HSBC AMANAH MALAYSIA BERHAD
(Company No. 807705-X)
(Incorporated in Malaysia)

FINANCIAL STATEMENTS – 31 DECEMBER 2018

Domiciled in Malaysia.
Registered Office:
10th Floor, North Tower
2, Leboh Ampang,
50100 Kuala Lumpur

HSBC AMANAH MALAYSIA BERHAD
(Company No. 807705-X)
(Incorporated in Malaysia)

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BOARD OF DIRECTORS

Datuk Kamaruddin bin Taib
Independent Chairman/Non-Executive Director *(appointed on 2 January 2018)*

Stuart Paterson Milne
Non-Independent Executive Director *(appointed on 24 May 2018)*

Mukhtar Malik Hussain
Non-Independent Executive Director

Adil Ahmad
Independent Non-Executive Director

Lee Choo Hock
Independent Non-Executive Director

Albert Quah Chei Jin
Independent Non-Executive Director

Ho Chai Huey
Independent Non-Executive Director *(appointed on 2 January 2018)*

Louisa Cheang Wai Wan
Non-Independent Executive Director *(resigned on 20 March 2018)*

Dr. Mohamed Ashraf bin Mohamed Iqbal
Non-Independent Non-Executive Director *(resigned on 31 October 2018)*

CORPORATE GOVERNANCE DISCLOSURES

The statement of corporate governance practices set out on pages 2 to 15 and the information referred to therein constitutes the Corporate Governance Report of HSBC Amanah Malaysia Berhad (the Bank). As a banking institution licensed under the Islamic Financial Services Act 2013, the Bank complies with the corporate governance standards set out in the Bank Negara Malaysia (BNM) Policy Document on Corporation Governance (BNM Corporate Governance Policy).

Directors

The Directors serving as at the date of this report are set out below:

Datuk Kamaruddin bin Taib, 62
Independent Chairman/Non-Executive Director
Member of Audit Committee and Nominations and Remuneration Committee: February 2018
Appointed to the Board and as Chairman**:** January 2018

Datuk Kamaruddin holds a Bachelor of Science Degree in Mathematics from the University of Salford, United Kingdom.

Datuk Kamaruddin is a Director of DNV GL Malaysia Sdn Bhd, part of the Global DNV GL Group. He has been with the DNV GL Group since 1995, and was a substantial shareholder until December 2016. He retired as the Executive Chairman in June 2017.

Datuk Kamaruddin has significant experience in investment banking, corporate finance, mergers and acquisitions. He started his career started in 1980 with a leading Investment Bank in Malaysia. Subsequently, he served as a Director of several private companies and companies listed on Bursa Malaysia. He has personal experience in listing several companies on Bursa Malaysia. Apart from his vast experience of serving on the board of companies listed on Bursa Malaysia, his experience included serving on the board of companies listed on the Stock Exchange of India as well as listed on Nasdaq (U.S.A.).

Datuk Kamaruddin is currently the Chairman of GHL Systems Berhad and Great Eastern Takaful Berhad.

Datuk Kamaruddin is also a Director of Great Eastern Life Assurance (Malaysia) Berhad, Great Eastern General Insurance (Malaysia) Berhad, BFC Exchange Sdn Bhd, FIDE Forum, Fraser & Neave Holdings Berhad and Malaysia Smelting Corporation Berhad.

Datuk Kamaruddin serves as a trustee for the Malaysian Oil & Gas Services Council. Prior to being a trustee, he was an elected executive council member.

Datuk Kamaruddin does not have any shareholding in the Bank.

Stuart Paterson Milne, 59
Non-Independent Executive Director
Appointed to the Board: May 2018

Mr Milne was appointed as the Non-Independent Executive Director on 24 May 2018.

Mr Milne graduated from the University of Durham, United Kingdom with a Bachelor of Arts (Honours) in Oriental Studies (Modern Arabic Studies). He joined HSBC in 1981. Since then, he has worked in a variety of businesses in the United Arab Emirates, Hong Kong, the Philippines, France, United States, Japan and India.

Prior to his appointment in Malaysia, he was the CEO of HSBC Japan and HSBC India respectively.

Mr Milne is a Non-Independent Executive Director and Chief Executive Officer (CEO) of HSBC Bank Malaysia Berhad.

Mr Milne does not have any shareholding in the Bank. His interest in the Bank's related corporation is as disclosed in the Directors' Report on page 17.

Mukhtar Malik Hussain, 59
Non-Independent Executive Director
Appointed to the Board**:** December 2009

Mr Mukhtar graduated from University of Wales with a Bachelor of Science in Economics. He first joined the HSBC Group in 1982 as a graduate trainee in Midland Bank International. He was then appointed as Assistant Director in Samuel Montagu in 1991. After more than 10 years of working in the HSBC Group's London offices, Mr Mukhtar subsequently held numerous posts in Dubai including CEO of HSBC Financial Services (Middle East) Limited from 1995 to 2003. He established the initiative to create the first foreign investment bank in Saudi Arabia for HSBC.

In 2003, Mr Mukhtar assumed the position of CEO, Corporate and Investment Banking. He headed back to London as the Co-Head of Global Banking in 2006. He was the Global Head of Principal Investments in London from 2006 to 2008. Between 2008 and 2009, he was the Deputy Chairman, HSBC Bank Middle East Limited and Global CEO of HSBC Amanah. He was also the CEO, Global Banking and Markets for Middle East and North Africa before assuming his role as the CEO of HSBC Bank Malaysia Berhad from 2009 to 2018. Mr Mukhtar is currently HSBC Group General Manager and Head of Belt & Road Initiatives for HSBC Asia Pacific.

Mr Mukhtar is a Non independent Executive Director of HSBC Bank Malaysia Berhad, Director and Chairman of HSBC Bank (Singapore) Limited and Director of The ICLIFF Leadership and Governance Centre.

Mr Mukhtar is currently HSBC Group General Manager and Head of Belt & Road Initiatives for HSBC Asia Pacific.

Mr Mukhtar does not have any shareholding in the Bank. His interest in the Bank's related corporation is as disclosed in the Directors' Report on page 17.

Adil Ahmad, 62
Independent Non-Executive Director
Chairman of the Nominations and Remuneration Committee and member of Audit Committee, Risk Committee and Connected Party Transactions Committee
Appointed to the Board: May 2014

Mr Adil holds a Masters in Business Administration (Finance & Accounting) and Bachelor in Economics from Cornell University, Ithaca, New York. He has 30 years of international banking experience and began his career in the 1980s at ANZ Grindlays Bank Pakistan. He was the Director and Head of Global Islamic Finance of ANZ Investment Bank in London from 1993 to 1997 and thereafter Executive, Group Strategy of ANZ Banking Group Ltd in Melbourne from 1997 to 2000. He assumed the position as the CEO of ANZ Banking Group Ltd Vietnam from 2000 to 2005. In 2006 he left the ANZ Banking Group to become CEO of Kuwait International Bank, from where he retired in 2009.

Since retiring to Malaysia, Mr Adil has advised international clients on strategic and financial matters for projects in Vietnam, Malaysia and Pakistan, and has provided Islamic and conventional banking training programs for banks and other financial institutions.

Mr Adil does not have any shareholding in the Bank. His interest in the Bank's related corporation is as disclosed in the Directors' Report on page 17.

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

Lee Choo Hock, 66
Independent Non-Executive Director
Chairman of the Risk Committee and member of the Audit Committee and Nominations and Remuneration Committee
Appointed to the Board: May 2016

Mr Lee is a member of the Institute of Chartered Accountants in England and Wales as well as the Malaysian Institute of Accountants. He began his career with Miller, Brener & Co., London, a professional accounting firm in 1975 and joined Maybank in 1982. Having worked with Maybank for 27 years, Mr Lee has built a successful career as a professional accountant. He served various management positions during his tenure with Malayan Banking Berhad until he retired in 2008 and his last position was as the Executive Vice President, Head of Accounting Services and Treasury Back Office Operations. He has also served as a Director of a number of subsidiaries of Malayan Banking Berhad.

In addition to his current role, Mr Lee also sits on the Board of HSBC Bank Malaysia Berhad, Kossan Rubber Industries Berhad and Yayasan Kossan.

Mr Lee does not have any shareholding in the Bank.

Albert Quah Chei Jin, 66
Independent Non-Executive Director
Chairman of Audit Committee and member of Risk Committee, Nominations and Remuneration Committee and Connected Party Trnsactions Committee
Appointed to the Board: September 2016

Mr Albert Quah holds a Masters Degree in Accounting and Finance from the London School of Economics and Political Science. He is a member of the Institute of Chartered Accountants in England and Wales as well as the Malaysian Institute of Accountants. He was with Touche Ross & Co, Chartered Accountants in London before returning to Malaysia.

He has more than 30 years banking experience. Mr Albert Quah began his banking career with Southern Bank Berhad in 1982 where he served in various management positions including as a Card Centre Manager as well as a Corporate Banker. He joined Standard Chartered Bank Malaysia Berhad as Senior Corporate Banker in 1989 and was the Chief Financial Officer (CFO) of Standard Chartered Bank Malaysia Berhad from 1993 to 2001. He later served as Group CFO of the AmBank Group from 2004 to 2006. He retired as CFO of United Overseas Bank Malaysia Berhad in 2013.

In addition to his current role, Mr Albert Quah also sits on the Board of Indah Water Konsortium Sdn Bhd and also the Non-Executive Trustee of Methodist Education Foundation.

Mr Albert Quah does not have any shareholding in the Bank.

Ho Chai Huey, 59
Independent Non-Executive Director
Member of Risk Committee: February 2018 and Member of Nominations and Remuneration Committee : December 2018
Appointed to the Board: January 2018.

Ms Ho graduated from the University of Malaya with a Bachelor of Economics, Honours Class 1 Statistics in 1983. Her career started with Bank Negara Malaysia (BNM) as an Information Technology (IT) Analyst on 1 August 1983 until she retired as an IT Director on 5 July 2016.

She has been a passionate IT management professional with 33 years of hands-on experiences in formulating and implementing IT business plans and transformation, leading and advising the implementation of many IT projects and managing the day-to-day IT Services and IT Operations in BNM.

During her career with BNM, she drove the planning and implementation of IT Plan and managed a resilient IT infrastructure in BNM in conformity with international industry standards and best practices. She provided strategic and operational direction for the planning, designing, implementation and maintenance of IT systems in BNM, including managing strategic IT projects and technology risk and IT crisis situations as well as ensuring strong IT governance processes and practices.

Ms Ho is currently an IT and project management consultant to an outsourcing company which provides advisory and business support functions to affiliated professional institutes in the financial sector.

In addition to her current role, Ms Ho also sits on the Board of Cagamas Berhad.

Ms Ho does not have any shareholding in the Bank.

BOARD RESPONSIBILITY AND OVERSIGHT

Board of Directors

The objectives of the management structure within the Bank, headed by the Board of Directors and led by the Independent Non-Executive Chairman, are to deliver sustainable value to shareholders and promote a culture of openness and debate. The Board is responsible for overseeing the management of the Bank and reviewing the Bank's strategic plans and key policies. Although the Board delegates the day-to-day management of the Bank's business and implementation of strategy to the Executive Committee, certain matters, including annual operating plans, risk appetite and performance targets, procedures for monitoring and controlling operations, approval of credit or market risk limits, specified senior appointments and any substantial change in balance sheet management policy are reserved by the Board for approval.

The Board meets regularly to review reports on performance against financial and other strategic objectives, key business challenges, risk, business developments, and investor and external relations. All Directors have full and timely access to all relevant information and are encouraged to have free and open contact with management at all levels. Directors may take independent professional advice if necessary, at the Bank's expense.

At the date of this report, the Board consists of seven (7) members comprising two (2) Non-Independent Executive Directors and five (5) Independent Directors. The names of the Directors serving at the date of this report and brief biographical particulars for each of them are set out on pages 2 to 5.

Datuk Kamaruddin bin Taib has been appointed as Independent Non-Executive Board Chairman of the Bank effective 2 January 2018. Ho Chai Huey has been appointed as Independent Non-Executive Director effective 2 January 2018. Mr Stuart Paterson Milne was appointed as Non-Independent Executive Director of the Bank on 24 May 2018.

Dr Mohamed Ashraf bin Mohamed Iqbal resigned as Non-Independent Non-Executive Director of the Bank on 31 October 2018.

Appointments to the Board are made on merit and candidates are considered against objective criteria, having due regard to the benefits of diversity on the Board. A rigorous selection process, overseen by the Nominations and Remuneration Committee and based on agreed requirements including BNM Corporate Governance Policy requirements are followed in relation to the appointment of Directors.

All Directors, including those appointed by the Board to fill a casual vacancy, are subject to annual re-election at the Bank's Annual General Meeting. Non-Executive Directors are appointed for an initial three-year term and, subject to re-election by shareholder at Annual General Meetings, are typically expected to serve two three-year terms. Any term beyond six (6) years is subject to rigorous review. Tenure of independent Non-Executive Directors shall not exceed a cumulative term of nine (9) years.

The terms and conditions of appointment of Non-Executive Directors are set out in a letter of appointment, which include the expectations of them and the time estimated for them to meet their commitment to the Bank. The current anticipated minimum time of commitment, which is subject to periodic review and adjustment by the Board, is 30 days per year and with appointment in not more than 5 public listed companies. Time devoted to the Bank could be considerably more, particularly if serving on Board committees. All Non-Executive Directors have confirmed they can meet this requirement.

Independent Non-Executive Directors are not HSBC employees and do not participate in the daily business management of the Bank. They bring an external perspective, constructively challenge and help develop proposals on strategy, scrutinise the performance of management in meeting agreed goals and objectives, and monitor the risk profile and reporting of performance of the Bank. The Board has determined that each Non-Executive Director is independent in character and judgment, and there are no relationships or circumstances likely to affect the judgment of the Independent Non-Executive Directors.

The roles of the Independent Chairman and CEO are separate, with a clear division of responsibilities between the running of the Board and executive responsibility for running the Bank's business.

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

Board of Directors (Cont'd)

Board and Committee Meetings

Seven (7) Board meetings were held in 2018. The table below show each Director's attendance (including attendance via video conferencing) at meetings of all Board and Committees' meetings during 2018. All Directors have complied with the Bank Negara Malaysia requirements that Directors must attend at least 75% of Board meetings held in the financial year.

2018 Board and Committee meeting attendance	**Board**	**Audit Committee**	**Risk Committee**	**Nominations and Remuneration Committee**
Total number of meetings held	**7**	**4**	**6**	**6**
Independent Non-Executive Chairman				
Datuk Kamaruddin bin Taib [1]	7	3	5[6]	5
Non-Independent Executive Directors				
Stuart Paterson Milne [2]	5	-	-	-
Mukhtar Malik Hussain	7	-	-	-
Louisa Cheang Wai Wan [3]	-	-	-	-
Independent Non-Executive Directors				
Adil Ahmad	7	4	6	6
Albert Quah Chei Jin	7	3	5	5
Lee Choo Hock	7	4	6	6
Ho Chai Huey[4]	7	4[6]	1[6]/5[7]	5[6]
Non-Independent Non-Executive Director				
Dr. Mohamed Ashraf bin Mohamed Iqbal [5]	6	-	-	5

[1] Appointed as Independent Chairman and Non-Executive Director on 2 January 2018.
[2] Appointed as Non-Independent Executive Director on 24 May 2018.
[3] Resigned as Non-Independent Executive Director on 20 March 2018.
[4] Appointed as Independent Non-Executive Director on 2 January 2018.
[5] Resigned as Non-Independent Non-Executive Director on 31 October 2018.
[6] Attendance as an Invitee.
[7] Attendance as a Member of the Committee.

Directors' Emoluments

Details of the emoluments of the Directors of the Bank for 2018, disclosed in accordance with the Companies Act 2016, are shown in Note 35(b) to the financial statements.

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

Board of Directors (Cont'd)

Training and Development

Formal, tailored induction programmes are arranged for newly appointed Directors. The induction programmes consists of a series of meetings with senior executives to enable new Directors to familiarise themselves with the Bank's business. Directors also received comprehensive guidance from the Company Secretary on Directors' duties and responsibilities.

Training and development are provided for Directors and are regularly reviewed by the Nominations and Remuneration Committee supported by the Company Secretary. Executive Directors develop and refresh their skills and knowledge through day-to-day interactions and briefings with senior management of the Bank's businesses and functions. Non-Executive Directors have access to external training and development resources under the Directors' training and development framework approved by the Board. Awareness and discussion sessions were conducted by senior executives and subject matter experts on emerging technologies, financial crime compliance, regulatory initiatives and other business developments.

During the year, Directors have also attended talks, dialogue sessions and focus group sessions organised by Financial Institutions Directors' Education (FIDE) Forum, and have received refresher training and courses related to financial crime and cybersecurity.

BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

Board Committees

The Board has established a number of committees, the membership of which comprise Independent Non-Executive Directors who have the skills, knowledge and experience relevant to the responsibilities of the committee. The Board and each Board committee have terms of reference to document their responsibilities and governance procedures. The details of the Board Charter comprising the Board committees' Terms of Reference are available at http://www.hsbcamanah.com.my/1/2/amanah/hsbc-amanah-and-you/corporate-information/board-of-directors.

The key roles of the Board committees are described in the paragraph below. The Chairman of each Board committee reports to each subsequent Board meeting on the activities of the Board committee. Each Board committee will evaluate its terms of reference and its own effectiveness annually.

As at the date of this report, the following are the principal Board committees:

1. Audit Committee

The Audit Committee is accountable to the Board and has non-executive responsibility for oversight of and advice to the Board on financial reporting including Pillar 3 Disclosures related matters and internal controls over financial reporting, covering all material controls The Audit Committee reviews the financial statements of the Bank before submission to the Board. It also monitors and reviews the effectiveness of the internal audit function and the Bank's financial and accounting policies and practices. The Audit Committee advises the Board on the appointment of the external auditors and is responsible for oversight of the external auditors.

The Audit Committee reviews and approves internal audit's annual plan and also discuss on the internal audit resources.

The Audit Committee meets regularly with the Bank's senior financial and internal audit management and the external auditor to consider, inter alia, the Bank's financial reporting, the nature and scope of audit reviews and the effectiveness of the systems of internal control relating to financial reporting.

The current members of the Audit Committee, all being Independent Non-Executive Directors, are:
- Albert Quah Chei Jin (Chairman)
- Adil Ahmad
- Lee Choo Hock
- Datuk Kamaruddin bin Taib *(effective 12 February 2018)*

During 2018, the Audit Committee held 4 meetings. Attendance is set out in the table on page 7.

2. Risk Committee

The Risk Committee is accountable to the Board and has non-executive responsibility for oversight of and advice to the Board on risk related matters and the principal risks impacting the Bank, risk governance and internal control systems (other than internal financial control systems).

The Risk Committee meets regularly with the Bank's senior financial, risk, internal audit and compliance management to consider, inter alia, risk reports and the effectiveness of compliance.

The Board and the Risk Committee oversee the maintenance and development of a strong risk management framework by continually monitoring the risk environment, top and emerging risks facing the Bank and mitigation actions planned and taken. The Risk Committee recommends the approval of the Bank's risk appetite statement to the Board and monitors performance against the key performance/risk indicators included within the statement. The Risk Committee monitors the risk profiles for all of the risk categories within the Bank's business.

BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

Board Committees (Cont'd)

2. Risk Committee (Cont'd)

The current members of the Risk Committee, all being Independent Non-Executive Directors, are:
- Lee Choo Hock (Chairman)
- Adil Ahmad
- Albert Quah Chei Jin
- Ho Chai Huey *(effective 12 February 2018)*

During 2018, the Risk Committee held 6 meetings. Attendance is set out in the table on page 7.

3. Nominations and Remuneration Committee

The combined Nominations and Remuneration Committee is accountable to the Board and has non-executive responsibility for (i) leading the process for Board appointments and for identifying and nominating, for the approval of the Board, candidates for appointment to the Board; (ii) reviewing the candidates for appointment to the senior management team; (iii) appointment and reappointment of Shariah Committee members; and (iv) supporting the Board in overseeing the operation of the Bank's remuneration system and reviewing the remuneration of Directors on the Board.

The Nominations and Remuneration Committee considers plans for orderly succession to the Board and the appropriate balance of skills, knowledge and experience on the Board. The Nominations and Remuneration Committee assists the Board in the evaluation of the Board's own effectiveness and that of its committees annually. The findings of the performance evaluation and the implementation of actions arising from the performance evaluation are reported to the Board during 2018.

CEO's performance evaluation is undertaken as part of the performance management process for all employees. The results will be considered by the Nominations and Remuneration Committees when reviewing the variable pay awards.

The members of the Nominations and Remuneration Committee, all being Independent Non-Executive Directors, are:
- Adil Ahmad
- Albert Quah Chei Jin
- Lee Choo Hock
- Dr. Mohamed Ashraf bin Mohamed Iqbal *(resigned on 31 October 2018)*
- Datuk Kamaruddin bin Taib *(effective 12 February 2018)*
- Ho Chai Huey *(effective 5 December 2018)*

During 2018, the Nominations and Remuneration Committee held 6 meetings. Attendance is set out in the table on page 7.

Delegations by the Board

Shariah Committee

The Shariah Committee was established with delegated authorities of the Board on the Shariah operations and management of day-to-day running of the Bank in accordance with Shariah compliance and principles based on the Board's policies and directions.

The current members of the Shariah Committee are:
- Dr. Ziyaad Mahomed *(Chairman)*
- Dr Aida Othman
- Dr Mohamed Ashraf Mohamed Iqbal *(appointed on 1 January 2018)*
- Khairul Anuar Ahmad
- Prof. Dr. Younes Soualhi
- Assoc. Prof. Dr. Muhammad Yusuf Saleem Ghulam Nabi *(term ended 31 March 2018)*

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

Board Committees (Cont'd)

Delegations by the Board (Cont'd)

Connected Party Transactions Committee

The Connected Party Transactions Committee is delegated with the authority of the Board to approve transactions with a connected party of the Bank.

The current members of the Connected Party Transactions Committee, are:
- Adil Ahmad
- Albert Quah Chei Jin
- Ho Chai Huey *(appointed on 18 July 2018)*
- Chief Risk Officer
- Head of Wholesale Credit and Market Risk

Executive Committee

The Executive Committee which consists of key senior management members, meets regularly and operates as a general management committee under the direct authority of the Board. The committee exercising all of the powers, authorities and discretions of the Board in so far as they concern the management and day-to-day running of the Bank, in accordance with such policies and directions as the Board may from time to time determine. The Bank's CEO, Arsalaan Ahmed, chairs the Executive Committee.

To strengthen the governance framework in anticipation of structural and regulatory changes that affect the Bank, the following sub-committees of the Executive Committee were established:

(i) Asset and Liability Management Committee

The Asset and Liability Management Committee is responsible for the efficient management of the Bank's balance sheet and the prudent management of risks.

(ii) Risk Management Meeting

The Risk Management Meeting is responsible for the oversight of the risk framework. Regular Risk Management Meetings (RMM), chaired by the Chief Risk Officer, are held to establish, maintain and periodically review the policy and guidelines for the management of risk within the Bank.

(iii) Financial Crime Risk Management Committee

The Financial Crime Risk Management Committee is responsible for the management of financial crime risk and to support the CEO in discharging the financial crime risk responsibilities.

(iv) IT Steering Committee

The IT Steering Committee is responsible for the oversight of the implementation and development of IT strategy. The committee is accountable for reviewing, challenging and approving the financial planning and IT performance.

(v) People Committee

The People Committee is established as a principle human resource forum to drive People Plan i.e. build capability, talent, succession and leaders. The Committee oversees the development and delivery of key people initiative or programs, and resolve any critical people risks or issues.

BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

<u>Board Committees (Cont'd)</u>

Conflicts of Interest and Indemnification of Directors

The Board has adopted a policy and procedures relating to Directors' conflicts of interest. Where conflicts of interest arise, the Board has the power to authorise them. A review of those conflicts which have been authorised, and the terms of those authorisations, is undertaken by the Audit Committee annually.

The Articles of Association provide that Directors are entitled to be indemnified out of the assets of the Bank against claims from third parties in respect of certain liabilities arising in connection with the performance of their functions. Such indemnity provisions have been in place but have not been utilised by the Directors. All Directors have the benefit of directors' and officers' liability insurance.

None of the Directors had, during the year, any material interest, directly or indirectly, in any contract of significance with the Bank. All Directors are regularly reminded of their obligations in respect of disclosure of conflicts or potential conflicts of interest in any transactions with the Bank.

MANAGEMENT REPORTS

The Board meetings are structured around a pre-set agenda and reports for discussion, notation and approvals are circulated in advance of the meeting dates. To enable Directors to keep abreast with the performance of the Bank, key reports submitted to the Board during the financial year include:

- Minutes of the Board Committees
- Annual Operating Plan
- CEO updates
- Capital Plan
- Credit Transactions and Exposures to Connected Parties
- Financial Crime Compliance: Anti-Money Laundering and Counter Terrorist Financing Reports
- Quarterly and Annual Financial Statements
- Quarterly Internal Audit Progress Reports
- Internal Capital Adequacy Assessment Process
- Risk Appetite Statement
- Risk and Compliance Reports
- Stress Testing Results

INTERNAL CONTROL FRAMEWORK

The Board is responsible for maintaining and reviewing the effectiveness of risk management and internal control systems and for determining the aggregate levels and types of risks the Bank is willing to take in achieving its strategic objectives. The Bank has procedures designed to safeguard assets against unauthorised use or disposal, maintain proper accounting records and ensure the reliability and usefulness of financial information whether published or used within the business. These controls are designed to provide effective internal control within the Bank. However, they can only provide reasonable, but not absolute, assurance against material mis-statement, errors, losses or fraud. They have been in place throughout the year and up to 11 February 2019, the date of approval of the audited financial statements of the Bank for the financial year ended 31 December 2018.

Key risk management and internal control procedures include the following:

- **HSBC Group standards**

  HSBC Global Standards Manual (GSM) establishes the high level standards and policies by which, and within which, all members of the Group conduct their businesses. The GSM is mandatory and applies to, and must be observed by, all businesses within the Group, regardless of the nature or location of their activities.

- **Financial reporting**

  The Bank's financial reporting process for preparing the financial statements is in accordance with the Malaysian Financial Reporting Standards, International Financial Reporting Standards, the requirements of the Companies Act 2016 in Malaysia and guidelines issued by BNM. The financial reporting process is further supported by a chart of accounts with detailed instructions and guidance on the reporting requirements issued by Global Finance to the Bank in advance of each quarterly reporting period, as well as analytical review procedure. The financial reports of the Bank is subject to certification by the Chief Financial Officer and Board's approval.

- **Internal audit**

  The establishment and maintenance of appropriate systems of risk management and internal control is primarily the responsibility of business management. The Global Internal Audit function, provides independent and objective assurance in respect of the adequacy of the design and operating effectiveness of the risk management framework, control and governance processes, focusing on the areas of greatest risk to HSBC through risk-based approach auditing.

  Executive committee is responsible for ensuring that Management Action Plans (MAPs) proposed by management and agreed by the Global Internal Audit function mitigate the risks on hand to within the acceptable risk tolerance level in a sustainable manner and are implemented within an appropriate timeframe.

- **Subsidiary Certifications**

  Half yearly confirmations are provided to the parent bank's Audit Committee from the Audit Committee of the Bank regarding whether the financial statements have been prepared in accordance with HSBC Group policies, present fairly the state of affairs of the Bank and are prepared on a going concern basis.

- **Delegation of authority within limits set by the Board**

  Authority to manage the day to day running of the Bank is delegated within limits set by the Board to the Chief Executive who has responsibility for overseeing the establishment and maintenance of systems of control appropriate to the business and who has the authority to delegate such duties and responsibilities as he sees fit. Appointments to the most senior positions within the Bank require the approval of the Board of Directors.

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

INTERNAL CONTROL FRAMEWORK (Cont'd)

- **Risk identification and monitoring**

  Systems and procedures are in place to identify, control and report on the material risks facing the Bank.

- **Changes in market conditions/practices**

  Processes are in place to identify new risks arising from changes in market conditions/practices or customer behaviours, which could expose the Bank to heightened risk of loss or reputational damage. The Bank employs a Top and Emerging risks framework at all levels of the organisation, which enables it to identify current and forward-looking risks and to take action which either prevents them materialising or limits their impact.

- **Responsibility for risk management**

  Individual managers are accountable for measuring, monitoring, mitigating and managing the risks and controls in their areas of responsibility. Processes are in place to ensure weaknesses are escalated to senior management and addressed, supported by the three lines of defence model.

- **Strategic plans**

  Strategic plans are prepared for Global Businesses and Functions. The Bank also prepares and adopts an Annual Operating Plan, which is informed by detailed analysis of risk appetite, describing the types and quantum of risk that the Bank is prepared to take in executing its strategy and sets out the key business initiatives and the likely financial effects of those initiatives.

- **IT operations**

  Centralised functional control is exercised over all IT developments and operations. Common systems are employed for similar business processes wherever practicable.

- **Global function management**

  Global functions management are responsible for setting policies, procedures and standards to control the principal risks across the Group.

During the financial year, the Risk Committee and the Audit Committee have kept under review the effectiveness of this system of internal control and have reported regularly to the Board. In carrying out their reviews, the Audit Committee and Risk Committee receive regular business and operational risk assessments; regular reports from the heads of key risk functions, which cover all internal controls, both financial and non-financial; internal audit reports; external audit reports; prudential reviews; and regulatory reports.

The Risk Committee monitors the status of principal risks and considers whether the mitigating actions put in place are appropriate. In addition, when unexpected losses have arisen or when incidents have occurred which indicate gaps in the control framework or in adherence to HSBC policies, the Risk Committee and the Audit Committee review special reports, prepared at the instigation of management, which analyse the cause of the issue, the lessons learned and the actions proposed by management to address the issue.

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

REMUNERATION POLICY

The remuneration policy for the HSBC Group aims to reward success, not failure, and to be properly aligned with the risk management framework and risk outcomes. In order to ensure alignment between remuneration and business strategy, individual remuneration is determined through assessment of performance, delivered against both annual and long-term objectives summarised in performance scorecards, as well as adherence to HSBC Values of being 'open, connected and dependable' and acting with 'courageous integrity'. Altogether, performance is judged not only on what is achieved over the short and long term, but also on how it is achieved, as the latter contributes to the sustainability of the organisation. The financial and non-financial measures incorporated in the annual and long-term scorecards are carefully considered to ensure alignment with the long-term strategy of the HSBC Group.

The Bank has fully adopted the remuneration policy of HSBC Holdings plc. Please refer to the HSBC remuneration practices and governance at http://www.hsbc.com/our-approach/remuneration for more details of the governance structure and the remuneration strategy of the HSBC Group.

In recognition to the local regulations, the materiality of definition needs to be taken into consideration in ensuring a robust corporate governance framework has been duly applied for the Bank. Further reviews will be conducted to ensure continued adherence to the underlying principles of the local regulations.

RATING BY EXTERNAL RATING AGENCIES

Details of the Bank's ratings are as follows:

Rating Agency	Date	Rating Classification	Ratings Received
RAM Ratings Services Berhad	June 2018	• Long term	AAA
		• Short term	P1
		• Multi-Currency Sukuk Programme	AAA
		• Outlook	Stable

DIRECTORS' REPORT

The Directors hereby submit their report and the audited financial statements of HSBC Amanah Malaysia Berhad (the Bank) for the financial year ended 31 December 2018.

DIRECTORS

The Directors in office during the financial year and during the period from the end of the financial year to the date of the report are:

- Datuk Kamaruddin bin Taib *(appointed on 2 January 2018)*
- Stuart Paterson Milne *(appointed on 24 May 2018)*
- Mukhtar Malik Hussain
- Adil Ahmad
- Lee Choo Hock
- Albert Quah Chei Jin
- Ho Chai Huey *(appointed on 2 January 2018)*
- Louisa Cheang Wai Wan *(resigned on 20 March 2018)*
- Dr. Mohamed Ashraf bin Mohamed Iqbal *(resigned on 31 October 2018)*

In accordance with Articles 73 of the Articles of Association, all Directors shall retire from the Board at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-election.

PRINCIPAL ACTIVITIES

The principal activities of the Bank are Islamic banking business and related financial services. There have been no significant changes in these activities during the financial year.

FINANCIAL RESULTS

	RM'000
Profit for the financial year attributable to the owner of the Bank	
Profit before tax	**211,569**
Tax expense	**(48,869)**
Profit after tax	**162,700**

RESERVES AND PROVISIONS

There were no material transfers to or from reserves or provisions during the financial year other than those disclosed in the financial statements.

ISSUE OF SHARES AND DEBENTURES

There were no material issues of shares or debentures during the financial year under review.

DIRECTORS' BENEFITS

Since the end of the previous financial year, no Director has received or become entitled to receive a benefit (other than the benefits shown under Directors' Remuneration) by reason of a contract made by the Bank or by a related corporation with the Director or with a firm of which the Director is a member, or with a company in which the Director has a substantial financial interest.

Neither during nor at the end of the financial year was the Bank a party to any arrangements whose object was to enable the Directors to acquire benefits by means of the acquisition of shares in, or debentures of, the Bank or any other body corporate, except for:

(i) Directors who were granted the option to subscribe for shares in the ultimate holding company, HSBC Holdings plc, under Executive/Savings-Related Share Option Schemes at prices and terms as determined by the schemes, and

(ii) Directors who were conditionally awarded shares of the ultimate holding company, HSBC Holdings plc, under its Restricted Share Plan/HSBC Share Plan.

DIRECTORS' INTERESTS IN SHARES OR DEBENTURES

According to the Register of Directors' Shareholdings required to be kept under Section 59 of the Companies Act 2016, none of the Directors who held office at the end of the financial year held any shares or debentures in the Bank or its holding company or subsidiaries of the holding company during the financial year except as follows:

	Number of Ordinary Shares			
	As at 1.1.2018/ Date of Appointment	Acquired	Disposed	As at 31.12.2018
HSBC Holdings plc				
Ordinary shares of USD0.50				
Mukhtar Malik Hussain	1,283,886	159,189	-	1,443,075
Stuart Paterson Milne [1]	205,070	1,444	-	206,514
Adil Ahmad	3,200	-	-	3,200

	Number of Shares			
	Shares held at 1.1.2018/ Date of Appointment	Shares issued during the year [2]	Shares vested during the year	Shares held at 31.12.2018
HSBC Holdings plc				
HSBC Share Plan				
Mukhtar Malik Hussain	358,635	90,315	(214,940)	234,010
Stuart Paterson Milne [1]	100,647	2,698	(1)	103,344

[1] *Including the interest of spouse*
[2] *Including scrip dividends.*

None of the other Directors holding office at 31 December 2018 had any interest in the ordinary shares and options over shares of the Bank and of its related corporations during the financial year.

DIVIDENDS

Since the end of the previous financial year the Bank paid a final dividend of RM0.10 per share, amounting to net dividend payment of RM10 million in respect of the financial year ended 31 December 2017. The dividend was paid on 3 May 2018.

The Directors recommend the payment of a final dividend of RM0.40 per share, amounting to net dividend payment of RM40 million in respect of the financial year ended 31 December 2018. This dividend will be recognised in the subsequent financial year upon approval by the owner of the Bank.

HOLDING COMPANIES

The Directors regard HSBC Bank Malaysia Berhad, a company incorporated in Malaysia, and HSBC Holdings plc, a company incorporated in United Kingdom, as the immediate and ultimate holding companies of the Bank respectively.

OTHER STATUTORY INFORMATION

Before the financial statements of the Bank were prepared, the Directors took reasonable steps:

i) to ascertain that proper action had been taken in relation to the writing off of bad debts and the making of provision for doubtful debts and satisfied themselves that all known bad debts had been written off and that adequate provision had been made for doubtful debts; and

ii) to ensure that any current assets which were unlikely to be realised in the ordinary course of business including the values of current assets as shown in the accounting records of the Bank had been written down to an amount which the current assets might be expected so to realise.

At the date of this report, the Directors are not aware of any circumstances:

i) which would render the amount written off for bad debts, or the amount of the provision for doubtful debts inadequate to any substantial extent, or

ii) which would render the values attributed to current assets in the financial statements of the Bank misleading, or

iii) which have arisen which would render adherence to the existing method of valuation of assets or liabilities of the Bank misleading or inappropriate

At the date of this report, there does not exist:

i) any charge on the assets of the Bank which has arisen since the end of the financial year which secures the liabilities of any other person, or

ii) any contingent liability in respect of the Bank which has arisen since the end of the financial year.

No contingent liability or other liability of the Bank has become enforceable, or is likely to become enforceable within the period of twelve months after the end of the financial year which, in the opinion of the Directors, will or may affect the ability of the Bank to meet their obligations as and when they fall due.

OTHER STATUTORY INFORMATION (Cont'd)

At the date of this report, the Directors are not aware of any circumstances not otherwise dealt with in this report or the financial statements of the Bank which would render any amount stated in the respective financial statements misleading.

In the opinion of the Directors:

i) the results of the operations of the Bank during the financial year were not substantially affected by any item, transaction or event of a material and unusual nature; and

ii) there has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely to affect substantially the results of the operations of the Bank for the financial year in which this report is made.

SIGNIFICANT AND SUBSEQUENT EVENTS

There were no significant events and events subsequent to the date of the statement of financial position that require disclosure or adjustment to the audited financial statements.

SUBSIDIARIES

The Bank does not have any subsidiary company.

ZAKAT OBLIGATION

The Bank is not obliged to pay zakat for the financial year ended 31 December 2018.

DIRECTORS' REMUNERATION

Details of Directors' remuneration are set out in Note 35(b) to the financial statements.

AUDITORS' REMUNERATION

Details of auditors' remuneration are set out in Note 32 to the financial statements.

Performance Review, Strategy and Outlook

Performance Review

The Bank had recorded an improved profit before tax of RM211.6 million for the financial year ended 31 December 2018, an increase RM105.3 million compared to previous financial year.

The higher profit was contributed by net income before impairment of RM530.1 million, an increase of RM16.5 million and benefited from lower impairment provision on financing (down by RM99.2 million), coupled with higher income derived from investment of depositors' funds. The Bank adopted MFRS 9 which introduces the Expected Credit Loss (ECL) model on impairment that replaces the incurred loss model used in MFRS 139 with effect from of 1 January 2018.

The Bank continued to place high emphasis in managing its operating expenses to ensure that the resources were spent in a sustainable manner. In 2018, operating expenses increased by 4.4%, mainly from expenses charged by parent bank for the services rendered under the embedment model, promotion and marketing related expenses and personnel expenses.

Total assets size at 31 December 2018 stood at RM20.3 billion, RM2.6 billion or 14.4% higher compared against 31 December 2017 (RM17.8 billion). The Bank's capital and liquidity ratios continue to remain strong and well above the regulatory requirements.

Business Strategy during the Year 2018

2018 was a year where the Bank's ultimate holding and parent, HSBC Holdings Plc and HSBC Bank Malaysia Berhad changed Chief Executive Officers. The transition went smoothly and the business strategy remained largely unchanged.

On the retail business, Retail Banking and Wealth Management (RBWM) focused its customer growth in three key customer segments primarily in Premier, Advance and the Retail Business Banking while maintaining balanced risk measures across its processes. Customer acquisitions was driven by its focus on HSBC Perks@Work proposition while the wealth penetration improved with strong marketing campaigns and new product offerings including the re-launch of the Islamic Structured Products for HBMS. The market share for cards and mutual funds also improved through successful acquisitions that leveraged on various acquisition channels. In its effort to provide more seamless customer experience and improve productivity, RBWM introduced/enhanced various initiatives that provides straight through processing capabilities such as real-time live pricing for foreign exchange (FX) transactions at branches, digital credit card application process, and simplification of debit card activation.

Global Banking & Markets (GBM) continued to seize advantage of its leadership and expertise in the debt capital to secure key deals that yielded other ancillary income and opportunities. Collaboration with other HSBC entities continued in order to capture key growth opportunities in ASEAN and Belt and Road Initiative (BRI) corridors.

Commercial Banking (CMB) focused on a balanced growth agenda in 2018. The Business deployed various robust risk management and streamlining initiatives with aim to support a sustainable business growth model. During the year, CMB conducted a thematic review of the Business Banking portfolio which saw the execution of various initiatives to improve the portfolio quality. Growth was achieved through cross border collaboration across ASEAN corridors and BRI with significant traction in China, Vietnam and Singapore by way of enhanced core capabilities and innovation in cross border cash management, financing solutions, end-to-end structured trade and banking capabilities. During 2018, various digital tools were launched focusing to improve our customers experience including on-boarding turnaround time.

Performance review, Strategy and Outlook (Cont'd)

Business Strategy during the Year 2018 (Cont'd)

HSBC Malaysia's strong financial position has been recognised by external parties including RAM Ratings Services Berhad, which in 2018 reaffirmed the Bank's long term and short term ratings of AAA and P1 ratings respectively. The Bank also continued to maintain its market leader position in various segments, evident by the numerous awards that the Bank won in 2018.

Corporate social responsibility continues to be a key focus area of HSBC. In 2018, the Bank continued to focus on three main pillars which include developing Future Skills, Sustainable Network & Entrepreneurship and Sustainable Finance. Through these efforts, the Bank attained the Sustainable Banking Excellence in Global Responsible Business Leadership Awards 2018 awarded by Asia CSR Council and Institute of Sustainability.

In addition, the Bank, aspires to implement HSBC's sustainability agenda which is also in line with recently launched Bank Negara's Value Based Intermediation (VBI). VBI is an initiative which aims to encourage banks to generate positive and sustainable impact to the economy, community and environment through practices, conduct and offerings consistent with shareholder's sustainable returns and long term profits. During the year, the Bank issued the world's first Sustainable Development Goals (SDG) Sukuk, wherein the proceeds will be utilised to finance eligible businesses and projects in accordance with the HSBC SDG Bond Framework. Moving forward the Bank will continue to explore different opportunities to ensure commitment towards the VBI agenda.

Outlook For 2019

Malaysia's economy registered a real Gross Domestic Product (GDP) of 4.7% in 2018 compared to 5.9% last year. Despite that, the growth rate demonstrated resilience of the Malaysia economy, given the challenging environment, both externally and internally. Market expects this trend to follow through to 2019 with growth anticipated to be in the range of 4.9%, driven by private sector activity amid the continued rationalisation of public sector expenditure, particularly public investment by public corporations. Exports are likely to moderate but would be supported by demand from major trade partners and the gradual recovery in commodities exports. Risks to growth remain tilted to the downside. These stem mainly from a more persistent-than-expected supply disruption in the commodity sector and a potential escalation of trade tensions between the US and China.

Headline inflation declined to 1.0% in 2018 (2017: 3.7%), primarily due to the zerorisation of the goods and services tax (GST) rate from 1 June 2018 to 31 August 2018, coupled with stronger consumer sentiments. Sales and services tax (SST) is reintroduced effective 1 September 2018. With the small average price increase for SST-taxable items in September 2018, the SST impact on inflation during the year has been limited.

Consistent with most regional currencies, the Ringgit underperformed against US dollar during the year before appreciating marginally in the last quarter of 2018. The improvement was despite cautious investor sentiments in global financial markets and non-resident portfolio outflows from the domestic bond and equity markets. However, these outflows were offset by resident inflows, mainly from goods and services, leading to the marginal appreciation of the Ringgit. Going forward, the Ringgit will continue to be influenced by external uncertainties as well as the trajectory of the US dollar.

From funding perspective, the banking system liquidity is expected to remain robust and sufficient to facilitate financial intermediation. However, competition among lenders for deposits will remain although the requirement of complying with Basel III's Net Stable Funding Ratio has been extended by another year to 1 January 2020.

Within HSBC Group, Malaysia is identified as a scalable market and an important footprint within ASEAN. The Bank will continue to capture opportunities along the entire supply chain of foreign investment into Malaysia and outbound business of our customers. Leveraging on HSBC connectivity, we will explore business opportunity based on intra ASEAN corridors and ASEAN government initiatives. The Bank will also focus on expanding customers' base to increase market share where there is comparative advantage. This include penetrating new customer segments, investing in digital capabilities for mobile and internet banking, strengthening our leading position in affluent segments, as well as developing change management programs that is customer centric focus.

Awards won during the financial year:

1. **Best Islamic Trade Finance Bank Malaysia –** The Asset Triple A Islamic Finance Awards 2018

2. **Best Quasi-Sovereign Sukuk for Cagamas dual re-opening of three-year 475 million ringgit sukuk and 525 million ringgit sukuk** - The Asset Triple A Islamic Finance Awards 2018

3. **Best Islamic Liability Management for Sime Darby Berhad any-and-all cash tender offer and consent solicitation** - The Asset Triple A Islamic Finance Awards 2018

4. **Best Islamic Syndicated Loan for Saudi Telecom Company (STC) Malaysia Holding Limited 1.508 billion ringgit syndicated murabaha facility –** The Asset Triple A Islamic Finance Awards 2018

5. **Best Islamic Banker –** The Asset Triple A Islamic Finance Awards 2018

6. **Social Impact deal of the year for HSBC Amanah's RM500 million (US$121.92 million) five-year SDG Sukuk –** IFN Deal Awards 2018

7. **Country deal of the year for HSBC Amanah's RM500 million (US$121.92 million) five-year SDG Sukuk –** IFN Deal Awards 2018

8. **Finalist for overall deal of the year for HSBC Amanah's RM500 million (US$121.92 million) five-year SDG Sukuk –** IFN Deal Awards 2018

AUDITORS

The auditors, PricewaterhouseCoopers PLT (LLP0014401-LCA & AF 1146), have expressed their willingness to accept re-appointment as auditors. A resolution to re-appoint PricewaterhouseCoopers PLT as auditor of the Bank will be proposed at the forthcoming Annual General Meeting.

This report was approved by the Board of Directors on 11 February 2019.

Signed on behalf of the Directors in accordance with a resolution of the Directors:

…………………….……………….…..….	…………………….……………….…..….
STUART PATERSON MILNE	**ALBERT QUAH CHEI JIN**
Director	Director

Kuala Lumpur, Malaysia
11 February 2019

HSBC AMANAH MALAYSIA BERHAD
(Company No. 807705-X)
(Incorporated in Malaysia)

STATEMENT BY DIRECTORS PURSUANT TO SECTION 251(2) OF THE COMPANIES ACT 2016

In the opinion of the Directors:

We, Stuart Paterson Milne and Albert Quah Chei Jin, being two of the Directors of HSBC Amanah Malaysia Berhad, do hereby state that, in the opinion of the Directors, the accompanying financial statements set out on pages 32 to 140 are drawn up so as to give a true and fair view of the financial position of the Bank as at 31 December 2018 and financial performance of the Bank for the financial year ended 31 December 2018 in accordance with the Malaysian Financial Reporting Standards, International Financial Reporting Standards and the requirements of the Companies Act 2016 in Malaysia.

Signed on behalf of the Board of Directors in accordance with a resolution of the Directors dated 11 February 2019.

……………………..……………………..…..….
STUART PATERSON MILNE
Director

……………………..……………………..…..….
ALBERT QUAH CHEI JIN
Director

Kuala Lumpur, Malaysia
11 February 2019

HSBC AMANAH MALAYSIA BERHAD
(Company No. 807705-X)
(Incorporated in Malaysia)

STATUTORY DECLARATION PURSUANT TO SECTION 251(1) OF THE COMPANIES ACT 2016

I, Wong Yeong Wai, being the officer primarily responsible for the financial management of HSBC Amanah Malaysia Berhad, do solemnly and sincerely declare that, to the best of my knowledge and belief, the financial statements set out on pages 32 to 140 are correct, and I make this solemn declaration conscientiously believing the same to be true, and by virtue of the provisions of the Statutory Declarations Act 1960.

Subscribed and solemnly declared by the abovenamed.

in Kuala Lumpur, Malaysia on 11 February 2019.

....
WONG YEONG WAI

BEFORE ME:

…………………………………………….
Signature of Commissioner for Oaths

SHARIAH COMMITTEE'S REPORT

In the name of Allah, the most Beneficent, the most Merciful.

Praise to Allah, the Lord of the Worlds and peace and blessings be upon our Prophet Muhammad, his family and companions.

Assalamu 'Alaikum Warahmatullahi Wabarakatuh

In carrying out the roles and responsibilities as Shariah Committee of HSBC Amanah Malaysia Berhad as prescribed in the Shariah Governance Framework for Islamic Financial Institutions issued by Bank Negara Malaysia, the Bank's Shariah Governance Policy as well as the Bank's Committee's Terms of Reference, we hereby submit the following report for the financial year ended 31 December 2018:

1. We have conducted nine (9) meetings for the whole year of 2018 and reviewed the principles and the contracts relating to the transactions and applications introduced by the Bank during the financial year ended 31 December 2018 to ensure conformity with Shariah requirements.

2. We have performed oversight role through the Shariah review and Shariah audit functions in ensuring the Bank has complied with the Shariah principles and rulings issued by us and the Shariah Advisory Council of Bank Negara Malaysia.

3. The management of the Bank is responsible for ensuring that the financial institution conducts its business in accordance with Shariah principles. It is our responsibility to form an independent opinion, based on our review of the operations of the Bank, and to report to you.

4. We have assessed the work carried out by Shariah Department and its effectiveness to implement the Shariah Governance Framework which included pre and post examination, on a test basis, each type of transaction across business lines, the relevant documentations and procedures adopted and/or entered into by the Bank.

5. In performing our duties, we planned and performed our review and had obtained all the information and explanations which we considered indispensable and necessary in order to provide us with satisfactory evidence to arrive at sound Shariah decisions and to give reasonable assurance that the Bank has complied with Shariah requirements and has not violated the Shariah rules and principles based on the evidences which have been disclosed and tabulated before us.

On that note, we, being the members of the Shariah Committee of HSBC Amanah Malaysia Berhad, do hereby confirm that, with the exception of identified breaches that are being remedied, in our opinion:

(a) the contracts, transactions, dealings entered into by the Bank during the financial year ended 31 December 2018 that have been reviewed by us and are in compliance with Shariah rules and principles;

(b) the allocation of profit and charging of losses relating to Investment Agency Account and Syndicated Investment Account for Financing conform to the basis that had been approved by us in accordance with Shariah principles;

(c) all earnings that have been realised from sources or by means prohibited by the Shariah principles have been considered for disposal to charitable causes; and

(d) the Bank is not required to pay zakat for the financial year ended 31 December 2018 because its shareholder has no obligation to pay zakat.

SHARIAH COMMITTEE'S REPORT (Cont'd)

We, the members of the Shariah Committee of HSBC Amanah Malaysia Berhad, do hereby confirm that with the exception of identified breaches that are being remedied, the operations of the Bank for the financial year ended 31 December 2018 have been conducted in conformity with the Shariah principles.

We pray to Allah the Almighty to grant us success and the path of straight forwardness.

Wassalamu 'Alaikum Warahmatullahi Wabarakatuh

Chairman of the Shariah Committee Dr. Ziyaad Mahomed (Chairman)	…………………………………………….
Member of the Shariah Committee Dr. Aida Othman	…………………………………………….
Member of the Shariah Committee Khairul Anuar Ahmad	…………………………………………….
Member of the Shariah Committee Prof. Dr. Younes Soualhi	…………………………………………….
Member of the Shariah Committee Dr Mohamed Ashraf Mohamed Iqbal	…………………………………………….

Kuala Lumpur, Malaysia
11 February 2019

INDEPENDENT AUDITORS' REPORT
TO THE MEMBER OF HSBC AMANAH MALAYSIA BERHAD
(Incorporated in Malaysia)
(Company No. 807705-X)

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Our opinion

In our opinion, the financial statements of HSBC Amanah Malaysia Berhad ("the Bank") give a true and fair view of the financial position of the Bank as at 31 December 2018, and of its financial performance and its cash flows for the year then ended in accordance with Malaysian Financial Reporting Standards, International Financial Reporting Standards and the requirements of the Companies Act 2016 in Malaysia.

What we have audited

We have audited the financial statements of the Bank, which comprise the statement of financial position as at 31 December 2018 of the Bank, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows of the Bank for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, as set out on pages 32 to 140.

Basis for opinion

We conducted our audit in accordance with approved standards on auditing in Malaysia and International Standards on Auditing. Our responsibilities under those standards 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 and other ethical responsibilities

We are independent of the Bank in accordance with the By-Laws (on Professional Ethics, Conduct and Practice) of the Malaysian Institute of Accountants (By-Laws) and the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the By-Laws and the IESBA Code.

INDEPENDENT AUDITORS' REPORT (CONT'D)
TO THE MEMBER OF HSBC AMANAH MALAYSIA BERHAD (CONT'D)
(Incorporated in Malaysia)
(Company No. 807705-X)

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS (CONT'D)

Information other than the financial statements and auditors' report thereon

The Directors of the Bank are responsible for the other information. The other information comprises the list of Board of Directors, Corporate Governance Disclosures, Rating by External Rating Agencies, Directors' Report and Shariah Committee's Report, but does not include the financial statements of the Bank and our auditors' report thereon.

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

In connection with our audit of the financial statements of the Bank, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements of the Bank or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the financial statements

The Directors of the Bank are responsible for the preparation of the financial statements of the Bank that give a true and fair view in accordance with Malaysian Financial Reporting Standards, International Financial Reporting Standards and the requirements of the Companies Act 2016 in Malaysia. The Directors are also responsible for such internal control as the Directors determine is necessary to enable the preparation of financial statements of the Bank that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements of the Bank, the Directors are responsible for assessing the Bank'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 Bank or to cease operations, or have no realistic alternative but to do so.

INDEPENDENT AUDITORS' REPORT (CONT'D)
TO THE MEMBER OF HSBC AMANAH MALAYSIA BERHAD (CONT'D)
(Incorporated in Malaysia)
(Company No. 807705-X)

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS (CONT'D)

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements of the Bank 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 approved standards on auditing in Malaysia and International Standards on Auditing will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with approved standards on auditing in Malaysia and International Standards on Auditing, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

(a) Identify and assess the risks of material misstatement of the financial statements of the Bank, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

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

(c) Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.

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

(e) Evaluate the overall presentation, structure and content of the financial statements of the Bank, including the disclosures, and whether the financial statements of the Bank represents the underlying transactions and events in a manner that achieves fair presentation.

INDEPENDENT AUDITORS' REPORT (CONT'D)
TO THE MEMBER OF HSBC AMANAH MALAYSIA BERHAD (CONT'D)
(Incorporated in Malaysia)
(Company No. 807705-X)

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS (CONT'D)

Auditors' responsibilities for the audit of the financial statements (Cont'd)

We communicate with the Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

OTHER MATTERS

This report is made solely to the member of the Bank, as a body, in accordance with Section 266 of the Companies Act 2016 in Malaysia and for no other purpose. We do not assume responsibility to any other person for the content of this report.

PRICEWATERHOUSECOOPERS PLT
LLP0014401-LCA & AF 1146
Chartered Accountants

SOO HOO KHOON YEAN
2682/10/19(J)
Chartered Accountant

Kuala Lumpur
18 February 2019

HSBC AMANAH MALAYSIA BERHAD
(Company No. 807705-X)
(Incorporated in Malaysia)

STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2018

	Note	**31 Dec 2018 RM'000**	31 Dec 2017 RM'000
Assets			
Cash and short-term funds	*7*	**2,804,494**	1,465,919
Financial investments available-for-sale	*8*	**-**	2,221,044
Financial investments at fair value through other comprehensive income (FVOCI)	*9*	**2,725,683**	-
Financing and advances	*10*	**14,137,337**	13,383,803
Derivative financial assets	*13*	**242,284**	278,472
Other assets	*14*	**50,664**	43,359
Statutory deposits with Bank Negara Malaysia	*15*	**364,662**	361,362
Equipment	*16*	**6,868**	5,520
Deferred tax assets	*18*	**17,363**	8,637
Tax recoverable	*19*	**-**	7,624
Total assets		**20,349,355**	17,775,740
Liabilities			
Deposits from customers	*20*	**11,444,577**	10,034,525
Deposits and placements from banks and other financial institutions	*21*	**3,299,964**	3,361,939
Structured liabilities designated at fair value through profit or loss (FVTPL)	*22*	**884,877**	-
Bills payable		**18,594**	16,678
Derivative financial liabilities	*13*	**227,330**	265,402
Other liabilities	*23*	**270,960**	644,441
Provision for taxation		**29,520**	-
Multi-Currency Sukuk Programme	*24*	**1,755,281**	1,252,829
Subordinated Commodity Murabahah Financing	*25*	**595,987**	583,598
Total liabilities		**18,527,090**	16,159,412
Equity			
Share capital	*26*	**660,000**	660,000
Reserves	*27*	**1,162,265**	956,328
Total equity attributable to owner of the Bank		**1,822,265**	1,616,328
Total liabilities and equity		**20,349,355**	17,775,740
Restricted investment accounts [1]		4,175,818	6,007,289
Total Islamic Banking asset [1]		24,525,173	23,783,029
Commitments and contingencies	*38*	**23,162,908**	20,501,738

[1] The disclosure is in accordance with the requirements of Bank Negara Malaysia's Guideline on Financial Reporting for Islamic Banking Institutions dated 2 February 2018.

The accompanying notes form an integral part of the financial statements.

HSBC AMANAH MALAYSIA BERHAD
(Company No. 807705-X)
(Incorporated in Malaysia)

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2018

	Note	**31 Dec 2018 RM'000**	31 Dec 2017 RM'000
Income derived from investment of depositors' funds and others	*28*	**823,353**	711,551
Income derived from investment of shareholder's funds	*29*	**147,435**	146,439
Impairment allowance/provision	*30*	**(69,444)**	(168,603)
Total distributable income		**901,344**	689,387
Income attributable to depositors	*31*	**(440,676)**	(344,360)
Total net income		**460,668**	345,027
Operating expenses	*32*	**(249,099)**	(238,714)
Profit before tax		**211,569**	106,313
Tax expense	*33*	**(48,869)**	(19,933)
Profit for the financial year		**162,700**	86,380
Other comprehensive income/(expense)			
Items that will not be reclassified to profit or loss			
Own credit reserves:			
Change in fair value		**(4,859)**	2,731
Income tax effect		**1,166**	(655)
Items that will subsequently be reclassified to profit or loss when specific conditions are met:			
Available-for-sale reserve:			
Change in fair value		**-**	8,850
Income tax effect		**-**	(2,124)
Fair value through other comprehensive income reserve:			
Change in fair value		**(287)**	-
Net amount transferred from profit or loss		**482**	-
Impairment charges		**25**	-
Income tax effect		**(46)**	-
Other comprehensive (expense)/income for the financial year, net of tax		**(3,519)**	8,802
Total comprehensive income for the financial year		**159,181**	95,182
Profit attributable to the owner of the Bank		**162,700**	86,380
Total comprehensive income attributable to the owner of the Bank		**159,181**	95,182
Basic earnings per RM0.50 ordinary share	*34*	**162.7 sen**	86.4 sen

The accompanying notes form an integral part of the financial statements.

HSBC AMANAH MALAYSIA BERHAD
(Company No. 807705-X)
(Incorporated in Malaysia)

STATEMENT OF CHANGES IN EQUITY FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2018

	Non-distributable						*Distributable*	
	Share capital	*Available-for-sale reserve*	*FVOCI reserve*	*Own credit reserve*	*Capital contribution reserve*	*Regulatory reserve*	*Retained profits*	*Total*
	RM'000	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**
2018								
Balance at 1 January								
- As previously stated	**660,000**	**179**	**-**	**230**	**408**	**34,000**	**921,511**	**1,616,328**
- Impact on transition to MFRS 9 (See Note 3)	**-**	**(179)**	**305**	**476**	**-**	**15,960**	**40,090**	**56,652**
- As restated	**660,000**	**-**	**305**	**706**	**408**	**49,960**	**961,601**	**1,672,980**
Total comprehensive income for the financial year								
Profit for the financial year	**-**	**-**	**-**	**-**	**-**	**-**	**162,700**	**162,700**
Other comprehensive income, net of tax								
Financial investments at FVOCI/Own Credit reserve								
Net change in fair value	**-**	**-**	**(217)**	**(3,693)**	**-**	**-**	**-**	**(3,910)**
Net amount transferred from profit or loss	**-**	**-**	**366**	**-**	**-**	**-**	**-**	**366**
Impairment charges	**-**	**-**	**25**	**-**	**-**	**-**	**-**	**25**
Total other comprehensive income	-	-	***174***	***(3,693)***	-	-	-	***(3,519)***
Total comprehensive income for the financial year	**-**	**-**	**174**	**(3,693)**	**-**	**-**	**162,700**	**159,181**
Transfer to regulatory reserves	**-**	**-**	**-**	**-**	**-**	**41,140**	**(41,140)**	**-**
Transactions with the owner, recorded directly in equity								
Share based payment transactions	**-**	**-**	**-**	**-**	**91**	**-**	**13**	**104**
Dividends paid to owner - 2017 final	**-**	**-**	**-**	**-**	**-**	**-**	**(10,000)**	**(10,000)**
Balance at 31 December	**660,000**	**-**	**479**	**(2,987)**	**499**	**91,100**	**1,073,174**	**1,822,265**

The accompanying notes form an integral part of the financial statements.

HSBC AMANAH MALAYSIA BERHAD
(Company No. 807705-X)
(Incorporated in Malaysia)

STATEMENT OF CHANGES IN EQUITY FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2018 (Cont'd)

	Non-distributable							*Distributable*	
	Share capital	*Share premium*	*Statutory reserve* [1]	*Available-for-sale reserve*	*Own Credit Reserve*	*Capital contribution reserve*	*Regulatory reserve*	*Retained profits*	*Total*
	RM'000	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**
2017									
Balance at 1 January	50,000	610,000	50,000	(6,547)	(1,846)	403	34,000	785,141	1,521,151
Total comprehensive income for the financial year									
Profit for the financial year	-	-	-	-	-	-	-	86,380	86,380
Other comprehensive income, net of tax									
Available-for-sale reserve:									
Net change in fair value	-	-	-	6,726	2,076	-	-	-	8,802
Total other comprehensive income	-	-	-	*6,726*	*2,076*	-	-	-	*8,802*
Total comprehensive income for the financial year	-	-	-	6,726	2,076	-	-	86,380	95,182
Transition to no par value regime on 31 January 2017 [1]	610,000	(610,000)	-	-	-	-	-	-	-
Transfer in accordance with BNM's requirement [2]	-	-	(50,000)	-	-	-	-	50,000	-
Transactions with the owner, recorded directly in equity									
Share based payment transactions	-	-	-	-	-	5	-	(10)	(5)
Balance at 31 December	660,000	-	-	179	230	408	34,000	921,511	1,616,328

[1] The new Companies Act 2016, which came into operation on 31 January 2017, abolished the concept of authorised share capital and par value of share capital. Consequently, the amounts standing to the credit of the share premium account of RM610m became part of the Bank's share capital pursuant to the transitional provisions set out in Section 618(2) of the Act. There was no impact on the numbers of ordinary shares in issue or the relative entitlement of any of the members as a result of this transition.

[2] With effect from 3 May 2017, the Bank is no longer required to maintain statutory reserve pursuant to Bank Negara Malaysia's guideline on Capital Funds for Islamic banks.

The accompanying notes form an integral part of the financial statements.

HSBC AMANAH MALAYSIA BERHAD
(Company No. 807705-X)
(Incorporated in Malaysia)

STATEMENT OF CASH FLOWS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2018

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Cash Flows from Operating Activities		
Profit before income tax expense	**211,569**	106,313
Adjustments for:		
Equipment written off	**1**	3
Unrealised (gains)/losses from dealing in foreign currency	**(360)**	756
Unrealised losses/(gains) from revaluation of financial assets at FVTPL	**952**	(74)
Unrealised losses/(gains) from trading in derivatives	**1,983**	(5,048)
Allowance for impairment losses	**110,427**	202,569
Share based payment transactions	**187**	107
Depreciation of equipment	**2,324**	4,015
Unrealised losses/(gains) of foreign exchange translation on subordinated commodity murabahah financing	**12,389**	(62,667)
Net expenses on financial instruments fair value through profit or loss	**16,081**	761
Operating profit before changes in operating assets and liabilities	**355,553**	246,735
Decrease/(Increase) in operating assets		
Financial assets held-for-trading	**-**	562
Financing and advances	**(788,596)**	(1,843,109)
Derivative financial assets	**33,613**	121,568
Other assets	**(11,509)**	36,553
Statutory deposits with Bank Negara Malaysia	**(3,300)**	(35,900)
Total increase in operating assets	**(769,792)**	(1,720,326)
(Decrease)/Increase in operating liabilities		
Deposits from customers	**1,410,052**	1,307,982
Deposits and placements from banks and other financial institutions	**(61,975)**	1,410,337
Structured liabilities designated at FVTPL	**586,264**	-
Bills payable	**1,916**	(6,954)
Derivative financial liabilities	**(38,072)**	(226,555)
Other liabilities	**(17,131)**	(455,930)
Total increase in operating liabilities	**1,881,054**	2,028,880
Cash generated from operating activities	**1,466,815**	555,289
Income tax paid	**(37,242)**	(18,304)
Net cash generated from operating activities	**1,429,573**	536,985

The accompanying notes form an integral part of the financial statements.

HSBC AMANAH MALAYSIA BERHAD
(Company No. 807705-X)
(Incorporated in Malaysia)

STATEMENT OF CASH FLOWS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2018 (Cont'd)

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Cash Flows from Investing Activities		
Purchase of financial assets available-for-sale	**-**	(1,598,580)
Purchase of financial investments at fair value through other comprehensive income	**(1,285,897)**	-
Proceeds from disposal of financial assets available-for-sale	**-**	755,089
Proceeds from disposal of financial investments at fair value through other comprehensive income	**785,933**	-
Purchase of equipment	**(3,673)**	(2,301)
Net cash used in investing activities	**(503,637)**	(845,792)
Cash Flows from Financing Activities		
Issuance of Multi-Currency Sukuk	**500,000**	-
Profits paid on Multi-Currency Sukuk Programme	**(50,186)**	(66,533)
Profit paid on Subordinated Commodity Murabahah Financing	**(27,175)**	(18,332)
Redemption of Multi-Currency Sukuk Programme	**-**	(500,000)
Dividend paid	**(10,000)**	-
Net cash generated from/(used in) financing activities	**412,639**	(584,865)
Net increase/(decrease) in Cash and Cash Equivalents	**1,338,575**	(893,672)
Cash and Cash Equivalents at beginning of the financial year	**1,465,919**	2,359,591
Cash and Cash Equivalents at end of the financial year	**2,804,494**	1,465,919
Analysis of Cash and Cash Equivalents		
Cash and short-term funds	**2,804,494**	1,465,919

The accompanying notes form an integral part of the financial statements.

HSBC AMANAH MALAYSIA BERHAD
(Company No. 807705-X)
(Incorporated in Malaysia)

STATEMENT OF CASH FLOWS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2018

Changes in liabilities arising from financing activities

	At 1 January RM'000	Cash inflow/ (outflow) RM'000	Foreign exchange adjustment RM'000	Fair value movement RM'000	Profit accrual RM'000	At 31 December RM'000
2018						
Multi-Currency Sukuk Programme	**1,252,829**	**500,000**	**-**	**2,452**	**-**	**1,755,281**
Subordinated Commodity Murabahah Financing	**583,598**	**-**	**12,389**	**-**	**-**	**595,987**
Other Liabilities of which:						
Profits paid on Multi-Currency Sukuk Programme	**12,815**	**(50,186)**	**-**	**-**	**55,546**	**18,175**
Profits paid on Subordinated Commodity Murabahah Financing	**2,371**	**(27,175)**	**-**	**-**	**25,111**	**307**
Dividend paid	**-**	**(10,000)**	**-**	**-**	**-**	**-**
	1,851,613	**412,639**	**12,389**	**2,452**	**80,657**	**2,369,750**
2017						
Multi-Currency Sukuk Programme	1,756,001	(500,000)	-	(3,172)	-	1,252,829
Subordinated Commodity Murabahah Financing	646,265	-	(62,667)	-	-	583,598
Other Liabilities of which:						
Profits paid on Multi-Currency Sukuk Programme	17,637	(66,533)	-	-	61,711	12,815
Profits paid on Subordinated Commodity Murabahah Financing	204	(18,332)	-	-	20,499	2,371
	2,420,107	(584,865)	(62,667)	(3,172)	82,210	1,851,613

The accompanying notes form an integral part of the financial statements.

HSBC AMANAH MALAYSIA BERHAD
(Company No. 807705-X)
(Incorporated in Malaysia)

NOTES TO THE FINANCIAL STATEMENTS

1 General Information

HSBC Amanah Malaysia Berhad (the Bank) is a licensed Islamic Bank under the Islamic Financial Services Act, 2013. The principal activities of the Bank is Islamic banking and related financial services.

There were no significant changes in these activities during the financial year.

The Bank is a public limited liability company, incorporated and domiciled in Malaysia. The registered office of the Bank is located at 10th Floor, North Tower, 2, Leboh Ampang, 50100 Kuala Lumpur.

The immediate parent bank and ultimate holding company during the financial year are HSBC Bank Malaysia Berhad (HBMY) and HSBC Holdings Plc, respectively.

The financial statements were approved and authorised for issue by the Board of Directors on 11 February 2019.

2 Basis of Preparation

(a) Statement of compliance

The financial statements of the Bank has been prepared in accordance with the requirements of Malaysian Financial Reporting Standards (MFRS), International Financial Reporting Standards, the requirements of the Companies Act 2016 in Malaysia and BNM requirements on Shariah related disclosures.

(i) Standards and amendments to published standards that are effective

The amendments to published accounts that are effective and applicable to the Bank for the financial year beginning on 1 January 2018 are as follows:

- MFRS 9 ‘Financial Instruments’
- MFRS 15 ‘Revenue from Contracts with Customers’
- Amendments to MFRS 2 ‘Share-based Payment - Classification and Measurement of Share-based Payment Transactions’
- Amendments to MFRS 140 ‘Investment Property - Transfers of Investment Property’
- IC Interpretation 22 ‘Foreign Currency Transactions and Advance Consideration’
- Annual Improvements to MFRSs 2014 - 2016 Cycle: MFRS 128 ‘Investments in Associates and Joint Ventures’

The Bank has adopted MFRS 9 and MFRS 15 for the first time in the 2018 financial statements, which resulted in changes in accounting policies. The detailed impact of changes in accounting policies for MFRS 9 are set out in Note 3. There is no significant financial impact arising from the adoption of MFRS 15.

Other than that, the adoption of other amendments listed above did not have any impact on the current period or any prior period and is not likely to affect future periods.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

2 Basis of Preparation (Cont'd)

(a) Statement of compliance (Cont'd)

(ii) Standards and amendments to published standards have been issued but not yet effective

The Bank will apply these standards, amendments to published standards from financial year beginning on/after 1 January 2019:

- MFRS 16 'Leases' supersedes MFRS 117 'Leases' and the related interpretations.

  Under MFRS 16, a lease is a contract (or part of a contract) that conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

  MFRS 16 eliminates the classification of leases by the lessee as either finance leases (on balance sheet) or operating leases (off balance sheet). MFRS 16 requires a lessee to recognise a "right-of-use" (ROU) of the underlying asset and a lease liability reflecting future lease payments for most leases. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost.

  The right-of-use asset is depreciated in accordance with the principle in MFRS 116 'Property, Plant and Equipment' and the lease liability is accreted over time with profit expense recognised in profit or loss.

  For lessors, MFRS 16 retains most of the requirements in MFRS 117. Lessors continue to classify all leases as either operating leases or finance leases and account for them differently.

  Transitional impact

  MFRS 16 has an effective date for annual periods beginning on or after 1 January 2019. MFRS 16 results in lessees accounting for most lease within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under MFRS 117 'Leases'. Lessees will recognise a right of use (ROU) asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease, and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as under MFRS 117. At 1 January 2019, the Bank expect to adopt the standard using a modified retrospective approach where the cumulative effect of initially applying the standard is recognised an adjustment to the opening balance of retained earnings and comparatives are not restated. The implementation is expected to increase assets (ROU assets) and increase financial liabilities with no significant impact on net assets or retained earnings.

- IC Interpretation 23 'Uncertainty over Income Tax Treatments' provides guidance on how to recognise and measure deferred and current income tax assets and liabilities where there is uncertainty over a tax treatment.

  If an entity concludes that it is not probable that the tax treatment will be accepted by the tax authority, the effect of the tax uncertainty should be included in the period when such determination is made. An entity shall measure the effect of uncertainty using the method which best predicts the resolution of the uncertainty.

  IC Interpretation 23 will be applied retrospectively.

- Amendments to MFRS 128 'Long-term Interests in Associates and Joint Ventures' clarify that an entity should apply MFRS 9 'Financial Instruments' (including the impairment requirements) to long-term interests in an associate or joint venture, which are in substance form part of the entity's net investment, for which settlement is neither planned nor likely to occur in the foreseeable future.

  In addition, such long-term interest are subject to loss allocation and impairment requirements in MFRS 128.

  The amendments shall be applied retrospectively.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

2 Basis of Preparation (Cont'd)

(a) Statement of compliance (Cont'd)

(ii) Standards and amendments to published standards have been issued but not yet effective (Cont'd)

- Amendments to MFRS 9 'Prepayment features with negative compensation' allow companies to measure some prepayable financial assets with negative compensation at amortised cost. Negative compensation arises where the contractual terms permit the borrower to prepay the instrument before its contractual maturity, but the prepayment amount could be less than the unpaid amounts of principal and profit. To qualify for amortised cost measurement, the negative compensation must be reasonable compensation for early termination of the contract, and the asset must be held within a 'held to collect' business model.

  The amendments will be applied retrospectively.

- Annual Improvements to MFRSs 2015 – 2017 Cycle:

  - Amendments to MFRS 3 'Business Combinations' clarify that when a party obtains control of a business that is a joint operation, the acquirer should account the transaction as a business combination achieved in stages. Accordingly it should remeasure its previously held interest in the joint operation (rights to the assets and obligations for the liabilities) at fair value on the acquisition date.

  - Amendments to MFRS 11 'Joint Arrangements' clarify that when a party obtains joint control of a business that is a joint operation, the party should not remeasure its previously held interest in the joint operation.

  - Amendments to MFRS 112 'Income Taxes' clarify that where income tax consequences of dividends on financial instruments classified as equity is recognised (either in profit or loss, other comprehensive income or equity) depends on where the past transactions that generated distributable profits were recognised. Accordingly, the tax consequences are recognised in profit or loss when an entity determines payments on such instruments are distribution of profits (that is, dividends). Tax on dividend should not be recognised in equity merely on the basis that it is related to a distribution to owners.

  - Amendments to MFRS 123 'Borrowing Costs' clarify that if a specific borrowing remains outstanding after the related qualifying asset is ready for its intended use or sale, it becomes part of general borrowings.

- Amendments to MFRS 119 'Plan amendment, curtailment or settlement' requires an entity to use the updated actuarial assumptions from remeasurement of its net defined benefit liability or asset arising from plan amendment, curtailment or settlement, to determine current service cost and net profit for the remaining period after the change to the plan. The amendments will be applied prospectively.

(b) Basis of measurement

The financial statements of the Bank has been prepared on the historical cost basis, except for the following assets and liabilities as explained in their respective accounting policy notes:

- Structured liabilities
- Financial investments
- Derivatives and hedge accounting
- Financial liabilities designated at fair value through profit or loss (FVTPL)

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

2 Basis of Preparation (Cont'd)

(c) Functional and presentation currency

These financial statements are presented in Ringgit Malaysia (RM), which is the Bank's functional currency. All financial information presented in RM has been rounded to the nearest thousand, unless otherwise stated.

(d) Use of estimates and judgments

The results of the Bank are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of the financial statements. The significant accounting policies are described in Note 4. The preparation of the financial statements in conformity with MFRSs requires management to make estimates and assumptions about future conditions. The use of available information and the application of judgment are inherent in the formation of estimates; actual results in the future may differ from estimates upon which financial information is prepared.

Management believes that the Bank's critical accounting policies where judgment is necessarily applied are those which relate to impairment of financing and advances and the valuation of financial instruments (refer Note 6). There are no other significant areas of estimation uncertainty and critical judgments in applying accounting policies that have significant effect on the amounts recognised in the financial statements other than those disclosed above.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

3 Changes in accounting policies

A. Adoption of MFRS 9 'Financial Instruments'

The Bank has applied MFRS 9 retrospectively with the date of initial application of 1 January 2018. In accordance with the transition provisions provided in MFRS 9, comparative information for 2017 was not restated and continued to be reported under the previous accounting policies governed under MFRS 139. The cumulative effects of initially applying MFRS 9 were recognised as an adjustment to the opening balances of retained earnings as at 1 January 2018.

(a) Classification and measurement of financial assets

Until 31 December 2017, financial assets were classified in the following categories: financial assets at fair value through profit or loss (FVTPL), financing and receivables and available-for-sale (AFS) financial assets. Note 4(t) set out the details of accounting policies for classification and measurement of financial instruments under MFRS 139.

From 1 January 2018, the Bank applies the following MFRS 9's classification approach to all types of financial assets, including those that contain embedded derivative features:

- Investments in debt instruments: There are 3 subsequent measurement categories: amortised cost, fair value with changes either recognised through other comprehensive income (FVOCI) or through profit or loss (FVTPL).
- Investments in equity instruments: These instruments are always measured at fair value with changes in fair value presented in profit or loss. However, the Bank has made an irrevocable choice to present changes in fair value in other comprehensive income (OCI) for investments that are not held for trading.
- Embedded derivatives in financial asset host contracts: The Bank applies the classification and measurement of financial assets to the entire hybrid instrument for financial assets with embedded derivatives.

The new accounting policies for classification and measurement of financial instruments under MFRS 9 are set out in Note 4(f).

To reflect this change in accounting policies, the Bank has made the following reclassification of financial assets upon adoption of MFRS 9:

(i) Reclassification of investment in debt securities from AFS to FVTPL
Investment in debt securities were reclassified from AFS to financial assets at FVTPL because their contractual cash flows do not represent solely payments of principal and interest (SPPI). Related fair value gains were transferred from AFS reserves, along with the related deferred tax expense impact, to retained earnings on 1 January 2018.

(ii) Reclassification of investment in non-trading equity securities from AFS to FVOCI
The Bank elected to present in OCI changes in the fair value of all its investments in equity securities previously classified as AFS, because these investments are neither held for trading nor arise from contingent consideration recognised by acquirer in business combination. As a result, investments in these equity securities were reclassified from AFS financial assets to financial assets at FVOCI. Related AFS reserves were reclassified to FVOCI reserve on 1 January 2018.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

3 Changes in accounting policies (Cont'd)

A. Adoption of MFRS 9 'Financial Instruments' (Cont'd)

(b) Impairment

Until 31 December 2017, the Bank assessed the impairment of financing and advances and AFS financial assets based on the incurred impairment loss model. Note 4(t) set out the details of accounting policies for impairment of financial assets under MFRS 139.

From 1 January 2018, the Bank applies expected credit loss (ECL) model to determine impairment on investment in debt instruments that are measured at amortised cost and at FVOCI and financial guarantee contracts. The new accounting policies for impairment under MFRS 9 are set out in Note 4(k).

The financial impact for the changes in accounting policies are disclosed in Note 3(i) to 3(iv).

B. Voluntary changes in accounting policies

While not necessarily required by the adoption of MFRS 9, the following voluntary changes in accounting policy and presentation have been made as a result of reviews carried out in conjunction with its adoption. The effect of presentational changes at 1 January 2018 is included in the reconciliation set out in Note 3(ii) and comparatives have not been restated.

- The Bank has considered market practices for the presentation of certain financial liabilities which contain both deposit and derivative components. The Bank has concluded that a change in accounting policy and presentation from 'Trading liabilities' would be appropriate, since it would better align with the presentation of similar financial instruments by peers and therefore provide more relevant information about the effect of these financial liabilities on the Bank's financial position and performance. As a result, rather than being classified as held for trading, the Bank designates these financial liabilities as at fair value through profit or loss since they are managed and their performance evaluated on a fair value basis. A further consequence of this change in presentation is that the effects of changes in the liabilities' credit risk will be presented in 'Other comprehensive income' with the remaining effect presented in profit or loss in accordance with bank's accounting policy adopted in 2017 (following the adoption of the requirements in MFRS 9 relating to the presentation of gains and losses on financial liabilities designated at fair value).

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

3 Changes in accounting policies (Cont'd)

(i) Classification and measurement of financial instruments

The measurement category and the carrying amount of financial assets and liabilities in accordance with MFRS 139 and MFRS 9 at 1 January 2018 are compared as follows:

	MFRS 139		*MFRS 9*	
	Measurement category	Carrying amount RM'000	Measurement category	Carrying amount RM'000
Financial assets				
Cash and short-term funds	Amortised cost (Financing and receivables)	1,465,919	Amortised cost	1,465,918
Financial investments available-for-sale (AFS)	AFS (Available-for-sale)	2,221,044	Not applicable	-
Financial investments at fair value through other comprehensive income (FVOCI)	Not applicable	-	FVOCI [1]	2,221,044
Financing and advances	Amortised cost (Financing and receivables)	13,383,803	Amortised cost	13,462,186
Derivative financial assets	HFT (Held-for-trading)	278,472	FVTPL [2]	278,472
Other assets	Amortised cost (Financing and receivables)	43,359	Amortised cost	43,359
Statutory deposits with Bank Negara Malaysia	Amortised cost (Financing and receivables)	361,362	Amortised cost	361,362
Total financial assets		17,753,959		17,832,341
Financial liabilities				
Deposits from customers	Amortised cost	10,034,525	Amortised cost	10,034,525
Deposits and placements from banks and other financial institutions	Amortised cost	3,361,939	Amortised cost	3,361,939
Structured liabilities designated at fair value through profit or loss (FVTPL)	Not applicable	-	FVTPL	279,975
Bills payable	Amortised cost	16,678	Amortised cost	16,678
Derivative financial liabilities	HFT (Held-for-trading)	265,402	FVTPL	265,402
Other liabilities	Amortised cost	644,441	Amortised cost	368,289
Multi-Currency Sukuk Programme	FVTPL (Designated)	1,252,829	FVTPL (Designated)	1,252,829
Subordinated Commodity Murabahah Financing	Amortised cost	583,598	Amortised cost	583,598
Total financial liabilities		16,159,412		16,163,235

[1] Fair Value through Other Comprehensive Income

[2] Fair Value through Profit and Loss

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

3 Changes in accounting policies (Cont'd)

(ii) Reconciliation of statement of financial position balances from MFRS 139 to MFRS 9

The following table is a reconciliation of the carrying amount in the Bank's statement of financial position from MFRS 139 to MFRS 9 as at 1 January 2018:

	MFRS 139 carrying amount as at 31 December 2017	Note 3A MFRS 9 adjustments		Note 3B - Other Changes in Classification	MFRS 9 carrying amount as at 1 January 2018	Retained profits impact as at 1 January 2018
		Reclassification	Remeasurement			
	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
Assets						
Cash and short-term funds	1,465,919	-	(1)	-	1,465,918	(1)
Financial investments available-for-sale	2,221,044	(2,221,044)	-	-	-	-
Financial investments at fair value through other comprehensive income (FVOCI)	-	2,221,044	-	-	2,221,044	-
Financing and advances	13,383,803	-	78,383	-	13,462,186	78,383
Derivative financial assets	278,472	-	-	-	278,472	-
Other assets	43,359	-	-	-	43,359	-
Statutory deposits with Bank Negara Malaysia	361,362	-	-	-	361,362	-
Deferred tax assets	8,637	-	(150)	-	8,487	-
Total change to financial asset balances, reclassification and remeasurement at 1 January 2018	17,762,596	-	78,232	-	17,840,828	78,382
Liabilities						
Deposits from customers	10,034,525	-	-	-	10,034,525	-
Deposits and placements from banks and other financial institutions	3,361,939	-	-	-	3,361,939	-
Structured liabilities designated at fair value through profit or loss	-	-	-	279,975	279,975	-
Bills payable	16,678	-	-	-	16,678	-
Derivative financial liabilities	265,402	-	-	-	265,402	-
Other liabilities	644,441	-	3,823	(279,975)	368,289	3,823
Provision for taxation	-	-	17,757	-	17,757	17,757
Multi-Currency Sukuk Programme	1,252,829	-	-	-	1,252,829	-
Subordinated Commodity Murabahah Financing	583,598	-	-	-	583,598	-
Total change to financial liabilities balances, reclassification and remeasurement at 1 January 2018	16,159,412	-	21,580	-	16,180,992	21,580

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

3 Changes in accounting policies (Cont'd)

(iii) The total impacts of the changes in accounting policies on the Bank's reserve as at 1 January 2018 are as follow:

Retained profits	**RM'000**
As previously reported at 31 December 2017	921,511
Impact of adoption of MFRS 9 (net of tax effect):	
Decrease in loss allowance financing and advances	78,383
Increase in loss allowance other liabilites	(3,823)
Remeasurement in provision for taxation	(17,757)
Reclassification of allowances to regulatory reserve upon adoption of MFRS 9	(15,960)
Others	(753)
Adjustment to retained earnings upon adoption of MFRS 9	40,090
As restated at 1 January 2018	961,601
FVOCI reserve	
As previously reported at 31 December 2017	-
Impact of adoption of MFRS 9 (net of tax effect):	
Reclassification of investment in AFS to FVOCI	179
Remeasurement of FVOCI	126
Adjustment to FVOCI reserve upon adoption of MFRS 9	305
As restated at 1 January 2018	305
Own credit reserve	
As previously reported at 31 December 2017	230
Impact of adoption of MFRS 9 (net of tax effect):	
Remeasurement of own credit reserve upon adoption of MFRS 9	476
As restated at 1 January 2018	706
Regulatory reserve	
As previously reported at 31 December 2017	34,000
Impact of adoption of MFRS 9 (net of tax effect):	
Reclassification of allowances from retained profits upon adoption of MFRS 9	15,960
As restated at 1 January 2018	49,960

(iv) Reconciliation of impairment allowance balance from MFRS 139 to MFRS 9

The following table reconciles the prior year's closing impairment allowance for the Bank measured in accordance with the MFRS 139 incurred loss model to the new impairment allowance measured in accordance with the MFRS 9 expected loss model at 1 January 2018:

	Impairment allowance under MFRS 139 RM'000	Reclassification RM'000	Remeasurement RM'000	Impairment allowance under MFRS 9 RM'000
Amortised cost (Financing and receivables) (MFRS 139)/ Amortised cost (MFRS 9)				
Financing and advances	355,807	-	(78,383)	277,424
Amortised cost (MFRS 139/MFRS 9)				
Cash and short-term funds	-	-	1	1
Other liabilities (including financial guarantee contracts)	-	-	3,823	3,823
FVOCI (MFRS 139/MFRS 9)				
Financial investment at FVOCI	-	-	126	126
Total	**355,807**	**-**	**(74,433)**	**281,374**

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Significant Accounting Policies

The accounting policies set out below have been applied consistently to the periods presented in these financial statements and have been applied consistently by the Bank.

(a) Foreign Currencies

Transactions in foreign currencies are translated to the functional currency at exchange rates at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting period are retranslated to the functional currency at the exchange rate at that date.

Non-monetary assets and liabilities denominated in foreign currencies are not retranslated at the end of the reporting date except for those that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined.

Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of FVOCI (comparative - AFS) equity instruments or a financial instrument designated as a hedge of currency risk, which are recognised in other comprehensive income.

(b) Financing Income and Expenses

Financing income and expenses for all financial instruments of the Bank, except those classified as financial instruments designated at fair value through profit or loss (FVTPL) are recognised in 'finance income' and 'income attributable to depositors' in the statement of profit or loss and other comprehensive income on an accrual basis using the effective profit rate method in accordance with the principles of Shariah. The effective profit rate method is a way of calculating the amortised cost of a financial asset or a financial liability (or groups of financial assets or financial liabilities) and of allocating the Islamic financing income or expense over the relevant period.

The effective profit rate is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instruments, or where appropriate, a shorter period, to the net carrying amount of the financial asset or liability. When calculating the effective profit rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but not future credit losses.

The calculation of the effective profit rate includes all amounts paid or received by the Bank that are an integral part of the effective profit rate, including transaction costs and all other premiums or discounts.

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

i) Murabahah
Income is recognised on effective profit rate basis over the period of the contract based on the principal amounts outstanding.

ii) Ijarah Thumma Al-Bai
Income is recognised on effective profit rate over the term of the contract.

iii) Musharakah (Co-ownership)
Income is accounted for on the basis of the reducing balance on a time-apportioned (the Bank's co-ownership portion) basis that reflects the effective yield on the asset.

iv) Bai Al-Inah (Sale and Buy Back)
Income is recognised on effective profit rate basis over the period of the contract based on the principal amounts outstanding.

v) Bai Bithaman Ajil
Income is recognised on effective profit rate basis over the period of the contract based on the principal amounts outstanding.

4 Significant Accounting Policies (Cont'd)

(b) Financing Income and Expenses (Cont'd)

vi) Ujrah (rendering services for credit card-i holders)
Income is recognised based on the identified services, benefits and privileges in exchange of a fee.

vii) Ujrah (rendering services for facilities other than credit card-i holders)
Income is recognised based on mutually agreed fee to provide the facility to customers.

Financing income and expense from Islamic Banking operations are recognised on an accrual basis in accordance with the principles of Shariah.

Financing income and expense of the Bank presented in the statement of profit and loss and other comprehensive income include:

- profit on financial assets and liabilities measured at amortised costs calculated on an effective profit rate basis;
- profit on FVOCI (comparative - AFS) investment securities calculated on an effective profit rate basis;
- the effective portion of fair value changes in qualifying hedging derivatives designated in cash flow hedges of variability in profit cash flows, in the same period that the hedged cash flows affect financing income/expense; and
- the effective portion of fair value changes in qualifying hedging derivatives designated in fair value hedges of profit rate risk.

(c) Fees and commission, net trading income and other operating income

Fee income is earned from a diverse range of services the Bank provides to their 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;
- income earned from the provision of services is recognised as revenue as the services are provided; and
- income which forms an integral part of the effective profit rate of a financial instrument is recognised as an adjustment to the effective profit rate and recorded in 'financing income' (see Note 4(b)).

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders approve the dividend for unlisted equity securities.

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities FVTPL, together with the related profit income and expense; and it also includes all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets and liabilities measured at fair value through profit or loss.

Net income/(expense) from financial instruments designated at fair value includes:

- all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value through profit or loss, including liabilities under investment contracts;
- all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets and liabilities designated at fair value through profit or loss; and
- profit income, profit expense and dividend income in respect of:
  - financial assets and financial liabilities designated at fair value through profit or loss; and
  - derivatives managed in conjunction with the above,

except for profit arising from debt securities issued by the Bank and derivatives managed in conjunction with those debt securities, which is recognised in 'financing income and expenses' (Note 4(b)).

The fair value of financial instruments is generally measured on an individual basis. However, in cases where the Bank 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 offsetting criteria.

(d) Income tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the profit or loss except to the extent that it relates to items recognised directly in other comprehensive income or directly in equity, in which case it is recognised in the same statement in which the related item appears.

Current tax is the tax expected to be payable or receivable on the taxable income or loss for the financial year, calculated using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous financial years. The Bank provides for potential current tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities. Current tax assets and liabilities are offset when the Bank intends to settle on a net basis and the legal right to offset exists.

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

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

Deferred tax relating to fair value of FVOCI (comparative - AFS) investments and cash flow hedging instruments which are charged or credited directly to other comprehensive income, is also charged or credited to other comprehensive income and is subsequently recognised in the profit or loss when the deferred fair value gain or loss is recognised in the profit or loss.

(e) Cash and cash equivalents

For the purpose of the statement of cash flows, 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 comprise cash at hand and bank balances, short term deposits and placements with banks maturing within one month.

(f) Financial instruments

(i) Initial recognition and measurement

A financial asset or a financial liability is recognised in the statement of financial position when, and only when the Bank becomes a party to the contractual provisions of the instrument.

A financial instrument is recognised initially, at its fair value plus, in the case of a financial instrument not at fair value through profit or loss, transactions costs that are directly attributable to the acquisition or issue of the financial instrument.

(ii) Financial instruments categories and subsequent measurement

The Bank categorises financial instruments as follows:

- financial instruments measured at amortised cost (See Note 4(g));
- financial assets measured at fair value through other comprehensive income (FVOCI) (Note 4(h));
- equity securities measured at fair value with fair value movements presented in OCI (Note 4(i)); or
- financial instruments designated at fair value through profit or loss (FVTPL) (Note 4(j)).

The Bank classifies its financial liabilities, as measured at amortised cost or designated at fair value through profit or loss (See accounting policies in Notes 4(f)(vi), 4(j), and 4(p)).

(f) Financial instruments (Cont'd)

(iii) Derecognition of financial assets and liabilities

Financial assets are derecognised when the rights to receive cash flows from the assets have expired; or where the Bank has transferred its contractual rights to receive the cash flows of the financial assets, and has transferred substantially all the risks and rewards of ownership; or where both control and substantially all the risks and rewards are not retained.

Financial liabilities are derecognised when they are extinguished, i.e. when the obligation is discharged, cancelled, or expires.

(iv) Offsetting financial assets/liabilities and income/expenses

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is currently a legally enforceable right to offset the recognised amounts and the Bank intends to settle on a net basis, or realise the asset and settle the liability simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy.

The 'Gross amounts not offset in the statement of financial position' for derivatives and securities purchased under resale agreements and similar arrangements include transactions where:

- the counterparty has an offsetting exposure with the Bank and a master netting or similar arrangement is in place with a right of set off only in the event of default, insolvency or bankruptcy, or the offset criteria are otherwise not satisfied; and
- cash and non-cash collaterals are received and pledged in respect of the transactions described above.

Income and expenses are presented on a net basis only when permitted under the MFRSs, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

(v) Valuation of financial instruments

All financial instruments are recognised initially 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). In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as profit rate yield curves, option volatilities and currency rates. When such evidence exists, the Bank recognises a trading gain or loss on inception of the financial instrument, being the difference between the transaction price and the fair value. When unobservable market data have a significant impact on the valuation of financial instruments, the entire initial difference in fair value from the transaction price as indicated by the valuation model is not recognised immediately in the profit or loss. Instead, it is recognised over the life of the transaction when the inputs become observable, the transaction matures or is closed out, or when the Bank enters into an offsetting transaction.

The fair value of financial instruments is generally measured on an individual basis. However, in cases where the Bank 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 MFRSs offsetting criteria.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value are measured in accordance with the Bank's valuation methodologies, which are described in Note 6(b)(ii).

(f) Financial instruments (Cont'd)

(vi) Derivative financial instruments and hedge accounting

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, profit rates or other indices. Derivatives are recognised initially and are subsequently measured at fair value, with changes in fair value generally recorded in the income statement. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative. This includes embedded derivatives in financial liabilities 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 Bank that are designated at fair value, the contractual profit is shown in 'financing expense' together with the profit payable on the issued debt.

Hedge accounting

When derivatives are held for risk management purposes, they are designated in hedge accounting relationships where the required criteria for documentation and hedge effectiveness are met. The Bank enters into 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 the 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 profit rate, unless the hedged item has been derecognised, in which case it is recognised in the income statement immediately.

- *Cash flow hedge*

  The effective portion of gains and losses on hedging instruments is recognised in other comprehensive income; the ineffective portion of the change in fair value of derivative hedging instruments that are part of a cash flow hedge relationship is recognised immediately in the income statement within 'Other operating income'. The accumulated gains and losses recognised in other comprehensive income are reclassified to the income statement in the same periods in which the hedged item affects profit or loss. In hedges of forecast transactions that result in recognition of a non-financial asset or liability, previous gains and losses recognised in other comprehensive income are included in the initial measurement of the asset or liability. When a hedge relationship is discontinued, or partially discontinued, any cumulative gain or loss recognised in other comprehensive income remains in equity until the forecast transaction is recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss previously recognised in other comprehensive income is immediately reclassified to the income statement.

4 Significant Accounting Policies (Cont'd)

(g) 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 profit, such as most advances and financing to banks and customers and some debt securities, are measured at amortised cost. In addition, most financial liabilities are measured at amortised cost. The carrying value of these financial assets at initial recognition includes any directly attributable transactions costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some leveraged finance and syndicated lending activities, the difference is deferred and recognised over the life of the financing through the recognition of profit income.

Financing and advances consist of Murabahah, Ijarah, Ijarah Thumma Al-Bai, Diminishing Musharakah, Bai Al-Inah, Bai Bithaman Ajil and Ujrah contracts. They include financing and advances to customers and placements with banks that originated from the Bank, which are not classified as either held for trading or designated at fair value. They are recognised when cash is advanced to customers and derecognised when either the customer repays its obligations, or the advances are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective profit rate method, less any reduction from impairment or uncollectibility.

Assets funded under Ijarah financing are owned by the Bank throughout the tenure of the Ijarah financing. Ownership of the assets will be transferred to the customers at the end of the Ijarah financing subject to the customer's execution of the purchase option.

The Bank may commit to underwrite financing and advances on fixed contractual terms for specified periods of time. When the financing and advances arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative. When the Bank intends to hold the financing and advances, the related commitment is included in the impairment calculations set out in Note 4(k). They are derecognised when either the borrower repays its obligations, or the financing and advances are sold or written off, or substantially all the risks and rewards of ownership are transferred.

For financing under the Syndicated Investment Account for Financing/Investment Agency Account (SIAF/IAA) arrangements, the Bank applies the derecognition principles as stated in accounting policy Note 4(f)(iii) on derecognition of financial assets.

Contracts under Islamic sell and buyback agreements

When debt securities are sold subject to a commitment to repurchase them at a predetermined price (repos), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to resell (reverse repos) are not recognised on the balance sheet and an asset is recorded in respect of the initial consideration paid. Non-trading repos and reverse repos are measured at amortised cost. The difference between the sale and repurchase price or between the purchase and resale price is treated as profit and recognised in net financing income over the life of the agreement. Contracts that are economically equivalent to reverse repurchase or repurchase agreements (such as sales or purchases of debt securities entered into together with total return swaps with the same counterparty) are accounted for similarly to, and presented together with, reverse repurchase or repurchase agreements.

Financial liabilities measured at amortised cost

Financial liabilities that are not classified as fair value through profit or loss fall into this category and are measured at amortised cost. The financial liabilities measured at amortised cost are deposits from customers, deposits and placement from banks and other financial institutions, bills payable, other liabilities and subordinated liabilities.

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

4 Significant Accounting Policies (Cont'd)

(g) Financial instruments measured at amortised cost (Cont'd)

Financial liabilities measured at amortised cost (Cont'd)

Subordinated liabilities of the Bank is measured at amortised cost using the effective profit rate method, except for the portions which are fair value hedged, which are adjusted for the fair value gains or losses attributable to the hedged risks. Profits payable on subordinated liabilities of the Bank is recognised on an accrual basis.

(h) Financial assets measured at fair value through other comprehensive income (FVOCI)

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

(i) Equity securities measured at fair value with fair value movements presented in OCI

The equity securities for which fair value movements are shown in OCI are business facilitation and other similar investments where the Bank holds the investments other than to generate a capital return. Gains or losses on the derecognition of these equity securities are not transferred to profit or loss.

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

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; and
- when a group of financial assets and liabilities or a group of financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy.

Designated financial assets are recognised when the Bank 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 Bank 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/(expenses) from financial liabilities designated at fair value'.

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

Long-term debt issues (including Multi-currency sukuk programme)

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

Structured liabilities designated at fair value through profit or loss (FVTPL)

As 1 January 2018, the Bank has changed the accounting policy, whereby structured liabilities which are not principal guaranteed and designated at fair value was reclassified from Other Liabilities to Structured Liabilities Designated at Fair Value. Please refer to Note 3.

(k) Impairment of amortised cost and FVOCI financial assets

Expected credit losses (ECL) are recognised for placements and advances to banks, advances and financing to customers, non-trading reverse repurchase agreements, other financial assets held at amortised cost, debt instruments measured at fair value through other comprehensive income, and certain financing commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of some financing 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'.

(i) Credit-impaired (Stage 3)

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

- Qualitative criteria
  - contractual payments of either principal or profit are past due for more than 90 days.

- Quantitative criteria
  - 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 financing is otherwise considered to be in default.

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due. Therefore the definitions of credit-impaired and default are aligned as far as possible so that Stage 3 represents all financings which are considered defaulted or otherwise credit-impaired. Financing income is recognised by applying the effective profit rate to the amortised cost amount, i.e. gross carrying amount less ECL allowance.

(ii) 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 financing 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.

Advances and financing are normally written off, either partially or in full, when there is no realistic prospect of further recovery. Where financing 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.

In line with HSBC Global policy, financing is made on the basis of the customer's capacity to repay, as opposed to placing primary reliance on credit risk mitigation. Depending on the customer's standing and the type of product, facilities may be provided unsecured. Mitigation of credit risk is nevertheless a key aspect of effective risk management and in the Bank, takes many forms, the most common method of which is to take collateral. The principal collateral types employed by the Bank are as follows:

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Significant Accounting Policies (Cont'd)

(k) Impairment of amortised cost and FVOCI financial assets (Cont'd)

(ii) Write-off (Cont'd)

- under the residential and real estate business; financing over residential and financed properties;
- under certain Islamic specialised financing and leasing transactions (such as machinery financing) where physical assets form the principal source of facility repayment, physical collateral is typically taken;
- in the commercial and industrial sectors, charges over business assets such as premises, stock and debtors;
- facilities provided to small and medium enterprises are commonly granted against guarantees by their owners/directors;
- guarantees from third parties can arise where facilities are extended without the benefit of any alternative form of security, e.g. where the Bank issue a bid or performance bond in favour of a non-customer at the request of another bank;
- under the institutional sector, certain trading facilities are supported by charges over financial instruments such as cash, debt securities and equities; and
- financial collateral in the form of marketable securities is used in much of the over-the-counter (OTC) derivatives activities and in the Bank's securities financing business (securities lending and borrowing or repos and reverse repos).

(iii) Renegotiation

Financing 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 financing 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 financing 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 financing is a substantially different financial instrument. The renegotiated financing will only be reclassified as unimpaired when restructured payment is received and observed for a minimum period of 12 months.

Other than originated credit-impaired financing, all other modified financing could be transferred out of Stage 3 if they no longer exhibit any evidence of being credit-impaired and, in the case of renegotiated financing, 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 financing 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.

(iv) Financing modifications that are not credit-impaired

Financing 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 financing contract) such that the Bank's rights to the cash flows under the original contract have expired, the old financing is derecognised and the new financing 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. The Bank also assesses whether the new financial asset recognised is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognised in profit or loss as a gain or loss on derecognition.

4 Significant Accounting Policies (Cont'd)

(k) Impairment of amortised cost and FVOCI financial assets (Cont'd)

(v) 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 to 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 financing 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 (PD) which encompasses a wide range of information including the obligor's customer risk rating, 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 (or that the origination PD has doubled in the case of origination CRR greater than 3.3). The significance of changes in PD was informed by expert credit risk judgment, 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	Significant trigger – PD to increase by
0.1-1.2	15bps
2.1-3.3	30bps
Greater than 3.3 and not impaired	2x

For financing originated prior to the implementation of MFRS 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 financing, 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 notches
8.3	0 notches

Please refer to Note 5(b)(vii) for the 23-grade scale used for CRR,

(k) Impairment of amortised cost and FVOCI financial assets (Cont'd)

(v) Significant increase in credit risk (Stage 2) (Cont'd)

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 product. 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 financings in that portfolio 12 months before they become 30 days past due. The expert credit risk judgment is that no prior increase in credit risk is significant. This portfolio-specific threshold identifies financings with a PD higher than would be expected from financings that are performing as originally expected and higher than that which would have been acceptable at origination. It therefore approximates a comparison of origination to reporting date PDs.

(vi) 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.

(vii) Movement between stages

Financial assets can be transferred between the different categories 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 financing, financial instruments are transferred out of Stage 3 when they no longer exhibit any evidence of credit impairment as described above. Renegotiated financing 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 financing 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 financing that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

(viii) Measurement of ECL

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

In general, the Bank calculates ECL using three main components, a probability of default, a loss given default 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 profit 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.

(k) Impairment of amortised cost and FVOCI financial assets (Cont'd)

(viii) Measurement of ECL (Cont'd)

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 profit. 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 profit 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 Bank and the judgment 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.

(ix) 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 the Bank 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 the Bank'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 the Bank 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 financing 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.

(x) Forward-looking economic inputs

The Bank will in general apply three forward-looking global economic scenarios determined with reference to external forecast distributions, 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 on either side of the Central, referred to as an Upside and a Downside scenario respectively. 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 Bank's current top and emerging risks. 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 economic factors include, but are not limited to, gross domestic product, unemployment, profit rates, inflation and commercial property prices across all the countries in which the HSBC 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.

(k) Impairment of amortised cost and FVOCI financial assets (Cont'd)

(x) Forward-looking economic inputs (Cont'd)

The Bank 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 estimates.

(xi) Critical accounting estimates and judgments

In determining ECL, management is required to exercise judgment 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. Judgment 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 MFRS 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 judgment 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 financing impairment allowances as a whole are sensitive. Note 5(b)(i) set out the Central scenario in relation to the Bank's top and emerging risks, 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.

(xii) Grouping of instruments for ECL measured on collective basis

ECL may be determined on collective or individual basis for the following:
- perform assessment of significant increases in credit risk
- determining loss allowance measurement

This disclosure is applicable for both general 3-stage approach and simplified approach.

The following factors are considered when computing ECL:
- availability of reasonable and supportable information that is more forward-looking than past due information without undue cost or effort, which considers comprehensive credit risk information
- availability of credit risk information for particular groups of financial instruments vs individual instruments
- shared credit risk characteristics. Example as follows:
  - instrument type
  - credit risk ratings
  - collateral type
  - date of initial recognition
  - remaining term to maturity
  - industry
  - geographical location of debtor
  - the value of collateral relative to the financial asset if it has impact to probability of a default occurring

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Significant Accounting Policies (Cont'd)

(l) Equipment

Equipment, fixtures and fittings and motor vehicles are stated at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is calculated on a straight-line basis to write off the assets over their useful lives as follows:

Office equipment, fixtures and fittings	5 to 7 years
Computer equipment	4 to 5 years
Motor vehicles	5 years

Additions to equipment costing RM1,000 and below are expensed to profit or loss in the month of purchase. For those assets costing more than RM1,000, depreciation is provided at the above rates.

The gains or losses on disposal of an item of equipment is determined by comparing the proceeds from disposal with the carrying amount of the equipment and is recognised net within "other operating income" in the profit or loss.

Equipment is subject to an impairment review if there are events or changes in circumstances which indicate that the carrying amount may not be recoverable.

(m) Operating leases

Leases in which a significant portion of the risks and rewards of ownership are not transferred to the Bank as lessee are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to profit or loss under 'Establishment related expenses' on a straight-line basis over the period of the lease.

(n) Intangible assets

Intangible assets of the Bank represent computer software that have a finite useful life, and are stated at cost less accumulated amortisation and any accumulated impairment losses. Computer software includes both purchased and internally generated software. The cost of internally generated software comprises all directly attributable costs necessary to create, produce and prepare the software to be capable of operating in the manner intended by management. Costs incurred in the ongoing maintenance of software are expensed immediately as incurred.

Amortisation of intangible assets is calculated to write off the cost of the intangible assets on a straight line basis over the estimated useful lives of 3 to 5 years. Intangible assets are subject to impairment review if there are events or changes in circumstances which indicate that the carrying amount may not be recoverable.

(o) Bills payable

Bills payable represents bills payable to various beneficiaries arising from the sale of bank drafts, demand drafts, cashier's orders and certified cheques.

4 Significant Accounting Policies (Cont'd)

(p) Provisions, contingent liabilities and financial guarantees contracts

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.

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 guarantees contracts

Liabilities under financial guarantees contracts which 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.

Financial guarantees contracts are subsequently measured at the higher of the amount determined in accordance with the expected credit loss model under MFRS 9 'Financial instruments' and the amount initially recognised less cumulative amount of income recognised in accordance with the principles of MFRS 15 'Revenue from Contracts with Customers', where appropriate.

(q) Employee benefits

(i) Short term employee benefits

Short term employee benefit obligations in respect of salaries, annual bonuses, paid annual leave and sick leave are measured at the amounts expected to be paid when the liabilities are settled and are expensed as the related service is provided.

A liability is recognised for the amount expected to be paid under short term cash bonus or profit-sharing plans if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(ii) Defined contribution plan

As required by law, companies in Malaysia make contributions to the Employees Provident Fund (EPF). Such contributions are recognised as an expense in the statement of profit or loss and other comprehensive income as incurred.

(iii) Termination benefits

Termination benefits where applicable are payable when employment is terminated by the Bank for mutual or voluntary separation. The Bank recognise termination benefits when the Bank recognises costs for a restructuring that is within the scope of MFRS 137 'Provisions, Contingent Liabilities and Contingent Assets' and involves the payment of termination benefits. In the case of voluntary separation, the termination benefits are estimated based on the number of employees expected to apply and be accepted for the separation.

4 Significant Accounting Policies (Cont'd)

(r) Share based payments

The Bank's ultimate holding company operates a number of equity-settled share based payment arrangements with the Bank's employees as compensation for services provided by the employees. Equity-settled share based payment arrangements entitle employees to receive equity instruments of the ultimate holding company, HSBC Holdings plc.

The cost of share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted, and recognised as an expense on a straight-line basis over the vesting period, with a corresponding credit to the equity. The credit to equity is treated as capital contribution as the ultimate holding company is compensating the Bank's employees with no expense to the Bank. The vesting period is the period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied. The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately.

Fair value is determined by using market prices or appropriate valuation models, taking into account the terms and conditions upon which the equity instruments were granted. Vesting conditions include service conditions and performance conditions; any other features of a share-based payment arrangement are non-vesting conditions. Market performance conditions and non-vesting conditions are taken into account when estimating the fair value of equity instruments at the date of grant, so that an award is treated as vesting irrespective of whether the market performance condition or non-vesting condition is satisfied, provided all other vesting conditions are satisfied.

Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

Where an award has been modified, as a minimum, the expense of the original award continues to be recognised as if it had not been modified. Where the effect of a modification is to increase the fair value of an award or increase the number of equity instruments, the incremental fair value of the award or incremental fair value of the extra equity instruments is recognised in addition to the expense of the original grant, measured at the date of modification, over the modified vesting period.

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

Where the ultimate holding company recharges the Bank for the equity instruments granted, the recharge is recognised over the vesting period.

(s) Earnings per share

The Bank presents basic earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to the ordinary shareholder of the Bank by the weighted average number of shares outstanding during the year.

4 Significant Accounting Policies (Cont'd)

(t) Accounting policies applicable prior to 1 January 2018

(i) Financial instruments measured at amortised cost

Financing and advances to banks and customers, held-to-maturity investments and most financial liabilities are measured at amortised cost. The carrying value of these financial assets at initial recognition includes any directly attributable transactions costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some leveraged finance and syndicated lending activities, the difference is deferred and recognised over the life of the financing and advances (Refer Note 4(f)(v)) through the recognition of financing income, unless the financing and advances becomes impaired.

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

Impairment of financing and advances

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

Individually assessed financing and advances

The factors considered in determining whether a financing and advance is individually significant for the purposes of assessing impairment include the size of the financing and advance, the number of financing and advances in the portfolio, the importance of the individual financing and advance relationship and how this is managed. Financing and advances 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.

Financing and advances considered as individually significant are typically to corporate and commercial customers, are for larger amounts and are managed on an individual basis. For these financing and advances, the Bank consider on a case-by-case basis at each balance sheet date whether there is any objective evidence that a financing and advances 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 financing and advances, which include expected future receipts of contractual profit, at the financing and advance's original effective profit rate or an approximation thereof, and comparing the resultant present value with the financing and advance's current carrying amount.

Collectively assessed financing and advances

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

(t) Accounting policies applicable prior to 1 January 2018 (Cont'd)

(i) Financial instruments measured at amortised cost (Cont'd)

Incurred but not yet identified impairment

Individually assessed financing and advances 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 Bank has incurred as a result of events occurring before the balance sheet date that the Bank is not able to identify on an individual financing and advances basis, and that can be reliably estimated. When information becomes available that identifies losses on individual financing and advances within a group, those financing and advances are removed from the group and assessed individually.

Homogeneous groups of financing and advances

Statistical methods are used to determine collective impairment losses for homogeneous groups of financing and advances not considered individually significant. The methods used to calculate collective allowances are set out below:

- When appropriate empirical information is available, the Bank utilises roll-rate methodology, which employs statistical analyses of historical data and experience of delinquency and default to reliably estimate the amount of the financing and advances that will eventually be written off as a result of events occurring before the balance sheet date. Individual financing and advances are grouped using ranges of past due days, and statistical estimates are made of the likelihood that financing and advances in each range will progress through the various stages of delinquency and become irrecoverable. Additionally, individual financings are segmented based on their credit characteristics, such as industry sector, financing grade or product. In applying this methodology, adjustments are made to estimate the periods of time between a loss event occurring, for example because of a missed payment, and its confirmation through write-off (known as the loss identification period). Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss. In certain highly developed markets, models also take into account behavioural and account management trends as revealed in, for example bankruptcy and rescheduling statistics.

- When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, the Bank adopts a basic formulaic approach based on historical loss rate experience, or a discounted cash flow model. Where a basic formulaic approach is undertaken, the period between a loss event occurring and its identification is estimated by local management, and is typically between six and 12 months.

Write-off of financing and advances

Financing and advances and the related impairment allowance accounts are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where financing and advances 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 financing and advances impairment allowance account accordingly. The write-back is recognised in the income statement.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Significant Accounting Policies (Cont'd)

(t) Accounting policies applicable prior to 1 January 2018 (Cont'd)

(i) Financial instruments measured at amortised cost (Cont'd)

Assets acquired in exchange for financing and advances

When non-financial assets acquired in exchange for financing and advances as part of an orderly realisation are held for sale, these assets are recorded as 'Assets held for sale.'

Renegotiated financing

Financing subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as up-to-date financings for measurement purposes once a minimum number of required payments has been received. Where collectively assessed financing and advances portfolios include significant levels of renegotiated financing, these financing are segregated from other parts of the financing and advances portfolio for the purposes of collective impairment assessment to reflect their risk profile.

Financing and advances 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 financing and advances that have been classified as renegotiated retain this classification until maturity or derecognition. A financing and advances 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 financing is substantially a different financial instrument. Any new financing and advances that arise following derecognition events will continue to be disclosed as renegotiated financing and are assessed for impairment as above.

Non-trading reverse repurchase, repurchase and similar agreements

When debt securities are sold subject to a commitment to repurchase them at a predetermined price (repos), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to resell (reverse repos) are not recognised on the balance sheet and an asset is recorded in respect of the initial consideration paid. Non-trading repos and reverse repos are measured at amortised cost. The difference between the sale and repurchase price or between the purchase and resale price is treated as profit and recognised in net financing income over the life of the agreement.

Contracts that are economically equivalent to reverse repurchase or repurchase agreements (such as sales or purchases of debt securities entered into together with total return swaps with the same counterparty) are accounted for similarly to, and presented together with, reverse repurchase or repurchase agreements.

(ii) Financial instruments measured at fair value

Available-for-sale financial assets

Available-for-sale financial assets are recognised on the trade date when the Bank enter into contractual arrangements to purchase them, and are normally derecognised when they are either sold or redeemed. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income until the assets are either sold or become impaired. Upon disposal, the cumulative gains or losses in other comprehensive income are recognised in the income statement as 'Gains less losses from financial investments'.

Impairment of available-for-sale financial assets

Available-for-sale financial assets are assessed at each balance sheet date for objective evidence of impairment. Impairment losses are recognised in the income statement within 'Financing impairment charges and other credit risk provisions' for debt instruments and within 'Gains less losses from financial investments' for equities.

(t) Accounting policies applicable prior to 1 January 2018 (Cont'd)

(ii) Financial instruments measured at fair value (Cont'd)

Available-for-sale debt securities

In assessing objective evidence of impairment at the reporting date, the Bank consider all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in the recovery of future cash flows. A subsequent decline in the fair value of the instrument is recognised in the income statement when there is objective evidence of impairment as a result of decreases in the estimated future cash flows. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, or the instrument is no longer impaired, the impairment loss is reversed through the income statement.

Available-for-sale equity securities

A significant or prolonged decline in the fair value of the equity below its cost is objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the continuous period in which the fair value of the asset has been below its original cost at initial recognition.

All subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised in other comprehensive income. Subsequent decreases in the fair value of the available-for-sale equity security are recognised in the income statement to the extent that further cumulative impairment losses have been incurred. Impairment losses recognised on the equity security are not reversed through the income statement.

Trading assets and trading liabilities

Treasury bills, financing and advances to and from customers, placings with and by banks, debt securities, structured deposits, equity securities, debt securities in issue, certain deposits and short positions in securities which have been acquired or incurred principally for the purpose of selling or repurchasing in the near term, or are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking are classified as held-for-trading. Financial assets or financial liabilities are recognised on trade date, when the Group and the Bank enter into contractual arrangements with counterparties to purchase or sell the financial instruments, and are normally derecognised when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the profit or loss. Subsequently, the fair values are remeasured and gains and losses from changes therein are recognised in the profit or loss within 'Net trading income (Note 4(c))'.

In order to conform with the BNM presentation of the balance sheet to present financial instruments by types rather than by measurement, trading liabilities are not disclosed as a separate item on the face of the balance sheet. They are included into the respective types of financial liabilities instrument categories.

Structured investment/Islamic structured placement is classified as trading liabilities as they are initiated by trading desk for trading and not for funding purpose and the market risk of the embedded derivative is actively managed as part of the trading portfolio.

Financial guarantee contracts

Liabilities under financial guarantee contracts which 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.

Financial guarantee contracts are subsequently measured at the higher of the amount determined in accordance with MFRS 137 'Provisions, contingent liabilities and contingent assets' and the amount initially recognised less cumulative amortisation, where appropriate.

(t) Accounting policies applicable prior to 1 January 2018 (Cont'd)

(iii) Financial instruments designated at fair value

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;
- when 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
- where financial instruments contain one or more non-closely related embedded derivatives.

Designated financial assets are recognised when the bank 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 bank 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/(expense) from financial instruments designated at fair value'. Under this criterion, the main classes of financial instruments designated by the Bank is:

Long-term debt issues

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

5 Financial risk management

a) Introduction and overview

All of the Bank's activities involve analysis, evaluation, acceptance and management of some degree of risk or combination of risks. The Bank has exposure to the following risks from financial instruments:

- credit risk
- liquidity risk
- market risks (includes foreign exchange, profit rate and basis risk)
- operational risks

This note presents information about the Bank's (i) exposure to each of the above risks; (ii) objectives, policies and processes for measuring and managing risk; and (iii) management of capital.

Risk management framework

The Bank's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and limits continually by means of reliable and up-to-date administrative and information systems. The Bank regularly review the risk management policies and systems to reflect changes in markets, products and best practice risk management processes. Training, individual responsibility and accountability, together with a disciplined, conservative and constructive culture of control, lie at the heart of the Bank's management of risk.

The Executive Committee and Board Risk Committee (comprised by Non-Executive Directors, appointed by the Board of Directors), formulate risk management policy, monitor risk and regularly review the effectiveness of the Bank's risk management policies.

The Board Risk Committee is entrusted with the responsibility to oversee Senior Management's activities in managing credit, market, liquidity, operational, legal and other risks and to ensure that the risk management process is in place and functioning. A separate internal Risk Management Meeting made up of EXCO members (in line with the HSBC Group's Enterprise Risk Management Framework) are responsible to oversee and ensure that risk issues across all businesses are appropriately managed, and that adequate controls exist. Additionally, the Bank also have an internal Operational Risk and Governance Working Group to oversee and manage operational risk and ensure that adequate controls are maintained over operational processes.

Day-to-day responsibility for risk management is delegated to senior managers with individual accountability for decision making. All employees have a role to play in risk management. These roles are defined using the three lines of defence model, which takes into account the Bank's business and functional structures.

Top and emerging risks management

The Bank uses a top and emerging risks process to provide a forward looking view of issues that have the potential to threaten the execution of our strategy or operations over the medium to long term.

The Bank proactively assess the internal and external risk environment, as well as review the themes identified across our regions and global businesses, for any risks that may require global escalation, updating our top and emerging risks as necessary.

The Bank defines a 'top risk' as a thematic issue that may form and crystallise between six months and one year, and has the potential to materially affect the Bank's financial results, reputation or business model. It may arise across any combination of risk types, countries or global businesses. The impact may be well understood by senior management and some mitigating actions may already be in place. Stress tests of varying granularity may already have been carried out to assess the impact.

An 'emerging risk' is defined as a thematic issue with large unknown components that may form and crystallise beyond a one year time horizon. If it were to materialise, it could have a significant material effect on a combination of the Bank's long term strategy, profitability and reputation. Existing management action plans are likely to be minimal, reflecting the uncertain nature of these risks at this stage. Some high-level analysis and/or stress testing may have been carried out to assess the potential impact.

5 Financial risk management (Cont'd)

a) Introduction and overview (Cont'd)

Top and emerging risks management (Cont'd)

Our current key top and emerging risks are as follows:
- Adverse credit risk outlook
- Cyber threat and unauthorised access to systems
- Elevated regional political risk
- Financial crime risk environment
- Regulatory developments with adverse impact on business model and profitability
- Impact of organisational change

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b) Credit risk management

Credit risk is the risk that financial loss arises from the failure of a customer or counterparty to meet its payment obligations under a contract. It arises principally from cash and deposit placements, direct lending, trade finance, capital market transactions, guarantees, foreign exchange derivatives and holdings of investment debt securities. The Bank has dedicated standards, policies and procedures to control and monitor all such risks.

Credit risk generates the largest regulatory capital requirement of the risks we incur. The Bank has standards, policies and procedures dedicated to controlling and monitoring risk from all such activities. The Bank's principal credit risk management procedures and policies, which follow policies established by HSBC Group Head Office, include the following:

- Formulating credit policies which are consistent with the Bank credit policy and documenting these in detail in dedicated manuals.
- Establishing and maintaining the Bank's large credit exposure policy. This policy delineates the Bank's maximum exposures to individual customers, customer groups and other risk concentrations.
- Establishing and complying with lending guidelines on the Bank's attitude towards, and appetite for, lending to specified market sectors and industries.
- Undertaking an objective assessment of risk. All commercial non-bank credit facilities originated by the Bank in excess of designated limits are subject to review prior to the facilities being committed to customers.
- Controlling exposures to banks and other financial institutions. The Bank's credit and settlement risk limits to counterparties in the finance and government sectors are designed to optimise the use of credit availability and avoid excessive risk concentration.
- Managing exposures to debt securities by establishing controls in respect of the liquidity of securities held for trading and setting issuer limits for financial investments. Separate portfolio limits are established for asset-backed securities and similar instruments.
- Managing country and cross-border risk where applicable.
- Controlling exposures to selected industries. When necessary, restrictions are imposed on new business, or exposures in the Bank's operating entities are capped.
- Maintaining and developing risk ratings in order to categorise exposures meaningfully and facilitate focused management of the attendant risks. Rating methodology is based upon a wide range of financial analytics together with market data-based tools which are core inputs to the assessment of counterparty risk. Although automated risk-rating processes are increasingly used for the larger facilities, ultimate responsibility for setting risk grades rests in each case with the final approving executive. Risk grades are reviewed frequently and amendments, where necessary, are implemented promptly.

The Bank's members of the Risk Management Meeting (RMM) and HSBC Group Head Office receive regular reports on credit exposures. These include information on large credit exposures, concentrations, industry exposures, levels of impairment provisioning and country exposures.

5 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

The CRO and the respective members of the RMM, under the recommendation of the RMM, has the responsibility for risk approval authorities and approving definitive risk policies and controls. The RMM monitors risk inherent to the financial services business, receives reports, determines action to be taken and reviews the efficacy of the risk management framework.

The Executive Committee (EXCO) and RMM are supported by a dedicated function headed by the Chief Risk Officer, who is a member of both EXCO and RMM and reports to the CEO.

The Risk Committee also has responsibility for oversight and advice to the Board on risk matters. The key responsibilities of the Risk Committee in this regard include preparing advice to the Board on the overall risk appetite tolerance and strategy within the Bank, and seeking such assurance as it may deem appropriate that account has been taken of the current and prospective macroeconomic and financial environment. The Risk Committee is also responsible for the periodic review of the effectiveness of the internal control and risk management frameworks and advising the Board on all high level risk matters. The Risk Committee approves the appointment and removal of the group Chief Risk Officer.

A Credit and Risk Management structure under the Chief Risk Officer, who reports to the CEO, is in place to ensure a more coordinated management of credit risk and a more independent evaluation of credit proposals. The Chief Risk Officer, who also has oversight of credit, market, operational and sustainability risk, has a functional reporting line to the HSBC Asia Pacific Regional Chief Risk Officer.

The Bank has established a credit process involving credit policies, procedures and lending guidelines which are regularly updated and credit approval authorities delegated from the Board of Directors to the Chief Risk Officer who in turn will delegate the credit approval authorities to the credit risk executives. Excesses or deterioration in credit risk grade are monitored on a regular and ongoing basis and at the periodic, normally annual, review of the facility. The objective is to build and maintain risk assets of acceptable quality where risk and return are commensurate. Reports are produced for the RMM, EXCO, Risk Committee and the Board, covering:

- well defined credit risk appetite on business;
- risk concentrations and exposures by industry (main sectors exposures) and portfolio/business;
- single counterparty exposure limit;
- portfolio management exposures by Customer Risk Rating (asset quality by CRR);
- large impaired accounts and impairment allowances;
- early risk identification "Worry & Watch" List trend and Top 10 Distressed names; and
- rescheduled and restructured financing.

The Bank has systems in place to control and monitor the exposure at the customer and counterparty level. A regional Credit Review and Risk Identification (CRRI) team undertakes regular thematic reviews based on a representative sample of accounts to assess the level and trend of portfolio credit risk, integrity of risk rating, quality of credit risk assessment and the approval process as well as quality of credit risk management and control activities. Where risk ratings are considered to be inappropriate, CRRI will discuss with the management and their subsequent recommendations for revised grades must then be assigned to the facilities concerned.

In addition, the regional CRRI team undertakes periodic sampling to assess the quality of credit assessment, integrity of customer risk ratings, quality of management controls, adherence to policy and procedures and use of appropriate approval authority. Furthermore, credit risk surveillance is also undertaken by a local Risk Identification team to identity potential high risk accounts for remedial or mitigating actions to be taken at an early stage.

The Bank's exposure to credit risk is shown in Note 5(b)(vii) and distribution of financial assets by credit quality in Note 5(b)(viii).

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

(i) Credit Risk Profile

The Bank has adopted the requirements of MFRS 9 from 1 January 2018. Under MFRS 9, the scope of impairment now covers amortised cost of financial assets, financing commitments and financial guarantees, as well as debt instruments measured at Fair Value through Other Comprehensive Income (FVOCI). Impairment is calculated in three stages and financial instruments are allocated into one of the three stages where the transfer mechanism depends on whether there is a significant increase in credit risk between its first recognition and the relevant reporting period. After the allocation, the measurement of expected credit loss (ECL), which is the product of probability of default (PD), loss given default (LGD) and exposure at default (EAD), will reflect the change in risk of default occurring over the remaining life of the instruments.

Below provides an overview of the Bank's credit risk by stage. 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.

Unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when they are 30 days past due (DPD) and are transferred from Stage 1 to Stage 2.

- **Credit impaired financings (Stage 3)**

  The Bank defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

  Quantitative criteria

  The borrower is more than 90 days past due on its contractual payments

  Qualitative criteria

  The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. These are instances where:

  - The borrower is in long-term forbearance
  - The borrower is deceased
  - The borrower is insolvent
  - The borrower is in breach of financial covenant(s)
  - An active market for that financial asset has disappeared because of financial difficulties
  - Concessions have been made by the lender relating to the borrower's financial difficulty
  - It is becoming probable that the borrower will enter bankruptcy
  - Financial assets are purchased or originated at a deep discount that reflects the incurred credit losses.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

(i) Credit Risk Profile (Cont'd)

- **Credit deterioration of financial instruments**

Measurement uncertainty and sensitivity analysis of ECL estimates

The recognition and measurement of expected credit loss (ECL) is highly complex and involves the use of significant judgment and estimation. This includes the formulation and incorporation of multiple forward-looking economic conditions into the ECL estimates to meet the measurement objective of MFRS 9.

Methodology for developing forward looking economic scenarios

The Bank has adopted the use of three economic scenarios, which are representative of our view of forecast economic conditions, sufficient to calculate unbiased ECL. They represent a 'most likely outcome', (the Central scenario) and two, less likely, 'Outer' scenarios on either side of the Central, referred to as an 'Upside' and a 'Downside' scenario respectively. Each outer scenario is consistent with a probability of 10%, while the Central scenario is assigned the remaining 80%. This weighting scheme is deemed as appropriate for the computation of unbiased ECL in most economic environments. Setting key scenario assumptions using the average of forecasts from external economists helps to ensure that the MFRS 9 scenarios are unbiased and maximise the use of independent information.

For the Central scenario, key assumptions such as GDP growth, inflation, unemployment and policy rates are set using either the average of external forecasts (commonly referred to as consensus forecasts) for most economies or market prices. An external vendor's global macro model, which is conditioned to follow the consensus forecasts, projects the other paths required as inputs to credit models. This vendor model is subject to HSBC's risk governance framework with oversight by a specialist internal unit. The Upside and Downside scenarios are designed to be cyclical in that GDP growth, inflation and unemployment usually revert back to the Central scenario after the first three years for major economies. The Bank determines the maximum divergence of GDP growth from the Central scenario using the 10th and the 90th percentile of the entire distribution of forecast outcomes for major economies. Using externally available forecast distributions ensures independence in scenario construction. While key economic variables are set with reference to external distributional forecasts, the Bank also aligns the overall narrative of the scenarios to the macroeconomic risks described in HSBC's Top and Emerging Risks. This ensures that scenarios remain consistent with the more qualitative assessment of risks captured in the Top and Emerging Risks. The Bank projects additional variable paths using the external vendor's global macro model.

The Central, Upside and Downside scenarios selected with reference to external forecast distributions using the above approach are termed the 'Consensus Economic Scenarios'. The Bank applies the following to generate the three economic scenarios:

- **Economic Risk Assessment**
  The Bank develops a shortlist of the downside and upside economic and political risks most relevant to HSBC and the MFRS 9 measurement objective. These risks include local and global economic/political risks that together impact on economies that materially matter to HSBC. The Bank compile this list by monitoring developments in the global economy, assessing the risk identified in the Bank's Top and Emerging Risks, and through external and internal consultations with subject matter experts.

- **Scenario Generation**
  For the Central scenario, the Bank obtains a pre-defined set of economic forecasts from the average forecast taken from the Consensus Forecast survey of professional forecasters. Paths for the outer scenarios are benchmarked to the Central scenario and reflect the economic risk assessment. The Bank assigns each path probabilities to reflect the likelihood of occurrence of that scenario. Scenario probabilities reflect management judgment and are informed by data analysis of past recessions (transitions in and out of recession) and the current economic outlook. The scenario probability represents a "best estimate" of the likelihood of occurrence of a scenario, given its key assumptions and scenario paths. Suitable narratives are developed for the Central scenario and the paths of the Outer scenarios.

b) Credit risk management (Cont'd)

(i) Credit Risk Profile (Cont'd)

- **Credit deterioration of financial instruments (Cont'd)**

Variable Enrichment

The Bank expands each scenario through enrichment of variables by using as inputs the agreed scenario narratives and the variables aligned to these narratives. Scenarios, once expanded, continue to be benchmarked to the latest events and information. Late breaking events could lead to revision of scenarios to reflect management judgment or a management adjustment.

The Bank 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. We anticipate there will be only limited instances when the standard approach will not apply.

- **Consensus Scenarios (average 2018 – 2022)**

	Scenario		
	Central (%)	Upside (%)	Downside (%)
GDP growth rate	4.8	5.2	4.4
Inflation	2.4	2.7	2.1
Unemployment	3.2	3.0	3.4
Short term profit rate	3.9	4.1	2.7
Property price growth	5.8	6.3	4.6
Probability	80.0	10.0	10.0

- **How economic scenarios are reflected in the Wholesale calculation of ECL**

HSBC has developed a globally consistent methodology for the application of Forward Economic Guidance (FEG) into the calculation of ECL by incorporating FEG into the estimation of the term structure of Probability of Default (PD) and Loss Given Default (LGD). For PDs, the Bank considers the correlation of FEG to default rates for a particular industry. For LGD calculations, we consider the correlation of FEG to collateral values and realisation rates for Malaysia and industry. PDs and LGDs are estimated for the entire term structure of each instrument.

For impaired financings, LGD estimates take into account independent recovery valuations provided by external consultants where available, or internal forecasts corresponding to anticipated economic conditions and individual company conditions. In estimating the ECL on impaired financings that are individually considered not to be significant, the Bank incorporates FEG proportionate to the probability-weighted outcome and the Central scenario outcome for non-stage 3 populations.

- **How economic scenarios are reflected in the Retail calculation of ECL**

HSBC has developed and implemented a globally consistent methodology for incorporating forecasts of future economic conditions into ECL estimates. The impact of FEG on PD is modelled at a portfolio level. Historic relationships between observed default rates and macro-economic variables are integrated into MFRS 9 ECL estimates by leveraging economic response models. The impact of FEG on PD is modelled over a period equal to the remaining maturity of underlying asset(s). The impact on LGD is modelled for house financing portfolios by forecasting future financing-to-value profiles for the remaining maturity of the asset by leveraging national level forecasts of the property price index (PPI) and applying the corresponding LGD expectation.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

(i) Credit Risk Profile (Cont'd)

- **Impact of multiple economic scenarios on ECL**

The ECL recognised in the financial statements (the MFRS 9 ECL) reflects the effect on expected credit losses of a range of possible outcomes, calculated on a probability-weighted basis, based on the economic scenarios described above, including management adjustments where required. The probability weighted amount is typically a higher number than would result from using only the Central (most likely) Economic Scenario. Expected losses typically have a non-linear relationship to the many factors which influence credit losses such that more favourable macro-economic factors do not reduce defaults as much as less favourable macro-economic factors increase defaults. Currently, the effect of non-linearity is not significant to ECL.

- **Economic scenarios sensitivity analysis of ECL estimates**

The ECL outcome is sensitive to judgment and estimations made with regards to the formulation and incorporation of multiple forward looking economic conditions described above. As a result, management assessed and considered the sensitivity of the ECL outcome against the forward looking economic conditions as part of the ECL governance process by recalculating the ECL for selected portfolios where 100% weighting is assigned to each of the three scenarios described above. The weighting is reflected in both the determination of significant increase in credit risk as well as the measurement of the resulting ECL. This analysis excludes any management adjustment.

The three economic scenarios are generated to capture HSBC's view of a range of possible forecast economic conditions that is sufficient for the calculation of unbiased and probability-weighted ECL. Therefore, the ECLs calculated for each of the scenarios represent a range of possible outcomes that is being evaluated while arriving at the ECL. As a result, the ECL calculated for the Upside and Downside scenarios should not be taken to represent the upper and lower limits of possible actual ECL outcomes. The ECL sensitivity below represents an estimate based on the underlying point-in-time distribution of economic scenarios which have the potential to change rapidly as economic conditions evolve in the various geographies in which we operate. The recalculated ECLs for each of the scenarios should be read in the context of the sensitivity analysis as a whole and in conjunction with the narrative disclosures provided below.

- **Wholesale analysis**

The portfolios below were selected based on contribution to ECL and sensitivity to macro economic factors.

MFRS 9 ECL sensitivity to future economic conditions [1]

ECL coverage of financial instruments subject to significant measurement uncertainty at 31 December 2018 [2]	**HBMS**
Reported ECL (RM'000)	9,571
Gross carrying/nominal amount [3] (RM'000)	14,212,188
Reported ECL Coverage (%)	0.07 %
Coverage Ratios by Scenario (%)	
Consensus central scenario	0.07 %
Consensus upside scenario	0.06 %
Consensus downside scenario	0.07 %

[1]Excludes ECL and financial instruments relating to defaulted obligors because the measurement of ECL is relatively more sensitive to credit factors specific to the obligor then future economic scenario.
[2]Includes off balance sheet financial instruments that are subject to significant measurement uncertainty.
[3]Includes low credit risk financial instruments such as Debt instruments at FVOCI which have low ECL coverage ratios under all the above scenarios. Coverage ratios on financing and advances to customers including financing commitments and financial guarantees are typically higher.

Changes to economic forecasts, underlying credit quality and relationships between macro-economic factors and credit risk will have a corresponding impact on ECL.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

(i) Credit Risk Profile (Cont'd)

- **Retail analysis**

MFRS 9 ECL sensitivity to future economic conditions [1]

ECL coverage of financing and advances at 31 December 2018 [2]	HBMS
Reported ECL (RM'000)	184,650
Gross Carrying Amount (RM'000)	6,345,715
Reported ECL Coverage (%)	2.91 %
Coverage Ratios by Scenario (%)	
Consensus central scenario	2.89 %
Consensus upside scenario	2.60 %
Consensus downside scenario	3.22 %

[1]ECL sensitivities excludes portfolios utilising less complex modelling approaches.
[2]ECL sensitivity includes only on balance sheet financial instruments to which MFRS 9 impairment requirements are applied.

The retail ECL sensitivity on a relative basis represents the differences in economic distribution and historical correlations to economic variables. The retail ECL sensitivity on absolute basis is largely a reflection of differences in level of credit quality across the Bank. As economic forecasts, historical economic variable correlations or credit quality changes this will have a corresponding change in the ECL sensitivity above.

(ii) Collateral held as security

Although collateral can be an important mitigant of credit risk, it is the Bank's general practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured. For other lending, a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of default, the Bank may use the collateral as a source of repayment.

The Bank does not disclose the fair value of collateral held as security or other credit enhancements on advances and financing past due but not impaired, or on individually assessed advances and financing, as it is not practicable to do so. The financial effect of collateral (quantification of the extent to which collateral and other credit enhancements mitigate credit risk) held for impaired advances and financing for the Bank as at 31 December 2018 are 48.1% (2017: 55.0%). The financial effect of collateral held for other remaining on-balance sheet financial assets is not significant.

Collateral especially properties are made available for sale in an orderly fashion, with the proceeds used to reduce or repay the outstanding indebtedness. If excess funds arise after the debt/financing has been repaid, they are made available either to repay other secured lenders/financier with lower priority or are returned to the customer. The Bank does not generally occupy repossessed properties for its business use.

(iii) Concentration of credit risk

The Bank monitors concentration of credit risk by sector and geographical location. The analysis of concentration of credit risk from advances and financing to customers is shown in Notes 10(v) and 10(vii). The analysis of concentration of credit risk from the Bank's financial assets is shown in Note 5(b)(viii).

(iv) Derivatives

As part of the risk management practices arising from derivatives activity, the Bank will enter into legally enforceable arrangements with its counterparties. The Bank will either (a) enter into a master agreement which (i) provides for a contractual framework within which dealing activity across a full range of OTC products is conducted, and (ii) contractually binds both parties to apply close-out netting across all outstanding transactions covered by the master agreement if either party defaults or another pre-agreed termination event occurs, or (b) specifically in respect of FX forward-i only, the Bank will enter into a master Wa'ad (undertaking) arrangement with its counterparties.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

(v) Stress testing

HSBC operates a comprehensive stress testing programme that supports our risk management and capital planning. It includes execution of stress tests mandated by our regulators, as well as internal stress tests and reverse stress tests. Our stress testing is carried out within a robust governance framework, overseen at the most senior level of the Bank.

Our stress testing programme assesses our capital strength through a rigorous examination of our resilience to external shocks. It also helps us understand and mitigate risks and informs our decisions about capital levels.

Internal stress tests are an important element in our risk management and capital management frameworks. Our capital plan is assessed through a range of stress scenarios which explore risks identified by management. They include potential adverse macroeconomic, geopolitical and operational risk events, and other potential events that are specific to the Bank. The selection of scenarios reflects our top and emerging risks identification process and our risk appetite. Stress testing analysis helps management understand the nature and extent of vulnerabilities to which the Bank is exposed. Using this information, management decides whether risks can or should be mitigated through management actions or, if they were to crystallise, should be absorbed through capital. This in turn informs decisions about preferred capital levels.

Reverse stress tests are conducted annually at the Bank in order to understand which potential extreme conditions would make our business model nonviable. Reverse stress testing identifies potential stresses and vulnerabilities which the Bank might face, and helps inform early warning triggers, management actions and contingency plans designed to mitigate risks.

(vi) Offsetting financial assets and liabilities

The disclosures set out in the table below include financial assets and financial liabilities that are subject to an enforceable master netting agreement, irrespective of whether they are offset in the statement of financial position. Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position 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 liability simultaneously (the offset criteria). During the financial year, no financial assets or financial liabilities were offset in the statement of financial position because the ISDA does not meet the criteria for offsetting in the statement of financial position. The ISDA creates for the parties to the agreement, a right of set off of recognised amounts that is enforceable only following an event of default, insolvency or bankruptcy of the Bank, or its counterparties. Financial instruments subject to offsetting, enforceable master netting agreements and similar agreements are shown as follows:

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

b) Credit Risk Management (Cont'd)

(vi) Offsetting financial assets and liabilities (Cont'd)

	(i)	(ii)	(iii) = (i) + (ii)	(iv)a	(iv)b	(v) = (iii) - (iv)
				Gross amounts not offset in the statement of financial position		
Description	Gross amounts of recognised assets RM'000	Gross amounts offset in the statement of financial position RM'000	Net amount of assets presented in the statement of financial position RM'000	Financial instruments RM'000	Cash collateral received RM'000	Net amount RM'000
2018						
Bank						
Derivative financial assets	**242,284**	**-**	**242,284**	**-**	**-**	**242,284**
Derivative financial liabilities	**227,330**	**-**	**227,330**	**-**	**-**	**227,330**
2017						
Bank						
Derivative financial assets	278,472	-	278,472	-	-	278,472
Derivative financial liabilities	265,402	-	265,402	-	-	265,402

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

(vii) Exposure to credit risk

The Bank 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 MFRS 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 MFRS 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 above each encompass a range of granular internal credit rating grades assigned to wholesale and retail lending businesses and the external ratings attributed by external agencies to debt securities, as shown below. Under IAS 39, retail lending credit quality was disclosed based on expected-loss percentages. Under MFRS 9 retail lending credit quality is now disclosed based on a 12-month probability-weighted PD. The credit quality classifications for wholesale lending are unchanged and are based on internal credit risk ratings.

Credit quality of debt securities and other bills	**External Credit Rating [1]**
Strong	A- and above
Good	BBB+ and BBB-
Satisfactory	BB+ to B and unrated
Sub-standard	B- to C
Impaired	D

Credit quality of corporate financing/derivative financial assets/ deposits and placements with banks and other financial institutions	**Internal Credit Rating**	**12-month Basel probability of default %**
Strong	CRR1 - CRR2	0.000–0.169
Good	CRR3	0.170–0.740
Satisfactory	CRR4 - CRR5	0.741–4.914
Sub-standard	CRR6 - CRR8	4.915–99.999
Impaired	CRR9 - CRR10	100

Credit quality of retail financing	**Internal Credit Rating**	**12-month Basel probability of default %**
Strong	Band 1 and 2	0.000–0.500
Medium-good	Band 3	0.501–1.500
Medium-satisfactory	Band 4 and 5	1.501–20.000
Sub-standard	Band 6	20.001-99.999
Impaired	Band 7	100

[1] External ratings have been aligned to the five quality classifications. The ratings of Standard and Poor's are cited, with those of other agencies being treated equivalently.

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.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

b) Credit Risk Management (Cont'd)

(viii) Distribution of financial assets by credit quality

(RM'000)	Gross Carrying Amount Strong	Good	Satisfactory	Sub-standard	Credit Impaired	Total	ECL allowances	Carrying amount (net of impairment provision)
Cash and short-term funds	**2,804,496**	**-**	**-**	**-**	**-**	**2,804,496**	**(2)**	**2,804,494**
Financial assets at FVOCI	**2,725,683**	**-**	**-**	**-**	**-**	**2,725,683**	**-**	**2,725,683**
Financing and advances to customers held at amortised cost	**3,554,164**	**5,236,751**	**4,743,977**	**512,554**	**398,425**	**14,445,871**	**(308,534)**	**14,137,337**
of which:								
- retail	***1,648,862***	***2,429,454***	***2,200,845***	***237,786***	***184,839***	***6,701,786***	**(262,343)**	***6,439,443***
- corporate and commercial	***1,905,302***	***2,807,297***	***2,543,132***	***274,768***	***213,586***	***7,744,085***	**(46,191)**	***7,697,894***
Derivatives financial assets	**81,907**	**9**	**160,325**	**43**	**-**	**242,284**	**-**	**242,284**
Other financial assets	**33,097**	**-**	**-**	**-**	**-**	**33,097**	**-**	**33,097**
Financial guarantees contracts	**174,420**	**59,535**	**181,142**	**51,100**	**1,951**	**468,148**	**(1,245)**	**466,903**

5 Financial risk management (Cont'd)

c) Liquidity and funding risk management

Liquidity risk is the risk that the Bank does not have sufficient financial resources to meet their obligations when they fall due, or will have to do it at excessive cost. This risk can arise from mismatches in the timing of cash flows. Funding risk is the risk that funding considered to be sustainable, and therefore used to fund assets, is not sustainable over time. Funding risk arises when the necessary liquidity to fund illiquid asset positions cannot be obtained at the expected terms and when required.

The Bank maintains a diversified and stable funding base comprising core retail and corporate customer deposits and institutional balances. This is augmented by wholesale funding and portfolios of highly liquid assets. The objective of the Bank's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due and that wholesale market access is coordinated and cost effective.

Current accounts and savings deposits payable on demand or at short notice form a significant part of HSBC Group's funding, and the Bank place considerable importance on maintaining their stability. For deposits, stability depends upon preserving depositor confidence in the Bank's capital strength and liquidity, and on competitive and transparent pricing. In aggregate, the Bank is net liquidity providers to the interbank market, placing significantly more funds with other banks than it borrows.

The management of liquidity and funding is primarily carried out through HSBC Group's liquidity and funding risk framework (LFRF) and BNM's Liquidity Coverage Ratio Framework. Limits are proposed by Asset, Liability and Capital Management (ALCM) through the RMM and approved by the Board. These limits vary to take account of the depth and liquidity of the local market in which the Bank operates. The Bank maintains strong liquidity positions and manage the liquidity profile of the assets, liabilities and commitments to ensure that cash flows are appropriately balanced and all obligations are met when due.

- The Asset and Liability Committee (ALCO) is responsible for managing all ALCM issues including liquidity and funding risk management. Compliance with liquidity and funding requirements is monitored by ALCO through the following processes: maintaining compliance with relevant regulatory requirements of the operating entity;
- projecting cash flows under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- monitoring liquidity and funding ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- managing the concentration and profile of term funding;
- managing contingent liquidity commitment exposures within predetermined limits;
- maintaining debt financing plans;
- monitoring of depositor concentration in order to avoid undue reliance on large individual depositors and ensuring a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises, while minimising adverse long-term implications for the business.

The HSBC Group's LFRF uses the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) regulatory framework as a foundation, but adds extra metrics, limits and overlays to address the risks that we consider are not adequately reflected by the regulatory framework.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

c) Liquidity and funding risk management (Cont'd)

The LFRF is delivered using the following key aspects:

- standalone management of liquidity and funding by operating entity;
- operating entity classification by inherent liquidity risk (ILR) categorisation;
- legal entity minimum LCR requirement;
- legal entity minimum NSFR requirement;
- legal entity depositor concentration limit;
- three-month and 12-month cumulative rolling term contractual maturity limits covering deposits from banks, deposits from non-bank financial institutions and securities issued;
- annual individual liquidity adequacy assessment (ILAA) by principal operating entity;
- minimum LCR requirement by currency;
- intraday liquidity; and
- forward-looking funding assessments.

The two key objectives of the ILAA process are to:

- demonstrate that all material liquidity and funding risks are captured within the internal framework; and
- forms the basis of the operating entity's risk tolerance/appetite setting and assessment of vulnerabilities through the use of severe stress scenarios.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

c) Liquidity and funding risk management (Cont’d)

(i) Liquidity risk

The following tables summarise the Bank's exposure to liquidity risk. The asset and liabilities at carrying amount are allocated to time bands by reference to the remaining contractual maturity and/or their behavioural profile.

	Non-trading book							
31 December 2018	**Up to 1 month RM'000**	**>1 - 3 months RM'000**	**>3 - 12 months RM'000**	**1 - 5 years RM'000**	**Over 5 years RM'000**	**Non-specific maturity RM'000**	**Trading book RM'000**	**Total RM'000**
ASSETS								
Cash and short-term funds	2,804,494	-	-	-	-	-	-	2,804,494
Financial investments at FVOCI	-	199,314	741,131	1,785,238	-	-	-	2,725,683
Financing and advances	3,013,962	1,502,192	1,287,475	2,421,226	5,912,482	-	-	14,137,337
Derivative financial assets	-	-	-	-	-	-	242,284	242,284
Others	587	-	6,314	14,842	-	414,383	3,431	439,557
Total Assets	5,819,043	1,701,506	2,034,920	4,221,306	5,912,482	414,383	245,715	20,349,355
LIABILITIES AND EQUITY								
Deposits from customers	6,443,475	2,251,387	2,409,787	339,898	30	-	-	11,444,577
Deposits and placements from banks and other financial institutions	988,238	275,195	630,865	1,405,666	-	-	-	3,299,964
Structured liabilities designated as FVTPL	-	-	129,938	747,422	7,517	-	-	884,877
Bills payable	18,594	-	-	-	-	-	-	18,594
Multi-Currency Sukuk Programme	-	-	501,173	1,254,108	-	-	-	1,755,281
Subordinated Commodity Murabahah Financing	-	-	-	-	595,987	-	-	595,987
Derivative financial liabilities	56	-	-	-	-	-	227,274	227,330
Others	98,088	19,887	27,227	22,765	307	132,206	-	300,480
Total Liabilities	7,548,451	2,546,469	3,698,990	3,769,859	603,841	132,206	227,274	18,527,090
Equity	-	-	-	-	-	1,822,265	-	1,822,265
Total Liabilities and Equity	7,548,451	2,546,469	3,698,990	3,769,859	603,841	1,954,471	227,274	20,349,355
Net maturity mismatches	(1,729,408)	(844,963)	(1,664,070)	451,447	5,308,641	(1,540,088)	18,441	-
Off balance sheet liabilities	10,622,773	1,702,398	7,166,015	3,420,467	251,255	-	-	23,162,908

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

c) Liquidity and funding risk management (Cont'd)

(i) Liquidity risk (Cont'd)

31 December 2017	Non-trading book							
	Up to 1 month RM'000	>1 - 3 months RM'000	>3 - 12 months RM'000	1 - 5 years RM'000	Over 5 years RM'000	Non-specific maturity RM'000	Trading book RM'000	Total RM'000
ASSETS								
Cash and short-term funds	1,465,919	-	-	-	-	-	-	1,465,919
Financial investments available-for-sale	-	174,019	512,989	1,534,036	-	-	-	2,221,044
Financing and advances	2,823,275	2,319,783	635,314	1,835,313	5,770,118	-	-	13,383,803
Derivative financial assets	-	-	-	-	-	-	278,472	278,472
Others	1,296	-	5,070	11,820	-	408,316	-	426,502
Total Assets	4,290,490	2,493,802	1,153,373	3,381,169	5,770,118	408,316	278,472	17,775,740
LIABILITIES AND EQUITY								
Deposits from customers	6,233,846	1,727,319	1,932,894	140,466	-	-	-	10,034,525
Deposits and placements from banks and other financial institutions	57,780	1,193,434	1,184,845	925,880	-	-	-	3,361,939
Bills payable	16,678	-	-	-	-	-	-	16,678
Multi-Currency Sukuk Programme	-	-	-	1,252,829	-	-	-	1,252,829
Subordinated Commodity Murabahah Financing	-	-	-	-	583,598	-	-	583,598
Derivative financial liabilities	-	26	130	335	-	-	264,911	265,402
Others	197,429	18,854	22,660	16,693	2,371	103,514	282,920	644,441
Total Liabilities	6,505,733	2,939,633	3,140,529	2,336,203	585,969	103,514	547,831	16,159,412
Equity	-	-	-	-	-	1,616,328	-	1,616,328
Total Liabilities and Equity	6,505,733	2,939,633	3,140,529	2,336,203	585,969	1,719,842	547,831	17,775,740
Net maturity mismatches	(2,215,243)	(445,831)	(1,987,156)	1,044,966	5,184,149	(1,311,526)	(269,359)	-
Off balance sheet liabilities	8,854,088	1,185,687	3,636,501	6,568,024	257,438	-	-	20,501,738

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

c) Liquidity and funding risk management (Cont'd)

The balances in the tables below will not agree directly with the balances in the statement of financial position as the table incorporates, on an undiscounted basis, all cash flows relating to principal and future coupon payments. In addition, financing and other credit-related commitments and financial guarantees and similar contracts are generally not recognised on the statement of financial position.

Cash flows payable in respect of customer accounts are primarily contractually repayable on demand or at short notice. However, in practice, short term deposit balances remain stable as inflows and outflows broadly match and a significant portion of financing commitments expire without being drawn upon.

(ii) Cash flows payable by the Bank under financial liabilities by remaining contractual maturities

RM'000	On Demand	Due within 3 months	Due between 3 months to 12 months	Due between 1 and 5 years	Due after 5 years	Total
At 31 December 2018						
Non-derivative liabilities						
Deposits by customers	**3,655,489**	**5,151,954**	**2,390,848**	**387,006**	**-**	**11,585,297**
Deposits and placements from banks and other financial institutions	**-**	**1,270,508**	**641,464**	**1,531,614**	**-**	**3,443,586**
Structured liabilities designated at fair value through profit or loss (FVTPL)	**-**	**-**	**118,461**	**839,711**	**-**	**958,172**
Bills payable	**18,594**	**-**	**-**	**-**	**-**	**18,594**
Multi-Currency Sukuk Programme	**-**	**10,513**	**553,287**	**1,346,630**	**-**	**1,910,430**
Subordinated Commodity Murabahah financing	**-**	**7,153**	**21,861**	**113,166**	**626,400**	**768,580**
Other liabilities	**106,310**	**41,009**	**20,715**	**3,350**	**85,241**	**256,625**
Financing and other credit-related commitments	**6,746,349**	**181,241**	**1,532,485**	**65,446**	**-**	**8,525,521**
Financial guarantees and similar contracts	**76,439**	**215,209**	**707,739**	**675,607**	**18,510**	**1,693,504**
	10,603,181	**6,877,587**	**5,986,860**	**4,962,530**	**730,151**	**29,160,309**
Derivative liabilities						
Gross settled derivatives						
- Inflow	**-**	**(2,897,779)**	**(1,672,299)**	**(308,571)**	**-**	**(4,878,649)**
- Outflow	**-**	**2,923,806**	**1,825,294**	**355,936**	**-**	**5,105,036**
Net settled derivatives	**-**	**299**	**631**	**-**	**-**	**930**

RM'000	On Demand	Due within 3 months	Due between 3 months to 12 months	Due between 1 and 5 years	Due after 5 years	Total
At 31 December 2017						
Non-derivative liabilities						
Deposits by customers	3,839,280	4,174,030	1,952,420	156,802	-	10,122,532
Deposits and placements from banks and other financial institutions	-	1,258,347	1,205,106	1,010,320	-	3,473,773
Bills payable	16,678	-	-	-	-	16,678
Multi-Currency Sukuk Programme	-	10,463	31,737	1,302,721	-	1,344,921
Subordinated Commodity Murabahah financing	-	7,246	15,782	83,729	623,495	730,252
Other liabilities	211,284	28,814	13,649	1,437	394,894	650,078
Financing and other credit-related commitments	7,692,240	267,022	1,164,750	3,474	-	9,127,486
Financial guarantees and similar contracts	98,206	228,640	565,790	644,632	3,534	1,540,802
	11,857,688	5,974,562	4,949,234	3,203,115	1,021,923	27,006,522
Derivative liabilities						
Gross settled derivatives						
- Inflow	-	(801,981)	(825,181)	(1,134,413)	-	(2,761,575)
- Outflow	-	859,718	876,365	1,280,061	-	3,016,144
Net settled derivatives	-	705	2,824	1,822	-	5,351

d) Market risk management

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

The objective of the Bank's market risk management is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the HSBC Group's status as one of the world's largest banking and financial services organisation.

There were no significant changes to the Bank's policies and practices for the management of market risk in 2018.

The Bank separates exposures to market risk into either trading or non-trading portfolios. Trading portfolios comprise positions arising from market-making and warehousing of customer-derived positions. Non-trading portfolios primarily arise from the profit rate management of the Bank's retail and commercial banking assets and liabilities, and financial investments designated as available-for-sale and held to maturity.

The nature of the hedging and risk mitigation strategies performed across the Bank corresponds to the market risk management instruments available within each operating jurisdiction. These strategies range from the use of traditional market instruments, such as profit rate swaps, to more sophisticated hedging strategies to address a combination of risk factors arising at portfolio level.

The management of market risk is principally undertaken using risk limit mandates approved by HSBC's Regional and Global Wholesale Credit and Market Risk Management (WCMR), an independent unit which develops HSBC Group's market risk management policies and measurement techniques. Market risks which arise on each product are transferred to the Global Markets. The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to manage such risks professionally. Limits are set for portfolios, products and risk types, with market liquidity and business need being the principal factor in determining the level of limits set. The Bank has an independent product control function that is responsible for measuring market risk exposures in accordance with the policies defined by WCMR. Positions are monitored daily and excesses against the prescribed limits are reported immediately to local Senior Management and WCMR.

Market risk in the trading portfolio is monitored and controlled at both portfolio and position levels using a complementary set of techniques such as sensitivity analysis, value at risk (VAR) and stress testing. Other controls to contain trading portfolio market risk at an acceptable level include rigorous new product approval procedures and a list of permissible instruments to be traded.

(i) Sensitivity Analysis

Sensitivity analysis measures the impact of individual market factor movements on specific instruments or portfolios including profit rates, foreign exchange rates and equity prices, for example, the impact of a one basis point change in yield. We use sensitivity measures to monitor the market risk positions within each risk type.

Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

(ii) Value at risk (VAR)

VAR is a technique that estimates the potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. The use of VAR is integrated into market risk management and is calculated for all trading positions regardless of how the Bank capitalises those exposures. Where there is no approved internal model, the Bank uses the appropriate local rules to capitalise exposures.

d) Market risk management (Cont'd)

(ii) Value at risk (VAR) (Cont'd)

In addition, the Bank calculates VAR for non-trading portfolios in order to have a complete picture of market risk. Where VAR is not calculated explicitly, alternative tools are used as summarised in the Market Risk stress testing section below.

The VAR models used by the Bank is predominantly based on historical simulation which incorporate the following features:

- historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, profit rates, equity prices and the associated volatilities;
- potential market movements utilised for VAR are calculated with reference to data from the past two years; and
- VAR measures are calculated to a 99 per cent confidence level and use a one-day holding period.

The models also incorporate the effect of option features on the underlying exposures. The nature of the VAR models means that an increase in observed market volatility will lead to an increase in VAR without any changes in the underlying positions.

The Bank routinely validate the accuracy of their VAR models by back-testing them against both actual and hypothetical profit and loss against the trading VAR numbers. Hypothetical profit and loss excludes non-modelled items such as fees, commissions and revenues of intra-day transactions. Statistically, the Bank would expect to see losses in excess of VAR only 1 per cent of the time over a one-year period. The actual number of excesses over this period can therefore be used to gauge how well the models are performing.

A summary of the VAR position of the Bank's trading portfolio at the reporting date is as follows:

RM'000	**At 31 December 2018**	**Average**	**Maximum**	**Minimum**
Foreign currency risk	**68**	**65**	**384**	**5**
Profit rate risk	**52**	**74**	**114**	**20**
Credit spread risk	**-**	**6**	**93**	**-**
Overall	**77**	**109**	**385**	**34**

RM'000	At 31 December 2017	Average	Maximum	Minimum
Foreign currency risk	36	48	112	8
Profit rate risk	22	28	35	4
Credit spread risk	-	-	-	-
Overall	52	621	135	25

Although a valuable guide to risk, VAR should always be viewed in the context of its limitations. For example:

- the use of 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 1-day holding period assumes that all positions can be liquidated or the risks offset during that period. This may not fully reflect the market risk arising at times of severe illiquidity, when a 1-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

d) Market risk management (Cont'd)

(iii) Exposure to profit rate risk – non trading portfolios

Profit rate risk or Rate of Return risk in the Banking book (PRR/RORBB) is defined as the exposure of the non-trading products of the Bank to profit rates. Non-trading portfolios are subject to prospective profit rate movements which could reduce future net finance income. Non-trading portfolios include positions that arise from the profit rate management of the Bank's retail and commercial banking assets and liabilities, and financial investments designated as available for sale. The risk arises from timing mismatches in the repricing of non-traded assets and liabilities and is the potential adverse impact of changes in profit rates on earnings and capital. Analysis of this risk is complicated by having to make assumptions within certain product areas such as the incidence of financing prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts.

In order to manage this structural profit rate risk, the non-traded assets asset is transferred to Balance Sheet Management based on their repricing and maturity characteristics. For assets and liabilities with no defined maturity or repricing characteristics, behaviouralisation is used to assess the profit rate risk profile. Behavioural assumptions for products with no contractual maturity are normally based on a two-year historical trend. These assumptions are important as they reflect the underlying profit rate risk of the products and hence are subject to scrutiny from ALCO. The net exposure is monitored against the limits granted by regional WCMR for the respective portfolios and, depending on the view on future market movement, economically hedged with the use of financial instruments within agreed limits.

The Bank manages market risk in non-trading portfolios by monitoring the sensitivity of projected net finance income under varying profit rate scenarios (simulation modeling), where all other economic variables are held constant. For simulation modeling, a combination of standard scenarios and non-standard scenarios relevant to the local market are used.

The standard scenarios monitored monthly include a 100 basis points parallel fall or rise in profit rates and a 25 basis points fall or rise in profit rates at the beginning of each quarter for the next 12 months.

The scenarios assume no management action. Hence, they do not incorporate actions that would be taken by the business units to mitigate the impact of the profit rate risk. In reality, the business units would proactively seek to change the profit rate profile to minimise losses and to optimise net revenues. Other simplifying assumptions are made, including that all positions run to maturity.

The profit rate sensitivities set out in the table below are illustrative only and are based on simplified scenarios.

a) Sensitivity of projected Net Finance Income

Change in projected finance income in next 12 months arising from a shift in profit rates of:

	RM'000			
	31 Dec 18		31 Dec 17	
Basis point parallel shift in yield curve	***+100bps***	***-100bps***	*+100bps*	***-100bps***
RM	**(14,977)**	**8,821**	(29,797)	18,274
USD	**12,756**	**(15,108)**	8,462	(9,966)
Others	**6,692**	**(8,568)**	(432)	(495)
	4,471	**(14,855)**	(21,767)	7,813

d) Market risk management (Cont'd)

(iii) Sensitivity of projected Net Finance Income (Cont'd)

b) Sensitivity of projected Economic value of equity

Change in projected economic value of equity arising from a shift in profit rates of:

	RM'000			
	31 Dec 18		31 Dec 17	
Basis point parallel shift in yield curve	***+200bps***	***-200bps***	*+200bps*	***-200bps***
RM	**(66,400)**	**82,614**	(85,346)	98,501
USD	**3,242**	**(5,433)**	(368)	(1,732)
Others	**564**	**10**	(678)	887
	(62,594)	**77,191**	(86,392)	97,656

(c) Sensitivity of reported reserves in "other comprehensive income" to profit rate movements

Sensitivity of reported reserves in "other comprehensive income" to profit rate movements are monitored on a monthly basis by assessing the expected reduction in valuation of available-for-sale portfolios and cash flow hedges to parallel movements of plus or minus 100 basis points in all yield curves.

	RM'000			
	31 Dec 18		31 Dec 17	
Basis point parallel shift in yield curve	***+100bps***	***-100bps***	*+100bps*	*-100bps*
RM	**(36,330)**	**36,330**	(35,388)	35,388

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

d) Market risk management (Cont'd)

(iv) Foreign exchange risk

Foreign exchange risk arises as a result of movements in the relative value of currencies. In addition to VAR and stress testing, the Bank controls the foreign exchange risk within the trading portfolio by limiting the open exposure to individual currencies, and on an aggregate basis.

	RM'000			
	31 Dec 18		31 Dec 17	
Appreciation/depreciation	***+1%***	***-1%***	*+1%*	*-1%*
Impact to profit after income tax expense	**93**	**(93)**	(26)	26

Change in foreign exchange rate has no significant impact to other comprehensive income for the financial year ended 31 December 2018 and 31 December 2017.

The Bank measures the foreign exchange sensitivity based on the foreign exchange net open positions (including foreign exchange structural position) under an adverse movement in all foreign currencies against the functional currency – RM. The result implies that the Bank may be subject to additional translation (losses)/gains if the RM appreciates against other currencies and vice versa.

5 Financial risk management (Cont'd)

d) Market risk management (Cont'd)

(v) Profit Rate Risk

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market profit rates on its financial position and cash flows. The following table summarises the Bank's exposure to the profit rates risk. The assets and liabilities at carrying amount are allocated to time bands by reference to the earlier of the next contractual repricing dates and maturity dates.

	Non-trading book								
31 December 2018	**Up to 1 month RM'000**	**>1 - 3 months RM'000**	**>3 - 12 months RM'000**	**1 - 5 years RM'000**	**Over 5 years RM'000**	**Non-profit sensitive RM'000**	**Trading book RM'000**	**Total RM'000**	**Effective profit rate %**
ASSETS									
Cash and short-term funds	**2,705,038**	**-**	**-**	**-**	**-**	**99,458**	**-**	**2,804,496**	**3.45**
- impairment allowances	**-**	**-**	**-**	**-**	**-**	**(2)**	**-**	**(2)**	**-**
Financial investments at FVOCI	**-**	**199,314**	**741,131**	**1,785,238**	**-**	**-**	**-**	**2,725,683**	**3.50**
Financing and advances									
- performing	**5,145,794**	**7,755,853**	**186,969**	**578,739**	**348,203**	**-**	**-**	**14,015,558**	**5.44**
- impaired[1]	**-**	**-**	**-**	**-**	**-**	**430,313**	**-**	**430,313**	**-**
- impairment allowances	**-**	**-**	**-**	**-**	**-**	**(308,534)**	**-**	**(308,534)**	**-**
Derivative financial assets	**-**	**-**	**-**	**-**	**-**	**-**	**242,284**	**242,284**	**-**
Other assets	**-**	**-**	**-**	**-**	**-**	**29,666**	**3,431**	**33,097**	**-**
Total Financial Assets	**7,850,832**	**7,955,167**	**928,100**	**2,363,977**	**348,203**	**250,901**	**245,715**	**19,942,895**	
LIABILITIES									
Deposits from customers	**5,737,514**	**2,251,387**	**2,409,787**	**339,898**	**30**	**705,961**	**-**	**11,444,577**	**2.66**
Deposits and placements from banks and other financial institutions	**963,798**	**275,195**	**630,865**	**1,405,666**	**-**	**24,440**	**-**	**3,299,964**	**2.24**
Structured liabilities designated as FVTPL	**-**	**-**	**129,938**	**747,422**	**7,517**	**-**	**-**	**884,877**	**3.78**
Bills payable	**-**	**-**	**-**	**-**	**-**	**18,594**	**-**	**18,594**	**-**
Multi-Currency Sukuk Programme	**-**	**-**	**501,173**	**1,254,108**	**-**	**-**	**-**	**1,755,281**	**4.02**
Subordinated Commodity Murabahah Financing	**-**	**-**	**-**	**-**	**595,987**	**-**	**-**	**595,987**	**4.32**
Derivative financial liabilities	**56**	**-**	**-**	**-**	**-**	**-**	**227,274**	**227,330**	**-**
Other liabilities	**-**	**-**	**-**	**-**	**-**	**208,460**	**-**	**208,460**	**-**
- provision for credit commitments	**-**	**-**	**-**	**-**	**-**	**2,859**	**-**	**2,859**	**-**
Total Financial Liabilities	**6,701,368**	**2,526,582**	**3,671,763**	**3,747,094**	**603,534**	**960,314**	**227,274**	**18,437,929**	
Total profit sensitivity gap	**1,149,464**	**5,428,585**	**(2,743,663)**	**(1,383,117)**	**(255,331)**	**(709,413)**	**18,441**	**1,504,966**	

[1] This is arrived at after deducting Stage 3 credit impaired allowances from impaired financing.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

d) Market risk management (Cont'd)

(v) Profit Rate Risk (Cont'd)

31 December 2017	Non-trading book: Up to 1 month RM'000	>1 - 3 months RM'000	>3 - 12 months RM'000	1 - 5 years RM'000	Over 5 years RM'000	Non-profit sensitive RM'000	Trading book RM'000	Total RM'000	Effective profit rate %
ASSETS									
Cash and short-term funds	1,363,980	-	-	-	-	101,939	-	1,465,919	3.00
Financial investments available-for-sale	-	174,019	512,989	1,534,036	-	-	-	2,221,044	3.41
Financing and advances									
- performing	4,077,736	8,130,322	180,810	610,954	357,739	-	-	13,357,561	5.22
- impaired[1]	-	-	-	-	-	267,150	-	267,150	-
- collective allowance	-	-	-	-	-	(240,908)	-	(240,908)	-
Derivative financial assets	-	-	-	-	-	-	278,472	278,472	-
Other assets	-	-	-	-	-	26,150	-	26,150	-
Total Financial Assets	5,441,716	8,304,341	693,799	2,144,990	357,739	154,331	278,472	17,375,388	
LIABILITIES									
Deposits from customers	5,518,050	1,727,319	1,932,894	140,466	-	715,796	-	10,034,525	2.28
Deposits and placements from banks and other financial institutions	35,005	1,193,434	1,184,845	925,880	-	22,775	-	3,361,939	2.28
Bills payable	-	-	-	-	-	16,678	-	16,678	-
Multi-Currency Sukuk Programme	-	-	-	1,252,829	-	-	-	1,252,829	3.80
Subordinated Commodity Murabahah Financing	-	-	-	-	583,598	-	-	583,598	3.31
Derivative financial liabilities	-	26	130	335	-	-	264,911	265,402	-
Other liabilities	-	-	-	-	-	296,360	282,920	579,280	2.30
Total Financial Liabilities	5,553,055	2,920,779	3,117,869	2,319,510	583,598	1,051,609	547,831	16,094,251	
Total profit sensitivity gap	(111,339)	5,383,562	(2,424,070)	(174,520)	(225,859)	(897,278)	(269,359)	1,281,137	

[1] This is arrived at after deducting individual impairment allowance from impaired financing.

5 Financial risk management (Cont'd)

d) Market risk management (Cont'd)

(vi) Specific issuer risk

Specific issuer (credit spread) risk arises from a change in the value of debt instruments due to a perceived change in the credit quality of the issuer or underlying assets. The Bank manages the exposure to credit spread movements within the trading portfolios through the use of limits referenced to the sensitivity of the present value of a basis point movement in credit spreads.

(vii) Equity risk

Equity risk arises from the holding of open positions, either long or short, in equities or equity based instruments, which create exposure to a change in the market price of the equities or underlying equity instruments. All equity derivative trades in the Bank is traded on a back-to-back basis with HSBC group offices and therefore have no open exposure.

(viii) Stress testing

The Bank operates a comprehensive stress testing programme that supports our risk management and capital planning. It includes execution of stress tests mandated by our regulators, as well as internal stress tests and reverse stress tests. Our stress testing is carried out within a robust governance framework, supported by dedicated teams and is overseen at the most senior level of the Bank. Our stress testing programme assesses our capital strength through a rigorous examination of our resilience to external shocks. It also helps us understand and mitigate risks and informs our decisions about capital levels.

Internal stress tests are an important element in our risk management and capital management frameworks. Our capital plan is assessed through a range of stress scenarios which explore risks identified by management. They include potential adverse macroeconomic, geopolitical and operational risk events, and other potential events that are specific to the Bank. The selection of scenarios reflects our top and emerging risks identification process and our risk appetite. Stress testing analysis helps management understand the nature and extent of vulnerabilities to which the bank is exposed. Using this information, management decides whether risks can or should be mitigated through management actions or, if they were to crystallise, should be absorbed through capital. This in turn informs decisions about preferred capital levels.

Reverse stress tests are conducted annually at the Bank to understand which potential extreme conditions would make our business model nonviable. Reverse stress testing identifies potential stresses and vulnerabilities which the Bank might face, and helps inform early warning triggers, management actions and contingency plans designed to mitigate risks.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

e) Operational risk management

Operational risk is the risk to achieving the Bank's strategy or objectives as a result of inadequate or failed internal processes, people and systems or from external events. Responsibility for minimising operational risk lies with HSBC's staff. All staff are required to manage the operational risks of the business and operational activities for which they are responsible.

(i) Operational Risk Management Framework

The Bank's Operational Risk Management Framework (ORMF) is its overarching approach for managing operational risk, the purpose of which is to:

- Identify and manage the Bank's operational risks in an effective manner;
- Remain within the operational risk appetite, which helps the organisation to understand the level of risk it is willing to accept; and
- Drive forward looking risk awareness and assist management focus.

Business and functional managers throughout the organisation are responsible for maintaining an acceptable level of internal control commensurate with the scale and nature of operations, and for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The ORMF helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

A centralised database is used to record the results of the operational risk management process. Operational risk and control self-assessments are input and maintained by business units. Business and functional management and business risk and control managers monitor the progress of documented action plans to address shortcomings. Operational risk losses are entered into the Group Operational Risk database and are reported to the Risk Management Meeting on a monthly basis.

Activities to strengthen the Bank's risk culture and better embed the use of ORMF were further implemented in 2018. In particular the use of activity-based "Three Lines of Defence" model sets out roles and responsibilities for managing operational risks on a daily basis.

(ii) Three Lines of Defence

The Bank uses the Three Lines of Defence model to delineate management accountabilities and responsibilities over risk management and the control environment, thereby creating a robust control environment to manage inherent risks. The model underpins the Bank's approach to strong risk management by defining responsibilities, encouraging collaboration and enabling efficient coordination of risk and control activities.

The three lines consists of:

- The first line of defence owns the risks and is responsible for identifying, recording, reporting and managing them and ensuring that the right controls and assessments are in pace to mitigate these risks.
- The second line of defence sets the policy and guidelines for managing the risks and provides advice, guidance and challenge to the first line of defence on effective risk management.
- The third line of defence is Internal Audit which helps the Board and Executive Committee to protect the assets, reputation and sustainability of the Bank.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

e) Operational risk management (Cont'd)

(iii) Independent Risk Function

The Risk function, headed by the Chief Risk Officer, is responsible for enterprise-wide risk oversight. This includes establishing and monitoring of risk profiles and forward-looking risk identification and management. The Risk function is made up of sub-functions covering all risks to our operations and forms part of the second line of defence. It is independent from the global businesses, including sales and trading functions, to provide challenge, appropriate oversight and balance in risk/return decisions.

(iv) Exposures

The Bank continues to strengthen those controls that manage its most material risks by:

- Further embedding Global Standards to ensure that the Bank knows and protects its customers, ask the right questions and escalate concerns;
- Increased monitoring and enhanced detective controls to manage those fraud risks which arise from new technologies and new ways of banking;
- Strengthening internal security controls to prevent cyber-attacks;
- Improve controls and security to protect customers when using digital channels.

f) Capital management

The Banks's approach to capital management is driven by its strategic and organisational requirements, taking into account the regulatory, economic and commercial environment in which the Bank operates.

It is the Bank's objective to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times. The policy on capital management is underpinned by a capital management framework, which enables the Bank to manage its capital in a consistent manner.

The Bank's capital management process is articulated in its annual capital plan which is approved by the Board. The plan is drawn up with the objective of maintaining both an appropriate amount of capital and an optimal mix between the different components of capital.

In accordance with Capital Management Framework, capital generated by subsidiaries in excess of planned requirements is returned to the parent companies, normally by way of dividends.

The Bank is primarily the provider of capital to its subsidiaries and these investments are substantially funded by the Bank's own capital issuance and profit retention. As part of its capital management process, the Bank seeks to maintain a prudent balance between the composition of its capital and that of its investment in subsidiaries.

The principal forms of capital are included in the following balances on the balance sheet: share capital, other equity instruments, retained profits, other reserves and subordinated liabilities.

(i) Externally imposed capital requirements

The Bank's regulatory capital is analysed in two tiers:

- Tier 1 capital is divided into Common Equity Tier 1 (CET1) Capital and Additional Tier 1 Capital. CET1 Capital includes ordinary share capital, share premium, capital redemption reserves, retained earnings, statutory reserves and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes. The Bank does not have any Additional Tier 1 Capital as at 31 December 2018.

- Tier 2 capital, which includes qualifying subordinated liabilities, collective impairment allowances (excluding collective impairment allowances attributable to financing classified as impaired), regulatory reserve, and the element of the fair value reserve relating to revaluation of property which are disclosed as regulatory adjustments.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Financial risk management (Cont'd)

f) Capital management (Cont'd)

(ii) Basel III

The Bank is required to comply with BNM's Capital Adequacy Framework for Islamic Banks (Capital Components) Guideline for the purpose of computing regulatory capital adequacy ratios. Under the said Guideline, the Bank is required to maintain the minimum capital adequacy ratios for Common Equity Tier 1 (CET1), Tier 1 and Total Capital Ratios of 4.5%, 6.0% and 8.0% respectively.

With effect from 1 January 2016, banking institutions in Malaysia are also required to maintain capital buffers above the minimum capital adequacy ratios. The capital buffer requirements comprise Capital Conversation Buffer (CCB) of 2.5%, which is to be phased-in from 2016 to 2019, and the Countercyclical Capital Buffer (CCyB) ranging between 0% to 2.5%. CCB is intended to build up capital buffers by individual banking institutions during normal times that can be drawn down during stress periods while CCyB is intended to protect the banking sector as a whole from the build-up of systemic risk during an economic upswing when aggregate credit growth tends to be excessive.

In addition, the Bank is also required to set further buffers to reflect risks not included in the regulatory capital calculation, arising from internal assessment of risks and the results of stress tests.

(iii) Leverage Ratio

Basel III introduces a simple non risk-based leverage ratio as a complementary measure to the risk-based Capital Adequacy Framework. It aims to constrain the build-up of excess leverage in the banking sector, introducing additional safeguards against model risk and measurement errors. The ratio is a volume-based measure calculated as Basel III Tier 1 Capital divided by Total on- and off-balance sheet exposures.

The Bank is required to comply with BNM Leverage Ratio Framework which came into effect on 1 January 2018. This includes the implementation of the leverage ratio framework in Malaysia with the minimum leverage ratio requirement of 3%.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

6 Use of estimates and judgments

The results of the Bank is sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its consolidated financial statements. The significant accounting policies used in the preparation of the consolidated financial statements are described in Note 4.

The accounting policies that are deemed critical to the Bank's results and financial positions, in terms of the materiality of the items to which the policy is applied, and which involve a high degree of judgment including the use of assumptions and estimation, are discussed below.

a) *Impairment of financing and advances*

The Bank's accounting policy for losses arising from the impairment of customer financing and advances is described in Note 4(k). Financing impairment allowances represent management's best estimate of losses incurred in the financing portfolios at the reporting date.

The specific counterparty component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgments about a counterparty's financial situation and the net realisable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function.

b) *Fair value of financial instruments carried at fair value*

The fair value of financial instruments is generally measured on the basis of the individual financial instrument. However, in cases where the Bank manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, the Bank measures the fair value of the group of financial instruments on a net basis, but presents the underlying financial assets and liabilities separately in the financial statements, unless they satisfy the offsetting criteria as described in Note 4(f)(iv).

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following table sets out the financial instruments carried at fair value.

2018	**Level 1 RM'000**	**Level 2 RM'000**	**Level 3 RM'000**	**Total RM'000**
Financial investments at FVOCI (Note 9)	**2,526,369**	**199,314**	**-**	**2,725,683**
Derivative financial assets (Note 13)	**281**	**241,856**	**147**	**242,284**
	2,526,650	**441,170**	**147**	**2,967,967**
Structured liabilities	**-**	**866,063**	**18,814**	**884,877**
Derivative financial liabilities (Note 13)	**1,538**	**225,792**	**-**	**227,330**
Multi-Currency Sukuk Programme (Note 24)	**-**	**1,755,281**	**-**	**1,755,281**
	1,538	**2,847,136**	**18,814**	**2,867,488**
2017				
Financial investments available-for-sale (Note 8)	2,047,025	174,019	-	2,221,044
Derivative financial assets (Note 13)	25	278,447	-	278,472
	2,047,050	452,466	-	2,499,516
Structured liabilities	-	282,920	-	282,920
Derivative financial liabilities (Note 13)	52	265,350	-	265,402
Multi-Currency Sukuk Programme (Note 24)	-	1,252,829	-	1,252,829
	52	1,801,099	-	1,801,151

6 Use of estimates and judgments (Cont'd)

b) Fair value of financial instruments carried at fair value (Cont'd)

(i) 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.

Where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. For inactive markets, the Bank sources alternative market information, with greater weight given to information that is considered to be more relevant and reliable. Examples of the factors considered are price observability, instrument comparability, consistency of data sources, underlying data accuracy and timing of prices.

For fair values determined using valuation models, the control framework includes development or validation by independent support functions of the model logic, inputs, model outputs and adjustments. Valuation models are subject to a process of due diligence before becoming operational and are calibrated against external market data on an ongoing basis.

Changes in fair value are generally subject to a profit and loss analysis process and are disaggregated into high-level categories including portfolio changes, market movements and other fair value adjustments.

(ii) Determination of fair value

Fair values are determined according to the following hierarchy:

- Level 1 – Valuation technique using quoted market price

  Financial instruments with quoted prices for identical instruments in active markets that the Bank can access at the measurement date.

- Level 2 – Valuation technique using observable inputs

  Financial instruments with quoted prices for identical or similar instruments in active markets or quoted prices for similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

- Level 3 – Valuation technique with significant unobservable inputs

  Financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

  The judgment as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. In inactive markets, obtaining assurance that the transaction price provides evidence of fair value or determining the adjustments to transaction prices that are necessary to measure the fair value of the instrument requires additional work during the valuation process.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

6 Use of estimates and judgments (Cont'd)

b) Fair value of financial instruments carried at fair value (Cont'd)

(iii) Valuation techniques

Valuation techniques incorporate assumptions about factors that other market participants would use in their valuations. A range of valuation techniques is employed, dependent upon the instrument type and available market data. Most sophisticated valuation techniques are based upon discounted cash flow analysis, in which expected future cash flows are calculated and discounted to present value using a discounting curve. Prior to consideration of credit risk, the expected future cash flows may be known, as would be the case for the fixed leg of an profit rate swap, or may be uncertain and require projection, as would be the case for the floating leg of an profit rate swap. Projection utilises market forward curves, if available. In option models, the probability of different potential future outcomes must be considered. In addition, the values of some products are dependent upon more than one market factor, and in these cases it will typically be necessary to consider how movements in one market factor may impact the other market factors. The model inputs necessary to perform such calculations include profit rate yield curves, exchange rates, volatilities, correlations, prepayment and default rates.

The majority of valuation techniques employ only observable market data. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them the measurement of fair value is more judgmental. 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 (day 1 gain or loss) or greater than 5% of the instrument's carrying value 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 market data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used). All fair value adjustments are included within the levelling determination.

Structured notes issued and certain other hybrid instrument liabilities are included within structured liabilities and are measured at fair value. The credit spread applied to these instruments is derived from the spreads at which the Bank issues structured notes.

Gains and losses arising from changes in the credit spread of liabilities issued by the Bank reverse over the contractual life of the debt, provided that the debt is not paid at a premium or a discount.

Changes in fair value are generally subject to a profit and loss analysis process. This process disaggregates changes in fair value into three high level categories; (i) portfolio changes, such as new transactions or maturing transactions, (ii) market movements, such as changes in foreign exchange rates or equity prices, and (iii) other, such as changes in fair value adjustments, discussed below.

(iv) Fair value adjustments

Fair value adjustments are adopted when the Bank determines there are additional factors considered by market participant that are not incorporated within the valuation model. Movements in the level of fair value adjustments do not necessarily result in the recognition of profits or losses within the income statement, such as when models are enhanced and therefore fair value adjustments may no longer be required.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

6 Use of estimates and judgments (Cont'd)

b) Fair value of financial instruments carried at fair value (Cont'd)

(iv) Fair value adjustments (Cont'd)

- **Risk-related adjustments**

(i) Bid-offer

MFRS 13 requires use of the price within the bid-offer spread that is most representative of fair value. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the extent to which bid-offer cost would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of, or unwinding the position.

(ii) Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, an adjustment may be necessary to reflect the likelihood that market participants would adopt more conservative values for uncertain parameters and/or model assumptions, than those used in the Bank's valuation model.

(iii) Credit valuation adjustment (CVA) and Debit valuation adjustment (DVA)

The CVA is an adjustment to the valuation of over-the-counter (OTC) derivative contracts to reflect the possibility that the counterparty may default and the Bank may not receive the full market value of the transactions.

The DVA is an adjustment to the valuation of OTC derivative contracts to reflect the possibility that the Bank may default, and that the Bank may not pay the full market value of the transactions.

The Bank calculates a separate CVA and DVA for each legal entity, and for each counterparty to which the entity has exposure. With the exception of central clearing parties, all third-party counterparties are included in the CVA and DVA calculations, and these adjustments are not netted across group entities. The Bank reviews and refines the CVA and DVA methodologies on an ongoing basis.

The Bank calculates the CVA by applying the probability of default (PD) of the counterparty, conditional on the non-default of the Bank, to the Bank's expected positive exposure to the counterparty and multiplying the result by the loss expected in the event of default. Conversely, the Bank calculates the DVA by applying the PD of the Bank, conditional on the non-default of the counterparty, to the expected positive exposure of the counterparty to the Bank and multiplying the result by the loss expected in the event of default. Both calculations are performed over the life of the potential exposure.

For most products the Bank uses a simulation methodology, which incorporates a range of potential exposures over the life of the portfolio, to calculate the expected positive exposure to a counterparty. The simulation methodology includes credit mitigants, such as counterparty netting agreements and collateral agreements with the counterparty.

The methodologies do not, in general, account for 'wrong-way risk' which arises when the underlying value of the derivative prior to any CVA is positively correlated to the PD of the counterparty. When there is significant wrong-way risk, a trade-specific approach is applied to reflect this risk in the valuation.

(iv) Funding fair value adjustment (FFVA)

The FFVA is calculated by applying future market funding spreads to the expected future funding exposure of any uncollateralised component of the OTC derivative portfolio. The expected future funding exposure is calculated by a simulation methodology, where available and is adjusted for events that may terminate the exposure, such as the default of the Bank or the counterparty. The FFVA and DVA are calculated independently.

6 Use of estimates and judgments (Cont'd)

b) Fair value of financial instruments carried at fair value (Cont'd)

(iv) Fair value adjustments (Cont'd)

- **Model-related adjustments**

  (i) Model limitation

  Models used for portfolio valuation purposes may be based upon a simplifying set of assumptions that do not capture all material market characteristics. In these circumstances, model limitation adjustments are adopted.

  (ii) Inception profit (Day 1 profit or loss reserves)

  Inception profit adjustments are adopted where the fair value estimated by a valuation model is based on one or more significant unobservable inputs.

- **Valuation of uncollateralised derivatives**

  In line with evolving industry practice, FFVA reflects the funding of uncollateralised derivative exposure at rates other than overnight indexed swap rate (OIS). As at 31 December 2018, the FFVA was -RM0.5 million (2017: -RM1.1 million) for the Bank, which has a one-off impact on trading revenue. This is an area in which a full industry consensus has not yet emerged. The Bank will continue to monitor industry evolution and refine the calculation methodology as necessary.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

6 Use of estimates and judgments (Cont'd)

b) Fair value of financial instruments carried at fair value (Cont'd)

(v) Reconciliation of fair value measurements in Level 3 of the fair value hierarchy

The following table provides a reconciliation of the movement between opening and closing balances of Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs:

	2018			2017		
	Derivative financial assets	**Derivative financial liabilities**	**Structured liabilities**	Derivative financial assets	Derivative financial liabilities	Structured liabilities
RM'000						
Balance at 1 January	-	-	-	-	-	-
Total gains or losses in profit or loss	**147[2]**	-	**(774)[2]**	-	-	-
Issues	-	-	**19,588**	-	-	-
Settlements	-	-	-	-	-	-
Transfer out of Level 3	-	-	-	-	-	-
Balance at 31 December	**147**	-	**18,814**	-	-	-

[1] Denotes losses in the Profit or Loss
[2] Denotes gains in the Profit or Loss

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

For derivative financial assets/liabilities, transfers out of Level 3 were due to the maturity of the derivatives or as a result of early termination.

For structured liabilities, transfers into Level 3 were due to new deals with unobservable volatilities. Transfers out of Level 3 resulted from maturity or early termination of the instruments.

For structured liabilities, realised and unrealised gains and losses are presented in profit or loss under "Other operating income".

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

6 Use of estimates and judgments (Cont'd)

b) Fair value of financial instruments carried at fair value (Cont'd)

(v) Reconciliation of fair value measurements in Level 3 of the fair value hierarchy (Cont'd)

Total gains or losses included in profit or loss for the financial year in the above tables are presented in the statement of comprehensive income as follows:

	Derivative financial assets	Derivative financial liabilities	Structured liabilities
2018 **RM'000**			
Total gains or losses included in profit or loss for the financial year ended:			
-Net trading income	**-**	**-**	**-**
Total gains or losses for the year ended included in profit or loss for assets and liabilities held at the end of the financial year			
-Net trading income	**147**[2]	**-**	**774**[2]
2017 RM'000			
Total gains or losses included in profit or loss for the financial year ended:			
-Net trading income	-	-	-
Total gains or losses for the year ended included in profit or loss for assets and liabilities held at the end of the financial year			
-Net trading income	-	-	-

[1] Denotes losses in the Profit or Loss
[2] Denotes gains in the Profit or Loss

(vi) Quantitative information about significant unobservable inputs in Level 3 valuations

Level 3 fair values are estimated using unobservable inputs for the financial assets and liabilities. The following table shows the valuation techniques used in the determination of fair values within Level 3 at Bank basis for the current year, as well as the key unobservable inputs used in the valuation models.

Type of financial instrument	Valuation technique	Key unobservable inputs	Range of estimates for unobservable input
Structured liabilities	Option model	Long term equity volatility	**2018: 13.37%** 2017: NIL [1]

[1] In 2017, there is nil balance within Level 3.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

6 Use of estimates and judgments (Cont'd)

b) Fair value of financial instruments carried at fair value (Cont'd)

(vii) Key unobservable inputs to Level 3 financial instruments

- **Volatility**

Volatility is a measure of the anticipated future variability of a market price. Volatility tends to increase in stressed market conditions, and decrease in calmer market conditions. Volatility is an important input in the pricing of options. In general, the higher the volatility, the more expensive the option will be. This reflects both the higher probability of an increased return from the option, and the potentially higher costs that the Bank may incur in hedging the risks associated with the option. If option prices become more expensive, this will increase the value of the Bank's long option positions (i.e. the positions in which the Bank has purchased options), while the Bank's short option positions (i.e. the positions in which the Bank has sold options) will suffer losses.

Volatility varies by underlying reference market price, and by strike and maturity of the option. Volatility also varies over time. Certain volatilities, typically those of a longer-dated nature, are unobservable. The unobservable volatility is then estimated from observable data. For example, longer-dated volatilities may be extrapolated from shorter-dated volatilities.

The range of unobservable volatilities quoted in the table reflects the wide variation in volatility inputs by reference to market price. For example, foreign exchange volatilities for a pegged currency may be very low, whereas for non-managed currencies the foreign exchange volatility may be higher. As a further example, volatilities for deep-in-the money or deep-out-of-the-money equity options may be significantly higher than at-the-money options. For any single unobservable volatility, the uncertainty in the volatility determination is significantly less than the range quoted above.

6 Use of estimates and judgments (Cont'd)

c) Fair values of financial assets and liabilities not measured at fair value

The fair value of each financial asset and liabilities presented in the statement of financial position of the Bank approximates the carrying amount as at the reporting date except for the following:

	31 Dec 2018 Carrying amount RM'000	**31 Dec 2018 Fair value RM'000**	31 Dec 2017 Carrying amount RM'000	31 Dec 2017 Fair value RM'000
Financial Assets				
Financing and advances	**14,137,337**	**14,131,279**	13,383,803	13,394,892
Financial Liabilities				
Deposits from customers	**11,444,577**	**11,395,286**	10,034,525	10,032,492
Deposits and placements from banks and other financial institutions	**3,299,964**	**3,349,428**	3,361,939	3,378,354
Subordinated Commodity Murabahah Financing	**595,987**	**614,451**	583,598	611,776

The methods and assumptions used in estimating the fair values of financial instruments other than those already mentioned in Note 4(f)(v) are as follows:

Cash and short-term funds
Deposits and placements with banks and other financial institutions

The carrying amounts approximate fair values due to their relatively short-term nature.

Financing and advances
To determine the fair value of financing and advances to banks and customers, financing and advances 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 Bank believes are consistent with those that would be used by market participants in valuing such financing; new business rates estimates for similar financing; and trading inputs from other market participants including observed primary and secondary trades. From time to time, the Bank may engage a third-party valuation specialist to measure the fair value of a pool of financing.

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

Deposits from customers
Deposits and placements from banks and other financial institutions
Deposits, placements and obligations which mature or reprice after six months are grouped by residual maturity. Fair value is estimated using discounted cash flows, applying either market rates, where applicable, or current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is approximated by its carrying value.

Multi-Currency Sukuk Programme
Subordinated Commodity Murabahah Financing
The fair value of subordinated bonds issued at cost were estimated based on discounted cash flows using rates currently offered for debt instruments of similar remaining maturities and credit grading.

6 Use of estimates and judgments (Cont’d)

c) Fair values of financial assets and liabilities not measured at fair value (Cont'd)

The fair value of each financial asset and liabilities presented in the statement of financial position of the Bank approximates the carrying amount as at the reporting date except for the following (Cont'd):

31 Dec 2018	**Level 1 RM'000**	**Level 2 RM'000**	**Level 3 RM'000**	**Total fair value RM'000**	**Total carrying amount RM'000**
Financial Assets					
Financing and advances	**-**	**-**	**14,131,279**	**14,131,279**	**14,137,337**
Financial Liabilities					
Deposits from customers	**-**	**11,395,286**	**-**	**11,395,286**	**11,444,577**
Deposits and placements from banks and other financial institutions	**-**	**3,349,428**	**-**	**3,349,428**	**3,299,964**
Subordinated Commodity Murabahah Financing	**-**	**614,451**	**-**	**614,451**	**595,987**
31 Dec 2017					
Financial Assets					
Financing and advances	-	-	13,394,892	13,394,892	13,383,803
Financial Liabilities					
Deposits from customers	-	10,032,492	-	10,032,492	10,034,525
Deposits and placements from banks and other financial institutions	-	3,378,354	-	3,378,354	3,361,939
Subordinated Commodity Murabahah Financing	-	611,776	-	611,776	583,598

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

7 Cash and Short-Term Funds

	31 Dec 2018 **RM'000**	31 Dec 2017 RM'000
Cash and balances with banks and other financial institutions	**165,396**	215,919
Money at call and interbank placements maturing within one month	**2,639,098**	1,250,000
	2,804,494	1,465,919

8 Financial Investments Available-For-Sale

Debt securities	**31 Dec 2018** **RM'000**	31 Dec 2017 RM'000
At fair value		
Money market instruments:		
Malaysian Government Islamic Sukuk	**-**	2,047,025
Negotiable instruments of deposit	**-**	149,083
Islamic Treasury Bill	**-**	24,936
	-	2,221,044

The maturity structure of money market instruments held as available-for-sale is as follows:

Maturing within one year	**-**	687,008
More than one year to three years	**-**	1,427,803
More than three years to five years	**-**	106,233
	-	2,221,044

9 Financial Investments at Fair Value through Other Comprehensive Income (FVOCI)

Debt securities	**31 Dec 2018**	31 Dec 2017
At fair value	**RM'000**	RM'000
Money market instruments:		
Malaysian Government Islamic Sukuk	**2,526,369**	-
Islamic Treasury Bill	**199,314**	-
	2,725,683	-

The maturity structure of money market instruments held as FVOCI is as follows:

Maturing within one year	**940,445**	-
More than one year to three years	**1,554,002**	-
More than three years to five years	**231,236**	-
	2,725,683	-

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

10 Financing and Advances

(i) By type and Shariah contracts

At amortised cost	Sale-based contracts		Lease-based contracts		Equity-based contracts		
	Commodity Murabahah	Bai Al-Inah	Ijarah	Ijarah Thumma Al-Bai	Diminishing Musharakah	Ujrah	Total
31 Dec 2018	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
Cash line-i	75,334	-	-	-	-	-	75,334
Term financing:							
House financing	-	-	-	-	4,329,220	-	4,329,220
Hire purchase receivables	-	-	-	195,636	-	-	195,636
Lease receivables	-	-	539	-	-	-	539
Syndicated term financing	1,334,656	-	-	-	-	-	1,334,656
Other term financing	3,381,217	62	-	-	1,010,142	-	4,391,421
Trust receipts	523,625	-	-	-	-	-	523,625
Claims on customers under acceptance credits	422,293	-	-	-	-	-	422,293
Bills receivables	456,578	-	-	-	-	-	456,578
Staff financing-i	1,520	52	-	-	1,572	-	3,144
Credit cards-i	-	-	-	-	-	1,075,634	1,075,634
Revolving financing	1,634,365	-	-	-	-	-	1,634,365
Other financing	-	-	-	-	3,426	-	3,426
Gross financing and advances	7,829,588	114	539	195,636	5,344,360	1,075,634	14,445,871
Less: Impairment allowance [1]							(308,534)
Total net financing and advances							14,137,337

[1] Adoption of the MFRS 9

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

10 Financing and Advances (Cont'd)

(i) By type and Shariah contracts (Cont'd)

	Sale-based contracts			Lease-based contracts		Equity-based contracts		
31 Dec 2017	Commodity Murabahah RM'000	Bai Bithaman Ajil RM'000	Bai Al-Inah RM'000	Ijarah RM'000	Ijarah Thumma Al-Bai RM'000	Diminishing Musharakah RM'000	Ujrah RM'000	Total RM'000
Cash line-i	82,183	-	-	-	-	-	-	82,183
Term financing:								
House financing	-	22	-	-	-	4,401,553	-	4,401,575
Hire purchase receivables	-	-	-	-	169,852	-	-	169,852
Lease receivables	-	-	-	1,379	-	-	-	1,379
Syndicated term financing [1]	1,889,969	-	-	-	-	-	-	1,889,969
Other term financing	3,181,937	1,177	89	-	-	988,724	-	4,171,927
Trust receipts	742,082	-	-	-	-	-	-	742,082
Claims on customers under acceptance credits	422,914	-	-	-	-	-	-	422,914
Bills receivables	109,065	-	-	-	-	-	-	109,065
Staff financing-i	2,307	-	107	-	-	2,233	-	4,647
Credit cards-i	-	-	-	-	-	-	925,417	925,417
Revolving financing [1]	816,952	-	-	-	-	-	-	816,952
Other financing	-	-	-	-	-	1,648	-	1,648
Gross financing and advances	7,247,409	1,199	196	1,379	169,852	5,394,158	925,417	13,739,610
Less: Allowance for impaired financing								
Collective impairment allowance								(240,908)
Individual impairment allowance								(114,899)
Total net financing and advances								13,383,803

[1] Comparatives of RM 250.7 million has been reclassified out from syndicated term financing to revolving financing to align with the classification in the Central Credit Reference Information System (CCRIS).

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

10 Financing and Advances (Cont'd)

(ii) By type of customer

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Domestic non-bank financial institutions	**619,421**	564,529
Domestic business enterprises:		
Small medium enterprises	**1,983,223**	1,962,425
Others	**3,781,656**	3,614,426
Government and statutory bodies	**4,527**	7,222
Individuals	**6,216,584**	6,117,218
Other domestic entities	**1,258**	14,641
Foreign entities	**1,839,202**	1,459,149
	14,445,871	13,739,610

(iii) By profit rate sensitivity

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Fixed rate:		
Hire purchase receivables	**195,636**	169,852
Other financing	**3,341,460**	3,105,148
Variable rate:		
Base Rate/Base Financing Rate plus	**5,392,670**	5,457,354
Cost-plus	**5,516,105**	5,007,256
	14,445,871	13,739,610

(iv) By residual contractual maturity

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Maturing within one year	**5,895,995**	5,850,745
More than one year to three years	**1,167,759**	982,143
More than three years to five years	**1,298,607**	901,874
Over five years	**6,083,510**	6,004,848
	14,445,871	13,739,610

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

10 Financing and Advances (Cont'd)

(v) By sector

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Agriculture, hunting, forestry & fishing	**18,986**	97,418
Mining and quarrying	**231,674**	96,376
Manufacturing	**1,495,092**	1,665,790
Electricity, gas and water	**128,262**	63,270
Construction	**783,688**	432,133
Real estate	**1,135,507**	1,073,840
Wholesale & retail trade, restaurants & hotels	**995,569**	904,765
Transport, storage and communication	**214,291**	549,382
Finance, takaful and business services	**1,040,672**	993,604
Household - Retail	**6,780,146**	6,738,960
Others	**1,621,984**	1,124,072
	14,445,871	13,739,610

(vi) By purpose

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Purchase of landed property:		
Residential	**4,330,789**	4,403,810
Non-residential	**835,867**	817,328
Purchase of transport vehicles	**1,255**	1,644
Consumption credit	**2,201,278**	2,070,438
Construction	**567,385**	346,798
Working capital	**5,229,130**	5,254,963
Other purpose	**1,280,167**	844,629
	14,445,871	13,739,610

(vii) By geographical distribution

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Northern Region	**1,499,020**	1,496,470
Southern Region	**1,464,999**	1,506,660
Central Region	**11,081,704**	10,295,163
Eastern Region	**400,148**	441,317
	14,445,871	13,739,610

Concentration by location for financing and advances is based on the location of the customer.
The Northern region consists of the states of Perlis, Kedah, Penang, Perak, Pahang, Kelantan and Terengganu.
The Southern region consists of the states of Johor, Malacca and Negeri Sembilan.
The Central region consists of the states of Selangor, Federal Territory of Kuala Lumpur and Federal Territory of Putrajaya.
The Eastern region consists of the states of Sabah, Sarawak and the Federal Territory of Labuan.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

10 Financing and Advances (Cont'd)

(viii) Assets under Management

The details of assets under management in respect of the Syndicated Investment Account Financing (SIAF)/Investment Agency Account (IAA) financing are as below. The exposures and the corresponding risk weighted amount are reported in investors' financial statements.

	31 Dec 2018	31 Dec 2017
	RM'000	RM'000
Total gross financing and advances	**3,381,964**	4,722,591
Less: Impairment allowance	**(896)**	-
Total net financing and advances	**3,381,068**	4,722,591
Maturity not exceeding one year	**794,750**	1,047,532
Maturity exceeding one year	**-**	237,166
Total commitments and contingencies	**794,750**	1,284,698
Risk weighted assets (RWA)	**2,939,702**	4,312,606

The SIAF/IAA arrangement is based on the Wakalah principle where HBMY, solely or together with other financial institutions provide the funds, whilst the assets are managed by the Bank (as the Wakeel or agent). However, in the arrangement, the profits of the underlying assets are recognised by HBMY and the other financial institutions proportionately in relation to the funding provided in the syndication arrangement. At the same time, risks on the financing are also proportionately borne by HBMY and the other financial institutions. Hence, the underlying assets and allowance for impairment arising thereon, if any, are proportionately recognised and accounted for by HBMY and the other financial institutions.

The recognition and derecognition treatments of the above are in accordance to Note 4(e).

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

11 Impaired Financing

(i) Movements in impaired financing and advances

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Balance at 1 January	**382,049**	303,526
- Adoption of MFRS 9	**(382,049)**	-
Balance restated	**-**	303,526
Classified as impaired during the financial year	**-**	436,574
Reclassified as performing	**-**	(155,516)
Amount recovered	**-**	(66,005)
Amount written off	**-**	(136,530)
Balance at 31 December	**-**	382,049

(ii) Movements in allowance for impaired financing

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Collective allowance for impairment		
Balance at 1 January	**240,908**	200,015
- Adoption of MFRS 9	**(240,908)**	-
Balance restated	**-**	200,015
Made during the financial year	**-**	207,831
Amount released	**-**	(43,974)
Amount written off	**-**	(122,964)
Balance at 31 December	**-**	240,908

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Individual allowance for impairment		
Balance at 1 January	**114,899**	62,757
- Adoption of MFRS 9	**(114,899)**	-
Balance restated	**-**	62,757
Made during the financial year	**-**	57,300
Amount released	**-**	(25,746)
Amount reinstated	**-**	20,588
Balance at 31 December	**-**	114,899

The impairment allowance by stage allocation upon adoption of MFRS 9 with effect from 1 January 2018 is disclosed in Note 12(i).

(iii) Gross carrying amount movement of financing and advances classified as credit impaired:

	31 Dec 2018 RM'000
Gross carrying amount as at 1 January 2018	**-**
Restated upon adoption of MFRS 9	**322,683**
Restated gross carrying amount as at 1 January 2018	**322,683**
Transfer within stages	**71,690**
Net remeasurement due to changes in credit risk	**115,711**
Written-off	**(113,156)**
Others	**33,385**
Gross carrying amount as at 31 December 2018	**430,313**

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

11 Impaired Financing (Cont'd)

(iv) By contract

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Ijarah Thumma Al-Bai (AITAB) *(hire purchase)*	**6,368**	9,841
Commodity Murabahah *(cost-plus)*	**275,947**	168,021
Diminishing Musharakah (*profit and loss sharing)*	**140,036**	184,393
Bai Al-Inah *(sell and buy back)*	**32**	3
Ujrah *(fee-based)*	**7,930**	19,791
	430,313	382,049

(v) By sector

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Mining and quarrying	**704**	765
Manufacturing	**17,354**	17,811
Construction	**3,142**	-
Wholesale & retail trade, restaurants & hotels	**11,139**	9,410
Transport, storage and communication	**4,153**	4,549
Finance, takaful and business services	**28,661**	29,310
Household - Retail	**339,334**	318,716
Others	**25,826**	1,488
	430,313	382,049

(vi) By purpose

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Purchase of landed property:		
Residential	**124,989**	162,963
Non-residential	**11,824**	12,805
Purchase of transport vehicles	**146**	3
Consumption credit	**212,228**	151,582
Construction	**2,402**	2,786
Working capital	**53,902**	51,910
Others	**24,822**	-
	430,313	382,049

(vii) By geographical distribution

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Northern Region	**39,459**	58,913
Southern Region	**40,283**	39,334
Central Region	**343,936**	271,572
Eastern Region	**6,635**	12,230
	430,313	382,049

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

12 Expected credit losses allowance charges (ECL)

(i) Movements in ECL allowances for financing and advances

The following table shows reconciliation from the opening to the closing balance of the ECL allowance for financing and advances:

	Stage 1	Stage 2	Stage 3			
	12-month ECL not credit impaired RM'000	Lifetime ECL not credit impaired RM'000	Lifetime ECL credit impaired RM'000	Lifetime ECL credit impaired Specific provision RM'000	Collective provision RM'000	Total RM'000
Balance at 1 January 2018	-	-	-	114,899	240,908	355,807
Restated for adoption of MFRS 9	61,134	65,520	150,770	(114,899)	(240,908)	(78,383)
Restated opening balance at 1 January 2018	61,134	65,520	150,770	-	-	277,424
Changes due to financial assets recognised in the opening balance that have:						
- Transferred to Stage 1	14,039	(12,550)	(1,489)	-	-	-
- Transferred to Stage 2	(4,667)	10,011	(5,344)	-	-	-
- Transferred to Stage 3	(638)	(3,821)	4,459	-	-	-
New financial assets originated or purchased	19,140	-	-	-	-	19,140
Net remeasurement due to changes in credit risk	(44,424)	5,304	131,234	-	-	92,114
Asset written-off	-	-	(113,156)	-	-	(113,156)
Others	(596)	-	33,608	-	-	33,012
Balance at 31 December 2018	43,988	64,464	200,082	-	-	308,534

The Bank measures the expected credit losses (ECL) using the three-stage approach, please refer to Note 4(k) for the details. The following section explains how significant changes in the gross carrying amount of financing and advances during the year have contributed to the changes in the ECL allowances for the Bank under the expected credit loss model.

Overall, the total ECL allowances increased by RM31.1 million compared to the balance at the beginning of the year which was restated under MFRS 9. This net increase was mainly contributed by remeasurement due to change in credit risk (RM92.1m) partially offset by accounts written off (RM113.2m).

- 12-months ECL not credit impaired (Stage 1) – decreased by RM17.1 million, primarily due to remeasurement due to change in credit risk based on the HSBC Group's model and partially offset by new financing and financings migrated back to Stage 1 due to improved credit quality.
- Lifetime ECL not credit-impaired (Stage 2) – decreased by RM1.1 million, primarily due to migration of financings from/to Stage 1, Stage 2 and Stage 3, and partially offset by remeasuremnt due to change in credit risk.
- Lifetime ECL credit-impaired (Stage 3) – increased by RM49.3 million, primarily due to the increase in remeasurement due to change in credit risk and partially offset by the written off of the impaired financing.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

12 Expected credit losses allowance charges (ECL) (Cont'd)

(ii) Movements in ECL allowances for financing commitments

The following table shows reconciliation from the opening to the closing balance of the ECL allowance for financing commitments:

	Stage 1	Stage 2	Stage 3	
	12-month ECL not credit impaired RM'000	Lifetime ECL not credit impaired RM'000	Lifetime ECL credit impaired RM'000	Total RM'000
Balance at 1 January 2018	-	-	-	-
Restated for adoption of MFRS 9	946	1,880	997	3,823
Restated opening balance at 1 January 2018	946	1,880	997	3,823
Changes due to financial assets recognised in the opening balance that have:				
- Transferred to Stage 1	152	(152)	-	-
- Transferred to Stage 2	(56)	56	-	-
- Transferred to Stage 3	(1)	(2)	3	-
New financial assets originated or purchased	240	-	-	240
Net remeasurement due to changes in credit risk	(99)	(857)	(175)	(1,131)
Others	(73)	-	-	(73)
Balance at 31 December 2018	1,109	925	825	2,859

Allowance for drawn amount and provisions for the undrawn commitments are not able to be split for retail portfolio, and in accordance to MFRS 7 Financial Instruments disclosure, the provisions for the financing and other credit related commitments for retail portfolio are presented together with the allowance for the drawn financing and advances in Note 12(i).

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

13 Derivative Financial Instruments

Details of derivative financial instruments outstanding are as follows:

Derivative financial instruments measured at their fair values together with their corresponding contract/notional amounts:

	Contract / Notional Amount				Positive Fair Value				Negative Fair Value			
	Up to 1 Year	>1 - 5 Years	> 5 Years	Total	Up to 1 Year	>1 - 5 Years	> 5 Years	Total	Up to 1 Year	>1 - 5 Years	> 5 Years	Total
31 Dec 2018	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
Trading derivatives:												
Foreign exchange contracts												
- Forwards	6,141,764	-	-	6,141,764	43,589	-	-	43,589	44,382	-	-	44,382
- Swaps	1,695,255	646,019	-	2,341,274	134,476	42,693	-	177,169	135,262	42,095	-	177,357
Profit rate related contracts												
- Swaps	1,997,822	1,250,000	232,745	3,480,567	3,387	1,846	281	5,514	2,848	-	-	2,848
- Options	-	421,166	-	421,166	-	3,441	-	3,441	-	942	-	942
Equity related contracts												
- Options purchased	116,883	362,229	-	479,112	2,033	10,538	-	12,571	-	1,745	-	1,745
Sub- total	9,951,724	2,679,414	232,745	12,863,883	183,485	58,518	281	242,284	182,492	44,782	-	227,274
Hedging Derivatives:												
Fair Value Hedge												
Profit rate related contracts												
- Swaps	80,000	-	-	80,000	-	-	-	-	56	-	-	56
Sub- total	80,000	-	-	80,000	-	-	-	-	56	-	-	56
Total	10,031,724	2,679,414	232,745	12,943,883	183,485	58,518	281	242,284	182,548	44,782	-	227,330

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

13 Derivative Financial Instruments (Cont'd)

	Contract / Notional Amount				Positive Fair Value				Negative Fair Value			
	Up to 1 Year	>1 - 5 Years	> 5 Years	Total	Up to 1 Year	>1 - 5 Years	> 5 Years	Total	Up to 1 Year	>1 - 5 Years	> 5 Years	Total
31 Dec 2017	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
Trading derivatives:												
Foreign exchange contracts												
- Forwards	3,275,446	-	-	3,275,446	101,206	-	-	101,206	101,638	-	-	101,638
- Swaps	-	2,345,181	-	2,345,181	-	156,798	-	156,798	-	155,394	-	155,394
- Options	36,534	295,613	-	332,147	736	1,114	-	1,850	736	1,114	-	1,850
Profit rate related contracts												
- Swaps	234,703	2,927,843	253,904	3,416,450	326	8,930	382	9,638	245	5,677	-	5,922
- Options	-	185,887	-	185,887	-	3,449	-	3,449	-	-	-	-
Equity related contracts												
- Options purchased	2,945	85,394	-	88,339	-	5,531	-	5,531	-	107	-	107
Sub- total	3,549,628	5,839,918	253,904	9,643,450	102,268	175,822	382	278,472	102,619	162,292	-	264,911
Hedging Derivatives:												
Fair Value Hedge												
Profit rate related contracts												
- Swaps	110,000	80,000	-	190,000	-	-	-	-	156	335	-	491
Sub- total	110,000	80,000	-	190,000	-	-	-	-	156	335	-	491
Total	3,659,628	5,919,918	253,904	9,833,450	102,268	175,822	382	278,472	102,775	162,627	-	265,402

Included in the net non-profit income is the net gains/(losses) arising from fair value hedges during the financial year as follows:

	31 Dec 2018	31 Dec 2017
	RM'000	RM'000
Gains on hedging instruments	**348**	487
Losses on the hedged items attributable to the hedged risk	**(366)**	(44)
Net (losses)/gains from fair value hedges	**(18)**	443

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

14 Other Assets

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Settlements	**3,431**	-
Income receivable	**7,733**	7,631
Profit receivable	**21,383**	17,197
Prepayments	**190**	334
Amount due from holding company	**360**	988
Other receivables	**17,567**	17,209
	50,664	43,359

15 Statutory Deposits with Bank Negara Malaysia

The non-profit bearing statutory deposits are maintained with Bank Negara Malaysia in compliance with Section 26(2)c and 26(3) of the Central Bank of Malaysia Act 2009, the amounts of which are determined at set percentages of total eligible liabilities.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

16 Equipment

2018	**Office equipment, fixtures and fittings**	**Computer equipment**	**Motor vehicles**	**Work in Progress**	**Total**
	RM'000	**RM'000**	**RM'000**	**RM'000**	**RM'000**
Cost					
Balance at 1 January	**37,419**	**18,402**	**299**	**-**	**56,120**
Additions	**761**	**1,406**	**-**	**1,506**	**3,673**
Written off	**(2,048)**	**(102)**	**-**	**-**	**(2,150)**
Balance at 31 December	**36,132**	**19,706**	**299**	**1,506**	**57,643**
Accumulated depreciation					
Balance at 1 January	**34,043**	**16,377**	**180**	**-**	**50,600**
Charge for the financial year	**1,028**	**1,236**	**60**	**-**	**2,324**
Written off	**(2,048)**	**(101)**	**-**	**-**	**(2,149)**
Balance at 31 December	**33,023**	**17,512**	**240**	**-**	**50,775**
Net book value at 31 December	**3,109**	**2,194**	**59**	**1,506**	**6,868**
2017					
Cost					
Balance at 1 January	37,044	18,279	299	-	55,622
Additions	1,739	562	-	-	2,301
Written off	(1,364)	(439)	-	-	(1,803)
Balance at 31 December	37,419	18,402	299	-	56,120
Accumulated depreciation					
Balance at 1 January	33,090	15,175	120	-	48,385
Charge for the financial year	2,314	1,641	60	-	4,015
Disposals	(1,361)	(439)	-	-	(1,800)
Balance at 31 December	34,043	16,377	180	-	50,600
Net book value at 31 December	3,376	2,025	119	-	5,520

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

17 Intangible assets

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Computer software		
Cost		
Balance at 1 January/31 December	**5,053**	5,053
Accumulated amortisation		
Balance at 1 January/31 December	**5,053**	5,053
Net book value at 31 December	**-**	**-**

18 Deferred Tax Assets

The amounts, prior to offsetting are summarised as follows:

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Deferred tax assets	**17,676**	9,668
Deferred tax liabilities	**(313)**	(1,031)
	17,363	8,637

Deferred tax assets and liabilities are offset where there is a legally enforceable right to set-off current tax assets against current tax liabilities.

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Deferred tax assets		
- settled more than 12 months	**6,153**	284
- settled within 12 months	**11,523**	9,384
Deferred tax liabilities		
- settled more than 12 months	**(103)**	(309)
- settled within 12 months	**(210)**	(722)
	17,363	8,637

The recognised deferred tax assets and liabilities (before offsetting) are as follows:

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Equipment capital allowances	**(210)**	(319)
FVOCI reserve	**(103)**	-
Available-for-sale reserve	**-**	(712)
Own credit reserve	**943**	-
Provision for accrued expenses	**7,938**	7,080
Deferred income	**2,838**	2,380
Lease receivables	**218**	208
Financing and advances	**5,739**	-
	17,363	8,637

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

18 Deferred Tax Assets (Cont'd)

The movements in temporary differences during the financial year are as follows:

2018	Balance at 1 January RM'000	Adoption of MFRS9 RM'000	Restated Balance at 1 January RM'000	Recognised in profit or loss RM'000	Recognised in other comprehensive income RM'000	Balance at 31 December RM'000
Financing and advances	**-**	**-**	**-**	**5,739**	**-**	**5,739**
Own Credit reserve	**-**	**-**	**-**	**-**	**943**	**943**
Provision for accrued expenses	**7,080**	**-**	**7,080**	**858**	**-**	**7,938**
Deferred income	**2,380**	**-**	**2,380**	**458**	**-**	**2,838**
Lease receivables	**208**	**-**	**208**	**10**	**-**	**218**
Deferred Tax Assets	**9,668**	**-**	**9,668**	**7,065**	**943**	**17,676**
Equipment capital allowances	**(319)**	**-**	**(319)**	**109**	**-**	**(210)**
Own Credit reserve	**(655)**	**(150)**	**(805)**	**583**	**222**	**-**
Financial investment at FVOCI	**(57)**	**-**	**(57)**	**-**	**(46)**	**(103)**
Deferred Tax Liabilities	**(1,031)**	**(150)**	**(1,181)**	**692**	**176**	**(313)**
Net Deferred Tax Assets	**8,637**	**(150)**	**8,487**	**7,757**	**1,119**	**17,363**
2017						
Available-for-sale reserve	2,067	-	2,067	-	(2,067)	-
Provision for accrued expenses	6,462	-	6,462	618	-	7,080
Deferred income	2,449	-	2,449	(69)	-	2,380
Lease receivables	66	-	66	142	-	208
Other temporary differences	124	-	124	(124)	-	-
Deferred Tax Assets	11,168	-	11,168	567	(2,067)	9,668
Equipment capital allowances	(649)	-	(649)	330	-	(319)
Own Credit reserve	-	-	-	-	(655)	(655)
Available-for-sale reserves	-	-	-	-	(57)	(57)
Deferred Tax Liabilities	(649)	-	(649)	330	(712)	(1,031)
Net Deferred Tax Assets	10,519	-	10,519	897	(2,779)	8,637

19 Tax Recoverable

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Tax recoverable	**-**	7,624

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

20 Deposits From Customers

(i) By type of deposit

At amortised cost	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Non-Mudharabah Fund		
Demand deposits		
- Qard	**1,770,373**	-
- Wadiah	**-**	2,114,167
Savings deposits		
- Qard	**1,689,423**	-
- Wadiah	**-**	1,644,028
Term deposits		
- Commodity Murabahah	**7,789,088**	6,195,246
- Qard	**195,693**	81,084
	11,444,577	10,034,525

The maturity structure of term deposits is as follows:

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Due within six months	**6,602,418**	4,897,455
More than six months to one year	**1,042,883**	1,239,371
More than one year to three years	**264,450**	110,069
More than three years to five years	**75,030**	29,435
	7,984,781	6,276,330

(ii) By type of customer

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Government and statutory bodies	**3,780**	5,623
Business enterprises	**2,349,937**	2,220,541
Individuals	**6,284,101**	5,411,494
Others	**2,806,759**	2,396,867
	11,444,577	10,034,525

21 Deposits and Placements from Banks and Other Financial Institutions

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Non-Mudharabah Fund		
Licensed banks	**579,301**	2,441,124
Bank Negara Malaysia	**27,971**	26,557
Other financial institutions	**2,692,692**	894,258
	3,299,964	3,361,939

Included in deposits and placements from banks and other financial institutions are placements from the Bank's parent company, HSBC Bank Malaysia Berhad, of RM0.6 billion (31 Dec 2017: RM2.4 billion).

22 Structured Liabilities Designated as Fair Value through profit or loss (FVTPL)

At fair value	**31 Dec 2018 RM'000**	31 Dec 2017 RM'000
Structured liabilities [1]		
- Wakalah with Commodity Wa'ad	**228,954**	-
- Tawarruq	**655,923**	-
	884,877	-

[1] Structured liabilities are measured at fair value over the life of the instruments. Structured liabilities are deposits with embedded derivatives, of which both profit paid and fair valuation on the structured liabilities are recorded as net income/expense from financial instruments designated at fair value.

On 1 January 2018, the Bank has changed the accounting policy and presentation from "Trading Liabilities" in Other Liabilities to Structured Liabilities Designated as Fair value through profit or loss. The Bank has designated these structured liabilities as at fair value through profit and loss to align with the presentation of similiar financial instrument by peers. Comparative of RM 280 million has not been restated as it is not significant in the contect of the overall materiality of the financial statements.

23 Other Liabilities

	Note	**31 Dec 2018 RM'000**	31 Dec 2017 RM'000
At amortised cost			
Settlements		**-**	2,945
Amounts due to holding company		**73,163**	169,489
Profit payable		**87,846**	74,428
Deferred income		**11,824**	10,716
Marginal deposit		**4,245**	13,092
Accrued expenses		**32,928**	29,044
Other creditors	(a)	**58,095**	64,752
Provision on financing and credit related commitments		**2,859**	-
		270,960	364,466
At fair value			
Structured liabilities			
- Wakalah with Commodity Wa'ad [1]		**-**	279,975
		270,960	644,441

[1] On 1 January 2018, the Bank has changes the accounting policy and presentation from "Trading Liabilities" in Other Liabilities to Structured Liabilities Designated as Fair value through profit or loss. The Bank has designated these structured liabilities as at fair value through profit and loss to align with the presentation of similiar financial instrument by peers. Comparative of RM 280 million has not been restated as it is not significant in the contect of the overall materiality of the financial statements.

(a) Other creditors and accruals

Included in other creditors and accruals is excess compensation balance and profit earned from inadvertent Shariah non-compliant activities. The contribution was distributed to the non-governmental organisations approved by the Shariah Committee during the financial year. There had not been any case on Shariah non-compliant event during the financial year (2017: Nil).

Source and use of charity funds	**31 Dec 2018 RM'000**	31 Dec 2017 RM'000
Balance at 1 January	**1**	4
Shariah non-compliant income for the financial year [2]	**16**	13
- Contribution to non-profit organisations	**-**	(16)
- Tax expense on Shariah non-compliant income	**(3)**	-
Balance at 31 December	**14**	1

[2] Income received from transactions via Nostro Accounts.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

24 Multi-Currency Sukuk Programme

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Multi-Currency Sukuk Programme (MCSP)	**1,755,281**	1,252,829

The Bank issued the following series of 5-year unsecured Sukuk under its RM3 billion MCSP.

Issuance under MCSP	Nominal Value RM'000	Issue Date	Maturity Date	Carrying Value 31 Dec 2018 RM'000	Carrying Value 31 Dec 2017 RM'000
At fair value					
2nd series	500,000	16 Oct 2014	16 Oct 2019	**501,173**	501,201
3rd series	750,000	27 Mar 2015	27 Mar 2020	**751,993**	751,628
4th series	500,000	2 Oct 2018	2 Oct 2023	**502,115**	-
	1,750,000			**1,755,281**	1,252,829

Movement in MCSP

2018	2nd series 31 Dec 2018 RM'000	3rd series 31 Dec 2018 RM'000	4th series 31 Dec 2018 RM'000
Balance at 1 January	**501,201**	**751,628**	**-**
New issuance during the financial year	**-**	**-**	**500,000**
Change in fair value other than from own credit risk	**(1,811)**	**445**	**1,054**
Change in fair value from own credit risk	**1,783**	**(80)**	**1,061**
Balance at 31 December	**501,173**	**751,993**	**502,115**

2017	2nd series 31 Dec 2017 RM'000	3rd series 31 Dec 2017 RM'000	4th series 31 Dec 2017 RM'000
Balance at 1 January	502,835	753,166	-
Change in fair value other than from own credit risk	(504)	64	-
Change in fair value from own credit risk	(1,130)	(1,602)	-
Balance at 31 December	501,201	751,628	-

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
The cumulative change in fair value due to changes in own credit risk	**2,764**	(2,732)

25 Subordinated Commodity Murabahah Financing

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Subordinated Commodity Murabahah Financing, at amortised costs		
- First tranche issued on 25 June 2014	**321,395**	314,714
- Second tranche issued on 30 June 2015	**274,592**	268,884
	595,987	583,598

The unsecured Subordinated Commodity Murabahah financing comprise of two tranches of Basel III compliant Tier 2 subordinated financing of USD equivalent of RM250 million each from the Bank's immediate holding company, HSBC Bank Malaysia Berhad (HBMY). The tenor for both the Subordinated Commodity Murabahah financing is 10 years from the utilisation date with profit payable quarterly in arrears.

26 Share Capital

	31 Dec 2018		31 Dec 2017	
	Number of Ordinary Shares ('000)	**RM'000**	Number of Ordinary Shares ('000)	RM'000
At 1 January - ordinary shares of RM0.50 each	**100,000**	**660,000**	100,000	50,000
Transition to no par value regime on 31 January 2017 under the Companies Act 2016	**-**	**-**	-	610,000
Ordinary Shares Issued and Fully Paid	**100,000**	**660,000**	100,000	660,000

27 Reserves

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Non-distributable		
Available-for-sale reserve	-	179
Financial investment at FVOCI	**479**	-
Own credit reserve	**(2,987)**	230
Capital contribution reserve [1]	**499**	408
Regulatory reserves [2]	**91,100**	34,000
	89,091	34,817
Distributable		
Retained profits	**1,073,174**	921,511
	1,162,265	956,328

[1] The capital contribution reserve is maintained to record the amount relating to share options granted to employees of the Bank directly by HSBC Holdings plc.

[2] The regulatory reserve is maintained in compliance with paragraph 10.5 of BNM's policy document on Financial Reporting and Financial Reporting for Islamic Banking Institutions issued on 2 February 2018, to maintain, in aggregate, loss allowance for non-credit-impaired exposures and regulatory reserve of no less than 1.0% of total credit exposures, net of loss allowance for credit-impaired exposures.

The regulatory reserve is debited against retained profits.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

28 Income Derived from Investment of Depositors' Funds and Others

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Income derived from investment of:		
(i) general investment deposits	**535,104**	448,502
(ii) specific investment deposits	**88,931**	51,602
(iii) others	**199,318**	211,447
	823,353	711,551
(i) Income derived from investment of general investment deposits		
Finance income:		
Financing and advances		
- Profit earned other than recoveries from impaired financing	**412,399**	364,310
- Recoveries from impaired financing	**18,249**	12,515
Financial investments at FVOCI	**58,444**	38,484
Money at call and deposit with financial institutions	**40,647**	22,783
	529,739	438,092
Other operating income		
Realised gains from dealing in foreign currency	**13,202**	16,837
Unrealised gains/(losses) from dealing in foreign currency	**236**	(461)
Gains/(losses) from sale of financial assets designated as FVTPL and other financial instruments	**1,436**	(32)
Unrealised (losses)/gains from revaluation of financial assets designated as FVTPL	**(623)**	45
Net profit received/(paid) for financial assets designated as FVTPL and other financial instruments	**1**	(11,675)
Realised gains from trading in derivatives	**2,728**	2,352
Unrealised (losses)/gains from trading in derivatives	**(1,298)**	3,074
Net expenses from financial liabilities designated at FVTPL	**(10,305)**	-
Other (expenses)/income	**(12)**	270
	5,365	10,410
	535,104	448,502

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

28 Income Derived from Investment of Depositors' Funds and Others (Cont'd)

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
(ii) Income derived from investment of specific investment deposits		
Finance income:		
Financing and advances		
- Profit earned other than recoveries from impaired financing	**80,805**	50,757
Money at call and deposit with financial institutions	**9,362**	-
	90,167	50,757
Other operating income		
Fees and commission	**694**	688
Realised (losses)/gains from dealing in foreign currency	**(1,929)**	156
Unrealised (losses)/gains from dealing in foreign currency	**(1)**	1
	(1,236)	845
	88,931	51,602
The above fees and commissions were derived from the following major contributors:		
Guarantee fees	**-**	8
Service charges and fees	**694**	597
(iii) Income derived from investment of others		
Finance income:		
Financing and advances		
- Profit earned other than recoveries from impaired financing	**153,612**	171,755
- Recoveries from impaired financing	**6,797**	5,900
Financial investments at FVOCI	**21,769**	18,143
Money at call and deposit with financial institutions	**15,141**	10,741
	197,319	206,539
Other operating income		
Realised gains from dealing in foreign currency	**4,917**	7,938
Unrealised gains/(losses) from dealing in foreign currency	**88**	(217)
Gains/(losses) from sale of financial assets designated as FVTPL and other financial instruments	**535**	(15)
Unrealised (losses)/gains from revaluation of financial assets at FVTPL	**(232)**	21
Net profit paid from financial assets designated as FVTPL and other financial instruments	**-**	(5,504)
Realised gains from trading in derivatives	**1,016**	1,109
Unrealised (losses)/gains from trading in derivatives	**(483)**	1,449
Net expenses from financial liabilities designated at FVTPL	**(3,838)**	-
Other (expenses)/income	**(4)**	127
	1,999	4,908
	199,318	211,447

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

29 Income Derived from Investment of Shareholder's Funds

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Finance income:		
Financing and advances		
- Profit earned other than recoveries from impaired financing	**64,295**	62,241
- Recoveries from impaired financing	**2,845**	2,138
Financial investments at FVOCI	**9,112**	6,575
Money at call and deposit with financial institutions	**6,337**	3,893
	82,589	74,847
Other operating income		
Fees and commission	**61,920**	67,761
Realised gains from dealing in foreign currency	**2,058**	2,877
Unrealised gains/(losses) from dealing in foreign currency	**37**	(79)
Gains/(losses) from sale of financial assets designated as FVTPL and other financial instruments	**224**	(6)
Unrealised (losses)/gains from revaluation of financial assets FVTPL	**(97)**	8
Net profit paid from financial assets designated as FVTPL and other financial instruments	**-**	(1,995)
Realised gains from trading in derivatives	**425**	402
Unrealised (losses)/gains from trading in derivatives	**(202)**	525
Shared-service fees from holding company	**2,400**	2,761
Net expenses from financial liabilities designated at FVTPL	**(1,938)**	(761)
Other income	**19**	99
	64,846	71,592
	147,435	146,439

The above fees and commissions were derived from the following major contributors:

Service charges and fees	**16,028**	22,863
Credit cards	**30,668**	26,910
Agency fees	**9,361**	11,060

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

30 Impairment Allowance/Provisions

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
New and increased allowance/provisions (net of releases)	**110,389**	195,411
Recoveries	**(40,983)**	(33,966)
Written off	**38**	7,158
Total charge to statement of profit or loss	**69,444**	168,603

Breakdown of the impairment allowance/provisions is disclosed by financial instruments type are as follow:

(i) Financing and advances

New and increased allowance (net of releases)	**111,254**	195,411
Recoveries	**(40,983)**	(33,966)
Written off	**38**	7,158
Total charge to statement of profit or loss	**70,309**	168,603

(ii) Money at call and interbank placements maturing within one month

New and increased provisions (net of releases)	**1**	**-**
Total charge to statement of profit or loss	**1**	-

(iii) Financing commitments

New and increased provisions (net of releases)	**(891)**	**-**
Total charge to statement of profit or loss	**(891)**	-

(iv) Financial investment at FVOCI

New and increased allowance (net of releases)	**25**	**-**
Total charge to statement of profit or loss	**25**	-

31 Income Attributable to Depositors

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Non-Mudharabah Fund		
- Deposits from customers	**288,598**	191,425
- Deposits and placements of banks and other financial institutions	**64,907**	65,025
- Others	**87,171**	87,910
	440,676	344,360

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

32 Operating Expenses

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Personnel expenses	**48,962**	46,047
Promotion and marketing related expenses	**15,701**	10,996
Establishment related expenses	**17,316**	18,511
General administrative expenses	**33,094**	35,349
Related company expenses	**134,026**	127,811
	249,099	238,714
Personnel expenses		
Salaries, allowances and bonuses	**38,832**	36,192
Employees Provident Fund contributions	**6,888**	6,285
Share based payment	**187**	107
Other staff related costs	**3,055**	3,463
	48,962	46,047
Promotion and marketing related expenses	**15,701**	10,996
Establishment related expenses		
Depreciation of equipment	**2,324**	4,015
Information technology costs	**2,983**	2,490
Rental of premises	**8,151**	7,631
Equipment written off	**1**	3
Utilities	**2,008**	2,080
Others	**1,849**	2,292
	17,316	18,511
General administrative expenses		
Auditors' remuneration		
- Statutory audit fees	**156**	126
- Regulatory related fees	**210**	158
- Non-audit fees	**8**	8
Professional fees	**1,819**	1,881
Communication	**1,497**	1,872
Others	**29,404**	31,304
	33,094	35,349

Included in professional fees are fees paid to the Shariah Committee members of the Bank:

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Fees	**393**	411
Dr. Ziyaad Mahomed	**91**	85
Dr. Aida Othman	**75**	61
Khairul Anuar bin Ahmad	**78**	75
Prof. Dr. Younes Soualhi	**73**	19
Dr Mohamed Ashraf bin Mohamed Iqbal	**76**	-
Assoc. Prof. Dr. Muhammad Yusuf Saleem Ghulam Nabi (term ended 31 March 2018)	**17**	75
Prof. Dr. Abdul Rahim Abdul Rahman	**-**	77
Prof. Dr. Obiyathulla Ismath Bacha	**-**	19

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

32 Operating Expenses (Cont'd)

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Related company charges	**134,026**	127,811
Of which by:		
Type of service		
- Information technology related cost	**7,048**	6,723
- Non information technology related cost	**126,978**	121,088
Countries		
- Malaysia	**133,262**	127,703
- United Kingdom	**764**	108

33 Income Tax Expense

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Malaysian income tax		
- Current year	**51,641**	22,682
- Prior year	**4,985**	(1,728)
Total current tax recognised in profit or loss	**56,626**	20,954
Deferred tax:		
Origination and reversal of temporary differences		
- Current year	**(7,757)**	(1,021)
Total income tax expense	**48,869**	19,933

A numerical reconciliation between tax expense and the accounting profit multiplied by the applicable tax rate is as follows:

	RM'000	RM'000
Profit before tax	**211,569**	106,313
Income tax using Malaysian tax rate	**50,777**	25,515
Non-deductible expenses	**847**	2,846
Tax exempt income	**(7,740)**	(6,700)
Under/(over) provision in respect of prior years	**4,985**	(1,728)
Tax expense	**48,869**	19,933

34 Earnings per share

The earnings per ordinary share have been calculated based on profit for the year and 100,000,000 number of ordinary shares in issue during the financial year.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

35 Significant Related Party Transactions and Balances

For the purpose of these financial statements, parties are considered to be related to the Bank if:

a. the Bank has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial or operational decisions, or vice versa, or

b. where the Bank and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

The related parties of the Bank comprise:

i the Bank's immediate parent bank, holding bank, and ultimate holding company (hereinafter collectively referred to as parent);

ii subsidiary and associated companies of the Bank's parent companies; and

iii key management personnel who are defined as those person having authority for planning, directing and controlling the activities of the Bank. Key personnel include all members of the Board of Directors of HSBC Amanah Malaysia Berhad. and certain members of Senior Management of the Bank. Transactions, arrangements and agreement are entered into by the Bank with companies that may be controlled/jointly controlled by Key Management Personnel of the Bank and their close family members.

(a) The significant transactions and outstanding balances of the Bank with parent banks and other related companies are as follows:

	31 Dec 2018			31 Dec 2017		
	Parent **RM'000**	***Other related companies*** **RM'000**	***Key management personnel*** **RM'000**	*Parent* RM'000	*Other related companies* RM'000	*Key management personnel* RM'000
Income						
Finance income from financing and advances	**-**	**-**	**12**	-	-	10
Fees and commission	**-**	**5,280**	**-**	-	6,200	-
Net trading income/expense	**(115,375)**	**(24,038)**	**-**	203,216	5,837	-
Other income	**2,400**	**22**	**-**	2,761	9	-
	(112,975)	**(18,736)**	**12**	205,977	12,046	10
Expenditure						
Profit attributable to deposits and placements from banks and other financial institutions	**49,991**	**41,493**	**-**	78,172	8,669	-
Fees and commission	**-**	**320**	**-**	-	446	-
Operating expenses	**126,184**	**7,842**	**-**	122,260	5,551	-
	176,175	**49,655**	**-**	200,432	14,666	-
Amount due from						
Deposits and placements with banks and other financial institutions	**-**	**63,559**	**-**	-	111,089	-
Financing and advances	**-**	**-**	**153**	-	-	124
Derivative financial assets	**37,844**	**-**	**-**	111,422	-	-
Other assets	**360**	**-**	**-**	988	926	-
	38,204	**63,559**	**153**	112,410	112,015	124
Amount due to						
Deposits and placements from banks and other financial institutions	**1,175,288**	**1,926,092**	**-**	3,024,695	944,364	-
Deposits from customers	**-**	**-**	**47**	-	-	101
Derivative financial liabilities	**207,763**	**-**	**-**	166,830	-	-
Other liabilities	**73,965**	**5,897**	**-**	183,269	3,253	-
	1,457,016	**1,931,989**	**47**	3,374,794	947,617	101

All transactions between the Bank and its related parties are made in the ordinary course of business.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

35 Significant Related Party Transactions and Balances (Cont'd)

(b) Key Management Personnel Compensation

The key management personnel compensation are as follows:

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Directors of the Bank:		
- Fees	**668**	513
Total short-term employee benefits	**668**	513
Total Directors' Remuneration	**668**	513

During the financial years ended 31 December 2018 and 31 December 2017, there were no such compensation incurred for the following:

- Professional fees paid to Directors or any firms of which the Directors are members for services rendered.
- Amount paid to or receivable by any third party for services provided by Directors.
- Indemnity give or insurance effected for any Directors.

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Other key management personnel:		
- Short-term employee benefits	**2,247**	1,513
Total key management personnel compensation	**2,915**	2,026

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

35 Significant Related Party Transactions and Balances (Cont'd)

(b) Key Management Personnel Compensation (Cont'd)

i) Directors/CEO' Remuneration

2018 **RM'000**	**Salaries and bonuses**	**Other short-term employee benefits**	**Benefits-in-kind**	**Fees**	**Total**
Non-Independent Executive Directors					
Louisa Cheang Wai Wan [1]	-	-	-	-	-
Mukhtar Malik Hussain	-	-	-	-	-
Stuart Paterson Milne [2]	-	-	-	-	-
Independent Non-Executive Directors					
Adil Ahmad	-	-	-	**117**	**117**
Albert Quah Chei Jin	-	-	-	**119**	**119**
Ho Chai Huey [3]	-	-	-	**94**	**94**
Datuk Kamaruddin Taib [4]	-	-	-	**142**	**142**
Lee Choo Hock	-	-	-	**119**	**119**
Dr. Mohamed Ashraf bin Mohamed Iqbal [5]	-	-	-	**77**	**77**
	-	-	-	**668**	**668**
CEO					
Arsalaan Ahmed	**1,688**	**534**	**25**	-	**2,247**

[1] Resigned on 20 March 2018
[2] Appointed on 24 May 2018
[3] Appointed on 2 January 2018
[4] Appointed on 2 January 2018
[5] Resigned on 31 October 2018

2017 **RM'000**	Salaries and bonuses	Other short-term employee benefits	Benefits-in-kind	Fees	Total
Non-Independent Executive Directors					
Louisa Cheang Wai Wan [6]	-	-	-	-	-
Mukhtar Malik Hussain	-	-	-	-	-
Independent Non-Executive Directors					
Adil Ahmad	-	-	-	117	117
Albert Quah Chei Jin	-	-	-	118	118
Azlan bin Abdullah [7]	-	-	-	36	36
Lee Choo Hock	-	-	-	119	119
Dr. Mohamed Ashraf bin Mohamed Iqbal [8]	-	-	-	123	123
	-	-	-	513	513
CEO					
Arsalaan Ahmed	1,061	427	25	-	1,513

[6] Reappointed and redesignated on 1 January 2017
[7] Retired 8 May 2017
[8] Reappointed and redesignated on 6 August 2017

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

35 Significant Related Party Transactions and Balances (Cont'd)

(b) Key management personnel compensation (Cont'd)

ii) Total value of remuneration awards for the financial year

	31 Dec 2018		31 Dec 2017	
	Unrestricted RM'000	**Deferred RM'000**	Unrestricted RM'000	Deferred RM'000
Fixed remuneration				
Cash	**1,151**	**-**	1,151	-
Variable remuneration				
Cash	**488**	**-**	698	-
Shares and share-linked instruments	**-**	**122**	-	78
	488	**122**	698	78
	1,639	**122**	1,849	78

Number of officers having received a variable remuneration during the financial year: 1 (2017: 1)

	31 Dec 2018		31 Dec 2017	
	Number	**Amount RM'000**	Number	Amount RM'000
Outstanding deferred remuneration				
Cash	**-**	**-**	-	-
Shares and share-linked instruments	**1**	**79**	-	-
		79		-
Deferred remuneration paid out	**-**	**-**	-	-

36 Credit exposure to connected parties

The credit exposures of the Bank to connected parties, as defined by Bank Negara Malaysia's Guidelines on Credit Transactions and Exposures with Connected Parties' are as follows:

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Aggregate value of outstanding credit exposures to connected parties	**973,888**	945,354
As a percentage of total credit exposures	**5.4%**	5.5%
Aggregate value of outstanding credit exposures to connected parties which is non-performing or in default	-	-
As a percentage of total credit exposures	-	-

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

37 Capital Adequacy

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Tier 1 capital		
Paid-up ordinary share capital	**660,000**	660,000
Retained profits	**1,073,174**	921,511
Other reserves	**88,251**	34,945
Regulatory adjustments	**(94,783)**	(47,023)
Total Common Equity Tier 1 (CET1) and Tier 1 capital	**1,726,642**	1,569,433
Tier 2 capital		
Subordinated Commodity Murabahah financing	**595,987**	583,598
Impairment allowance (unimpaired portion) & regulatory reserves	**152,771**	149,254
Total Tier 2 capital	**748,758**	732,852
Capital base	**2,475,400**	2,302,285
Inclusive of proposed dividend		
CET1 and Tier 1 Capital ratio	**13.025%**	12.203%
Total Capital ratio	**18.673%**	17.902%
Net of proposed dividend		
CET 1 and Tier 1 Capital ratio	**12.723%**	12.125%
Total Capital ratio	**18.371%**	17.824%

The total capital and capital adequacy ratios have been computed based on the Standardised Approach in accordance with the Capital Adequacy Framework for Islamic Banks (CAFIB). The Bank has adopted the Standardised Approach for Credit Risk and Market Risk, and the Basic Indicator Approach for Operational Risk.

Breakdown of RWA in the various categories of risk weights:

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Total RWA for credit risk	**12,221,665**	11,940,340
Total RWA for market risk	**91,851**	9,450
Total RWA for operational risk	**943,049**	910,994
	13,256,565	12,860,784

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

38 Commitments and Contingencies

The table below shows the contracts or underlying principal amounts, positive fair value of derivative contracts, credit equivalent amounts and risk weighted amounts of unmatured off-balance sheet transactions at the statement of financial position date. The underlying principal amounts indicate the volume of business outstanding and do not represent amounts at risk.

These commitments and contingencies are not secured over the assets of the Bank.

Principal amount	**31 Dec 2018 RM'000**	31 Dec 2017 RM'000
Direct credit substitutes	**491,803**	494,387
Transaction-related contingent items	**1,138,590**	996,770
Short-term self-liquidating trade-related contingencies	**63,111**	49,645
Formal standby facilities and credit lines		
- Maturity not exceeding one year	**1,374,867**	1,739,249
- Maturity exceeding one year	**2,156,256**	2,130,614
Other unconditionally cancellable	**1,541,548**	2,233,191
Unutilised credit card lines	**3,452,850**	3,024,432
Equity related contracts		
- Less than one year	**116,883**	2,945
- One year to less than five years	**362,229**	85,394
Profit rate related contracts		
- Less than one year	**2,077,822**	344,703
- One year to less than five years	**1,671,166**	3,193,730
- Over five years	**232,745**	253,904
Foreign exchange related contracts		
- Less than one year	**7,837,019**	3,311,980
- One year to less than five years	**646,019**	2,640,794
	23,162,908	20,501,738

39 Lease commitments

The Bank has lease commitments in respect of rented premises, all of which are classified as operating leases. A summary of the non-cancellable long term commitments net of sub-leases (if any) are as follows:

	31 Dec 2018 RM'000	31 Dec 2017 RM'000
Less than one year	**7,225**	5,291
Between one and three years	**6,088**	3,333
Between three and five years	**91**	16
	13,404	8,640

40 Capital commitments

	1,541,548 RM'000	31 Dec 2017 RM'000
Authorised and contracted, but not provided for	**193**	-

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

41 Equity-based compensation

The Bank participated in the following cash settled share compensation plans operated by the HSBC Group for the acquisition of HSBC Holdings plc shares.

a) *Restricted Share Plan and Share Match Schemes*

The HSBC Holdings Restricted Share Plan is intended to align the interests of executives with those of shareholders by linking executive awards to the creation of superior shareholder value. This is achieved by focusing on predetermined targets. 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. Vested shares may be subject to a retention requirement (restriction) post-vesting. The cost of the conditional awards is recognised through an annual charge based on the likely level of vesting of shares, apportioned over the period of service to which the award relates.

The Share Match Schemes was first introduced in Malaysia in 2014. Eligible HSBC employees will acquire HSBC Holdings ordinary shares. Shares are purchased in the market each quarter up to a maximum value of £750 or the equivalent in local currency over a period of one year. Matching awards are added at a ratio of one free share for every three purchased. Matching awards vest subject to continued employment and the retention of the purchased shares for a maximum period of two years and nine months.

	31 Dec 2018 Number ('000)	31 Dec 2017 Number ('000)
Balance at 1 January	**4**	6
Granted in the financial year	**5**	3
Exercised in the financial year	-	(1)
Released in the financial year	**(2)**	(2)
Cancelled in the financial year	**(1)**	(1)
Transferred out in the financial year	**(1)**	(1)
Balance at 31 December	**5**	4
Compensation cost recognised during the financial year	**187**	107

The weighted average purchase price for all shares purchased by HSBC for awards under the Restricted Share Plan and the Share Match Schemes is £7.16 (2017: £6.59). The weighted average fair value of the HSBC share at 31 December 2018 was £6.99 (2017: £5.84). The weighted average remaining vesting period as at 31 December 2018 for shares granted during the year was 1.26 years (2017: 1.27 years).

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

42 Shariah Advisors

In line with Bank Negara Malaysia's Guideline on Shariah Governance Framework for Islamic Financial Institution, the current Scholars appointed are:

1) Dr. Ziyaad Mahomed
Dr. Ziyaad Mahomed is currently an Associate Dean of E-Learning and Director of Executive Education at International Centre for Education of Islamic Finance (INCEIF). He holds a PhD in Islamic Finance from INCEIF, BA (Hons) Business (Finance) from Anglia Ruskin University, United Kingdom, and a Chartered Islamic Finance Professional (CIFP) holder from INCEIF. He is also an MBA and Certificate in Islamic Law holder from The Management College of Southern Africa (MANCOSA) and University of Kwazulu Natal, South Africa, respectively.

2) Dr. Aida Othman
Dr. Aida Othman is currently a Partner at Zaid Ibrahim & Co. She is also a Director with ZICO Shariah Advisory Services Sdn. Bhd. She holds a PhD in Comparative Law & Middle Eastern Studies from Harvard University, a Masters of Law from University of Cambridge and a Bachelor of Laws and Bachelor of Islamic Law (Syariah) (both with First Class Honours), from International Islamic University Malaysia (IIUM).

3) Khairul Anuar bin Ahmad
Khairul Anuar bin Ahmad is currently a Senior Lecturer in International Islamic University College Selangor (KUIS). He holds a Bachelor and Master of Shariah from University of Malaya and PhD in Islamic Banking and Finance from IIUM.

4) Prof. Dr. Younes Soualhi
Prof. Dr. Younes Soualhi is currently a Senior Researcher at International Shariah Research Academy. He holds a Bachelor, Master and PhD in Usul al-Fiqh from the Emir Abdul Qadir University for Islamic Sciences, Algeria, IIUM and University Malaya respectively. He also holds a diploma in Human Sciences from IIUM. He is certified financial planner registered under Malaysian Financial Planning Council (MFPC).

5) Dr Mohamed Ashraf bin Mohamed Iqbal
Dr. Mohamed Ashraf Mohamed Iqbal is currently a Director of MindSpring Sdn Bhd, a consulting firm that he started in 2005. He was appointed as a non-executive director for HSBC Amanah Malaysia Berhad for ten years before resigning in October 2018. He holds a Bachelor of Science in Mechanical Engineering, Masters in Business Administration from California State University, United States of America, and a Postgraduate Diploma in Islamic Studies from IIUM. He subsequently obtained his doctorate in Islamic Finance from INCEIF in 2016.