**	585,370
Tier 1 capital	**594,831**	585,370
Total regulatory capital	**594,831**	585,370
Risk-weighted assets [unaudited]		
Credit and counterparty risk	**1,708,927**	1,768,503
Market risk	**109**	3,844
Operational risk	**320,869**	346,500
Total	**2,029,905**	2,118,847
Capital ratios (%)		
Common equity tier 1 ratio	**29**	28
Tier 1 ratio	**29**	28
Total capital ratio	**29**	28

Independent auditors

PricewaterhouseCoopers LLP ('PwC') is external auditor to the Entity. PwC has expressed its willingness to continue in office and the Board recommends that PwC be re-appointed as the Entity's auditor.

Directors' responsibility statement

The Directors are responsible for preparing the *Annual Report and Financial Statements*, in accordance with applicable law and regulations.

Company law requires the Directors to prepare a Strategic Report, a Report of the Directors and Financial Statements for each financial year. The Directors are required to prepare the financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union ('EU').

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 Entity and of the profit or loss 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 a going concern basis unless it is inappropriate to presume the Entity will continue in business.

The Directors have responsibility for ensuring that sufficient accounting records are kept that disclose with reasonable accuracy at any time the financial position of the Entity and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for safeguarding the assets of the Entity and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Disclosure of Information to Auditors

In accordance with section 418 of the Companies Act 2006, the Directors' report includes a statement, in the case of each Director in office as at the date the Report of the Directors is approved, that:

- so far as the Director is aware, there is no relevant audit information of which the Entity's auditors are unaware; and
- they have taken all the steps they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Entity's auditors are aware of that information.

On behalf of the Board

Charles Boulton
Director
19 February 2019

8 Canada Square
Londong E14 5HQ

Independent auditors' report to the members of HSBC Private Bank (UK) Limited

Report on the audit of the financial statements

Opinion

In our opinion, HSBC Private Bank (UK) Limited's ("the Entity") financial statements:

- give a true and fair view of the state of the Entity's affairs as at 31 December 2018 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the balance sheet as at 31 December 2018; the income statement, the statement of comprehensive income, the statement of cash flows, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Entity.

Other than those disclosed in note 6 to the financial statements, we have provided no non-audit services to the Entity in the period from 1 January 2018 to 31 December 2018.

Our audit approach

Overview

Materiality	• Overall materiality: £5.9 million (2017: £5.9 million), based on 1% of regulatory capital.
Audit Scope	• The Entity comprises one legal entity in the UK.
Key audit matters	• Impairment of loans and advances to customers. • Litigation provisions relating to film finance transactions. • IT Access management.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the Entity and the industry in which it operates, and considered the risk of acts by the Entity which were contrary to applicable laws and regulations, including fraud. We designed audit procedures to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the Entity's financial statements, including, but not limited to, the Companies Act 2006, Pensions legislation, UK tax legislation, the Financial Conduct Authority's Client Asset Sourcebook, the Prudential Regulation Authority's regulations. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with the regulators, review of correspondence with legal advisors, enquiries of management and review of internal audit reports in so far as they related to the financial statements. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries to increase revenue or reduce expenditure, and management bias in accounting estimates. Our audit procedures included challenging assumptions and judgements made by management in their significant accounting estimates, in particular in relation to impairment of loans and advances to customer (see related key audit matter below); and identifying and testing journal entries, in particular any journal entries posted with unusual account combinations or posted by senior management.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Impairment of loans and advances to customers As this is the first year of adoption of IFRS 9, there is limited experience available to back-test the charge for expected credit losses with actual results. There is also a significant increase in the number of data inputs required for the impairment calculation. The data is sourced from a number of systems that have not been used previously for the preparation of the accounting records. This increases risk around completeness and accuracy of certain data used to create assumptions and operate the models. The credit environment has remained relatively benign for an extended period of time, in part due to low interest rates, relative strength of the economy and low unemployment. However, there are a number of headwinds to the economy as well as specific risks relating to the exact nature of the UK's exit from the European Union. As a result, whilst the current levels of delinquencies and defaults remains low, the risk of impairment remains significant.	Controls were tested over: The annual loan review process, the compilation and review of the credit watch list, approval of external collateral valuation vendors, approval of significant individual impairments; Inputs of critical data, into source system, and the flow and transformation of data between source systems to the impairment calculation engine were tested. User acceptance testing over the automated calculation of ECL to ensure it is performed in line with business requirements. Review and assessment of key assumptions and judgements, including calculation methodologies and adjustments or overlays. Review and challenge forums to assess ECL output and approval of post model adjustments. Review and approval of the key inputs, assumptions and discounted cash-flows that support significant individual impairments. Further substantive procedures included: Testing a sample of loans as at year end using a risk-based sampling methodology directed at those loans which we consider to represent the highest credit risk; Risk based testing of models, including independent re-build of certain assumptions. Assessing the appropriateness of changes to the modelling policy and methodology used for material portfolios, against the requirements of the standard. Assessing refreshed analysis on global judgements and simplifications. Testing of the critical data used in the year end ECL calculation.
Litigation provisions relating to film finance transactions The determination of when and how to recognise conduct and litigation provisions is highly judgemental and the exposure of the banking industry to claims is high. In prior years judgement has been required around the exposure to claims made by parties in relation to film financing transactions. Further development around open cases have taken place this year. We have determined this remains an area of audit focus.	Our audit procedures in relation to litigation included: Understanding and testing of controls around identification and assessment of current legal and regulatory related provisions. Testing completeness of litigation and regulatory claims through: Inspecting regulatory correspondence Reviewing a sample of legal expenses to test completeness of litigation. Inspecting minutes of key governance meetings including Board minutes, Audit & Risk Committee minutes. For material open legal cases, we examined case status, met internal counsel and in certain instances obtained external legal counsel confirmations to understand the legal position and the basis of material risk positions.
IT Access management All banks are highly dependent on technology due to the significant number of transactions that are processed daily. The audit approach relies extensively on automated controls and therefore on the effectiveness of controls over IT systems. In previous years, we identified and reported that controls over access to applications, operating systems and data in the financial reporting process required improvements. Access management controls are critical to ensure that changes to applications and underlying data are made in an appropriate manner. Appropriate access controls contribute to mitigating the risk of potential fraud or errors as a result of changes to applications and data. Management implemented several remediation activities that contributed to reducing the risk over access management in the financial reporting process. These included implementation of preventative and detective controls across critical applications and infrastructure, with the aim of reducing risks presented by excessive privileged access to IT infrastructure.	Our audit procedures in relation to IT Access management included:: Access rights were tested over applications, operating systems and databases relied upon for financial reporting. Specifically, the audit tested that: New access requests for joiners were properly reviewed and authorised; User access rights were removed on a timely basis when an individual left or moved role; Access rights to applications, operating systems and databases were periodically monitored for appropriateness; and Highly privileged access is restricted to appropriate personnel. As a consequence of deficiencies identified, a range of other procedures were performed: Where inappropriate access was identified, we understood the nature of the access and obtained additional evidence on the appropriateness of the activities performed; and A list of users' access permissions was obtained and manually compared to other access lists where segregation of duties was deemed to be of higher risk, for example, users having access to both core banking and payments systems.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Entity, the accounting processes and controls, and the industry in which it operates.

The Entity comprises one legal entity in the UK; in establishing the overall approach to the audit a key element of our audit involved assessing controls and processes to be tested in other HSBC Group and shared service centre locations. The HSBC Group engagement team performed audit procedures for our purposes, including the revaluation of financial instruments and testing of IT applications under our instruction.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall Materiality	£5.9 million (2017: £5.9 million).
How we determined it	1% of Regulatory Capital
Rationale for benchmark applied	Considering the principal users of the financial statements, and that the Entity is a wholly owned subsidiary, we believe that capital resources is the appropriate benchmark.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £297,000 (2017: £293,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Entity's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Entity's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Report of the Directors, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic Report and Report of the Directors

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Report of the Directors for the year ended 31 December 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the Entity and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Report of the Directors.

Responsibilities for the financial statements and the audit

Responsibilities of the Directors for the financial statements

As explained more fully in the Directors' responsibility statement set out on page 6, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the *directors either intend to liquidate the Entity or to cease operations, or have no realistic alternative but to do so.*

Auditors' responsibilities for the audit of the financial statements

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

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Entity's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the directors on 15 July 2015 to audit the financial statements for the year ended 31 December 2015 and subsequent financial periods. The period of total uninterrupted engagement is 4 years, covering the years ended 31 December 2015 to 31 December 2018.

Matthew Falconer

Matthew Falconer (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
19 February 2019

Financial statements

Income statement for the year ended 31 December 2018

	Notes	2018 £'000	2017 £'000
Interest income		**140,742**	122,755
Interest expense		**(27,068)**	(12,082)
Net interest income	2	**113,674**	110,673
Fee and commission income		**40,719**	39,658
Fee and commission expense		**(14,077)**	(13,232)
Net fee income	2	**26,642**	26,426
Net trading income		**3,049**	2,971
Other operating income		**9,894**	36,232
Net operating income before loan impairment charges and other credit risk provision		**153,259**	176,302
Loan impairment charges and other credit risk provisions	2	**(605)**	(10,431)
Net operating income		**152,654**	165,871
Employee compensation and benefits	3	**(42,751)**	(38,441)
General and administrative expenses		**(64,297)**	(101,057)
Amortisation and impairment of intangible assets	19	**(3,167)**	(634)
Total operating expenses		**(110,215)**	(140,132)
Operating profit		**42,439**	25,739
Profit before tax		**42,439**	25,739
Tax expense	7	**(10,932)**	(7,187)
Profit for the year		**31,507**	18,552

*The Entity's business will become a discontinued operation upon divisionalisation. Revenues and expenses will be recognised in HSBC UK plc upon the date of transfer. Please see Strategic Report on page 1 for further information.

Statement of comprehensive income for the year ended 31 December 2018

There has been no comprehensive income or expense other than the profit for the year as shown above (2017: nil).

Balance sheet at 31 December 2018
Registration No: 499482

	Notes	2018 £'000	2017 £'000
Assets			
Cash and balances at central banks		**9,490**	16,316
Derivatives	14	**5,248**	9,626
Loans and advances to banks	16	**1,967,797**	2,438,975
Loans and advances to customers	17	**4,258,627**	4,474,483
Prepayments and accrued income		**15,817**	17,228
Other assets	20	**123,710**	43,977
Property, plant and equipment	18	**330**	23
Intangible assets	19	**21,084**	9,092
Deferred tax assets	8	**2,138**	1,399
Total assets		**6,404,241**	7,011,119
Liabilities and equity			
Liabilities			
Customer accounts	21	**5,338,158**	6,045,228
Derivatives	14	**5,464**	8,989
Accruals, deferred income and other liabilities	22	**435,602**	343,704
Current tax liabilities	7	**10,599**	6,813
Provisions	23	**350**	2,628
Total liabilities		**5,790,173**	6,407,362
Equity			
Called up share capital	26	**176,910**	176,910
Share premium account		**404,636**	404,636
Retained earnings		**32,522**	22,211
Total equity		**614,068**	603,757
Total liabilities and equity		**6,404,241**	7,011,119

*The Entity's business will become a discontinued operation upon divisionalisation. The assets and liabilities will be transferred at their book value to HSBC UK Bank plc upon the date of transfer. Please see Strategic Report on page 1 for further information.

The accompanying notes on pages 15 to 50 form an integral part of these financial statements.

These financial statements were approved by the Board of Director on 19 February 2019 and signed on its behalf by:

Charles Boulton
Director

Statement of cash flows for the year ended 31 December 2018

	Notes	2018 £'000	2017 £'000
Cash flows from operating activities			
Profit before tax		42,439	25,739
Adjustments for:			
Non-cash items included in profit before tax	10	1,912	12,268
Change in operating assets	10	1,702,681	(1,337,370)
Change in operating liabilities	10	(668,457)	982,602
Elimination of exchange differences		(3,001)	(2,843)
Tax paid		(6,956)	(37,167)
Net cash generated from/(used in) operating activities		1,068,618	(356,771)
Cash flows from investing activities			
Proceeds from disposal of subsidiary		–	401,360
Net cash generated from investing activities		–	401,360
Cash flows from financing activities			
Dividends paid		(18,000)	(128,000)
Net cash used in financing activities		(18,000)	(128,000)
Net increase/(decrease) in cash and cash equivalents		1,050,618	(83,411)
Cash and cash equivalents brought forward		733,440	822,285
Effect of exchange rate changes on cash and cash equivalents		(1,848)	(5,434)
Cash and cash equivalents carried forward	10	1,782,210	733,440

*The Entity's business will become a discontinued operation upon divisionalisation. The cash flows of the Entity will be part of HSBC UK Bank plc upon the date of transfer. Please see Strategic Report on page 1 for further information

Statement of changes in equity for the year ended 31 December 2018

	Called up share capital	Share Premium	Retained earnings	Total equity
	£'000	£'000	£'000	£'000
As at 31 Dec 2017	**176,910**	**404,636**	**22,211**	**603,757**
Impact on transition to IFRS 9			**(3,679)**	**(3,679)**
At 1 Jan 2018	**176,910**	**404,636**	**18,532**	**600,078**
Total comprehensive income for the year	**—**	**—**	**31,507**	**31,507**
Dividends to shareholders	**—**	**—**	**(18,000)**	**(18,000)**
Net impact of equity-settled share-based payments	**—**	**—**	**544**	**544**
Other movements	**—**	**—**	**(61)**	**(61)**
At 31 Dec 2018	**176,910**	**404,636**	**32,522**	**614,068**

At 1 Jan 2017	176,910	404,636	131,680	713,226
Total comprehensive income for the year	—	—	18,552	18,552
Dividends to shareholders	—	—	(128,000)	(128,000)
Net impact of equity-settled share-based payments	—	—	(50)	(50)
Other movements	—	—	29	29
At 31 Dec 2017	176,910	404,636	22,211	603,757

Equity is fully attributable to equity shareholders of HSBC Private Bank (UK) Limited.

Notes on the financial statements

1 Basis of preparation and significant accounting policies

The financial statements of the Entity have been prepared in accordance with the Companies Act 2006 as applicable to companies using International Financial Reporting Standards ('IFRSs'). The principal accounting policies applied in the preparation of these financial statements have been consistently applied to all of the years presented, unless otherwise stated.

1.1 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The financial statements of the Entity have been prepared in accordance with IFRSs as issued by the International Accounting Standards Board ('IASB'), including interpretations issued by the IFRS Interpretations Committee, and as endorsed by the European Union ('EU').

Standards adopted during the year ended 31 December 2018

The Entity has adopted the requirements of IFRS 9 from 1 January 2018. This includes the adoption of 'Prepayment Features with Negative Compensation (Amendments to IFRS 9)' which is effective for annual periods beginning on or after 1 January 2019 with early adoption permitted. The effect of its adoption is not considered to be significant. IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting, which the Entity has exercised. The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application. As permitted by IFRS 9, the Entity has not restated comparatives. Adoption reduced net assets at 1 January 2018 by £3.7m as set out in Note 31.

In addition, the Entity has adopted the requirements of IFRS 15 'Revenue from contracts with customers' and a number of interpretations and amendments to standards which have had an insignificant effect on the financial statements of the Entity. Revenue from contracts with customers is disclosed together with other sources of revenue in the statement of profit and loss.

There is no impact of adoption of IFRS16, since there are no leases.

IFRS 9 transitional requirements

The transitional requirements of IFRS 9 necessitated a review of the designation of financial instruments at fair value. No changes were made as the result of the review as it is set out in Note 31.

(b) Future accounting developments

Minor amendments to IFRSs

The IASB published a number of minor amendments to IFRSs which are effective from 1 January 2019, some of which have been endorsed for use in the EU. The Entity expects they will have an insignificant effect, when adopted, on the financial statements of the Entity.

Major new IFRSs

The IASB has published IFRS 16 'Leases' and IFRS 17 'Insurance contracts'. IFRS 16 has been endorsed for use in the EU and IFRS 17 has not yet been endorsed. In addition, an amendment to IAS 12 'Income Taxes' has not yet been endorsed.

Amendment to IAS 12 'Income Taxes'

An amendment to IAS 12 was issued in December 2017 as part of the annual improvement cycle. The amendment clarifies that an Entity should recognise the tax consequences of dividends where the transactions or events that generated the distributable profits are recognised. This amendment is effective for annual periods beginning on or after 1 January 2019 and is applied to the income tax consequences of distributions recognised on or after the beginning of the earliest comparative period. As a consequence, income tax related to distributions on perpetual subordinated contingent convertible capital securities will be presented in profit or loss rather than equity.

(c) Foreign currencies

The functional currency of the Entity is Sterling pounds, which is also the presentational currency of the financial statements of the Entity.

Transactions in foreign currencies are recorded at the rate of exchange on the date of the transaction. Assets and liabilities denominated in foreign currencies are translated at the rate of exchange at the balance sheet date except non-monetary assets and liabilities measured at historical cost, which are translated using the rate of exchange at the initial transaction date. Exchange differences are included in other comprehensive income or in the income statement depending on where the gain or loss on the underlying item is recognised.

(d) Presentation of information

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

(e) Critical accounting estimates and judgements

The preparation of financial information requires the use of estimates and judgements about future conditions. In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of items, highlighted as the 'critical accounting estimates and judgements' in section 1.2 to follow, it is possible that the outcomes in the next financial year could differ from those on which management's estimates are based. This could result in materially different conclusions from those reached by management for the purposes of these financial statements.

Directors' selection of the Entity 's accounting policies which contain critical estimates and judgements reflects the materiality of the items to which the policies are applied and the high degree of judgement and estimation uncertainty involved.

(f) Going concern

Please see Report of the Directors on page 4.

1.2 Summary of significant accounting policies

(a) Income and expense

Interest income and expense

Interest income and expense for all financial instruments, excluding 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.

Interest on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Non-interest income and expense

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

- Income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating a transaction, such as the acquisition of shares, for a third party); and
- Income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management services).

Fees and commissions related to the acquisition of loans or securities are included in determination of their effective interest rate. Management advisory and service fees are recognised based on the applicable service contracts. Fees related to provision of services are recognised over the period as the service is provided. Fees such as underwriting fees or brokerage fees that are related to provision of specific transaction type services are recognised when the service has been completed.

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 the related interest income, expense and dividends.

(b) Valuation of financial instruments

All financial instruments are initially recognised at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, if there is a difference between the transaction price and the fair value of financial instruments whose fair value is based on a quoted price in an active market or a valuation technique that uses only data from observable markets, the Entity recognises the difference as a trading gain or loss at inception (a 'day 1 gain or loss'). In all other cases, the entire day 1 gain or loss is deferred and recognised in the income statement over the life of the transaction either until the transaction matures or is closed out and the valuation inputs become observable or the Entity enters into an offsetting transaction.

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

Critical accounting estimates and judgements

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

(c) Financial instruments measured at amortised cost

Financial assets that are held to collect the contractual cash flows and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest, are measured at amortised cost. Such financial assets include most loans and advances to banks and customers and some debt securities. In addition, most financial liabilities are measured at amortised cost. The Entity accounts for regular way amortised cost financial instruments using trade date accounting. The carrying value of these financial assets and initial recognition includes any directly attributable transaction costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some leveraged finance and syndicated lending activities, the difference is deferred and recognised over the life of the loan through the recognition of interest income.

The Entity may commit to underwriting loans on fixed contractual terms for specified periods of time. When the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative. When the Entity intends to hold the loan, a provision on the loan commitment is only recorded where it is probable that the Entity will incur a loss.

(d) Financial instruments designated at fair value through profit or loss

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated irrevocably at inception:

- the use of the designation removes or significantly reduces an accounting mismatch;
- a group of financial assets, liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; and
- the financial liability contain one or more non-closely related embedded derivatives.

Designated financial assets are recognised when the Entity enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when the rights to the cash flows expire or are transferred. Designated financial liabilities are recognised when the Entity enters into contracts with counterparties, which is generally on settlement date, and are normally derecognised when extinguished. Subsequent changes in fair values are recognised in the income statement in 'Net income from financial instruments held for trading or managed on a fair value basis', including related derivatives, measured at fair value through profit or loss.

Under the above criterion, the main classes of financial instruments designated by the Entity are:

- Long-term debt issues.

The interest and/or foreign exchange exposure on certain fixed rate debt securities issued has been matched with the interest and/or foreign exchange exposure on certain swaps as part of a documented risk management strategy.

- Financial assets and financial liabilities under unit-linked and non-linked investment contracts.

A contract under which the Entity does not accept significant insurance risk from another party is not classified as an insurance contract, other than investment contracts with discretionary participation features ('DPF'), but is accounted for as a financial liability. Customer liabilities under linked and certain non-linked investment contracts issued by insurance subsidiaries are determined based on the fair value of the assets held in the linked funds. If no fair value designation was made for the related assets, at least some of the assets would otherwise be measured at either fair value through other comprehensive income or amortised cost. The related financial assets and liabilities are managed and reported to management on a fair value basis. Designation at fair value of the financial assets and related liabilities allows changes in fair values to be recorded in the income statement and presented in the same line.

(e) Derivatives

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, interest rates or other indices. Derivatives are recognised initially and are subsequently measured at fair value through profit or loss. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative. This includes embedded derivatives which are bifurcated from the host contract when they meet the definition of a derivative on a stand-alone basis.

Where the derivatives are managed with debt securities issued by the group that are designated at fair value, the contractual interest is shown in 'Interest expense' together with the interest payable on the issued debt.

Hedge accounting

When derivatives are not part of fair value designated relationships, if held for risk management purposes they are designated in hedge accounting relationships where the required criteria for documentation and hedge effectiveness are met. The Entity uses these derivatives or, where allowed, other non-derivative hedging instruments in fair value hedges, cash flow hedges or hedges of net investments in foreign operations as appropriate to the risk being hedged.

Fair value hedge

Fair value hedge accounting does not change the recording of gains and losses on derivatives and other hedging instruments, but results in recognising changes in the fair value of hedged assets or liabilities attributable to the hedged risk that would not otherwise be recognised in the income statement. If a hedge relationship no longer meets the criteria for hedge accounting, hedge accounting is discontinued; the cumulative adjustment to the carrying amount of the hedged item is amortised to the income statement on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised, in which case it is recognised in the income statement immediately.

Derivatives that do not qualify for hedge accounting

Non-qualifying hedges are derivatives entered into as economic hedges of assets and liabilities for which hedge accounting was not applied.

(f) Impairment of amortised cost financial assets

Expected credit losses are recognised for loans and advances to banks and customers, other financial assets held at amortised cost, certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is required for ECL resulting from default events that are possible within the next 12 months or less, where the remaining life is less than 12 months, ('12-month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit-impaired are in 'stage 3'. Purchased or originated credit-impaired financial assets (POCI) are treated differently as set out below.

Credit-impaired (stage 3)

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

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

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due, even where regulatory rules permit default to be defined based on 180 days past due. Therefore the definitions of credit-impaired and default are aligned as far as possible so that stage 3 represents all loans which are considered defaulted or otherwise credit-impaired.

Interest income is recognised by applying the effective interest rate to the amortised cost amount, i.e. gross carrying amount less ECL allowance.

Write-off

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

Renegotiation

Loans are identified as renegotiated and classified as credit-impaired when we modify the contractual payment terms due to significant credit distress of the borrower. Renegotiated loans remain classified as credit-impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows and retain the designation of renegotiated until maturity or derecognition

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

Other than originated credit-impaired loans, all other modified loans could be transferred out of stage 3 if they no longer exhibit any evidence of being credit-impaired and, in the case of renegotiated loans, there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, over the minimum observation period, and there are no other indicators of impairment. These loans could be transferred to stage 1 or 2 based on the mechanism as described below by comparing the risk of a default occurring at the reporting date (based on the modified contractual terms) and the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms). Any amount written off as a result of the modification of contractual terms would not be reversed.

The operational process is for the interest to be passed to the current account. Loans will therefore not report as being past due. Interest is passed quarterly rather than monthly, hence days past due count cannot be calculated until it becomes impaired.

Loan modifications that are not credit-impaired

Loan modifications that are not identified as renegotiated are considered to be commercial restructuring. Where a commercial restructuring results in a modification (whether legalised through an amendment to the existing terms or the issuance of a new loan contract) such that the Entity's rights to the cash flows under the original contract have expired, the old loan is derecognised and the new loan is recognised at fair value. The rights to cash flows are generally considered to have expired if the commercial restructure is at market rates and no payment-related concession has been provided.

Significant increase in credit risk (stage 2)

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

For wholesale portfolios, the quantitative comparison assesses default risk using a lifetime probability of default which encompasses a wide range of information including the obligor's customer risk rating ('CRR'), macroeconomic condition forecasts and credit transition probabilities. Significant increase in credit risk is measured by comparing the average PD for the remaining term estimated at origination with the equivalent estimation at reporting date. For origination CRRs up to 3.3, a significant increase in credit risk is considered to have occured when the PD increase exceeds the below thresholds. For CRRs greater than 3.3 which are not impaired, a significant increase in credit risk is considered to have occured when the origination PD has doubled. The significance of changes in PD was informed by expert credit risk judgement, referenced to historical credit migrations and to relative changes in external market rates. The quantitative measure of significance varies depending on the credit quality at origination as follows:

Origination CRR	Significance trigger – PD to increase by
0.1–1.2	15bps
2.1–3.3	30 bps
Greater than 3.3 and not impaired	2x

For loans originated prior to the implementation of IFRS 9, the origination PD does not include adjustments to reflect expectations of future macroeconomic conditions since these are not available without the use of hindsight. In the absence of this data, origination PD must be approximated assuming through-the-cycle ('TTC') PDs and TTC migration probabilities, consistent with the instrument's underlying modelling approach and the CRR at origination. For these loans, the quantitative comparison is supplemented with additional CRR deterioration-based thresholds, as set out in the table below:

Origination CRR	Additional significance criteria – Number of CRR grade notches deterioration required to identify as significant credit deterioration (stage 2) (> or equal to)
0.1	5 notches
1.1–4.2	4 notches
4.3–5.1	3 notches
5.2–7.1	2 notches
7.2–8.2	1 notch
8.3	0 notch

For certain portfolios of debt securities where external market ratings are available and credit ratings are not used in credit risk management, the debt securities will be in stage 2 if their credit risk increases to the extent they are no longer considered investment grade. Investment grade is where the financial instrument has a low risk of incurring losses, the structure has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil their contractual cash flow obligations.

For retail portfolios, default risk is assessed using a reporting date 12-month PD derived from credit scores, which incorporate all available information about the customer. This PD is adjusted for the effect of macroeconomic forecasts for periods longer than 12 months and is considered to be a reasonable approximation of a lifetime PD measure. Retail exposures are first segmented into homogeneous portfolios, generally by country, product and brand. Within each portfolio, the stage 2 accounts are defined as accounts with an adjusted 12-month PD greater than the average 12-month PD of loans in that portfolio 12 months before they become 30 days past due. The expert credit risk judgement is that no prior increase in credit risk is significant. This portfolio-specific threshold identifies loans with a PD higher than would be expected from loans that are performing as originally expected, and higher than what would have been acceptable at origination. It therefore approximates a comparison of origination to reporting date PDs.

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

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

Purchased or originated credit-impaired

Financial assets that are purchased or originated at a deep discount that reflects the incurred credit losses are considered to be POCI. This population includes the recognition of a new financial instrument following a renegotiation where concessions have been granted for economic or contractual reasons relating to the borrower's financial difficulty that otherwise would not have been considered. The amount of change-in-lifetime ECL is recognised in profit or loss until the POCI is derecognised, even if the lifetime ECL are less than the amount of ECL included in the estimated cash flows on initial recognition.

Movement between stages

Financial assets can be transferred between the different categories (other than POCI) depending on their relative increase in credit risk since initial recognition. Financial instruments are transferred out of stage 2 if their credit risk is no longer considered to be significantly increased since initial recognition based on the assessments described above. Except for renegotiated loans, financial instruments are transferred out of stage 3 when they no longer exhibit any evidence of credit impairment as described above. Renegotiated loans that are not POCI will continue to be in stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, observed over a minimum one-year period and there are no other indicators of impairment. For loans that are assessed for impairment on a portfolio basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

Measurement of ECL

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

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

The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated using the lifetime PD instead. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument respectively.

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of committed facilities. The LGD represents expected losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realised and the time value of money.

HSBC leverages the Basel II IRB framework where possible, with recalibration to meet the differing IFRS 9 requirements set out in the following table:

Model	Regulatory capital	IFRS 9
PD	• Through the cycle (represents long-run average PD throughout a full economic cycle) • The definition of default includes a backstop of 90+ days past due, although this has been modified to 180+ days past due for some portfolios, particularly UK and US mortgages	• Point in time (based on current conditions, adjusted to take into account estimates of future conditions that will impact PD) • Default backstop of 90+ days past due for all portfolios
EAD	• Cannot be lower than current balance	• Amortisation captured for term products
LGD	• Downturn LGD (consistent losses expected to be suffered during a severe but plausible economic downturn) • Regulatory floors may apply to mitigate risk of underestimating downturn LGD due to lack of historical data • Discounted using cost of capital • All collection costs included	• Expected LGD (based on estimate of loss given default including the expected impact of future economic conditions such as changes in value of collateral) • No floors • Discounted using the original effective interest rate of the loan • Only costs associated with obtaining/selling collateral included
Other		• Discounted back from point of default to balance sheet date

While 12-month PDs are recalibrated from Basel II models where possible, the lifetime PDs are determined by projecting the 12-month PD using a term structure. For the wholesale methodology, the lifetime PD also takes into account credit migration, i.e. a customer migrating through the CRR bands over its life.

The ECL for wholesale stage 3 is determined on an individual basis using a discounted cash flow ('DCF') methodology. The expected future cash flows are based on the credit risk officer's estimates as at the reporting date, reflecting reasonable and supportable assumptions and projections of future recoveries and expected future receipts of interest. Collateral is taken into account if it is likely that the recovery of the outstanding amount will include realisation of collateral based on its estimated fair value of collateral at the time of expected realisation, less costs for obtaining and selling the collateral. The cash flows are discounted at a reasonable approximation of the original effective interest rate. For significant cases, cash flows under four different scenarios are probability-weighted by reference to the three economic scenarios applied more generally by the Group and the judgement of the credit risk officer in relation to the likelihood of the workout strategy succeeding or receivership being required. For less significant cases, the effect of different economic scenarios and work-out strategies is approximated and applied as an adjustment to the most likely outcome.

Period over which ECL is measured

Expected credit loss is measured from the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which HSBC is exposed to credit risk. For wholesale overdrafts, credit risk management actions are taken no less frequently than on an annual basis and therefore this period is to the expected date of the next substantive credit review. The date of the substantive credit review also represents the initial recognition of the new facility. However, where the financial instrument includes both a drawn and undrawn commitment and the contractual ability to demand repayment and cancel the undrawn commitment does not serve to limit HSBC's exposure to credit risk to the contractual notice period, the contractual period does not determine the maximum period considered. Instead, ECL is measured over the period HSBC remains exposed to credit risk that is not mitigated by credit risk management actions. This applies to retail overdrafts and credit cards, where the period is the average time taken for stage 2 exposures to default or close as performing accounts, determined on a portfolio basis and ranging from between two and six years. In addition, for these facilities it is not possible to identify the ECL on the loan commitment component separately from the financial asset component. As a result, the total ECL is recognised in the loss allowance for the financial asset unless the total ECL exceeds the gross carrying amount of the financial asset, in which case the ECL is recognised as a provision.

Forward-looking economic inputs

The group will in general apply three forward-looking global economic scenarios determined with reference to external forecast distributions representative of our view of forecast economic conditions, the consensus economic scenario approach. This approach is considered sufficient to calculate unbiased expected loss in most economic environments. They represent a 'most likely outcome' (the Central scenario) and two, less likely, 'outer' scenarios referred to as the Upside and Downside scenarios. The Central scenario is used by the annual operating planning process and, with regulatory modifications, will also be used in enterprise-wide stress tests. The Upside and Downside are constructed following a standard process supported by a scenario narrative reflecting the Group's current top and emerging risks and by consulting external and internal subject matter experts. The relationship between the outer scenarios and Central scenario will generally be fixed with the Central scenario being assigned a weighting of 80% and the Upside and Downside scenarios 10% each, with the difference between the Central and outer scenarios in terms of economic severity being informed by the spread of external forecast distributions among professional industry forecasts. The outer scenarios are economically plausible, internally consistent states of the world and will not necessarily be as severe as scenarios used in stress testing. The period of forecast is five years, after which the forecasts will revert to a view based on average past experience. The central forecast and spread between the Central and outer scenarios is grounded on the expected gross domestic product of the following economies: UK, eurozone, Hong Kong, mainland China and, US. The economic factors include, but are not limited to, gross domestic product, unemployment, interest rates, inflation and commercial property prices across all the countries and territories in which the group operates.

In general, the consequences of the assessment of credit risk and the resulting ECL outputs will be probability-weighted using the standard probability weights. This probability weighting may be applied directly or the effect of the probability weighting determined on a periodic basis, at least annually, and then applied as an adjustment to the outcomes resulting from the Central economic forecast. The Central economic forecast is updated quarterly.

The group recognises that the consensus economic scenario approach using three scenarios will be insufficient in certain economic environments. Additional analysis may be requested at management's discretion, including the production of extra scenarios. If conditions warrant, this could result in a management overlay for economic uncertainty which is included in the ECL.

Critical accounting estimates and judgements

In determining ECL, management is required to exercise judgement in defining what is considered to be a significant increase in credit risk and in making assumptions and estimates to incorporate relevant information about past events, current conditions and forecasts of economic conditions. Judgement has been applied in determining the lifetime and point of initial recognition of revolving facilities.
The PD, LGD and EAD models which support these determinations are reviewed regularly in light of differences between loss estimates and actual loss experience, but given that IFRS 9 requirements have only just been applied, there has been little time available to make these comparisons. Therefore, the underlying models and their calibration, including how they react to forward-looking economic conditions, remain subject to review and refinement. This is particularly relevant for lifetime PDs, which have not been previously used in regulatory modelling and for the incorporation of 'upside scenarios' which have not generally been subject to experience gained through stress testing.
The exercise of judgement in making estimations requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas. Many of the factors have a high degree of interdependency and there is no single factor to which loan impairment allowances as a whole are sensitive. Page 20 sets out the assumptions underlying the Central scenario and information about how scenarios are developed in relation to the Group's top and emerging risks and its judgements, informed by consensus forecasts of professional industry forecasters. The adjustment from the ECL determined by using the Central scenario alone, which is used to calculate an unbiased expected loss, provides an indication of the overall sensitivity of ECL to different economic assumptions.

(g) Offsetting of financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(h) Employee compensation and benefits

Share-based payments

The Entity enters into both equity-settled and cash-settled share-based payment arrangements with its employees as compensation for the provision of their services.

The vesting period for these schemes may commence before the grant date if the employees have started to render services in respect of the award before the grant date. Expenses are recognised when the employee starts to render service to which the award relates.

Cancellations result from the failure to meet a non-vesting condition during the vesting period, and are treated as an acceleration of vesting recognised immediately in the income statement. Failure to meet a vesting condition by the employee is not treated as a cancellation, and the amount of expense recognised for the award is adjusted to reflect the number of awards expected to vest.

Post-employment benefit plans

The HSBC group operates a number of pension schemes including defined benefit, defined contribution, and post-employment benefit schemes.

Payments to defined contribution schemes are charged as an expense as the employees render service.

Defined benefit pension obligations are calculated using the projected unit credit method. The net charge to the income statement mainly comprises the service cost and the net interest on the net defined benefit asset or liability, and is presented in operating expenses.

Remeasurement of the net defined benefit asset or liability, which comprise actuarial gains and losses, return on plan assets excluding interest and the effect of the asset ceiling (if any, excluding interest), are recognised immediately in other comprehensive income. The net defined benefit asset or liability represents the present value of defined benefit obligations reduced by the fair value of plan assets, after applying the asset ceiling test, where the net defined benefit surplus is limited to the present value of available refunds and reductions in future contributions to the plan.

The cost of obligations arising from other post-employment plans is accounted for on the same basis as defined benefit pension plans.

(i) 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 the tax 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 and on any adjustment to tax payable in respect of previous years. The Entity provides for potential current tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities. Payments associated with any incremental base erosion and anti-abuse tax are reflected in tax expense in the period incurred.

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 is calculated using the tax rates expected to apply in the periods as the assets will be realised or the liabilities settled.

Current and deferred tax are calculated based on tax rates and laws enacted, or substantively enacted, by the balance sheet date.

Critical accounting estimates and judgements

The recognition of a deferred tax asset relies on an assessment of the probability and sufficiency of future taxable profits, future reversals of existing taxable temporary differences and ongoing tax planning strategies. In the absence of a history of taxable profits, the most significant judgements relate to expected future profitability and to the applicability of tax planning strategies, including corporate reorganisations.

(j) Provisions, contingent liabilities and guarantees

Provisions

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

Critical accounting estimates and judgements

Judgement is involved in determining whether a present obligation exists and in estimating the probability, timing and amount of any outflows. Professional expert advice is taken on the assessment of litigation, property (including onerous contracts) and similar obligations. Provisions for legal proceedings and regulatory matters typically require a higher degree of judgement than other types of provisions. When matters are at an early stage, accounting judgements can be difficult because of the high degree of uncertainty associated with determining whether a present obligation exists, and estimating the probability and amount of any outflows that may arise. As matters progress, management and legal advisers evaluate on an ongoing basis whether provisions should be recognised, revising previous judgements and estimates as appropriate. At more advanced stages, it is typically easier to make judgements and estimates around a better defined set of possible outcomes. However, the amount provisioned can remain very sensitive to the assumptions used. There could be a wide range of possible outcomes for any pending legal proceedings, investigations or inquiries. As a result, it is often not practicable to quantify a range of possible outcomes for individual matters. It is also not practicable to meaningfully quantify ranges of potential outcomes in aggregate for these types of provisions because of the diverse nature and circumstances of such matters and the wide range of uncertainties involved. Provisions for customer remediation also require significant levels of estimation and judgement. The amounts of provisions recognised depend on a number of different assumptions, such as, the volume of inbound complaints, the projected period of inbound complaint volumes, the decay rate of complaint volumes, the population identified as systemically mis-sold and the number of policies per customer complaint.

Contingent liabilities, contractual commitments and guarantees

Contingent liabilities

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, and contingent liabilities related to legal proceedings or regulatory matters, are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

Financial guarantee contracts

Liabilities under financial guarantee contracts that are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received or present value of the fee receivable.

The Entity has issued financial guarantees and similar contracts to other group entities. The group elects to account for certain guarantees as insurance contracts in the bank's financial statements, in which case they are measured and recognised as insurance liabilities. This election is made on a contract by contract basis, and is irrevocable.

(k) Property, plant and equipment

Land and buildings are stated at historical cost, or fair value at the date of transition to IFRSs ('deemed cost'), less impairment losses and depreciation over their estimated useful lives, as follows:

- freehold land is not depreciated;
- freehold buildings are depreciated at the greater of 2% per annum on a straight-line basis or over their remaining useful lives; and
- leasehold land and buildings are depreciated over the shorter of their unexpired terms of the leases or their remaining useful lives.

Equipment, fixtures and fittings (including equipment on operating leases where the Entity is the lessor) are stated at cost less impairment losses and depreciation over their useful lives, which are generally between 0 years and 20 years. Property, plant and equipment is subject to an impairment review if their carrying amount may not be recoverable.

(l) Intangible assets

Intangible assets are stated at cost less amortisation and are amortised straight line over their estimated useful lives of five years. Expenditure on internally developed software is recognised as an asset when the Entity is able to demonstrate its intention and ability to complete the development and use the software in a manner that will generate future economic benefits and can reliably measure the cost to complete development. Borrowing costs are not included in the capitalised costs of intangible assets. Assets are subject to regular impairment reviews which compare the carrying value to the expected value in use. Any impairment losses are recognised in the Income Statement. Amortisation does not commence until the asset is brought into operational use.

(m) Called up share capital

Financial instruments issued are generally classified as equity when there is no contractual obligation to transfer cash or other financial assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

(n) Cash and cash equivalents

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 three months' maturity from the date of acquisition.

(o) Accounting policies applicable prior to 1 January 2018

Financial instruments measured at amortised cost

Loans and advances to banks and customers, are measured at amortised cost unless in a hedging relationship. The carrying value of these financial instruments at initial recognition includes any directly attributable transaction costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some leveraged finance and syndicated lending activities, the difference is deferred and recognised over the life of the loan through the recognition of interest income, unless the loan becomes impaired.

Impairment of loans and advances

Losses for impaired loans are recognised when there is objective evidence that impairment of a loan portfolio has occurred. Losses which may arise from future events are not recognised.

Individually assessed loans and advances

The factors considered in determining whether a loan is individually significant for the purposes of assessing impairment include the size of the loan, the number of loans in the portfolio, the importance of the individual loan relationship and how this is managed. Loans that are determined to be individually significant will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective methodology.

Loans considered as individually significant are typically to corporate and commercial customers, are for larger amounts and are managed on an individual basis. For these loans, the Entity considers on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired.

The determination of the realisable value of security is based on the most recently updated market value at the time the impairment assessment is performed. The value is not adjusted for expected future changes in market prices, though adjustments are made to reflect local conditions such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which include expected future receipts of contractual interest, at the loan's original effective interest rate or an approximation thereof, and comparing the resultant present value with the loan's current carrying amount.

Collectively assessed loans and advances

Impairment is assessed collectively to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment or for homogeneous groups of loans that are not considered individually significant, which are generally retail lending portfolios.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for a collective impairment assessment. This assessment captures impairment losses that the Entity has incurred as a result of events occurring before the balance sheet date that the Entity is not able to identify on an individual loan basis, and that can be reliably estimated. When information becomes available that identifies losses on individual loans within a group, those loans are removed from the group and assessed individually.

Write-off of loans and advances

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

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognised in the income statement.

Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as up to date loans for measurement purposes once a minimum number of required payments have been received. Where collectively assessed loan portfolios include significant levels of renegotiated loans, these loans are segregated from other parts of the loan portfolio for the purposes of collective impairment assessment, to reflect their risk profile. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired. The carrying amounts of loans that have been classified as renegotiated retain this classification until maturity or derecognition.

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. Any new loans that arise following derecognition events will continue to be disclosed as renegotiated loans and are assessed for impairment as above.

2 Operating Profit

	2018 £'000	2017 £'000
Interest income		
Short-term funds and loans and advances to banks	**18,001**	6,358
Loans and advances to customers	**122,741**	116,397
Total interest income	**140,742**	122,755
Deposit by banks	**498**	164
Customer accounts	**26,570**	11,918
Total interest expense	**27,068**	12,082

	2018 £'000	2017 £'000
Fee income		
Fees earned on financial assets or liabilities not held for trading nor designated at fair value other than included in effective interest rate calculations on these types of assets and liabilities	**6,106**	9,866
Fees earned on trust and other fiduciary activities where the Entity holds or invests assets on behalf of its customers	**34,613**	29,792
Total fee income	**40,719**	39,658
Fee expense		
Fees payable on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	**14,077**	13,232
Total fee expense	**14,077**	13,232
Loan impairment charge and other credit risk provisions		
Net impairment charge on loans and advances	**605**	10,431

3 Employee compensation and benefits

Total employee compensation

	2018 £'000	2017 £'000
Wages and salaries including share-based payments	**33,884**	31,200
Social security costs	**4,881**	4,076
Post-employment benefits	**3,986**	3,165
Year ended 31 Dec	**42,751**	38,441

Average number of persons employed by the Entity during the year

	2018	2017
Client/Product Services	**277**	265
Operations and Support	**5**	6
Head Office Administration	**11**	10
Year ended 31 Dec	**293**	281

Management charge for services provided by ServCo group is included in General and administrative expense.

Post-employment benefit plans

The Entity's employees are members of various schemes. Some are defined benefit plans, of which the largest is the HSBC Bank (UK) Pension Scheme ('the principal plan').

The principal plan

The principal plan has a defined benefit section and a defined contribution section. The defined benefit section was closed to future benefit accrual in 2015, with defined benefits earned by employees at that date continuing to be linked to their salary while they remain employed by HSBC UK Bank plc. The plan is overseen by an independent corporate trustee, who has a fiduciary responsibility for the operation of the plan. Its assets are held separately from the assets of the group.

To meet the requirements of the Banking Reform Act, from 1 July 2018, the main employer of the plan changed from HSBC Bank plc to HSBC UK Bank plc, with additional support from HSBC Holdings plc.

There is no contractual agreement or stated policy for charging the net defined benefit cost from HSBC UK Bank plc to the other members of the group pension plan. Instead the Entity makes a regular payment to HSBC UK Bank plc, for HSBC UK Bank plc to invest in the various schemes on behalf of the Entity's employees. The Entity would not contribute to any scheme deficit, except through amendments to its regular payments. Full disclosure of the principal actuarial financial assumptions used to calculate the defined benefit pension plans at 31 December 2018, of which employees of the Entity are members, are disclosed in the statutory accounts of HSBC UK Bank plc.

In 2018, the pension cost for defined contribution plans which cover 98% of the Entity's employees was £3,986,000 (2017: £3,165,000). The Entity expects to make £4,564,536 of contributions to the defined contribution plans during 2019.

4 Share-based payments

The share-based payment income statement charge is recognised in wages and salaries as follows:

	2018 £'000	2017 £'000
Restricted share awards	**608**	332
Savings-related and other share award option plans	**376**	158
Year ended 31 Dec	**984**	490

HSBC share award plans

Plans	Policy
Restricted share awards (including annual incentive awards delivered in shares) and Group Performance Share Plan ('GPSP')	• An assessment of performance over the relevant period ending on 31 December is used to determine the amount of the award to be granted. • Deferred awards generally require employees to remain in employment over the vesting period and are not subject to performance conditions after the grant date. • Deferred share awards generally vest over a period of three years and GPSP awards vest after five years. • Vested shares may be subject to a retention requirement post-vesting. GPSP awards are retained until cessation of employment. Awards granted from 2010 onwards are subject to malus provision prior to vesting. • Awards granted to Material Risk Takers from 2016 onwards are subject to clawback post vesting.

Movement on HSBC share awards

	2018 Number	2017 Number
Restricted share awards outstanding at 1 Jan	**363,239**	492,210
Additions during the year	**204,207**	219,491
Released during the year	**(229,452)**	(301,919)
Forfeited during the year	**(6,829)**	(48,977)
Transferred (out)/in during the year	**(76,820)**	2,434
Restricted share awards outstanding at 31 Dec	**254,345**	363,239
Weighted average fair value of awards granted (£)	**6.37**	5.84

HSBC share option plans

Plans	Policy
Savings-related share option plans ('Sharesave')	• Two plans: the UK plan and the International Plan. The last grant of options under the International Plan was in 2012. • From 2014, eligible employees can save up to £500 per month with the option to use the savings to acquire shares. • Exercisable within six months following either the third or fifth anniversaries of the commencement of a three-year or five-year contract, respectively. • The exercise price is set at a 20% (2016: 20%) discount to the market value immediately preceding the date of invitation.

Calculation of fair values

The fair values of share options are calculated using a Black-Scholes model. The fair value of a share award is based on the share price at the date of the grant.

Movement on HSBC share option plans

	Savings-related share options	
	Number	WAEP[1] £
Outstanding at 1 Jan 2018	**563,744**	**4.41**
Granted during the year	**212,562**	**5.45**
Exercised during the year	**(219,993)**	**4.09**
Expired during the year	**(46,078)**	**5.16**
Transferred in during the year	**3,384**	**4.46**
Outstanding at 31 Dec 2018	**513,619**	**4.94**
Weighted average remaining contractual life (years)		**2.67**

1 Weighted average exercise price

	Savings-related share options	
	Number	WAEP[1]
		£
Outstanding at 1 Jan 2017	564,679	4.26
Granted during the year	138,320	5.96
Exercised during the year	(53,345)	5.08
Expired during the year	(48,188)	4.11
Transferred out during the year	(37,722)	4.30
Outstanding at 31 Dec 2017	563,744	4.41
Weighted average remaining contractual life (years)		2.32

1 Weighted average exercise price

The weighted average fair value of share options outstanding, which is calculated when transactions are contracted, was £0.95 (2017: £0.82).

5 Directors' emoluments

The aggregate emoluments of the Directors of the Entity, computed in accordance with the Companies Act 2006 as amended by statutory instrument 2008 No. 410, were:

	2018	2017
	£'000	£'000
Fees [1]	**160**	154
Salaries and other emoluments	**1,650**	1,650
Annual incentives [2]	**1,191**	1,307
Year ended 31 Dec	**3,001**	3,191

1 Fees included fees paid to non-executive Directors.
2 Awards made to executive Directors in respect of 2018 performance comprise a mixture of cash and HSBC Holdings plc ordinary shares. The amount shown comprised £275,588 (2017: £241,000) in cash, £269,110 (2017:£392,000) in deferred cash (vesting annually over a three-year period), £275,841 (2017: £223,000) in Restricted Shares and £370,432 (2017: £531,000) in deferred Restricted Shares (vesting annually over a three-year period) issued under the HSBC Share Plan.

4 Directors exercised share options over HSBC Holdings plc ordinary shares during the year (2017: 2).

Awards were made to 4 Directors under long-term incentive plans in respect of qualifying services rendered in 2018 (2017: 3 Directors). During 2018, 4 Directors received shares in respect of awards under long-term incentive plans that vested during the year (2017: 3).

Retirement benefits are accrued for 4 Directors under money purchase schemes in respect of Directors' qualifying service. Contributions of £39,794 (2017:£38,129) were made during the year to money purchase arrangements.

Discretionary bonuses for Directors are based on a combination of individual and corporate performance and are determined by the Remuneration Committee of the Entity's ultimate parent company, HSBC Holdings plc. The cost of any conditional awards under the HSBC Share Plan and the HSBC Plan 2011 ('the Plans') is recognised through an annual charge based on the fair value of the awards, apportioned over the period of service to which the award relates. Details of the Plans are contained within the Directors' Remuneration Report of HSBC Holdings plc.

Of these aggregate figures, the following amounts are attributable to the highest paid Director:

	2018	2017
	£'000	£'000
Salaries and other emoluments	**877**	858
Annual incentives [1]	**563**	762
Year ended 31 Dec	**1,440**	1,620

1 Awards made to the highest paid Director in respect of 2018 performance comprise a mixture of cash and HSBC Holdings plc ordinary shares. The amount shown comprised £113,369.6 (2017: £122,000) in cash, £141,669.5 (2017: £229,000) in deferred cash (vesting annually over a three-year period), £113,063 (2017: £122,000) in Restricted Shares and £195,299 in deferred Restricted Shares (2017: £289,000) (vesting annually over a three-year period) issued under the HSBC Share Plan.

The highest paid Director received 51,386 (2017: 61,856) shares, in respect of qualifying services, as the result of awards under long-term incentive plans that vested during the year. The highest paid Director did not exercised any share options over HSBC Holdings plc ordinary shares during the year (2017: 3,361).

Pension contributions of £10,702 (2017: £10,810) were made by the Entity in respect of services by the highest paid Director during the year.

6 Auditors' remuneration

	2018	2017
	£'000	£'000
Audit fees for statutory audit		
- Fees relating to current year	**100**	92
- Fees relating to previous year	**–**	21
Fees for other services provided to the Entity		
- Other audit-related services pursuant to such legislation	**26**	26
Year ended 31 Dec	**126**	139

There were no non-audit fees incurred during the year (2017: nil).

7 Tax

Tax expense

	2018 £'000	2017 £'000
Current tax		
UK Corporation tax		
- For this year	**10,854**	6,944
- Adjustments in respect of prior years	**(124)**	(102)
Total current tax	**10,730**	6,842
Deferred tax		
- For this year	**156**	175
- Effects of changes in tax rates	**55**	78
- Adjustments in respect of prior years	**(9)**	92
Total deferred tax	**202**	345
Year ended 31 Dec	**10,932**	7,187

The UK corporation tax rate applying to the Entity was 19 % (2017: 19.25%).

In the UK Budget on 8 July 2015, the UK Government proposed to reduce the main rate of UK corporation tax to 19% with effect from 1 April 2017. Additionally in the Budget on 16 March 2016 a further rate reduction to 17% was proposed from 1 April 2020, and this was enacted in Finance (No2) Act in September 2016.

This therefore has been taken into account in the calculation of the UK related deferred tax balances as these balances will materially reverse after 1 April 2020.

The UK Government introduced a surcharge on banking companies in the Finance (No 2) Act 2015 to apply with effect from 1 January 2016. The Entity meets the definition of a banking company and is therefore subject to the 8% bank surcharge. The surcharge has also been taken into account in the calculation of the deferred tax balances of this Entity, therefore deferred tax is recognised at 25%.

In addition to the amount charged to the income statement, the aggregate amount of current and deferred tax relating to items that are debited directly to equity is £60,871.

The tax liability value was £10.6 million as at 31 December 2018.

Tax reconciliation

The tax charged to income statement differs from the tax expense that would apply if all profits had been taxed at the UK Corporation tax rate as follows:

	2018		2017	
	£'000	(%)	£'000	(%)
Profit before tax	**42,439**		25,739	
Tax at 19.00% (2017: 19.25%)	**8,063**	**19.00**	4,953	19.24
Adjustments in respect of prior period liabilities	**(134)**	**(0.31)**	(10)	(0.04)
Permanent disallowables	**33**	**0.07**	337	1.31
Adjustments in respect of share-based payments	**39**	**0.09**	(170)	(0.66)
Impact due to changes in tax rates	**67**	**0.16**	78	0.30
Non-taxable income and gains	**(254)**	**(0.60)**	–	–
Banking surcharge	**3,118**	**7.35**	1,999	7.77
Year ended 31 Dec	**10,932**	**25.76**	7,187	27.92

The effective tax rate for 2018 of 25.76% was higher than the UK corporation tax rate of 19%.

8 Deferred tax

The following table shows the gross deferred tax assets and liabilities recognised in the balance sheet and the related amounts recognised in the income statement:

	Property, plant and equipment	Share based payments	Other temporary differences	IFRS 9 Transitional adjustments	Total
	£'000	£'000	£'000	£'000	£'000
At 1 Jan 2018	**200**	**946**	**253**	**1,255**	**2,654**
Income statement charge	**90**	**(172)**	**5**	**(133)**	**(210)**
Equity statement (expense)/credit	**–**	**(333)**	**–**	**–**	**(333)**
Prior year adjustments	**(6)**	**33**	**–**	**–**	**27**
At 31 Dec 2018	**284**	**474**	**258**	**1,122**	**2,138**
At 1 Jan 2017	40	1,086	486	–	1,612
Income statement charge	160	(272)	(233)	–	(345)
Equity statement credit	–	132	–	–	132
At 31 Dec 2017	200	946	253	–	1,399

9 Dividends

An interim dividend of £18,000,000 was declared and paid by the Directors on 9 March 2018.

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

	2018	2017
	£'000	£'000
Non-cash item included in profit and loss		
Depreciation, amortisation and impairment	**3,167**	634
Share-based payment expense	**209**	158
Credit-related impairment gains/(losses)losses	**605**	10,431
Provisions (released)/raised	**(2,278)**	1,116
Fair value movements in financial assets designated at fair value	**209**	(71)
	1,912	12,268
Change in operating assets		
Change in prepayment and accrued income	**1,411**	95
Change in loans and advances to banks	**1,546,874**	(1,681,150)
Change in loans and advances to customers	**222,690**	61,110
Change in other assets	**(68,294)**	282,575
	1,702,681	(1,337,370)
Change in operating liabilities		
Change in accruals, deferred income and other liabilities	**91,899**	283,945
Change in deposits by banks	**–**	(48,399)
Change in customer accounts	**(760,356)**	747,056
	(668,457)	982,602
Cash and cash equivalents comprise		
Cash and balances at central banks	**9,490**	16,316
Loans and advances to bank of one month or less	**1,772,720**	717,124
	1,782,210	733,440
Interest and dividends		
Interest paid	**26,881**	12,993
Interest received	**142,734**	124,194
	169,615	137,187

11 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.

At 31 Dec 2018	FVPL £'000	Amortised cost £'000	Total £'000
Assets			
Cash and balances with central banks	–	9,490	9,490
Derivatives	5,248	–	5,248
Loans and advances to banks	–	1,967,797	1,967,797
Loans and advances to customers	–	4,258,627	4,258,627
Total financial assets	5,248	6,235,914	6,241,162
Total non-financial assets			163,079
Total assets			6,404,241
Liabilities			
Customer accounts	–	5,338,158	5,338,158
Derivatives	5,464		5,464
Total financial liabilities	5,464	5,338,158	5,343,622
Total non-financial liabilities			446,551
Total liabilities			5,790,173

Categories of financial instruments are disclosed under IFRS 9 at 31 December 2018. These are not directly comparable with 31 December 2017, where the instruments were categorised in accordance with IAS 39.

At 31 Dec 2017	Held for trading £'000	Loans and receivables £'000	Financial assets and liabilities at amortised cost £'000	Derivatives designated as fair value hedging instruments £'000	Total £'000
Assets					
Cash and balances with central banks	–	–	16,316	–	16,316
Derivatives	9,557	–	–	69	9,626
Loans and advances to banks	–	2,438,975	–	–	2,438,975
Loans and advances to customers	–	4,474,483	–	–	4,474,483
Total financial assets	9,557	6,913,458	16,316	69	6,939,400
Total non-financial assets					71,719
Total assets					7,011,119
Liabilities					
Customer accounts	–	–	6,045,228	–	6,045,228
Derivatives	8,115	–	–	874	8,989
Total financial liabilities	8,115	–	6,045,228	874	6,054,217
Total non-financial liabilities					353,145
Total liabilities					6,407,362

12 Fair value of financial instruments carried at fair value

Control framework

Fair values are subject to a control framework designed to ensure that they are either determined, or validated, by a function independent of the risk taker.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the Entity will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors that are considered in this regard are, *inter alia*:

- the extent to which prices may be expected to represent genuine traded or tradable prices;
- the degree of similarity between financial instruments;
- the degree of consistency between different sources;
- the process followed by the pricing provider to derive the data;
- the elapsed time between the date to which the market data relates and the balance sheet date; and
- the manner in which the data was sourced.

For fair values determined using a valuation model, the control framework may include, as applicable, development or validation by independent support functions of: (i) the logic within valuation models; (ii) the inputs to these models; (iii) any adjustments required outside the valuation models; and (iv) where possible, model outputs. Valuation models are subject to a process of due diligence and calibration before becoming operational and are calibrated against external market data on an ongoing basis.

Fair value hierarchy

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

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

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

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

Financial instruments carried at fair value and bases of valuation

	2018			
	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
Recurring fair value measurements at 31 Dec				
Assets				
Derivatives	**–**	**5,248**	**–**	**5,248**
Liabilities				
Derivatives	**–**	**5,464**	**–**	**5,464**

	2017			
	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
Assets				
Derivatives	–	9,626	–	9,626
Liabilities				
Derivatives	–	8,989	–	8,989

There were no significant transfers between financial instruments classified as Level 1 and Level 2 in 2018 (2017: nil).

13 Fair value of financial instruments not carried at fair value

Fair values are determined according to the hierarchy set out in Note 12 .

Fair values at the balance sheet date of the assets and liabilities set out below are estimated for the purpose of disclosure as follows:

		Fair values			
			Valuation techniques		
	Carrying amount	Quoted price	Observable inputs	Significant unobservable inputs	
		Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000	£'000
At 31 Dec 2018					
Assets					
Loans and advances to banks	**1,967,797**	**–**	**1,967,797**	**–**	**1,967,797**
Loans and advances to customers	**4,258,627**	**–**	**1,276,130**	**3,004,818**	**4,280,948**
Liabilities					
Customer accounts	**5,338,158**	**–**	**5,318,515**	**–**	**5,318,515**

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.

		Fair values			
			Valuation techniques		
	Carrying amount	Quoted price	Observable inputs	Significant unobservable inputs	
		Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000	£'000
At 31 Dec 2017					
Assets					
Loans and advances to banks	2,438,975	–	2,438,975	–	2,438,975
Loans and advances to customers	4,474,483	–	1,586,001	2,945,683	4,531,684
Liabilities					
Customer accounts	6,045,228	–	6,021,519	–	6,021,519

Gross amount of fair value of loans and advances to customers by industry sector

	Gross amount			Fair value		
	Not impaired	*Impaired*	*Total*	*Not impaired*	*Impaired*	*Total*
	£'000	£'000	£'000	£'000	£'000	£'000
Loans and advances to customers						
- personal	**3,009,225**	**151,004**	**3,160,229**	**3,024,687**	**129,865**	**3,154,552**
- corporate and commercial	**887,896**	**148,785**	**1,036,681**	**911,499**	**132,221**	**1,043,720**
- non-bank financial institutions	**103,685**	**5,730**	**109,415**	**82,404**	**272**	**82,676**
At 31 Dec 2018	**4,000,806**	**305,519**	**4,306,325**	**4,018,590**	**262,358**	**4,280,948**

Valuation

Fair value is an estimate of price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It does not reflect the economic benefits and costs that the Entity expects to flow from an instrument's cash flow over its expected future life. The Entity's valuation methodologies and assumptions in determining fair values for which no observable market process are available may differ from those of other companies.

Loans and advances to banks and customers

To determine the fair value of loans and advances to banks and customers loans are segregated, as far as possible, into portfolios of similar characteristics. Fair values are based on observable market transactions, when available. When they are unavailable, fair values are estimated using valuation models incorporating a range of input assumptions. These assumptions may include: value estimates from third-party brokers reflecting over-the-counter trading activity; forward-looking discounted cash flow models, taking account of expected customer prepayment rates, using assumptions that the Entity believes are consistent with those that would be used by market participants in valuing such loans; new business rates estimates for similar loans and trading inputs from other market participants including observed primary and secondary trades. From time to time, we may engage a third-party valuation specialist to measure the fair value of a pool of loans.

The fair value of loans reflects expected credit losses at the balance sheet date and estimates of market participants' expectations of credit losses over the life of the loans, and the fair value effect of repricing between origination and the balance sheet date. For credit impaired loans, fair value is estimated by discounting future cash flows over the time period they are expected to be recovered.

Customer accounts

The fair values of on-demand deposits are approximated by their carrying value. For deposits with longer-term maturities, fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities.

14 Derivatives

Trading derivatives

Derivatives classified as held-for-trading include non-qualifying hedging derivatives, ineffective hedging derivatives and the components of hedging derivatives that are excluded from assessing hedge effectiveness. Non-qualifying hedging derivatives are entered into for risk management purposes but do not meet the criteria for hedge accounting. The held-for-trading category also includes derivatives managed in conjunction with financial instruments designated at fair value.

Notional contract amounts and fair values of derivatives by product contract types

	At 31 Dec 2018			At 31 Dec 2017		
	Notional contract	Fair value - Assets	Fair value - Liabilities	Notional contract	Fair value - Assets	Fair value - Liabilities
	£'000	£'000	£'000	£'000	£'000	£'000
Foreign exchange	560,479	5,239	5,464	1,571,664	6,467	7,252
Interest rate	20,000	9	—	37,125	773	1,737
Commodities	—	—	—	78,195	2,386	—
Total	580,479	5,248	5,464	1,686,984	9,626	8,989

15 Hedging instruments

The Entity uses derivatives (interest rate swaps) for hedging purposes in the management of its own asset and liability portfolios. This enables the Entity to mitigate the market risk which would otherwise arise from structural imbalances in the contract rates and other profiles of its assets and liabilities. All derivatives qualifying as hedging instruments are fair value hedges as defined under IFRS 9.

The notional contract amounts of derivatives held for hedge accounting purposes indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Fair value hedges

Fair values of outstanding derivatives designated as fair value hedges

The Entity's fair value hedges consisted of interest rate swaps that were used to protect against changes in the fair value of fixed-rate long-term loans to customers due to movements in market interest rates. If the hedge relationship was terminated, the fair value adjustment to the hedged item continued to be reported as part of the basis of the item and was amortised to income as a yield adjustment over the remainder of the hedging period. There were no fair value hedges on 31 December 2018.

Notional contract amounts of derivatives held for hedging purposes by product type

	2018	2017
Fair value Hedge	£'000	£'000
Interest rate contracts		
- pay fixed swaps	—	122,210

Gains and losses arising from fair value hedges

	2018 £'000	2017 £'000
Gains arising from the change in fair value of fair value hedges:		
- on hedging instruments	—	984
- on hedged item attributable to hedged risk	—	(883)
Year ended 31 Dec	**—**	**101**

16 Loans and advances to banks

	2018 £'000	2017 £'000
Nostro balances with parent and other group companies	**222,073**	340,272
Loans and advances held with banks	**1,745,724**	2,098,703
At 31 Dec	**1,967,797**	2,438,975

17 Loans and advances to customers

	2018 £'000	2017 £'000
Gross loans and advances to customers	**4,305,801**	4,522,444
Fair value adjustment to loans hedged by designated swaps	**524**	1,542
Impairment allowances	**(47,698)**	(49,503)
At 31 Dec	**4,258,627**	4,474,483

Loans and advances to customers by industry sector

	2018		2017	
	Gross loans and advances to customers £'000	Gross loan by industry as % of total gross loans %	Gross loans and advances to customers £'000	Gross loan by industry as % of total gross loans %
Personal				
- Residential mortgages	**2,198,873**	**51.06**	2,365,926	52.20
- Other personal	**961,356**	**22.32**	699,428	15.50
Corporate and commercial				
- Commercial, industrial and trade	**36,141**	**0.84**	66,348	1.50
- Commercial real estate	**460,090**	**10.68**	652,139	14.40
- Other property-related	**203,840**	**4.73**	556,749	12.30
- Other commercial	**336,610**	**7.82**	139,336	3.10
Financial	**109,415**	**2.54**	44,060	1.00
At 31 Dec	**4,306,325**	**100.00**	4,523,986	100.00
Impaired loans	**305,519**		242,862	
as a % of total		**7**		5

18 Property, plant and equipment

The value increased by £0.3m due to reclassification of a gold set from precious metals to artwork. All other artworks were sold by the Entity during 2018.

19 Intangible assets

	Software Development 2018 £'000	Software Development 2017 £'000
Cost		
At 1 Jan	**9,697**	3,225
Additions	**15,159**	6,552
Impairment	**(29)**	(80)
As at 31 Dec	**24,827**	9,697
Accumulated amortisation		
At 1 Jan	**(605)**	(51)
Charge for the year	**(3,138)**	(554)
As at 31 Dec	**(3,743)**	(605)
Net book value		
At 1 Jan	**9,092**	3,174
As at 31 Dec	**21,084**	9,092

20 Other assets

	2018 £'000	2017 £'000
Amounts due from parent	**116,266**	–
Amounts due from HSBC Bank plc	**445**	5,061
Amounts due from other group companies	**5,146**	35,269
Other assets	**1,853**	3,647
At 31 Dec	**123,710**	43,977

Amounts due from group companies are unsecured and repayable on demand.

21 Customer accounts

Customer accounts decreased by 13.2% from £6,045m in December 2017 to £5,338m in December 2018. The decrease was mainly driven by lower average new deposits of £1,307,000 compared to prior year (2017: £1,801,000).

22 Accruals, deferred income and other financial liabilities

	2018 £'000	2017 £'000
Accruals and deferred income	**19,011**	24,742
Share-based payment liabilities	**1,816**	3,037
Amounts owed to immediate parent undertaking	**242,717**	–
Amounts owed to HSBC Bank plc	**132,783**	273,277
Amounts owed to other group companies	**22,505**	38,636
Other liabilities	**16,770**	4,012
At 31 Dec	**435,602**	343,704

23 Provisions

	Restructuring provision £'000	Legal provision £'000	Customer redress provision £'000	Other £'000	Total £'000
At 1 Jan	**–**	**1,600**	**–**	**1,028**	**2,628**
Increase in provision	**–**	**–**	**264**	**–**	**264**
Decrease in provision	**–**	**(1,600)**	**–**	**–**	**(1,600)**
Provision utilised	**–**	**–**	**–**	**–**	**–**
Unused amounts reversed	**–**	**–**	**–**	**(942)**	**(942)**
At 31 Dec 2018	**–**	**–**	**264**	**86**	**350**
At 1 Jan	583	–	–	1,261	1,844
Increase in provision	–	1,600	–	–	1,600
Provision utilised	(336)	–	–	–	(336)
Unused amounts reversed	(247)	–	–	(233)	(480)
At 31 Dec 2017	–	1,600	–	1,028	2,628

The Entity has reversed the provision of £1.6 million raised in 2017 for potential liabilities relating to its administration of certain film finance related services, since this is no longer required. A new provision of £0.3 million was raised for customer redress and £0.9 million of unused amounts related to off-balance sheet loan commitments and guarantees was reversed in 2018.

24 Maturity analysis of assets and liabilities

The following is an analysis of assets and liabilities by residual 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	Undated	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Assets							
Cash and balances with central banks	–	–	9,490	–	–	–	9,490
Derivatives	3,073	301	1,858	16	–	–	5,248
Loans and advances to banks	1,772,720	–	195,077	–	–	–	1,967,797
Loans and advances to customers	970,032	257,022	661,507	1,864,617	505,449	–	4,258,627
Prepayment and accrued income	–	–	–	–	–	15,817	15,817
Other assets	5,200	118,510	–	–	–	–	123,710
Non-financial assets	–	–	–	–	–	23,552	23,552
At 31 Dec 2018	2,751,025	375,833	867,932	1,864,633	505,449	39,369	6,404,241
Liabilities and Equity							
Customer accounts	3,951,339	1,276,891	101,250	8,046	632	–	5,338,158
Derivatives	3,100	290	2,061	13	–	–	5,464
Accruals and other financial liabilities	6,316	427,557	1,139	577	13	–	435,602
Provisions	–	–	–	–	–	350	350
Non-financial liabilities	–	–	–	–	–	10,599	10,599
Equity	–	–	–	–	–	614,068	614,068
At 31 Dec 2018	3,960,755	1,704,738	104,450	8,636	645	625,017	6,404,241

	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 balances with central banks	8,895	–	7,421	–	–	–	16,316
Derivatives	4,218	3,461	554	1,393	–	–	9,626
Loans and advances to banks	717,124	–	1,721,851	–	–	–	2,438,975
Loans and advances to customers	1,139,193	397,307	634,379	1,873,788	429,816	–	4,474,483
Prepayment and accrued income	3,219	14,009	–	–	–	–	17,228
Other assets	–	43,977	–	–	–	–	43,977
Non-financial assets	–	–	–	–	–	10,514	10,514
At 31 Dec 2017	1,872,649	458,754	2,364,205	1,875,181	429,816	10,514	7,011,119
Liabilities and Equity							
Customer accounts	5,790,573	147,990	92,753	12,976	936	–	6,045,228
Derivatives	6,481	242	802	1,238	226	–	8,989
Accruals and other financial liabilities	15,372	326,103	975	1,242	12	–	343,704
Provisions	–	–	–	–	–	2,628	2,628
Non-financial liabilities	–	–	–	–	–	6,813	6,813
Equity	–	–	–	–	–	603,757	603,757
At 31 Dec 2017	5,812,426	474,335	94,530	15,456	1,174	613,198	7,011,119

25 Offsetting of financial assets and financial liabilities

The amounts not set off in the balance sheet include transactions where:

- The counterparty has an offsetting exposure with HSBC and a master netting or similar arrangement in place with a right to set off only in the event of default, insolvency or bankruptcy, or the offset criteria are otherwise not satisfied; and
- In the case of derivative and reverse repurchase/repurchase, stock borrowing/lending and similar agreements, cash and non-cash collateral has been received/pledged.

For risk management purposes, the net amounts of loans and advances to customers are subject to limits, which are monitored and the relevant customer agreements are subject to review and updated, as necessary, to ensure that the legal right to set off remains appropriate.

	Amounts subject to enforceable netting arrangements				
	Gross amounts	Impairment Allowances	Net amounts in the balance sheet	Amounts offset	Net amount
	£'000	£'000	£'000	£'000	£'000
Financial assets					
Derivatives	**5,248**	**–**	**5,248**	**–**	**5,248**
Loans and advances to customers	**4,306,325**	**(47,698)**	**4,258,627**	**(41,605)**	**4,217,022**
At 31 Dec 2018	**4,311,573**	**(47,698)**	**4,263,875**	**(41,605)**	**4,222,270**
Derivatives	9,626		9,626		9,626
Loans and advances to customers	4,522,444	(49,503)	4,474,483	(48,814)	4,473,630
At 31 Dec 2017	4,532,070	(49,503)	4,484,109	(48,814)	4,483,256
Financial liabilities					
Derivatives	**5,464**	**–**	**5,464**	**–**	**5,464**
Customer accounts	**5,338,158**	**–**	**5,338,158**	**(41,605)**	**5,296,553**
At 31 Dec 2018	**5,343,622**	**–**	**5,343,622**	**(41,605)**	**5,302,017**
Derivatives	8,989	–	8,989	–	8,989
Customer accounts	6,045,228	–	6,045,228	(48,814)	5,996,414
At 31 Dec 2017	6,054,217	–	6,054,217	(48,814)	6,005,403

26 Called up share capital

	2018		2017	
	Number	**£'000**	Number	£'000
Issued, allotted and fully paid up				
Ordinary shares of £10 each	**17,691,000**	**176,910**	17,691,000	176,910
As at 1 Jan and 31 Dec	**17,691,000**	**176,910**	17,691,000	176,910
Authorised				
Ordinary shares of £10 each	**19,500,000**	**195,000**	19,500,000	195,000
As at 1 Jan and 31 Dec	**19,500,000**	**195,000**	19,500,000	195,000

27 Contingent liabilities, contractual commitments and guarantees

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

	2018 £'000 Contract amount	2017 £'000 Contract amount
Contingent liabilities		
Guarantees and assets pledged as collateral security	**21,957**	24,494
Commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend	**853,559**	770,860
At 31 Dec	**875,516**	795,354

The Entity could be liable to pay a proportion of the outstanding amount that Financial Services Compensation Scheme ('FSCS') has borrowed from HM Treasury.

The ultimate FSCS levy to the industry as a result of the collapse cannot currently be estimated reliably as it is dependent on various uncertain factors including the potential recoveries of assets by the FSCS and changes in the level of protected deposits and the population of FSCS members at the time.

28 Management of financial risk

All of the Entity's activities involve to varying degrees, the analysis, evaluation, acceptance and management of risks 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 Entity as a going concern.

Credit risk management

Credit risk is the risk of financial loss if a customer or counterparty of the Entity fails to meet a payment obligation under a contract.

Within the overall framework of the HSBC Group policy, theEntity 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 Entity 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 identify problem exposures in order to accelerate remedial action while building a portfolio of high quality risk assets. The Entity's credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. Regular reviews are undertaken to assess and evaluate levels of risk concentration.

Summary of credit risk

The disclosure below presents the gross carrying/nominal amount of financial instruments to which the impairment requirements in IFRS 9 are applied and the associated allowance for ECL. Due to the forward-looking nature of IFRS 9, the scope of financial instruments on which ECL are recognised is greater than the scope of IAS 39.

The entity-specific PD model for the Entity's loan portfolio had been developed but was not implemented in time for the transition to IFRS 9 on 1 January 2018. As the Entity is exposed to broadly similar UK systematic risks, management decided to use the UK corporate PD model as a tactical solution to calculate ECL, until the entity-specific model was deployed in the systems.

The PD model for Entity's loan portfolio was replaced in August 2018 run. This has resulted in a £5m reduction in ECL.

Since the entity-specific model was not available until August 2018, the specific PDs for the portfolio in question are not obtainable, nor is it reasonably expected to have been obtained prior to the August 2018 run. Therefore, the resulting reduction in ECL following the implementation of the PD model has been accounted as a change in estimate as this takes into account the latest available information, where it reflects, amongst others:

a. The specific PD of the loan portfolio available for the first time following the implementation of the model

b. The changes in the underlying book and exposure

c. The changes in the Entity default rate.

The IFRS 9 allowance for ECL has decreased from £55,465,000 at 1 January 2018 to £47,784,000 at 31 December 2018.

The IFRS 9 allowance for ECL at 31 December 2018 comprises £47,698,000 in respect of assets held at amortised cost and £86,000 in respect of loan commitments and financial guarantees.

The following table analyses loans by industry sector and represent the concentration of exposures on which credit risk are managed.

Summary of financial instruments to which impairment requirements in IFRS 9 are applied

	Gross carrying/ nominal amount	Allowance/Provision for ECL
	£'000	£'000
Loans and advances to customers at amortised cost	**4,306,325**	**(47,698)**
- personal	3,160,229	(25,676)
- corporate and commercial	1,036,681	(21,662)
- non-bank financial institutions	109,415	(360)
Loans and advances to banks at amortised cost	**1,967,797**	**–**
Other financial assets measured at amortised cost	**149,017**	**–**
Cash and balances at central banks	9,490	–
Prepayment accrued income and other assets	139,527	–
Total gross carrying amount on balance sheet	**6,423,139**	**(47,698)**
Loans and other credit related commitments	**853,559**	**(86)**
- personal	413,400	(1)
- corporate and commercial	397,429	(85)
- financial	42,730	–
Financial guarantees and similar contracts	**21,957**	**–**
- personal	19,787	–
- corporate and commercial	2,170	–
Total nominal amount off-balance sheet	**875,516**	**(86)**
At 31 Dec 2018	**7,298,655**	**(47,784)**

**The total ECL is recognised in the loss allowance for the financial asset unless the total CL exceeds the gross carrying amount of the financial asset, in which case the ECL is recognised as a provision*

The following table provides an overview of the Entity's credit risk by stage and industry, and the associated ECL coverage. The financial assets recorded in each stage have the following characteristics:

- Stage 1: Unimpaired and without significant increase in credit risk on which a 12-month allowance for ECL is recognised.
- Stage 2: A significant increase in credit risk has been experienced since initial recognition on which a lifetime ECL is recognised.
- Stage 3: Objective evidence of impairment, and are therefore considered to be in default or otherwise credit-impaired on which a lifetime ECL is recognised.
- POCI: Purchased or originated at a deep discount that reflects the incurred credit losses on which a lifetime ECL is recognised.

Summary of credit risk by stage distribution and ECL coverage by industry sector

	Gross carrying/nominal amount			Allowance for ECL			ECL Coverage %		
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3
	£'000	£'000	£'000	£'000	£'000	£'000	%	%	%
Loans and advances to customers at amortised cost	**3,782,099**	**218,707**	**305,519**	**(3,696)**	**(3,157)**	**(40,845)**	**(0.10)**	**(1.44)**	**(13.37)**
- personal	**2,858,492**	**150,733**	**151,004**	**(3,113)**	**(2,996)**	**(19,567)**	**(0.11)**	**(1.99)**	**(12.96)**
- corporate and commercial	**822,347**	**65,549**	**148,785**	**(552)**	**(153)**	**(20,957)**	**(0.07)**	**(0.23)**	**(14.09)**
- non-bank financial institutions	**101,260**	**2,425**	**5,730**	**(31)**	**(8)**	**(321)**	**(0.03)**	**(0.33)**	**(5.60)**
Loans and advances to banks at amortised cost	**1,967,797**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Other financial assets measured at amortised cost	**149,017**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Loan and other credit-related commitments	**627,666**	**217,283**	**8,610**	**(9)**	**(73)**	**(4)**	**–**	**(0.03)**	**(0.05)**
- personal	**335,820**	**74,561**	**3,019**	**–**	**(1)**	**–**	**(0.01)**	**(0.01)**	**–**
- corporate and commercial	**254,795**	**137,090**	**5,544**	**(9)**	**(72)**	**(4)**	**–**	**(0.04)**	**–**
- non-bank financial institutions	**37,051**	**5,632**	**47**	**–**	**–**	**–**	**–**	**–**	**–**
Financial guarantees and similar contracts	**13,160**	**8,797**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
At 31 Dec 2018	**6,539,739**	**444,787**	**314,129**	**(3,705)**	**(3,230)**	**(40,849)**	**(0.06)**	**(0.73)**	**(13.00)**

I. Maximum exposure to credit risk

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet plus contractual commitments.

The following table presents our maximum exposure before taking account of any collateral held or other credit enhancements (*unless such enhancements meet accounting offsetting requirements*). The table excludes financial instruments whose carrying amount best represents the net exposure to credit risk and it excludes equity securities as they are not subject to credit risk. For the financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees and similar contracts granted, it is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments, it is generally the full amount of the committed facilities. The offset in the table relates to amounts where there is a legally enforceable right of offset in the event of counterparty default and where, as a result, there is a net exposure for credit risk purposes. However, as there is no intention to settle these balances on a net basis under normal circumstances, they do not qualify for net presentation for accounting purposes. No offset has been applied to off-balance sheet collateral. In the case of derivatives the offset column also includes collateral received in cash and other financial assets.

	2018		
	Maximum exposure	Offset	Net
	£'000	£'000	£'000
Derivatives	5,248	–	5,248
Loans and advances to banks at amortised cost	1,967,797	–	1,967,797
Loans and advances to customers at amortised cost	4,258,627	(41,605)	4,217,022
Other financial assets measured at amortised cost	149,017	–	149,017
Total on balance sheet exposure to credit risk	6,380,689	(41,605)	6,339,084
Total off Balance sheet			
- Financial guarantees and similar contracts	21,957	–	21,957
- Loan and other credit related commitments	853,559	–	853,559
At 31 Dec	7,256,205	–	7,214,600

Please refer to page 43 for 2017 values.

II. Concentration of credit risk exposure

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or such counterparties are engaged in similar activities, or operate in the same geographical areas or industry sectors, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions (see loans and advances to customers by industry table on Note 17). The Entity uses a number of controls and measures to minimise undue concentration of exposure in the Entity's portfolios across industry, country and customer groups. These include portfolio and counterparty limits, approval and review controls, and stress testing.

Credit deterioration of financial instruments

A summary of our current policies and practices regarding the identification, treatment and measurement of stage 1, stage 2, stage 3 (credit impaired) and POCI financial instruments can be found in note 1 of the financial statements.

Reconciliation of gross exposure and allowances/provision for loans and advances to customers including loan commitment and financial guarantee (IFRS 9) in £'000s

The following disclosure provides a reconciliation of the Entity's gross carrying/nominal amount and allowances for loans and advances to customers including loan commitments and financial guarantees.

The transfers of financial instruments represents the impact of stage transfers upon the gross carrying/nominal amount and associated allowance for ECL. The net remeasurement of ECL arising from stage transfers represents the increase in ECL due to these transfers.

	Non credit - impaired				Credit impaired		Total	
	Stage 1		Stage 2					
	Gross exposure £'000	Allowance/ provision for ECL £'000	Gross exposure £'000	Allowance /provision for ECL £'000	Gross exposure £'000	Allowance/ provision for ECL £'000	Gross exposure £'000	Allowance/ provision for ECL £'000
As at 01 Jan 2018	**4,849,765**	**(4,771)**	**223,301**	**(2,189)**	**246,274**	**(48,505)**	**5,319,340**	**(55,465)**
Transfer of financial instruments	–	–	–	–	–	–	–	–
- transfers from stage 1 to stage 2	(404,985)	277	404,985	(277)	–	–	–	–
- transfers from stage 2 to stage 1	848,715	(411)	(848,715)	411	–	–	–	–
- transfers to stage 3	(151,888)	88	(48,726)	830	200,614	(918)	–	–
- Net remeasurement of ECL arising from transfer of stage	–	163	–	(537)	–	(20)	–	(394)
New financial assets originated or purchased	1,303,923	(1,642)	–	–	–	–	1,303,923	(1,642)
Changes to risk parameters (model inputs)	(875,993)	(12,072)	1,131,707	(2,617)	39,823	(7,145)	295,537	(21,834)
Asset derecognised (including final repayments)	(1,157,865)	14,447	(417,765)	1,327	(152,070)	7,470	(1,727,700)	23,244
Assets written off	–	–	–	–	(8,349)	8,349	(8,349)	8,349
Others	11,253	216	–	(178)	(12,163)	(80)	(909)	(43)
At 31 Dec 2018	**4,422,925**	**(3,705)**	**444,787**	**(3,230)**	**314,129**	**(40,849)**	**5,181,841**	**(47,784)**
ECL income statement charge/ (release) for the period	–	1,066	–	(1,064)	–	(10,052)	–	(10,050)
Recoveries	–	–	–	–	–	9,445	–	9,445
Total ECL income charge/ (release) for the period	–	1,066	–	(1,064)	–	(607)	–	(605)

III. Credit quality

Credit quality of financial instruments

The Entity assesses the credit quality of all financial instruments that are subject to credit risk. The credit quality of financial instruments is a point in time assessment of the probability of default of financial instruments, whereas IFRS 9 stages 1 and 2 are determined based on relative deterioration of credit quality since initial recognition. Accordingly, for non-credit impaired financial instruments there is no direct relationship between the credit quality assessment and IFRS 9 stages 1 and 2, though typically the lower credit quality bands exhibit a higher proportion in stage 2.

The five credit quality classifications defined below each encompass a range of more granular, internal credit rating grades, as well as external rating:

	Debt Securities and other bills	Lending and derivatives
Quality classification	**External credit rating**	**Internal credit rating**
Strong	A- and above	CRR1 to CRR2
Good	BBB+ to BBB-	CRR3
Satisfactory	BB+ to B and unrated	CRR4 to CRR5
Sub-standard	B- to C	CRR6 to CRR8
Credit-impaired	Default	CRR9 to CRR10

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

Quality classification definitions

'Strong' exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default.

Good' exposures demonstrate a good capacity to meet financial commitments, with low default risk

'Satisfactory' exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk.

'Sub-standard' exposures require varying degrees of special attention and default risk is of greater concern.

'Credit-impaired' exposures have been assessed as impaired.

Distribution of financial instruments to which the impairment requirements of IFRS 9 are applied by credit quality stage allocation

	Gross carrying/notional amount							
	Strong	Good	Satisfactory	Substandard	Credit impaired	Total	Allowance provision for ECL	Net
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Cash and balances at central bank	9,490	–	–	–	–	9,490	–	9,490
- stage 1	9,490	–	–	–	–	9,490	–	9,490
- stage 2	–	–	–	–	–	–	–	–
- stage 3	–	–	–	–	–	–	–	–
Loans and advances to banks at amortised cost	1,967,797	–	–	–	–	1,967,797	–	1,967,797
- stage 1	1,967,797	–	–	–	–	1,967,797	–	1,967,797
- stage 2	–	–	–	–	–	–	–	–
- stage 3	–	–	–	–	–	–	–	–
Prepayment accrued income and other assets	15,817	–	–	–	–	15,817	–	15,817
- stage 1	15,817	–	–	–	–	15,817	–	15,817
- stage 2	–	–	–	–	–	–	–	–
- stage 3	–	–	–	–	–	–	–	–
Loans and advances to customers at amortised cost	675,689	2,071,772	1,199,636	53,709	305,519	4,306,325	(47,698)	4,258,627
- stage 1	670,389	2,054,239	1,057,471	–	–	3,782,099	(3,696)	3,778,403
- stage 2	5,300	17,533	142,165	53,709	–	218,707	(3,157)	215,550
- stage 3	–	–	–	–	305,519	305,519	(40,845)	264,674
Other financial assets measured at amortised cost	123,710	–	–	–	–	123,710	–	123,710
- stage 1	123,710	–	–	–	–	123,710	–	123,710
- stage 2	–	–	–	–	–	–	–	–
- stage 3	–	–	–	–	–	–	–	–
At 31 Dec 2018	2,792,503	2,071,772	1,199,636	53,709	305,519	6,423,139	(47,698)	6,375,441
Percentage of total credit quality (%)	43%	32%	19%	1%	5%			
Loans and other credit related commitments	517,527	206,525	119,872	1,025	8,610	853,559	(86)	853,473
- stage 1	440,394	187,272	–	–	–	627,666	(9)	627,657
- stage 2	77,133	19,253	119,872	1,025	–	217,283	(73)	217,210
- stage 3	–	–	–	–	–	8,610	(4)	8,606
Financial guarantee and similar contracts	112	13,918	7,927	–	–	21,957	–	21,957
- stage 1	112	13,048	–	–	–	13,160	–	13,160
- stage 2	–	870	7,927	–	–	8,797	–	8,797
- stage 3	–	–	–	–	–	–	–	–
At 31 Dec 2018	3,310,142	2,292,215	1,327,435	54,734	314,129	7,298,655	(47,784)	7,250,871

Please refer to page 43 for 2017 values.

Credit impaired loans

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

- contractual payments of either principal or interest are past due for more than 90 days;
- there are other indications that the borrower is unlikely to pay such as that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and
- the loan is otherwise considered to be in default. If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due, even where regulatory rules permit default to be defined based on 180 days past due. Therefore the definitions of credit-impaired and default are aligned as far as possible so that stage 3 represents all loans which are considered defaulted or otherwise credit impaired.

IV. Renegotiated loans and forbearance

The Entity 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 Entity 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 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-aging. These management policies and practices typically provide the customer with terms and 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 Entity discloses loan forbearance as 'renegotiated loans', which represent concessions granted which the Entity would normally consider as a result of financial difficulties of a customer.

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

	At 31 Dec 2018			At 31 Dec 2017		
	Neither past due not impaired	Impaired	Total	Neither past due not impaired	Impaired	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Retail	23,231	56,342	79,573	49,291	57,256	106,547
- Residential Mortgages	13,579	26,355	39,934	34,812	39,263	74,075
- Other personal	9,652	29,987	39,639	14,479	17,993	32,472
Commercial and real estate	7,644	64,136	71,780	14,565	69,009	83,574
Corporate and commercial	–	7,451	7,451	–	2,432	2,432
Other	14,001	20,778	34,779	6,590	4,793	11,383
	44,876	148,707	193,583	70,446	133,490	203,936
Impairment allowance on renegotiated loans			(32,670)			(8,507)
Renegotiated loans and advances as % of total gross loans (%)			4.5%			4.5%

V. Collateral and other credit enhancements

The Entity follows guidelines as to the acceptability of specific classes of collateral or credit risk mitigation. While collateral is important in mitigating credit risk, it is the Entity's practice to lend on the basis of the customer's ability to meet their obligations out of cash from resources rather than rely on the value of security offered.

The principal collateral types are as follows:

- in the personal sector, mortgages over residential properties, cash and securities;
- 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.

Summary of loan book analysed by collateral type is provided below

	2018	2017
	£'000	£'000
Other property	663,876	745,961
Residential property	2,470,132	2,188,172
Cash backed	359,958	502,260
Other	767,537	872,358
Unsecured	44,822	213,693
Gross loans and advances to customers	4,306,325	4,522,444

Other property is predominantly UK residential investment property and UK commercial investment property.

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

Collateral held is analysed separately for commercial real estate, other corporate, commercial, financial (non-bank) and residential mortgage lending.

Commercial real estate and other commercial loans and advances including loan commitments by level of collateral.

	2018 £'000	2017 £'000
Rated CRR 1 to 7		
Not collateralised	**47,239**	6,821
Fully collateralised	**1,527,199**	1,079,107
Partially collateralised	**19,117**	1,477
- collateral value	14,932	915
Rated CRR 8 to 10		
Not collateralised	**1,387**	332
Fully collateralised	**153,676**	112,682
LTV ratio:		
- Less than 50%	74,792	10,414
- 51% to 75%	39,735	37,761
- 76% to 90%	32,727	62,635
- 91% to 100%	6,422	1,872
Partially collateralised		
greater than 100% LTV	**2,215**	8,470
- collateral value	—	5,242
At 31 Dec	**1,750,833**	1,208,889

Other corporate and financial (non-bank) loans and advances including loan commitments by level of collateral rated CRR 8 to 10

	2018 £'000	2017 £'000
Not collateralised	**85,272**	—
Fully collateralised	**5,777**	4,689
LTV Ratio:		
- Less than 50%	359	2,432
- 51% to 75% LTV	4,809	2,257
- 76% to 90% LTV	609	—
Partially collateralised		
greater than 100% LTV	—	—
- collateral value	—	—
At 31 Dec	**91,049**	4,689

Residential mortgage lending

The table below shows residential mortgage lending including off-balance sheet loan commitments by level of collateral. The LTV ratio is calculated as the gross on-balance sheet carrying amount of the loan and any off-balance sheet loan commitment at the balance sheet date divided by the value of collateral. The value of collateral is determined using professional valuations and house prices indices.

	2018 £'000	2017 £'000
Non-impaired loans and advances		
Fully collateralised	**2,954,134**	2,221,721
- Less than 50% LTV	886,591	655,146
- 51% to 60% LTV	501,401	418,871
- 61% to 70% LTV	803,180	672,975
- 71% to 80% LTV	470,454	342,852
- 81% to 90% LTV	200,780	113,300
- 91% to 100% LTV	91,728	18,577
Partially collateralised		
greater than 100% LTV	**153,402**	50,106
- collateral value	145,815	46,525
Impaired loans and advances		
Fully collateralised	**38,597**	69,712
- Less than 50% LTV	822	13,476
- 51% to 60% LTV	462	14,740
- 61% to 70% LTV	16,668	11,712
- 71% to 80% LTV	6,152	15,321
- 81% to 90% LTV	8,018	7,133
- 91% to 100% LTV	6,475	7,330
Partially collateralised		
greater than 100% LTV	**11,851**	20,803
- collateral value	15,633	16,108
At 31 Dec	**3,157,984**	2,362,342

2017 Credit risk disclosures

The below disclosures were included in the *Annual Report and Accounts 2017* and do not reflect the adoption of IFRS 9. As these tables are not directly comparable to the current 2018 credit risk tables which are disclosed on the IFRS 9 basis, the 2017 disclosures have been shown below and not adjacent to the 2018 tables.

Maximum exposure to credit risk

	2017		
	Maximum exposure	Offset	Exposure to credit risk (net)
	£'000	£'000	£'000
Cash and balances at central banks	16,316	–	16,316
Derivatives	9,626	–	9,626
Loans and advances at amortised cost	4,525,508	(48,814)	4,476,694
Other assets	57,162	–	57,162
Financial guarantees	24,494	–	24,494
Loan commitments	770,860	–	770,860
At 31 Dec	5,403,966	(48,814)	5,355,152

Distribution of total financial instruments exposed to credit risk by credit quality

	Neither past due not impaired							
	Strong	Good	Satisfactory	Substandard	Past due not impaired	Impaired	Impairment allowances	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
At 31 Dec 2017								
Cash and balances at central bank	16,316	–	–	–	–	–	–	16,316
Derivatives	5,356	4,270	–	–	–	–	–	9,626
Loans and advances to banks	2,438,975	–	–	–	–	–	–	2,438,975
Loans and advances to customers	548,900	1,960,155	1,679,399	92,670	–	242,862	(49,503)	4,474,483

Liquidity risk management

Liquidity risk is the risk that the Entity does not have sufficient financial resources to meet obligations as they fall due or will have access to such resources only at an excessive cost. The risk arises from mismatches in the timing of cash flows.

The Company is part of the Domestic Liquidity Sub-group ('Liquidity Group') of HSBC UK Bank plc and therefore part of the internal liquidity control and management structure of HSBC UK Bank plc. The entity liquidity position is managed as part of the HSBC Bank UK plc Liquidity Group, under which members agree to provide liquidity support when necessary.

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

	Carrying value	**Contractual cash flows**	**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**	**£'000**	**£'000**
Customer accounts	**–**	**–**	**3,951,340**	**1,282,343**	**102,546**	**8,592**	**731**	**5,345,552**
Financial guarantees	**–**	**–**	**364**	**10,636**	**10,957**	**–**	**–**	**21,957**
Loan commitments	**–**	**–**	**–**	**152,876**	**570,166**	**121,717**	**8,800**	**853,559**
At 31 Dec 2018	**–**	**–**	**3,951,704**	**1,445,855**	**683,669**	**130,309**	**9,531**	**6,221,068**
Customer accounts	–	–	5,325,954	616,231	94,365	14,098	1,125	6,051,773
Financial guarantees	–	–	–	7,059	17,070	–	365	24,494
Loan commitments	–	–	410,945	45,426	176,078	129,158	9,253	770,860
At 31 Dec 2017	–	–	5,736,899	668,716	287,513	143,256	10,743	6,847,127

Market risk management

Market risk is the risk that movements in market factors including interest rates, foreign exchange rates or equity and commodity prices will impact the Entity's income or the value of its portfolios.

The Entity's objective is to manage and control market rate exposures while maintaining a market profile consistent with its risk appetite.

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

Disclosures on market price risk, foreign exchange risk and interest rate risk are provided below.

Market price risk

Market risk is the risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices will reduce the Entity's income or the value of its portfolios.

The Entity uses Value at risk ('VAR') to monitor and limit market risk exposures. VAR is a technique that estimates the potential losses on risk positions in a portfolio as a result of movement in market rates and prices over a specified time horizon and to a given level of confidence. The VAR model is based predominantly on historical simulation. This model derives plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates such as interest rates and foreign exchange rates.

VAR measures in the table below are calculated to a 99% confidence level and use a one-day holding period.

	2018 £'000	2017 £'000
Value at risk		
At 31 Dec	**34**	48
Average	**89**	54
Minimum	**10**	17
Maximum	**175**	161

The nature of VAR models means that an increase in observed market volatility will lead to an increase in VAR without any changes in the underlying positions. Although a valuable guide to risk, VAR should always be viewed in the context of limitations. For example:

- the use of a historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or the risks offset in one day;
- the use of a 99% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence.

Foreign exchange risk

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

As at 31 Dec 2018	US dollars £'000	Sterling £'000	Euro £'000	Other £'000	Total £'000
Total assets	**891,515**	**5,017,012**	**329,896**	**120,276**	**6,358,699**
Total liabilities and equity	**(895,174)**	**(5,022,764)**	**(332,430)**	**(108,331)**	**(6,358,699)**
Net exposure	**(3,659)**	**(5,752)**	**(2,534)**	**11,945**	**–**

As at 31 Dec 2017					
Total assets	515,513	5,675,593	473,981	72,908	6,737,995
Total liabilities and equity	(869,238)	(4,886,227)	(808,603)	(173,927)	(6,737,995)
Net exposure	(353,725)	789,366	(334,622)	(101,019)	–

Interest rate risk

Interest rate risk is managed internally by monitoring the sensitivity of the fair value of the Entity's assets and liabilities to a 0.01% shift in yield curves (the present value of a basis point or 'PVBP'). At 31 December 2018 the Entity's risk as measured by PVBP was nil (2017: £13,045). PVBP is the change in the present value of future cash flows and not recognised as an immediate gain or loss in the income statement.

The table below discloses the mismatch of the dates on which interest on assets and liabilities are next reset to market rate on a contractual basis or, if earlier, the dates on which assets and liabilities mature as at 31 December 2018. 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 assets and liabilities.

At 31 Dec 2018	Not more than 3 months £'000	Between 3 and 6 months £'000	Between 6 months and 1 year £'000	Between 1 and 5 years £'000	More than 5 years £'000	Non-interest bearing £'000	Total £'000
Assets							
Loans and advances to banks	**1,772,720**	**–**	**195,077**	**–**	**–**	**–**	**1,967,797**
Loans and advances to customers	**1,280,675**	**205,991**	**449,596**	**1,864,614**	**505,449**	**(47,697)**	**4,258,628**
Other assets	**147,261**	**–**	**9,490**	**–**	**–**	**21,065**	**177,816**
Total assets	**3,200,656**	**205,991**	**654,163**	**1,864,614**	**505,449**	**(26,632)**	**6,404,241**
Equity and Liabilities							
Customer accounts	**5,228,230**	**71,118**	**30,132**	**8,046**	**–**	**632**	**5,338,158**
Other liabilities	**–**	**–**	**–**	**–**	**–**	**452,015**	**452,015**
Shareholders' equity	**–**	**–**	**–**	**–**	**–**	**614,068**	**614,068**
Total equity and liabilities	**5,228,230**	**71,118**	**30,132**	**8,046**	**–**	**1,066,715**	**6,404,241**
Notional value:							
Interest rate sensitivity gap	**(2,027,574)**	**134,873**	**624,033**	**1,856,568**	**505,449**	**(1,093,348)**	**–**
Cumulative interest rate sensitivity gap	**(2,027,574)**	**(1,892,701)**	**(1,268,668)**	**587,899**	**1,093,348**	**–**	**–**

At 31 Dec 2017	Not more than 3 months £'000	Between 3 and 6 months £'000	Between 6 months and 1 year £'000	Between 1 and 5 years £'000	More than 5 years £'000	Non-interest bearing £'000	Total £'000
Assets							
Loans and advances to banks	2,438,975	–	–	–	–	–	2,438,975
Loans and advances to customers	845,445	2,187,379	40,369	1,066,231	384,417	(49,358)	4,474,483
Other assets	63,385	–	7,421	–	–	26,855	97,661
Total assets	3,347,805	2,187,379	47,790	1,066,231	384,417	(22,503)	7,011,119
Equity and Liabilities							
Customer accounts	5,938,562	60,140	32,613	12,977	–	936	6,045,228
Other liabilities	–	–	–	–	–	362,134	362,134
Shareholders' equity	–	–	–	–	–	603,757	603,757
Total equity and liabilities	5,938,562	60,140	32,613	12,977	–	966,827	7,011,119
Notional value:							
Interest rate swaps	6,941	(4,238)	(1,112)	(1,591)	–	–	–
Interest rate sensitivity gap	(2,583,816)	2,123,001	14,065	1,051,663	384,417	(989,330)	–
Cumulative interest rate sensitivity gap	(2,583,816)	(460,815)	(446,750)	604,913	989,330	–	–

A positive interest rate sensitivity gap exists where more assets than liabilities reprice 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 repricing periods and among currencies.

Similarly, a negative interest rate sensitivity gap exists where more liabilities than assets reprice 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.

29 Legal proceedings and regulatory matters

The Entity is party to legal proceedings and regulatory matters in a number of jurisdictions arising out of its normal business operations. Apart from the matters described below, the Entity considers that none of these matters are material. The recognition of provisions is determined in accordance with the accounting policies set out in Note 1. While the outcome of legal proceedings and regulatory matters is inherently uncertain, management believes that, based on the information available to it, no provisions are appropriate in respect of these matters as at 31 December 2018. It is not practicable to provide an aggregate estimate of potential liability for the Entity's legal proceedings and regulatory matters as a class of contingent liabilities

In August 2013, an action was brought in the High Court of Zimbabwe against the Entity and HSBC Bank Plc claiming losses in respect of an alleged failure to respond to enquiries following a regulatory notification. This action is ongoing. A claim against the Entity relating to the same facts was dismissed by the High Court of England and Wales in 2012.

In March 2014, an action was brought in the High Court of England and Wales against the Entity, HSBC Private Bank (Monaco) SA and HSBC Holdings plc claiming a failure by the Entity and HSBC Holdings plc to investigate properly allegations relating to the mis-selling of certain products by HSBC Private Bank (Monaco) SA. The court has dismissed the claim against HSBC Private Bank (Monaco) SA on jurisdictional grounds. The action against HSBC Holdings plc and the Entity is ongoing.

In July 2015 and November 2015 respectively, two actions were brought by individuals against the Entity in the High Court of England and Wales seeking damages on various alleged grounds, including breach of duty to the claimants, in connection with their participation in certain Ingenious film finance schemes.

In December 2018, a further action was brought against the Entity in the High Court of England and Wales by multiple claimants seeking damages for alleged unlawful means conspiracy and dishonest assistance in connection with lending provided by the Entity to third parties in respect of certain Ingenious film finance schemes in which the claimants participated. In February 2019, the Entity received a letter before claim by investors in Eclipse film finance schemes asserting various claims against the Entity and others in connection with their roles in facilitating the design, promotion and operation of such schemes. These matters are at very early stages.

It is possible that additional actions or investigations will be initiated against the Entity as a result of its historic involvement in the provision of certain film finance related services.

In February 2019, various HSBC companies, including the Entity, were named as defendants in a claim issued in the High Court of England and Wales that alleges foreign exchange-related misconduct.

Based on the facts currently known, it is not practicable to estimate the resolution of these matters, including the timing or possible aggregate impact on the Entity, which could be significant.

30 Related party transactions

(a) Transactions with Directors and other Key Management Personnel

Key Management Personnel ('KMP') are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Entity directly and indirectly and include members of the Board of Directors of the Entity and HSBC UK Bank plc.

IAS 24 'Related party disclosures' requires the following additional information for key management compensation.

A number of KMP are not directors of the Entity, but are directors of the Parent Company, HSBC UK Bank plc. Emoluments of these KMP are paid by other HSBC Group companies, which make no recharge to the Entity. It is not possible to make reasonable apportionment of their emoluments in respect of the Entity. Accordingly, no emoluments in respect of these KMP are included in the following disclosure.

The following represents the compensation for Directors of the Entity in exchange for services rendered to the Entity for the period they served during the year.

Compensation of Key Management Personnel

	2018 £'000	2017 £'000
Short-term employee benefits	**1,650**	1,650
Post-employment benefits	**40**	38
Other long-term benefits	**325**	204
Share-based payments	**687**	568
At 31 Dec 2018	**2,702**	2,460

Transactions, arrangements and agreements including Directors and other Key Management Personnel

There are no transactions which fall to be disclosed under IAS 24 'Related Party Disclosures' between the Entity and the Key Management Personnel.

Shareholdings, options and securities of Directors and other Key Management Personnel

	2018	2017
Number of HSBC Holding plc shares held by Directors and other key management personnel beneficially	**377,906**	327,135

(b) Transactions with other related parties

Transactions detailed below include amounts due to/from HSBC UK Bank plc

	2018		2017	
	Highest balance during the year £'000	**Balance at 31 December £'000**	Highest balance during the year £'000	Balance at 31 December £'000
Assets				
Loans and advances to banks	**2,073,538**	**1,932,455**	–	–
Other assets	**116,266**	**116,266**	–	–
	–	**–**		
Liabilities				
Other liabilities	**242,716**	**242,716**	–	–
Derivatives	**74**	**74**	–	–

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

	2018 £'000	2017 £'000
Income statement		
Interest income	**11,643**	–
General and administrative expenses	**2,069**	–

Transactions detailed below include amounts due to/from HSBC Bank plc

	2018		2017	
	Highest balance during the year £'000	**Balance at 31 December £'000**	Highest balance during the year £'000	Balance at 31 December £'000
Assets				
Loans and advances to banks	**1,834,365**	**25,253**	2,437,047	2,437,047
Derivatives	**21,412**	**3,340**	8,810	2,970
Other assets	**6,232**	**445**	5,156	5,061
Liabilities				
Other liabilities	**169,170**	**132,783**	273,277	273,277
Derivatives	**13,986**	**2,254**	12,859	7,598

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

	2018 £'000	2017 £'000
Income statement		
Interest income	**5,768**	6,348
Interest expense	**–**	338
Fee income	**1,284**	(102)
Fee expense	**1,168**	2,316
Other operating income / (expense)	**(703)**	1,916
General and administrative expenses	**7,765**	5,600
Dividend expense	**18,000**	128,000

Transactions detailed below include amounts due to/from Other Group Companies

	2018		2017	
	Highest balance during the year	**Balance at 31 December**	Highest balance during the year	Balance at 31 December
	£'000	**£'000**	£'000	£'000
Assets				
Loans and advances to banks	**40,018**	**10,089**	7,946	1,928
Other assets	**37,386**	**5,146**	37,884	35,269
Liabilities				
Other liabilities	**60,306**	**22,505**	40,025	38,636

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

	2018 £'000	2017 £'000
Income statement		
Interest expense	**–**	71
Fee income	**–**	915
Fee expense	**5,073**	8,823
Other operating income / (expense)	**8,515**	33,250
General and administrative expenses	**45,489**	84,211

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.

31 Effects of reclassification on adoption of IFRS 9

Reclassification of balance sheet as at 31 December 2017 and 1 January 2018

	IAS 39 measurement category	IAS 39 carrying amount at 31 Dec 2017	IFRS 9 reclassification to: Fair value through profit and loss	IFRS 9 reclassification to: Fair value through other comprehensive income	IFRS 9 reclassification to: Amortised cost	Carrying amount post reclassification	IFRS 9 re-measurement including expected credit losses	IFRS 9 carrying amount at 1 Jan 2018
		£'000	£'000	£'000	£'000	£'000	£'000	£'000
Assets								
Cash and balances at central banks	Amortised cost	16,316	–	–	–	16,316	–	16,316
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	FVPL	–	–	–	–	–	–	–
Financial assets designated at fair value	FVPL	–	–	–	–	–	–	–
Derivatives	FVPL	9,626	–	–	–	9,626	–	9,626
Loans and advances to banks	Amortised cost	2,438,975	–	–	–	2,438,975	–	2,438,975
Loans and advances to customers	Amortised cost	4,474,483	–	–	–	4,474,483	(4,934)	4,469,549
Prepayments and accrued income	Amortised cost	17,228	–	–	–	17,228	–	17,228
Other assets	Amortised cost	43,977	–	–	–	43,977	–	43,977
Current tax assets	N/A	–	–	–	–	–	–	–
Investments in subsidiaries	N/A	–	–	–	–	–	–	–
Property, plant and equipment	N/A	23	–	–	–	23	–	23
Goodwill and intangible assets	N/A	9,092	–	–	–	9,092	–	9,092
Deferred tax assets	N/A	1,399	–	–	–	1,399	1,255	2,654
Total assets		7,011,119	–	–	–	7,011,119	(3,679)	7,007,440

	IAS 39 measurement category	IAS 39 carrying amount at 31 Dec 2017	IFRS 9 reclassification to: Fair value through profit and loss	IFRS 9 reclassification to: Fair value through other comprehensive income	IFRS 9 reclassification to: Amortised cost	Carrying amount post reclassification	IFRS 9 re-measurement including expected credit losses	IFRS 9 carrying amount at 1 Jan 2018
		£'000	£'000	£'000	£'000	£'000	£'000	£'000
Liabilities								
Customer accounts	Amortised cost	6,045,228	–	–	–	6,045,228	–	6,045,228
Derivatives	FVPL	8,989	–	–	–	8,989	–	8,989
Accruals, deferred income and other liabilities	Amortised cost	343,704	–	–	–	343,704	–	343,704
Current tax liabilities	N/A	6,813	–	–	–	6,813	–	6,813
Provisions	N/A	2,628	–	–	–	2,628	–	2,628
Total liabilities		6,407,362	–	–	–	6,407,362	–	6,407,362

	IAS 39 carrying amount as at 31 Dec 2017	IFRS 9 reclassification	Carrying amount post reclassification	IFRS 9 remeasurement including expected credit losses	Carrying amount at 1 Jan 2018
	£'000	£'000	£'000	£'000	£'000
Equity					
Called up share capital	176,910	–	176,910	–	176,910
Other equity instruments	404,636	–	404,636	–	404,636
Retained earnings	22,211	–	22,211	(3,679)	18,532
Total shareholders' equity	–	–	–	–	–
Non-controlling interest	–	–	–	–	–
Total equity	603,757	–	603,757	(3,679)	600,078

Reconciliation of impairment allowances under IAS 39 and provisions under IAS 37 to expected credit losses under IFRS 9

	IAS 39 measurement category	Reclassification to: Fair value through profit or loss	Reclassification to: Fair value through other comprehensive income	Reclassification to: Amortised cost	Remeasurement: Stage 3	Remeasurement: Stage 1 & Stage 2	Total
		£'000	£'000	£'000	£'000	£'000	£'000
Financial assets at amortised cost							
IAS 39 impairment allowances at 31 Dec 2017							–
Cash and balances at central banks	Amortised cost (Loans and receivable)	–	–	–	–	–	–
Loans and advances to banks	Amortised cost (Loans and receivable)	–	–	–	–	–	–
Loans and advances to customers	Amortised cost (Loans and receivable)	–	–	(49,503)	(48,505)	(6,716)	(55,221)
Prepayments and accrued income	Amortised cost (Loans and receivable)	–	–	–	–	–	–
Other assets	Amortised cost (Loans and receivable)	–	–	–	–	–	–
Expected credit loss allowances as at 1 Jan 2018							(55,221)
Loan commitments and financial guarantee contracts							
IAS 37 provision at 31 Dec 2017							–
Provisions (Loan commitments and guarantees)	–	–	–	(1,028)	–	(244)	(244)
Expected credit loss provisions at 1 Jan 2018							(244)

The adoption of IFRS 9 reduced the loans to customers by £4.9 million and net assets by £3.7 million.

32 UK leaving the EU

The UK is due to leave the EU in March 2019 and negotiations are ongoing. We will continue to work with regulators, governments and our customers and employees to manage the risks of the UK's exit from the EU (and the current period of uncertainty) as they arise.

Uncertainty regarding the terms of the UK's exit agreement and its future relationship (including trading) with both the EU and the rest of the world is expected to continue for the next few years at least. Market volatility will therefore persist as the UK continues its negotiations with the EU and its potential future trading partners around the world. Throughout this period, we will continually update our assessment of potential consequences for our customers, products and banking model and re-evaluate our mitigating actions accordingly. The scale and nature of the impact on us will depend on the precise terms on which we and our *customers will be able to conduct cross-border business following the UK's departure from the EU:*

- Clients: Providing investment advice on a cross-border basis is expected to become more difficult after UK's full exit from the European Union (EU). However, given the Entity's focus on clients resident in the UK, any servicing issues with non-resident clients would most likely lead the Entity to stop doing this business and either exit clients or try to transfer them to another HSBC Private Bank booking centre in the EU.
- People: the potential loss of freedom of movement could impact our EEA staff resident in the UK and UK staff resident in an EEA country

Our priority is to ensure we continue to support our clients and people through this period of uncertainty, and help minimise any disruption.

Changes to the UK's current trade relationships could require changes to our banking model to ensure we continue to comply with law and regulation in meeting the needs of our customers and conducting our business.

Mitigating actions

- We have undertaken a comprehensive impact assessment to understand the range of potential implications for our customers, our products and our business. Where necessary, we have identified actions, including evolving our business models, to ensure we can continue to serve our customers.
- We actively monitor our portfolio to identify areas of stress, supported by stress testing analyses. Vulnerable sectors are subject to additional management review to determine if any adjustments to risk policy or appetite are required.
- We continue to stay very close to our clients, via proactive communications and dedicated channels to respond to customer queries.
- We will be supporting our EEA staff resident in the UK with their settlement applications.
- We will continue to work with regulators, governments and our clients in an effort to manage risks as they arise, particularly across the most impacted sectors.

33 Parent undertakings

The ultimate parent undertaking and ultimate controlling party is HSBC Holdings plc which is the parent undertaking of the largest group to consolidate these financial statements. HSBC UK Bank plc is the parent undertaking of the smallest group to consolidate these financial statements.

On 1 July 2018 the immediate parent undertaking changed from HSBC Bank plc to HSBC UK Bank plc plc as part of structural changes within HSBC Group to meet Ring Fenced Bank requirements. All companies are registered in England and Wales.

Copies of HSBC Holdings plc's and HSBC UK Bank plc plc's consolidated financial statements can be obtained from:

8 Canada Square
London E14 5HQ
United Kingdom
www.hsbc.com

34 Events after the balance sheet date

A dividend for 2018 of £31.5m was declared by the Directors after 31 December 2018.