HSBC AMANAH MALAYSIA BERHAD
(Company No. 200801006421 (807705-X))
(Incorporated in Malaysia)

FINANCIAL STATEMENTS – 31 DECEMBER 2019

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

HSBC AMANAH MALAYSIA BERHAD
(Company No. 200801006421 (807705-X))
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BOARD OF DIRECTORS

Datuk Kamaruddin bin Taib
Independent Non-Executive Chairman

Stuart Paterson Milne
Non-Independent Executive Director

Mukhtar Malik Hussain
Non-Independent Executive Director

Adil Ahmad
Independent Non-Executive Director

Lee Choo Hock
Non-Independent Non-Executive Director *(re-designated as Non-Independent on 30 May 2019)*

Albert Quah Chei Jin
Independent Non-Executive Director

Ho Chai Huey
Independent Non-Executive Director

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 Corporate Governance (BNM Corporate Governance Policy).

Directors

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

Datuk Kamaruddin bin Taib, 63
Independent Non-Executive Chairman
Member of Audit Committee and Nominations and Remuneration Committee
Appointed to the Board and as Chairman**:** January 2018

Datuk Kamaruddin Bin Taib was appointed as Independent Non-Executive Chairman of the Bank on 2 January 2018. He is a member of the Audit Committee and Nominations and Remuneration Committee of the Bank.

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

Datuk Kamaruddin is the Chairman 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. 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.

Datuk Kamaruddin is currently the Chairman of GHL Systems Berhad. Datuk Kamaruddin is also a Director of Great Eastern General Insurance (Malaysia) Berhad, FIDE Forum, Fraser & Neave Holdings Berhad, Malaysia Smelting Corporation Berhad and RAM Holdings Berhad.

Datuk Kamaruddin currently sits as Internal Audit Sub-Committee of The Royal Selangor Golf Club.

Datuk Kamaruddin does not have any shareholding in the Bank.

Stuart Paterson Milne, 60
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, 60
Non-Independent Executive Director
Appointed to the Board**:** December 2009

Mr Mukhtar was appointed as Non-Independent Executive Director on 15 December 2009.

Mr Mukhtar graduated from the 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 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 then 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 to 2009, he was the Deputy Chairman of HSBC Bank Middle East Limited and Global CEO of HSBC Amanah Malaysia Berhad. He was also the CEO, Global Banking and Markets for Middle East and North Africa before assuming his role as the CEO of the Bank 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.

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, 63
Independent Non-Executive Director
Chairman of the Risk Committee and member of Audit Committee and Nominations and Remuneration Committee
Appointed to the Board: May 2014

Mr Adil was appointed as Independent Non-Executive Director on 5 May 2014. He is the Chairman of Risk Committee and member of the Audit Committee and Nominations and Remuneration Committee of the Bank.

Mr Adil holds a Masters in Business Administration (Finance & Accounting) and BA in Economics from Cornell University, Ithaca, New York. He has 35 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 Chief Executive Officer 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 is currently a council member of GLG (Gerson Lehrman Group) and an Independent Director of FIDE Forum.

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, 67
Non-Independent Non-Executive Director
Member of the Audit Committee, Risk Committee and Nominations and Remuneration Committee
Appointed to the Board: May 2016

Mr Lee was appointed as Independent Non-Executive Director on 30 May 2016 and subsequently re-designated as Non-Independent Non-Executive Director on 30 May 2019. He is a member of the Audit Committee, Risk Committee and Nominations and Remuneration Committee of the Bank.

He 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 Malayan Banking Berhad (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 Maybank 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 Maybank.

He is a Director of Kossan Rubber Industries Berhad, Yayasan Kossan and Independent Non-Executive Director of HSBC Bank Malaysia Berhad.

Mr Lee does not have any shareholding in the Bank.

Albert Quah Chei Jin, 67
Independent Non-Executive Director
Chairman of Audit Committee and member of Risk Committee and Nominations and Remuneration Committee
Appointed to the Board: September 2016

Mr Albert Quah was appointed as Independent Non-Executive Director on 5 September 2016. He is the Chairman of Audit Committee and member of the Risk Committee and Nominations and Remuneration Committee of the Bank.

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

Mr Albert Quah 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 in 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.

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

Ho Chai Huey, 60
Independent Non-Executive Director
Chairman of Nominations and Remuneration Committee and Member of Risk Committee
Appointed to the Board: January 2018

Ho Chai Huey was appointed as Independent Non-Executive Director on 2 January 2018. She is the Chairman of Nominations and Remuneration Committee and member of the Risk Committee of the Bank.

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 24 by 7 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, one (1) Non-Independent Non-Executive Director and four (4) 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.

Mr Lee Choo Hock was re-designated as Non-Independent Non-Executive Director on 30 May 2019. He was previously an Independent Non-Executive Director.

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

Six (6) Board meetings were held in 2019. The table below show each Director's attendance (including attendance via video conferencing) at meetings of all Board and Committees' meetings during 2019. 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.

2019 Board and Committee meeting attendance	Board	Audit Committee	Risk Committee	Nominations and Remuneration Committee
Total number of meetings held	**6**	**4**	**6**	**5**
Independent Non-Executive Chairman				
Datuk Kamaruddin bin Taib	6	4	-	5
Non-Independent Executive Directors				
Stuart Paterson Milne	6	-	-	-
Mukhtar Malik Hussain	5	-	-	-
Independent Non-Executive Directors				
Adil Ahmad	6	4	6	5
Albert Quah Chei Jin	6	4	6	5
Ho Chai Huey	6	-	6	5
Non-Independent Non-Executive Director				
Lee Choo Hock[1]	6	4	6	5

[1] Re-designated as Non-Independent Non-Executive Director on 30 May 2019. He was previously an Independent Non-Executive Director.

Directors' Emoluments

Details of the emoluments of the Directors of the Bank for 2019, 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, majority being Independent Non-Executive Directors, are:
- Albert Quah Chei Jin (Chairman)
- Adil Ahmad
- Lee Choo Hock
- Datuk Kamaruddin bin Taib

During 2019, 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, majority being Independent Non-Executive Directors, are:
- Adil Ahmad *(Chairman)*
- Lee Choo Hock
- Albert Quah Chei Jin
- Ho Chai Huey

During 2019, 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 2019.

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, majority being Independent Non-Executive Directors, are:
- Ho Chai Huey *(Chairman)*
- Adil Ahmad
- Albert Quah Chei Jin
- Lee Choo Hock
- Datuk Kamaruddin bin Taib

During 2019, the Nominations and Remuneration Committee held 5 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:
- Asst. Prof Dr Ziyaad Mahomed *(Chairman)*
- Dr Aida binti Othman
- Dr Khairul Anuar bin Ahmad
- Prof Dr. Younes Soualhi
- Dr Mohamed Ashraf bin Mohamed Iqbal

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
- 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 capital, liquidity, funding, profit risk in the banking book, structural foreign exchange and strategic equity risk.

(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)

Board Committees (Cont'd)

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 Bank maintained on a group basis, a Directors' and Officers' Liability Insurance which provides adequate insurance cover for the Directors and Officers.

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 their strategic objectives.

To meet this requirement and to discharge its obligations, procedures have been designed for safeguarding assets against unauthorised use or disposal; for maintaining proper accounting records; and for ensuring the reliability and usefulness of financial information used within the business or for publication.

These procedures provide reasonable assurance against material mis-statement, errors, losses or fraud. They are designed to provide effective internal control within the Bank. The procedures have been in place throughout the year and up to 4 February 2020, the date of approval of the audited financial statements of the Bank for the financial year ended 31 December 2019.

The key risk management and internal control procedures over financial reporting includes the following:

- **Entity level controls**

  The primary mechanism through which comfort over risk management and internal control systems is achieved is through assessments of the effectiveness of entity level controls, and the reporting of risk and control issues on a regular basis through the various risk management and risk governance forums. Entity level controls are internal controls that have a pervasive influence over the entity as a whole. They include controls related to the control environment, for example the Bank's values and ethics, the promotion of effective risk management and the overarching governance exercised by the Board and its non-executive committees.

  The design and operational effectiveness of entity level controls are assessed annually as part of the assessment of the effectiveness of internal controls over financial reporting. If issues are significant to the Bank, they are escalated to the Audit Committee for financial reporting issues and/or the Risk Committee for all other risk types. HSBC Group has commenced a refresh exercise to simplify the suite of entity level controls relied upon to meet the internal control principles of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework, which is expected to complete in 2020 at HSBC Group level, and subsequently rolled-out to sites, including HSBC Malaysia.

- **Process level transactional controls**

  Key process level controls that mitigate the risk of financial misstatement are identified, recorded and monitored in accordance with the risk framework. This includes the identification and assessment of relevant control issues, against which action plans are tracked through to remediation. The Audit Committee and Risk Committee have continued to receive regular updates on the Bank's ongoing activities for improving the effective oversight of 'end-to-end' business processes, which continues to identify opportunities for enhancing key controls, such as through the use of automation technologies.

- **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 documented accounting policies and reporting formats 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 are subject to certification by the Chief Financial Officer and Board's approval.

- **Group's Global Principles**

  The Global Principles set an overarching standard for all other policies and procedures throughout the HSBC Group and are fundamental to the Bank's risk management structure. It spells out, and connect, the Bank's purpose, values, strategy and risk management principles, guiding on what is right and the manner to treat customers and colleagues fairly at all times.

INTERNAL CONTROL FRAMEWORK (Cont'd)

- **Enterprise risk management framework (ERMF)**

  The ERMF provides an effective and efficient approach to govern and oversee the organisation and monitor and mitigate risks to the delivery of the Bank's strategy. It applies to all categories of risk, covering core governance, standards and principles that bring together all of the Bank's risk management practices into an integrated structure.

- **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.

- **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.

- **Risk identification and monitoring**

  Systems and procedures are in place to identify, assess, control and monitor the material risk types facing the Bank as set out in the enterprise-wide risk framework. The Bank's risk measurement and reporting systems are designed to help ensure that material risks are captured with all the attributes necessary to support well-founded decisions, that those attributes are accurately assessed and that information is delivered in a timely manner for those risks to be successfully managed and mitigated.

- **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, which contains an aggregate of all current and forward-looking risks and enables it to take action that either prevents these risk from materialising or to limit their impact.

- **Responsibility for risk management**

  All employees are responsible for identifying and managing risk within the scope of their role as part of the three lines of defence model, which is an activity-based model to delineate management accountabilities and responsibilities for risk management and the control environment. The second line of defence sets the policy and guidelines for managing specific risk areas, provides advice and guidance in relation to the risk, and challenges the first line of defence (the risk owners) on effective risk management.

- **Strategic plans**

  Strategic plans are prepared for global businesses and global functions within the framework of the HSBC Group's overall strategy. Annual operating plans, 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, are prepared and adopted, and sets out the key business initiatives and the likely financial effects of those initiatives.

The effectiveness of the Bank's system of risk management and internal control is reviewed regularly by the Board, the Risk Committee and the Audit Committee. The Risk Committee and the Audit Committee have received confirmation that executive management has taken or is taking the necessary actions to remedy any failings or weaknesses identified through the operation of the framework of controls. The Audit Committee and Risk Committee have worked closely to ensure there were procedures to manage risk and oversee the internal control framework.

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 2019	• 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 2019.

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
- Stuart Paterson Milne
- Mukhtar Malik Hussain
- Adil Ahmad
- Lee Choo Hock [1]
- Albert Quah Chei Jin
- Ho Chai Huey

In accordance with Rule 21.6 of the Constitution, all Directors shall retire from the Board at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-election.

[1] Re-designated as Non-Independent Non-Executive Director on 30 May 2019. He was previously an Independent Non-Executive Director.

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	**229,390**
Tax expense	**(41,569)**
Profit after tax	**187,821**

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 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 1.1.2019	Acquired	Disposed	As at 31.12.2019
HSBC Holdings plc				
Ordinary shares of USD0.50				
Mukhtar Malik Hussain	1,455,407	161,508	-	1,616,915
Stuart Paterson Milne [1]	206,514	82,802	(38,146)	251,170
Adil Ahmad	3,200	-	-	3,200

	Number of Shares			
	Shares held at 1.1.2019	Shares issued during the year [2]	Shares vested during the year	Shares held at 31.12.2019
HSBC Holdings plc				
HSBC Share Plan				
Mukhtar Malik Hussain	240,174	109,606	(169,537)	180,243
Stuart Paterson Milne [1]	103,344	34,064	(48,026)	89,382

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

None of the other Directors holding office at 31 December 2019 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 RM0.40 per share, amounting to net dividend payment of RM40 million in respect of the financial year ended 31 December 2018. The dividend was paid on 26 April 2019.

The Directors recommend the payment of a final dividend of RM0.50 per share, amounting to net dividend payment of RM50 million in respect of the financial year ended 31 December 2019. 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 2019.

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 recorded a higher profit before tax of RM229.4 million for the financial year ended 31 December 2019, an increase of RM17.8 million compared to previous financial year.

The higher profit was contributed by net income before impairment of RM550.0 million, an increase of RM13.5 million, mainly due to higher finance income earned from financial assets designated at fair value through other comprehensive income and deposit placements with financial institutions.

The Bank continues to place high emphasis in managing its operating expenses to ensure that the resources were spent in a sustainable manner. The Bank is committed to invest in people to support its growth aspiration and control agenda.

Total assets size at 31 December 2019 stood at RM21.2 billion, RM0.9 billion or 4.4% higher compared against 31 December 2018 (RM20.3 billion). The Bank's capital and liquidity ratios continue to remain strong and well above the regulatory requirements.

Business Strategy during the Year 2019

During 2019, the Bank have largely focused its business strategy on sustainable growth, risk management, efficiency and streamlining, as well as offering innovative products and digital service solution to its clients.

In the retail business, the 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. New products and propositions were launched to meet different customer needs and widen our product based. The prominent ones are HSBC Fusion, which provides a new and unique solution to both the small businesses and its owners, and HSBC Everyday Global Account, which is a transactional multi-currency account where customers open their accounts in MYR and get automatic access to various foreign currencies. Customers' growth remain strong, and market share in cards and mutual funds continue to trend upwards.

Commercial Banking (CMB) continued to deliver its strategy to position HSBC Malaysia as a leading international bank, assisting local corporates to expand their operations overseas, and thereby support foreign direct investment into Malaysia. Strong growth was recorded across key corridors in 2019, in particular ASEAN and China, as evidenced by robust revenue uplift in both ASEAN outbound and China inbound revenue. From the digital front, CMB has successfully launched the first of its kind HSBCnet Trade Transaction Tracker, which enables customers to track real-time status of trade transactions quickly and easily. CMB also implemented a Supply Chain Finance Platform to enhance the digital trade capabilities in the emerging market of structured trade. In addition, there have been on-going efforts in the commercialisation of digital tools and streamlining initiatives to simplify processes and improvements in customer journeys.

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

HSBC Malaysia's strong financial position is also recognised by external parties including RAM Ratings Services Berhad, which in 2019 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 2019.

Corporate social responsibility continues to be a key focus area of HSBC. In 2019, the Bank continued to focus on three main pillars which include developing Future Skills, Sustainable Network & Entrepreneurship and Sustainable Finance.

Performance review, Strategy and Outlook (Cont'd)

Business Strategy during the Year 2019 (Cont'd)

In addition the Bank aspires to support HSBC Group's sustainability agenda which is also in line with 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 interests. In 2019, the Bank was awarded The Islamic Deal of the Year, The Best Deal in Malaysia, The Best Sukuk, and The Most Innovative Deal by The Asset Triple A Islamic Finance Awards for the issuance of 500 million ringgit United Nations Sustainable Development Goals (SDG) Sukuk, whereby the proceeds will be utilised to finance eligible businesses and projects in accordance with the HSBC SDG Bond Framework. The Bank will continue to explore different opportunities to ensure commitment towards the VBI agenda.

Outlook For 2020

For 2019, the Malaysian economy expanded annually by 4.3% (2018: 4.7%). Headline inflation was lower at 1.0% during 4Q 2019, mainly reflecting the lapse in the impact from sales and services tax (SST) implementation.

Going into 2020, the outlook of the global economy remains uncertain due to the ongoing coronavirus outbreak, outcome of various trade negotiations, geopolitical risks, weaker-than-expected growth of major trading countries and heightened volatility in the financial markets.

Amid the challenging environment, the growth in the Malaysian economy is expected to gradually improve in 2020 with continued support from household spending and supportive monetary and fiscal policy changes. To secure the growth trajectory amid price stability, Bank Negara Malaysia, has on 22 January 2020, reduced the Overnight Policy Rate (OPR) by 25 basis points to 2.75%. This is in addition to the previous 25-basis point cut in May 2019.

Overall investment activity in 2020 is expected to record a modest recovery, underpinned by ongoing and new projects, both in the public and private sectors. The Finance Ministry, during Budget for 2020, has also forecasted the GDP for 2020 to grow by 4.8%.

In 2020, headline inflation is expected to average higher but remain modest. The trajectory of headline inflation will continue to be primarily dependent on global crude oil prices and the timing of the lifting of the domestic retail fuel price ceilings, but is expected to be broadly stable. The Ringgit, consistent with most regional currencies, has generally depreciated against US dollar during the year, and will continue to be affected by external factors.

From funding perspective, the banking system liquidity is expected to remain robust and sufficient to facilitate financial intermediation despite continuous strong competition among banks for deposits especially in view of Basel III's Net Stable Funding Ratio requirement coming into effect on 1 July 2020. BNM has also reduced the Statutory Reserve Requirement (SRR) Ratio from 3.5% to 3.0% effective from 16 November 2019 in an effort to maintain sufficient liquidity in the domestic financial system.

Separately, the much awaited digital banking licensing framework has been issued by BNM for industry consultation in late December 2019. BNM is expected to finalise the policy in first half of 2020 and up to five digital bank licences is expected to be issued to qualified applicants to conduct either conventional or Islamic banking business in Malaysia. Many local players are already eyeing the licence following from the issuance of digital banking licence in Singapore and Hong Kong, along with the successful set-up of a few digital banks in China, Australia and South Korea. Non-bank players from the FinTech sector are expected to join the crowd, leveraging on their well-established e-payment and e-wallet platforms. In time to come, the banking industry will face an unprecedented, new stream of competitors. Digital banking will definitely change the banking landscape and may prove to be one of the biggest disruption that the banking industry has seen in decades.

In attune to the rapid technology development, the Bank is also gearing up its technology frontier by enhancing digital capabilities for mobile and internet banking to improve customer service and experience. In addition, the Bank will continue to deepen the relationship with existing customers and also to penetrate new customer segments including the tech-savvy group.

Performance review, Strategy and Outlook (Cont'd)

Outlook For 2020 (Cont'd)

The Bank will also continue to leverage on HSBC Group's international network and capabilities to capture cross-border opportunities in the ASEAN and Belt and Road Initiative (BRI) corridors, and grow its business by leveraging on government schemes, providing customers with structured banking solutions and sustainable financing, besides maintaining its commitment towards the VBI agenda.

In the spirit of putting customer's interest first and doing the right things, the Bank will continue its journey in building the right culture for the organisation, providing continuous training and staff development, and gaining efficiency as it progress.

Awards won during the financial year:

1. **Islamic deal of the year for HSBC Amanah's 500 million ringgit United Nations sustainable development goals sukuk** - The Asset Triple A Islamic Finance Awards 2019

2. **Best deal, Malaysia for HSBC Amanah's 500 million ringgit United Nations sustainable development goals sukuk** - The Asset Triple A Islamic Finance Awards 2019

3. **Best sukuk for HSBC Amanah's 500 million ringgit United Nations sustainable development goals sukuk** - The Asset Triple A Islamic Finance Awards 2019

4. **Most innovative deal for HSBC Amanah's 500 million ringgit United Nations sustainable development goals sukuk** - The Asset Triple A Islamic Finance Awards 2019

5. **Best Trade Finance Bank** - The Asset Triple A Islamic Finance Awards 2019

6. **Best Corporate Sukuk for Tenaga Nasional's US$750 million sukuk wakala** – The Asset Triple A Islamic Finance Awards 2019

7. **Largest Payment Volume Islamic Credit Card** – Visa Malaysia Bank Awards 2018/2019

8. **Best Country Deal Award for Serba Dinamik's US$300 million 3-year high yield sukuk -** FinanceAsia Achievement Awards 2019

DIRECTORS' REPORT (Cont'd)

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 4 February 2020.

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

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

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

Kuala Lumpur, Malaysia
4 February 2020

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 2019 and financial performance of the Bank for the financial year ended 31 December 2019 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 4 February 2020.

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

Kuala Lumpur, Malaysia
4 February 2020

HSBC AMANAH MALAYSIA BERHAD
(Company No. 200801006421 (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

at Kuala Lumpur, Malaysia on 4 February 2020.

....
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 be 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 2019:

1. We have conducted eight (8) meetings for the whole year of 2019 in which the Shariah Committee members have met the minimum attendance requirement of at least 75% of the Shariah committee meetings and reviewed the principles and the contracts relating to the transactions and applications introduced by the Bank during the financial year ended 31 December 2019 to ensure conformity with Shariah requirements.

2. We have performed an 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 2019 that have been reviewed by us, are in compliance with Shariah rules and principles;

(b) the allocation of profit and charging of losses relating to the 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 either been realised from sources or by means prohibited by the Shariah principles have been considered for disposal to charitable causes where remedial actions have been put in place; and

(d) the Bank is not required to pay zakat for the financial year ended 31 December 2019 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 2019 have been conducted in conformity with the Shariah principles.

We pray to Allah the Almighty to grant us success and the path of continued guidance.

Wassalamu 'Alaikum Warahmatullahi Wabarakatuh

Chairman of the Shariah Committee ……………………………………………….
Asst Prof Dr Ziyaad Mahomed (Chairman)

Member of the Shariah Committee ……………………………………………….
Dr Aida binti Othman

Member of the Shariah Committee ……………………………………………….
Dr Khairul Anuar bin Ahmad

Member of the Shariah Committee ……………………………………………….
Prof Dr Younes Soualhi

Member of the Shariah Committee ……………………………………………….
Dr Mohamed Ashraf bin Mohamed Iqbal

Kuala Lumpur, Malaysia
4 February 2020

INDEPENDENT AUDITORS' REPORT
TO THE MEMBER OF HSBC AMANAH MALAYSIA BERHAD
(Incorporated in Malaysia)
(Company No. 200801006421 (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 2019, 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 2019 of the Bank, and the statement of profit or loss, statement of 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.

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. 200801006421 (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 judgement 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.

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.

INDEPENDENT AUDITORS' REPORT (CONT'D)
TO THE MEMBER OF HSBC AMANAH MALAYSIA BERHAD (CONT'D)
(Incorporated in Malaysia)
(Company No. 200801006421 (807705-X))

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

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
02682/10/2021 J
Chartered Accountant

Kuala Lumpur
18 February 2020

HSBC AMANAH MALAYSIA BERHAD
(Company No. 200801006421 (807705-X))
(Incorporated in Malaysia)

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2019

	Note	**31 Dec 2019 RM'000**	31 Dec 2018 RM'000
Assets			
Cash and short-term funds	*8*	**4,781,964**	2,804,494
Deposits and placements with banks and other financial institutions	*9*	**139,153**	-
Financial investments at fair value through other comprehensive income (FVOCI)	*10*	**2,719,975**	2,725,683
Financing and advances	*11*	**13,042,953**	14,137,337
Derivative financial assets	*14*	**125,674**	242,284
Other assets	*15*	**68,641**	50,664
Statutory deposits with Bank Negara Malaysia	*16*	**329,662**	364,662
Equipment	*17*	**7,101**	6,868
Deferred tax assets	*19*	**23,908**	17,363
Total assets		**21,239,031**	20,349,355
Liabilities			
Deposits from customers	*20*	**13,320,333**	11,444,577
Deposits and placements from banks and other financial institutions	*21*	**2,339,954**	3,299,964
Structured liabilities designated at fair value through profit or loss (FVTPL)	*22*	**1,295,358**	884,877
Bills payable		**22,036**	18,594
Derivative financial liabilities	*14*	**79,721**	227,330
Other liabilities	*23*	**343,396**	270,960
Provision for taxation		**12,007**	29,520
Multi-Currency Sukuk Programme	*24*	**1,265,929**	1,755,281
Subordinated Commodity Murabahah Financing	*25*	**589,612**	595,987
Total liabilities		**19,268,346**	18,527,090
Equity			
Share capital	*26*	**660,000**	660,000
Reserves	*27*	**1,310,685**	1,162,265
Total equity attributable to owner of the Bank		**1,970,685**	1,822,265
Total liabilities and equity		**21,239,031**	20,349,355
Restricted investment accounts [1]		4,144,225	4,175,818
Total Islamic Banking asset [1]		25,383,256	24,525,173
Commitments and contingencies	*38*	**20,854,027**	23,162,908

[1] The disclosure is in accordance with the requirements of Bank Negara Malaysia's Guideline on Financial Reporting for Islamic Banking Institutions dated 27 September 2019.

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

HSBC AMANAH MALAYSIA BERHAD
(Company No. 200801006421 (807705-X))
(Incorporated in Malaysia)

STATEMENT OF PROFIT OR LOSS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2019

	Note	**31 Dec 2019 RM'000**	31 Dec 2018 RM'000
Income derived from investment of depositors' funds and others	*28*	**826,138**	823,353
Income derived from investment of shareholder's funds	*29*	**162,451**	147,435
Impairment allowance/provision	*30*	**(75,483)**	(69,444)
Total distributable income		**913,106**	901,344
Income attributable to depositors	*31*	**(438,635)**	(434,346)
Total net income		**474,471**	466,998
Operating expenses	*32*	**(245,081)**	(255,429)
Profit before tax		**229,390**	211,569
Tax expense	*33*	**(41,569)**	(48,869)
Profit for the financial year		**187,821**	162,700

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

HSBC AMANAH MALAYSIA BERHAD
(Company No. 200801006421 (807705-X))
(Incorporated in Malaysia)

STATEMENT OF COMPREHENSIVE INCOME FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2019

	Note	**31 Dec 2019 RM'000**	31 Dec 2018 RM'000
Other comprehensive income/(expense)			
Items that will not be reclassified to profit or loss			
Own credit reserves:			
Change in fair value		**(6,934)**	(4,859)
Income tax effect		**1,664**	1,166
Items that will subsequently be reclassified to profit or loss when specific conditions are met:			
Fair value through other comprehensive income/(expense) reserve:			
Change in fair value		**16,285**	(287)
Net amount transferred from profit or loss		**(8,653)**	482
Impairment charges		**14**	25
Income tax effect		**(1,831)**	(46)
Other comprehensive income/(expense) for the financial year, net of tax		**545**	(3,519)
Total comprehensive income for the financial year		**188,366**	159,181
Profit attributable to the owner of the Bank		**187,821**	162,700
Total comprehensive income attributable to the owner of the Bank		**188,366**	159,181
Basic earnings per RM0.50 ordinary share	*34*	**187.8 sen**	162.7 sen
Dividends per RM0.50 ordinary share (net)			
- final dividend paid in respect of the year		**40.0 sen**	10.0 sen

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

HSBC AMANAH MALAYSIA BERHAD
(Company No. 200801006421 (807705-X))
(Incorporated in Malaysia)

STATEMENT OF CHANGES IN EQUITY FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2019

	Non-distributable					*Distributable*	
	Share capital	*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**
2019							
Balance at 1 January	**660,000**	**479**	**(2,987)**	**499**	**91,100**	**1,073,174**	**1,822,265**
Profit for the financial year	**-**	**-**	**-**	**-**	**-**	**187,821**	**187,821**
Other comprehensive income, net of tax							
FVOCI reserve/Own Credit reserve							
Net change in fair value	**-**	**12,377**	**(5,270)**	**-**	**-**	**-**	**7,107**
Net amount transferred to profit or loss	**-**	**(6,576)**	**-**	**-**	**-**	**-**	**(6,576)**
Impairment charges	**-**	**14**	**-**	**-**	**-**	**-**	**14**
Total other comprehensive income	***-***	***5,815***	***(5,270)***	***-***	***-***	***-***	***545***
Total comprehensive income for the financial year	**-**	**5,815**	**(5,270)**	**-**	**-**	**187,821**	**188,366**
Net change in regulatory reserves	**-**	**-**	**-**	**-**	**(38,000)**	**38,000**	**-**
Transactions with the owner, recorded directly in equity							
Share based payment transactions	**-**	**-**	**-**	**38**	**-**	**16**	**54**
Dividends paid to owner - 2018 final	**-**	**-**	**-**	**-**	**-**	**(40,000)**	**(40,000)**
Balance at 31 December	**660,000**	**6,294**	**(8,257)**	**537**	**53,100**	**1,259,011**	**1,970,685**

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

HSBC AMANAH MALAYSIA BERHAD
(Company No. 200801006421 (807705-X))
(Incorporated in Malaysia)

STATEMENT OF CHANGES IN EQUITY FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2019 (Cont'd)

	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	-	(179)	305	476	-	15,960	40,090	56,652
- As restated	660,000	-	305	706	408	49,960	961,601	1,672,980
Profit for the financial year	-	-	-	-	-	-	162,700	162,700
Other comprehensive income, net of tax								
FVOCI reserve/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
Net change in 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. 200801006421 (807705-X))
(Incorporated in Malaysia)

STATEMENT OF CASH FLOWS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2019

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Cash Flows from Operating Activities		
Profit before income tax expense	**229,390**	211,569
Adjustments for:		
Equipment written off	**3**	1
Unrealised losses/(gains) from dealing in foreign currency	**529**	(360)
Unrealised (gains)/losses from revaluation of financial assets at FVTPL	**(2,080)**	952
Unrealised (gains)/losses from trading in derivatives	**(427)**	1,983
Allowance for impairment losses	**123,815**	110,427
Share based payment transactions	**728**	187
Depreciation of equipment	**1,962**	2,324
Depreciation of Right-of-use assets	**6,674**	-
Unrealised (gains)/losses of foreign exchange translation on subordinated commodity murabahah financing	**(6,375)**	12,389
Net expenses on financial instruments fair value through profit or loss	**39,395**	16,081
Operating profit before changes in operating assets and liabilities	**393,614**	355,553
Decrease/(Increase) in operating assets		
Deposits and placements with banks and other financial institutions	**(139,157)**	-
Financing and advances	**970,288**	(788,596)
Derivative financial assets	**118,588**	33,613
Other assets	**(20,273)**	(11,509)
Statutory deposits with Bank Negara Malaysia	**35,000**	(3,300)
Total decrease/(increase) in operating assets	**964,446**	**(769,792)**
(Decrease)/Increase in operating liabilities		
Deposits from customers	**1,875,756**	1,410,052
Deposits and placements from banks and other financial institutions	**(960,010)**	(61,975)
Structured liabilities designated at FVTPL	**374,800**	586,264
Bills payable	**3,442**	1,916
Derivative financial liabilities	**(147,609)**	(38,072)
Other liabilities	**169,453**	(17,131)
Total increase in operating liabilities	**1,315,832**	1,881,054
Cash generated from operating activities	**2,673,892**	1,466,815
Income tax paid	**(65,817)**	(37,242)
Net cash generated from operating activities	**2,608,075**	1,429,573

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

HSBC AMANAH MALAYSIA BERHAD
(Company No. 200801006421 (807705-X))
(Incorporated in Malaysia)

STATEMENT OF CASH FLOWS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2019 (Cont'd)

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Cash Flows from Investing Activities		
Purchase of financial investments at fair value through other comprehensive income	**(2,055,476)**	(1,285,897)
Proceeds from disposal of equipment	**30**	-
Proceeds from disposal of financial investments at fair value through other comprehensive income	**2,064,439**	785,933
Purchase of equipment	**(2,228)**	(3,673)
Net cash generated from/(used in) investing activities	**6,765**	(503,637)
Cash Flows from Financing Activities		
Issuance of Multi-Currency Sukuk	**-**	500,000
Profits paid on Multi-Currency Sukuk Programme	**(70,024)**	(50,186)
Profit paid on Subordinated Commodity Murabahah Financing	**(27,346)**	(27,175)
Redemption of Multi-Currency Sukuk Programme	**(500,000)**	-
Dividend paid	**(40,000)**	(10,000)
Net cash (used in)/generated form financing activities	**(637,370)**	412,639
Net increase in Cash and Cash Equivalents	**1,977,470**	1,338,575
Cash and Cash Equivalents at beginning of the financial year	**2,804,494**	1,465,919
Cash and Cash Equivalents at end of the financial year	**4,781,964**	2,804,494
Analysis of Cash and Cash Equivalents		
Cash and short-term funds	**4,781,964**	2,804,494

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

HSBC AMANAH MALAYSIA BERHAD
(Company No. 200801006421 (807705-X))
(Incorporated in Malaysia)

STATEMENT OF CASH FLOWS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2019 (Cont'd)

Changes in liabilities arising from financing activities

	At 1 January RM'000	Cash (outflow)/ inflow RM'000	Foreign exchange adjustment RM'000	Fair value movement RM'000	Profit accrual RM'000	At 31 December RM'000
2019						
Multi-Currency Sukuk Programme	**1,755,281**	**(500,000)**	**-**	**10,648**	**-**	**1,265,929**
Subordinated Commodity Murabahah Financing	**595,987**	**-**	**(6,375)**	**-**	**-**	**589,612**
Other Liabilities of which:						
Profits paid on Multi-Currency Sukuk Programme	**18,175**	**(70,024)**	**-**	**-**	**65,573**	**13,724**
Profits paid on Subordinated Commodity Murabahah Financing	**307**	**(27,346)**	**-**	**-**	**27,320**	**281**
Dividend paid	**-**	**(40,000)**	**-**	**-**	**-**	**-**
	2,369,750	**(637,370)**	(6,375)	**10,648**	**92,893**	**1,869,546**
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

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

HSBC AMANAH MALAYSIA BERHAD
(Company No. 200801006421 (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 holding company 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 4 February 2020.

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 2019 are as follows:

- MFRS 16 'Leases'
- Amendments to MFRS 9 'Prepayment Features with Negative Compensation'
- Amendments to MFRS 128 'Long-term Interests in Associates and Joint Ventures'
- Amendments to MFRS 119 'Plan Amendment, Curtailment or Settlement'
- IC Interpretation 23 'Uncertainty over Income Tax Treatments'
- Annual Improvements to MFRSs 2015 – 2017 Cycle

The Bank has adopted MFRS 16 for the first time in the 2019 financial statements, which resulted in changes in accounting policies. The detailed impact of changes in accounting policies for MFRS 16 are set out in Note 3.

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.

2 Basis of Preparation (Cont'd)

(a) Statement of compliance (Cont'd)

(ii) Standards early adopted by the Bank

The Bank elected to early adopt the Interest/Profit Rate Benchmark Reform (Amendments to MFRS 9 'Financial Instruments', MFRS 139 'Financial Instruments: Recognition and Measurement' and MFRS 7 'Financial Instruments: Disclosures'). Amendments to MFRS 9, MFRS 139 and MFRS 7 were issued in October 2019 that modify the specific hedge accounting requirements so that entities apply those hedge accounting requirements assuming that the profit rate benchmark on which the hedged cash flows and cash flows of the hedging instrument are based is not altered as a result of profit rate benchmark reform. These amendments apply from 1 January 2020 with early adoption permitted. The Bank has adopted the amendments that apply to MFRS 139 from 1 January 2019 and has made the additional disclosures as required by the amendments.

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

A number of new standards and amendments to standards and interpretations are effective for financial year beginning after 1 January 2020. None of these is expected to have a significant effect on the financial statements of the Bank, except the following set out below:

- Amendments to MFRS 3 'Definition of a Business' (effective 1 January 2020) revise the definition of a business. To be considered a business, an acquisition would have to include an input and a substantive process that together significantly contribute to the ability to create outputs.

The amendments provide guidance to determine whether an input and a substantive process are present, including situation where an acquisition does not have outputs. To be a business without outputs, there will now need to be an organised workforce. It is also no longer necessary to assess whether market participants are capable of replacing missing elements or integrating the acquired activities and assets.

In addition, the revised definition of the term 'outputs' is narrower, focusses on goods or services provided to customers, generating investment returns and other income but excludes returns in the form of cost savings.

The amendments introduce an optional simplified assessment known as 'concentration test' that, if met, eliminates the need for further assessment. Under this concentration test, if substantially all of the fair value of gross assets acquired is concentrated in a single identifiable asset (or a group of similar assets), the assets acquired would not represent a business.

The amendments shall 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 7). 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.

3 Changes in accounting policies

Adoption of MFRS 16 'Lease'

On 1 January 2019, the Bank changed its accounting policies on leases upon the adoption of MFRS16, which supersedes MFRS 117 'Leases'. The Bank has elected to use the simplified retrospective transition method and to apply a number of practical expedients as provided in MFRS 16.

On adoption of MFRS 16, the Bank recognised lease liabilities in relation to leases which had previously been classified as "operating leases" under the principles of MFRS 117. These liabilities were measured at the present value of the remaining lease payments, discounted at the lessee's incremental borrowing rate as at 1 January 2019. The associated right-of-use (ROU) assets were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments or provisions for onerous leases recognised on balance sheet at 31 December 2018.

In addition, the following practical expedients permitted by the standard were applied:
- Reliance was placed on previous assessments on whether leases were onerous;
- Operating leases with a remaining lease term of less than 12 months as at 1 January 2019 were treated as short-term leases; and
- Initial direct costs were not included in the measurement of ROU assets for leases previously accounted for as operating leases.

The differences between MFRS 16 and MFRS 117 are summarised below:

- Under MFRS 117, leases were classified as either finance or operating leases. Payments made under operating leases were charged to profit or loss on a straight-line basis over the period of the lease.
- Under the new MFRS 16:
  - Leases are recognised as an ROU asset and a corresponding liability at the date at which the leased asset is made available for use. Lease payments are allocated between the lease liability and finance cost. The finance cost is charged to the profit or loss over the lease term so as to produce a constant period profit rate on the remaining balance of the liability. The ROU asset is depreciated over the shorter of the ROU asset's useful economic life and the lease term on a straight-line basis.

  - In determining lease term, the Bank considers all facts and circumstances that create an economic incentive to exercise an extension option or not exercise a termination option over the planning horizon of five years.

  - In general, it is not expected that the discount rate implicit in the lease is available so the lessee's incremental borrowing rate is used. This is the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of a similar value in a similar economic environment with similar terms and conditions. The rates are determined for each economic environment in which the Bank operates by adjusting swap rates with funding spreads (own credit spread) and cross-currency basis where appropriate.

Under the simplified retrospective transition method, the 2018 comparative information was not restated and the cumulative effects of initial application of MFRS 16 where the Bank is a lessee were recognised as an adjustment to the opening balance of retained earnings as at 1 January 2019. The comparative information continued to be reported under the previous accounting policies governed under MFRS 117 'Leases' and IC Interpretation 4 'Determining whether an Arrangement Contains a Lease'.

As at 1 January 2019, the change in accounting policies has affected the following items:

Other assets - increase by RM31,733,000
Other liabilities - increase by RM31,733,000

There is no impact on retained profits and deferred tax of the Bank arising from the adoption of MFRS 16.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

3 Changes in accounting policies (Cont'd)

Adoption of MFRS 16 'Lease (Cont'd)

The reconciliation between the operating lease commitments disclosed applying MFRS 117 at 31 December 2018 to the lease liabilities recognised at 1 January 2019 is as follows:

	RM'000
Operating lease commitments disclosed as at 31 December 2018	13,404
Discounted using incremental borrowing rate	(610)
Less: short-term leases recognised on a straight-line basis as expense	(203)
Add: adjustments as a result of a different treatment on extension and termination options	19,142
Lease liability recognised as at 1 January 2019	31,733
Of which:	
- Current lease liabilities	6,020
- Non-current lease liabilities	25,713
	31,733

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

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

iii) <u>Musharakah (Co-ownership)</u>
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) <u>Bai Al-Inah (Sale and Buy Back)</u>
Income is recognised on effective profit rate basis over the period of the contract based on the principal amounts outstanding.

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

(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 expenses from Islamic Banking operations are recognised on an accrual basis and in accordance with the principles of Shariah.

Financing income and expenses of the Bank presented in the statement of profit and loss include:

- profit on financial assets and liabilities measured at amortised costs calculated on an effective profit rate basis;
- profit on FVOCI 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 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(g) and 4(j)).

(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). However, if there is a difference between the transaction price and the fair value of financial instruments whose fair value is based on a quoted price in an active market or a valuation technique that uses only data from observable markets, the Bank recognises the difference as a trading gain or loss at inception (day 1 gain or loss). In all other cases, the entire day 1 gain or loss is deferred and recognised in the income statement over the life of the transaction 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 7(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.

- *Hedging Instruments impacted by Inter-Bank Offered Rates (IBOR) Reform*

  Following the request received by the Financial Stability Board from the G20, a fundamental review and reform of the major profit rate benchmarks is under way across the world's largest financial markets. This reform was not contemplated when the standard was published, and consequently the MASB has published a set of temporary exceptions from applying specific hedge accounting requirements to provide clarification on how the standard should be applied in these circumstances. Under the temporary exceptions, IBORs are assumed to continue for the purposes of hedge accounting until such time as the uncertainty is resolved.

  Interest/Profit Rate Benchmark Reform: Amendments to MFRS 9 Financial Instruments, MFRS 139 Financial Instruments: Recognition and Measurement and MFRS 7 Financial Instruments: Disclosures)

  Amendments to MFRS 9, MFRS 139 and MFRS 7 were issued in October 2019 and modified specific hedge accounting requirements (the 'temporary exceptions'). For example, under the temporary exceptions, IBORs are assumed to continue for the purposes of hedge accounting until such time as the uncertainty is resolved.

(f) Financial instruments (Cont'd)

(vi) Derivative financial instruments and hedge accounting (Cont'd)

- *Hedging Instruments impacted by Inter-Bank Offered Rates (IBOR) Reform (Cont'd)*

The application of this set of temporary exceptions is mandatory for accounting periods starting on or after 1 January 2020, but early adoption is permitted and the Bank has elected to apply these exceptions for the year ended 31 December 2019.

The Bank does not have any hedging instruments as at 31 December 2019.

(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 pays 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.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Significant Accounting Policies (Cont'd)

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

(i) 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.

(ii) 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.

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 Other Comprehensive Income (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. Dividend income is recognised in 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.
- where the financial liability contains 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/(expenses) from financial liabilities designated at fair value' except for the effect of changes in the liabilities' credit risk which is presented in OCI, unless that treatment would create or enlarge an accounting mismatch in profit or loss.

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

- Debt instruments for funding purposes that are designated to reduce an accounting mismatch (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)

  Structured liabilities of the Bank designated at fair value are recognised in the balance sheet in 'Structured Liabilities Designated at Fair Value'. Please refer to Note 22.

4 Significant Accounting Policies (Cont'd)

(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
  - there are other indications that the borrower is unlikely to pay such as when a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and
  - the financing and advances is otherwise considered to be in default.

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

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.

In line with HSBC Global policy, financing and advances 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:

- 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).

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

(iii) Renegotiation

Financing and advances are identified as renegotiated and classified as credit-impaired when the contractual payment terms are modified 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 and advances 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. For detail of the risk management process on renegotiated financings, please refer to 'Renegotiated financings and forbearance' in Note 5(b)(iii).

(iv) Financing and advances modifications that are not credit-impaired

Financing and advances 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.

(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, and are included in the watch or worry list due to credit reason, are included in Stage 2.

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) (Cont'd)

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. For origination CRRs up to 3.3, 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. 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

For CRRs greater than 3.3 that are not impaired, a significant increase in credit risk is considered to have occurred when the origination PD has doubled. The significance of changes in PD was informed by expert credit risk judgement, referenced to historical credit migrations and to relative changes in external market rates.

For financing and advances 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)(ii) for the 23-grade scale used for CRR.

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.

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

(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.

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.

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

(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 applies multiple forward-looking global economic scenarios determined with reference to external forecast distributions representative of their view of forecast economic conditions. This approach is considered sufficient to calculate unbiased expected loss in most economic environments. Additional analysis may be necessary and may result in additional scenarios or adjustments, to reflect a range of possible economic outcomes sufficient for an unbiased estimate. The detailed methodology is disclosed in 'Measurement uncertainty and sensitivity analysis of ECL estimates'in Note 5(b)(v).

(xi) 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) Leases

Prior to 1 January 2019

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

After 1 January 2019

Leases are recognised as a ROU asset and a corresponding lease liability at the date at which the leased asset is made available for use. ROU asset is presented within "Other Assets" in the statement of financial position, and is depreciated, over the shorter of the ROU asset's useful economic life and the lease term, on a straight-line basis.

Lease liability is represented in the "Other Liabilities" in the statement of financial position. Lease payments are allocated between the liability and finance cost. The finance cost is charged to the statement of profit or loss as finance expense over the lease term so as to produce a constant period profit rate on the remaining balance of the liability.

In determining the lease term, all facts and circumstances that create an economic incentive to exercise an extension or termination option are considered.

Where the discount rate implicit in the lease is unavailable, the incremental borrowing rate is used. This is the rate that the Bank would has to pay to borrow the funds necessary to obtain an asset of a similar value in a similar economic environment at similar terms and conditions.

The Bank has elected not to recognise ROU assets and lease liabilities for short-term leases that have lease terms of 12 months or less and leases of low value leases. Lease payments relating to these leases are expensed to the statement of profit or loss on a straight-line basis over the lease term.

4 Significant Accounting Policies (Cont'd)

(n) 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.

(o) 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.

(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.

4 Significant Accounting Policies (Cont'd)

(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 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.

(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.

4 Significant Accounting Policies (Cont'd)

(r) Share based payments (Cont'd)

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) Share capital and other equity instruments

Ordinary shares and other equity instruments with discretionary dividends are classified as equity according to the substance of the contractual arrangement of the particular instrument. Dividend distributions to holders of an equity instrument is recognised directly in equity.

(t) 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.

5 Risk

a) Introduction and overview

(i) Conservative risk appetite

The Bank maintains a conservative approach to risk. These are central to the business and strategy.

The importance of a strong risk culture is long recognised, which refers to shared attitudes, values and norms that shape behaviours related to risk awareness, risk taking and risk management. All employees are responsible for the management of risk, with the ultimate accountability residing with the Board.

We seek to build our business for the long term by balancing social, environmental and economic considerations in the decisions we make. Our strategic priorities are underpinned by our endeavour to operate in a sustainable way. This helps us to carry out our social responsibility and manage the risk profile of the business. We are committed to managing and mitigating climate related risks, both physical and transition, and will continue to incorporate this into how we manage and oversee risks internally and with our customers.

The following principles guide our overarching risk appetite and determine how its businesses and risks are managed.

Financial position

- Aim to maintain a strong capital position, defined by regulatory and internal capital ratios.
- Carry out liquidity and funding management for each operating entity, on a stand-alone basis.

Operating model

- Seek to generate returns in line with a conservative risk appetite and strong risk management capability.
- Aim to deliver sustainable earnings and consistent returns for shareholders.

Business practice

- Zero tolerance for any of the employee to knowingly engage in any business, activity or association where foreseeable reputational risk or damage has not been considered and/or mitigated.
- No appetite for deliberately or knowingly causing detriment to consumers, or incurring a breach of the letter or spirit of regulatory requirements.
- No appetite for inappropriate market conduct by a member of staff or by any group business.

Enterprise-wide application

The Bank's risk appetite encapsulate considerations of financial and non-financial risks. They are applied at the across HSBC Group entities.

Financial risk is defined as the risk of a financial loss as a result of business activities. These types of risks are actively taken to maximise shareholder value and profits. Non-financial risk is defined as 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.

HSBC Group's risk appetite is expressed in both quantitative and qualitative terms and applied at the global business level, at the regional level and to material operating entities such as the Bank.

a) Introduction and overview (Cont'd)

(i) Conservative risk appetite (Cont'd)

Enterprise-wide application (Cont'd)

The Board reviews and approves the Bank's risk appetite to make sure it remains fit for purpose. The risk appetite is considered, developed and enhanced through:

- an alignment with our strategy, purpose, values and customer needs;
- trends highlighted in other group risk reports, such as the 'Risk map' and 'Top and emerging risks';
- communication with risk stewards on the developing risk landscape;
- strength of our capital, liquidity and balance sheet;
- compliance with applicable laws and regulations;
- effectiveness of the applicable control environment to mitigate risk, informed by risk ratings from risk control assessments;
- functionality, capacity and resilience of available systems to manage risk; and
- the level of available staff with the required competencies to manage risks.

The Bank formally articulate risk appetite through the risk appetite statement (RAS), which is approved by the Board. Setting out risk appetite helps to make sure that planned business activities provide an appropriate balance of return for the risk taken, and that suitable level of risk is agreed for the Bank. In this way, risk appetite informs financial planning process and helps senior management to allocate capital to business activities, services and products.

The RAS consists of qualitative statements and quantitative metrics, covering financial and non-financial risks. It is fundamental to the development of business line strategies, strategic and business planning, and senior management balanced scorecards.

The performance against the RAS is reported to the Risk Management Meeting (RMM) on a monthly basis so that any actual performance that falls outside the approved risk appetite is discussed and appropriate mitigating actions are determined. This reporting allows risks to be promptly identified and mitigated, and informs risk-adjusted remuneration to drive a strong risk culture. All RASs and business activities are guided and underpinned by qualitative principles and or quantitative metrics.

(ii) Risk management

The Bank recognises that the primary role of risk management is to protect the business, customers, colleagues, shareholders and the communities that we serve, while ensuring we are able to support our strategy and provide sustainable growth. As we move into revised business focus, active risk management will be critical in ensuring the associated change and execution risks arising from a major change programme are managed. In addition periodic risk assessments will be performed, including strategies to ensure retention of key personnel to ensure continued safe operation.

An enterprise-wide risk management framework is used across the organisation and across all risk types, underpinned by the Bank's risk culture. This outlines the key principles, policies and practices that is employed in managing material risks, both financial and non-financial.

The framework fosters continuous monitoring, promotes risk awareness and encourages sound operational and strategic decision making. It also ensures a consistent approach to identifying, assessing, managing and reporting the risks we accept and incur in our activities.

a) Introduction and overview (Cont'd)

(ii) Risk management (Cont'd)

Risk management framework

The following diagram and descriptions summarise key aspects of the framework, including governance and structure, risk management tools and risk culture, which together help align employee behaviour with Bank's risk appetite.

Key components of our risk management framework

Risk governance	**Non-executive risk governance**	The Board approves the risk appetite, plans and performance targets. It sets the 'tone from the top' and is advised by the Risk Committee.
	Executive risk governance	Executive risk governance structure is responsible for the enterprise-wide management of all risks, including key policies and frameworks for the management of risk within the HSBC Group.
Roles and responsibilities	**Three lines of defence model**	The 'three lines of defence' model defines roles and responsibilities for risk management. An independent Risk function ensures the necessary balance in risk/return decisions.
Processes and tools	**Risk appetite** **Enterprise-wide risk** **Active risk management: identification/assessment, monitoring, management and reporting**	HSBC Group has several processes to identify/assess, monitor, manage and report risks to ensure we remain within our risk appetite.
Internal controls	**Policies and procedures**	Policies and procedures define the minimum requirements for the controls required to manage risks.
	Control activities	The operational risk management framework defines minimum standards and processes for managing operational risks and internal controls.
	Systems and infrastructure	HSBC Group has systems and/or processes that support the identification, capture and exchange of information to support risk management activities.

a) Introduction and overview (Cont'd)

(ii) Risk management (Cont'd)

Risk governance

The Board has ultimate responsibility for the effective management of risk and approves the Bank's risk appetite. It is advised on risk-related matters by the Risk Committee.

Executive accountability for the ongoing monitoring, assessment and management of risk environment and the effectiveness of the risk management framework resides with the Chief Risk Officer. He is supported by the RMM.

The management of financial crime risk resides with the Chief Executive Officer. He is supported by the Financial Crime Risk Management Committee.

The 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 our business and functional structures.

A defined executive risk governance structure is used to help ensure appropriate oversight and accountability of risk, which facilitates reporting and escalation to the RMM.

Responsibilities for risk management

All employees are responsible for identifying and managing risk within the scope of their role as part of the three lines of defence model.

Three lines of defence

To create a robust control environment to manage risks, we use an activity-based three lines of defence model. This model delineates management accountabilities and responsibilities for risk management and the control environment.

The model underpins our approach to risk management by clarifying responsibilities, encouraging collaboration and enabling efficient coordination of risk and control activities.

The three lines of defence are summarised below:

- The first line of defence owns the risks and is responsible for identifying, recording, reporting and managing them in line with risk appetite, and ensuring that the right controls and assessments are in place to mitigate them.
- The second line of defence sets the policy and guidelines for managing specific risk areas, provides advice and guidance in relation to the risk, and challenges the first line of defence on effective risk management.
- The third line of defence is the Internal Audit function, which provides independent assurance that risk management, governance and internal control processes are designed and operating effectively

Risk function

The Risk function, headed by the Chief Risk Officer, is responsible for the risk management framework. This responsibility 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 business 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.

Responsibility for minimising both financial and non-financial risk lies with the employees. They are required to manage the risks of the business and operational activities for which they are responsible. Adequate oversight of risks are maintained through various specialist Risk Stewards, along with an aggregate overview through the Chief Risk Officer.

a) Introduction and overview (Cont'd)

(ii) Risk management (Cont'd)

Risk function (Cont'd)

Non-financial risk includes some of the most material risks the Bank faces, such as cyber-attacks, the loss of data and poor conduct outcomes. Actively managing non-financial risk is crucial to serving our customers effectively and having a positive impact on society. During 2019 we continued to strengthen the control environment and our approach to the management of non-financial risk, as set out in our Operational Risk Management Framework. The approach outlines non-financial risk governance and risk appetite, and provides a single view of the non-financial risks that matter the most, and associated controls. It incorporates a risk management system designed to enable the active management of non-financial risk. Our ongoing focus is on simplifying our approach to non-financial risk management, while driving more effective oversight and better end-to-end identification and management of non-financial risks. This is overseen by the Operational Risk function, headed by the HSBC Group Head of Operational Risk.

Stress testing

The Bank operates a wide-ranging stress testing programme that supports risk management and capital planning. Stress testing provides management with key insights into the impact of severely adverse events, and provides confidence to regulators on financial stability.

As well as undertaking regulatory-driven stress tests, we conduct our own internal stress tests, in order to understand the nature and level of all material risks, quantify the impact of such risks and develop plausible business as usual mitigating actions.

The stress testing programme assesses capital and liquidity strength through a rigorous examination of resilience to external shocks from a range of stress scenarios. They include potential adverse macroeconomic, geopolitical and operational risk events, and other potential events that are specific to the Bank. Stress testing analysis helps management understand the nature and extent of vulnerabilities to which the Bank is exposed and informs decisions about preferred capital or liquidity levels.

Separately, reverse stress tests are conducted at the Bank in order to understand which potential extreme conditions would make the business model non-viable. 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.

Key developments in 2019

In 2019, a number of initiatives were undertaken to enhance the approach to management of risk. There have been continued efforts to simplify and enhance how we manage risk. The HSBC Group risk taxonomy has been simplified through consolidating certain existing risks into broader categories. These changes streamlined risk reporting and promoted common language in our risk management approach. Further simplification will continue during 2020, including the combining of two key risk management frameworks. These changes include:

- Forming a Resilience Risk sub-function to reflect the growing regulatory importance of being able to ensure our operations continue to function when an operational disturbance occurs. Resilience Risk was formed to simplify the way we interact with our stakeholders and to deliver clear, consistent and credible responses globally. The leadership of the resilience risk function is the responsibility of the Head of Resilience Risk.

- Placing greater focus on our model risk activities during 2019. To reflect this, HSBC Group has created the role of Chief Model Risk Officer, which for group is undertaken by the Head of Model Risk Management.

a) Introduction and overview (Cont'd)

(ii) Risk management (Cont'd)

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 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 regions and global businesses, for any risks that may require global escalation, updating 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 our 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.

The Bank's current key top and emerging risks are as follows:
- Forward looking balance sheet position
- Geopolitical risk
- System resilience, Cyber threat and unauthorised access to systems
- Increased regulatory scrutiny and efforts
- IBOR transition and reform
- Climate-related risk
- People risk

Areas of special interest **-** *IBOR Transition*

The Financial Stability Board has observed that the decline in interbank short-term unsecured funding poses structural risks for interest/profit rate benchmarks that reference these markets. In response, regulators and central banks in various jurisdictions have convened national working groups (NWGs) to identify replacement rates for these interbank offer rates (Ibors) and, where appropriate, to facilitate an orderly transition to these rates.

Following the announcement by the UK's Financial Conduct Authority in July 2017 that it will no longer persuade or require banks to submit rates for Libor after 2021, the NWGs for the affected currencies were tasked with facilitating an orderly transition of the relevant Libors to their chosen replacement rates. The euro NWG is also responsible for facilitating an orderly transition of the Euro Overnight Index Average (Eonia) to the euro short-term rate (€STER) as a result of the determination that Eonia cannot be made to comply with the European Benchmark Regulations (BMR) and can therefore no longer be used beyond 2021. Although NWGs in other jurisdictions have identified replacements for their respective Ibors, there is no intention for these benchmark rates to be discontinued.

Given the current lack of alternatives, HSBC Group has an increasing portfolio of contracts referencing Libor and Eonia with maturities beyond 2021. HSBC Group established the IBOR transition programme with the objective of facilitating an orderly transition from Libor and Eonia for HSBC Group and its clients. This global programme oversees the transition effected by each of the global businesses and is led by the Group Chief Risk Officer.

a) Introduction and overview (Cont'd)

(iv) Top and emerging risks management (Cont'd)

Areas of special interest (Cont'd)

IBOR Transition (Cont'd)

The programme is currently focused on developing alternative rate products, and the supporting processes and systems, that reference the NWG-selected replacement rates and making them available to customers. Depending on the take up of these products by customers, this should reduce the current growth in Libor and Eonia contracts being transacted with maturities beyond end 2021, while the new product capabilities will also enable the transition of outstanding Libor and Eonia products onto the replacement rates. A structured development plan is required given the widespread use of Libor and Eonia in a wide range of products, systems and processes across each of the four global businesses and all of the jurisdictions in which HSBC Group operates, including the Group and the Bank. The resulting execution risk is closely monitored by the programme.

The programme is concurrently developing the capability to transition, through repapering, outstanding Libor and Eonia contracts. The process of implementing International Swaps and Derivatives Association's (ISDA's) proposed protocol and transitioning outstanding contracts is nonetheless a material undertaking for the industry as a whole and may expose HSBC Group to the risk of financial losses.

HSBC Group intends to actively engage in the process to achieve an orderly transition of HSBC Group's Libor and Eonia bond issuance, HSBC Group's holdings of Libor/Eonia bonds and of those bonds where HSBC Group is the payment agent. At this stage HSBC Group is confident of transitioning the bulk of these exposures and is actively engaged in industry working groups.

Although HSBC Group has plans to transition multi-billion dollar contractually IBOR-referenced commercial financings onto replacement rates, the ability to transition this portfolio by the end of 2021 is materially dependent on the availability of products that reference the replacement rates and on customers being ready and able to adapt their own processes and systems to accommodate the replacement products. This may give rise to an elevated level of conduct related risks. HSBC Group is engaging with impacted clients to ensure that customers are aware of the risks associated with the ongoing purchase of Libor and Eonia referencing contracts as well as the need to transition legacy contracts prior to the end of 2021.

In addition to the execution and conduct risk previously highlighted, the process of adopting new reference rates may expose HSBC Group to an increased level of operational and financial risks, such as potential earnings volatility resulting from contract modifications, changes in hedge accounting and a large volume of product and associated process changes. Furthermore, the transition to alternative reference rates could have a range of adverse impacts on our business, including legal proceedings or other actions regarding the interpretation and enforceability of provisions in IBOR-based contracts, and regulatory investigations or reviews in respect of our preparation and readiness for the replacement of IBOR with alternative reference rates. The Bank continues to engage with industry participants, the official sector and their clients to support an orderly transition and the mitigation of the risks resulting from the transition.

a) Introduction and overview (Cont'd)

(v) Material banking risks

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 and funding risk
- market risks (includes foreign exchange, profit rate and basis risk)
- resilience risk
- regulatory compliance risk
- financial crime and fraud risk
- model risk

This note presents information about the Bank's exposure to each of the above risks as well as the objectives, policies and processes for measuring and managing those risks.

b) Credit risk management

(i) Overview

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. Credit risk arises principally from direct lending, trade finance and leasing business, but also from other products, such as guarantees and credit derivatives.

(ii) Credit risk management framework

Key developments 2019

There were no material changes to the policies and practices for the management of credit risk in 2019. We continued to apply the requirements of MFRS 9 'Financial Instruments' within Credit Risk.

Governance and structure

The Bank has established credit risk management and related MFRS 9 processes. The Bank continues to actively assess the impact of economic developments in key markets on specific customers, customer segments or portfolios. As credit conditions change, the Bank takes mitigating action, including the revision of risk appetites or limits and tenors, as appropriate. In addition, the Bank continues to evaluate the terms under which credit facilities are provided within the context of individual customer requirements, the quality of the relationship, regulatory requirements, market practices and the Bank's market position.

(iii) Credit risk sub-function

Credit approval authorities are delegated by the Board to the Chief Executive (CEO) together with the authority to sub-delegate them. The Credit Risk sub-function in Global Risk at HSBC Group is responsible for the key policies and processes for managing credit risk, which include formulating credit policies and risk rating frameworks, guiding the Bank's appetite for credit risk exposures, undertaking independent reviews and objective assessment of credit risk, and monitoring performance and management of portfolios.

The principal objectives of credit risk management are:

- to maintain a strong culture of responsible lending, and robust risk policies and control frameworks;
- to both partner and challenge businesses in defining, implementing and continually re-evaluating risk appetite under actual and scenario conditions; and
- to ensure there is independent, expert scrutiny of credit risks, their costs and their mitigation.

b) Credit risk management (Cont'd)

(iii) Credit risk sub-function (Cont'd)

Key risk management processes

MFRS 9 'Financial Instruments' process

The MFRS 9 process comprises three main areas: modelling and data; implementation; and governance.

- Modelling and data
  To address the MFRS 9 requirements, the Bank has established modelling and data processes in various geographies which are subject to internal model risk governance including independent review of significant model developments.

- Implementation
  A centralised impairment engine performs the expected credit loss (ECL) calculation using data, which is subject to a number of validation checks and enhancements, from a variety of client, finance and risk systems. Where possible, these checks and processes are performed in a globally consistent and centralised manner.

- Governance
  Management review forums are established both in regions and sites in order to review and approve the impairment results. The management review forums have representatives from Credit Risk and Finance. The site and regional approvals are reported up to the global business impairment committee for final approval of the Bank's ECL for the period. Required members of the forum at site level are the Chief Risk Officer, heads of Wholesale Credit, Market Risk, and Retail Banking and Wealth Management (RBWM) Risk, as well as the Chief Financial Officer and the Financial Controller.

Concentration of exposure

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or such counterparties are engaged in similar activities or operate in the same geographical areas or industry sectors so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. The Bank uses a number of controls and measures to minimise undue concentration of exposure in portfolios across industries, countries and global businesses. These include portfolio and counterparty limits, approval and review controls, and stress testing.

The Bank monitors concentration of credit risk by sector and geographical location. The analysis of concentration of credit risk from financing and advances is shown in Notes 11(v) and 11(vii). The analysis of concentration of credit risk from the Bank's financial assets is shown in Note 5(b)(vi).

Credit quality of financial instruments

The Bank's risk rating system facilitates the internal ratings-based approach under the adopted Basel framework to support the calculation of minimum credit regulatory capital requirement. The five credit quality classifications 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. For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications based upon the mapping of related customer risk rating (CRR) to external credit rating.

- *Wholesale lending*
  The CRR 10-grade scale summarises a more granular underlying 23-grade scale of obligor probability of default (PD). All corporate customers are rated using the 10- or 23-grade scale, depending on the degree of sophistication of the Basel approach adopted for the exposure. Each CRR band is associated with an external rating grade by reference to long-run default rates for that grade, represented by the average of issuer-weighted historical default rates. This mapping between internal and external ratings is indicative and may vary over time.

5 Risk (Cont'd)

b) Credit risk management (Cont'd)

(iii) Credit risk sub-function (Cont'd)

Key risk management processes (Cont'd)

Credit quality of financial instruments (Cont'd)

- *Retail lending*
  Retail lending credit quality is based on a 12-month point-in-time (PIT) probability-weighted probability of default (PD).

- *Credit quality classification*

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

Credit quality of the corporate lending/ derivative financial assets/ securities purchased under resale agreements/ 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 the retail lending	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 and/or low levels of expected loss.
- 'Good' exposures demonstrate a good capacity to meet financial commitments, with low default risk.
- 'Satisfactory' exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk.
- 'Sub-standard' exposures require varying degrees of special attention and default risk is of greater concern.
- 'Credit-impaired' exposures have been assessed as impaired.

b) Credit risk management (Cont'd)

(iii) Credit risk management framework (Cont'd)

Key risk management processes (Cont'd)

Renegotiated financings and forbearance

'Forbearance' describes concessions made on the contractual terms of a financing in response to an obligor's financial difficulties.

A financing and advances is classed as 'renegotiated' when we modify the contractual payment terms on concessionary terms because we have significant concerns about the borrowers' ability to meet contractual payments when due.

Non-payment-related concessions (e.g. covenant waivers), while potential indicators of impairment, do not trigger identification as renegotiated financings.

Financing and advances that have been identified as renegotiated retain this designation until maturity or derecognition. For details of the policy on derecognised renegotiated financings, see Note 4(k)(iii).

- Credit quality of renegotiated financings

  On execution of a renegotiation, the financing will also be classified as credit impaired if it is not already so classified. In wholesale lending, all facilities with a customer, including financings that have not been modified, are considered credit impaired following the identification of a renegotiated financing.

  Wholesale renegotiated financings are classified as credit-impaired 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. Personal renegotiated financings are deemed to remain credit impaired until repayment or derecognition.

- Renegotiated financings and recognition of expected credit losses

  For retail lending, unsecured renegotiated financings are generally segmented from other parts of the financing portfolio. Renegotiated expected credit loss assessments reflect the higher rates of losses typically encountered with renegotiated financings. For wholesale lending, renegotiated financings are typically assessed individually. Credit risk ratings are intrinsic to the impairment assessments. The individual impairment assessment takes into account the higher risk of the future non-payment inherent in renegotiated financings.

Impairment assessment

For details of impairment policies on financing and advances and financial investments, see Note 4(k).

b) Credit risk management (Cont'd)

(iii) Credit risk management framework (Cont'd)

Key risk management processes (Cont'd)

Write-off of financing and advances

For details of policy on the write-off of financing and advances, see Note 4(k)(ii).

Unsecured personal facilities, including credit cards, are generally written off at between 150 and 210 days past due. The standard period runs until the end of the month in which the account becomes 180 days contractually delinquent. Write-off periods may be extended, generally to no more than 360 days past due. However, in exceptional circumstances, they may be extended further.

For secured facilities, write-off should occur upon repossession of collateral, receipt of proceeds via settlement, or determination that recovery of the collateral will not be pursued. Any secured assets maintained on the balance sheet beyond 60 months of consecutive delinquency-driven default require additional monitoring and review to assess the prospect of recovery.

In the event of bankruptcy or analogous proceedings, write-off may occur earlier than the maximum periods stated above. Collection procedures may continue after write-off.

(iv) Credit risk profile

The financial assets recorded in each stage have the following characteristics:

Stage 1: These financial assets are 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 on these financial assets since initial recognition for which a lifetime ECL is recognised.

Stage 3: There is objective evidence of impairment and the financial assets 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.

(v) Credit deterioration of financial instruments

Measurement uncertainty and sensitivity analysis of ECL estimates

The recognition and measurement of expected credit losses (ECL) involves the use of significant judgment and estimation. We form multiple economic scenarios based on economic forecasts, apply these assumptions to credit risk models to estimate future credit losses, and probability-weight the results to determine an unbiased ECL estimate.

b) Credit risk management (Cont'd)

(v) Credit deterioration of financial instruments (Cont'd)

Methodology for developing forward looking economic scenarios

The Bank has adopted the use of multiple scenarios, representative of their view of forecast economic conditions, sufficient to calculate unbiased expected loss in most economic environments.

We rely on an average of external forecasts and their distributions to create three scenarios that represent a 'most likely outcome', the Central scenario, and two less likely outcomes, referred to as the Upside and Downside scenarios. Each outer scenario is consistent with a probability of 10%, while the Central scenario is assigned the remaining 80%, according to the decision of the senior management. This weighting scheme is deemed appropriate for the unbiased estimation of ECL in most circumstances. These three scenarios are referred to as the 'consensus economic scenarios. Additional scenarios are used to specifically address the forward looking risks that management consider are not adequately captured by the consensus. Together, these scenarios represent our approach to forward economic guidance.

Economic assumptions in the Central consensus economic scenario are set using consensus forecasts which represent the average of forecasts of external economists. Reliance on external forecasts helps ensure that the Central scenario is unbiased and maximises the use of independent information. The Upside and Downside scenarios are selected with reference to externally available forecast distributions and 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. We determine 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. While key economic variables are set with reference to external distributional forecasts, we also align the overall narrative of the scenarios to the macroeconomic risks described in the 'Top and Emerging risks'. This ensures that scenarios remain consistent with the more qualitative assessment of these risks. We project additional variable paths using an external provider's global macro model.

The Upside and Downside scenarios are generated once a year, reviewed at each reporting date to ensure that they are an appropriate reflection of managements view and updated if economic conditions change significantly. The Central scenario is generated every quarter. For quarters without updates to outer scenarios, wholesale and retail credit risk use the updated central scenario to approximate the impact of the most recent outer scenarios.

Additional scenarios are created as required, to address those forward-looking risks that management consider are not adequately captured by the consensus.

The following table describes key macroeconomic variables and the probabilities assigned in the Consensus Central, Upside and Downside scenarios.

	2019			2018		
	Scenario			Scenario		
	Central (%)	**Upside (%)**	**Downside (%)**	Central (%)	Upside (%)	Downside (%)
GDP growth rate	**4.6**	**5.2**	**4.0**	4.8	5.2	4.4
Inflation	**2.4**	**2.7**	**2.1**	2.4	2.7	2.1
Unemployment	**3.2**	**3.0**	**3.4**	3.2	3.0	3.4
Short term profit rate	**2.9**	**3.0**	**2.6**	3.9	4.1	2.7
Property price growth	**3.3**	**3.9**	**2.5**	5.8	6.3	4.6
Probability	**80.0**	**10.0**	**10.0**	80.0	10.0	10.0

b) Credit risk management (Cont'd)

(v) Credit deterioration of financial instruments (Cont'd)

How economic scenarios are reflected in the Wholesale calculation of ECL

HSBC Group has developed a globally consistent methodology for the application of forward economic guidance into the calculation of ECL by incorporating forward economic guidance into the estimation of the term structure of probability of default (PD) and loss given default (LGD). For PDs, the correlation of forward economic guidance to default rates is considered for a particular industry in a country. For LGD calculations the correlation of forward economic guidance to collateral values and realisation rates is considered for a particular country 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, HSBC Group 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 Group has developed and implemented a globally consistent methodology for incorporating forecasts of economic conditions into ECL estimates. The impact of economic scenarios on PD is modelled at a portfolio level. Historic relationships between observed default rates and macro-economic variables are integrated into HKFRS 9 ECL estimates by leveraging economic response models. The impact of these scenarios on PD is modelled over a period equal to the remaining maturity of underlying asset or assets. The impact on LGD is modelled for house financing portfolios by forecasting future financing-to-value (FTV) profiles for the remaining maturity of the asset by leveraging national level forecasts of the house price index and applying the corresponding LGD expectation.

Economic scenarios sensitivity analysis of ECL estimates

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 under each scenario described above for selected portfolios, applying a 100% weighting to each scenario in turn. The weighting is reflected in both the determination of significant increase in credit risk as well as the measurement of the resulting ECL.

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 impact of defaults that might occur in future under different economic scenarios is captured by recalculating ECL for financings in stages 1 and 2 at the balance sheet date. The population of stage 3 financings (in default) at the balance sheet date is unchanged in these sensitivity calculations. Stage 3 ECL would only be sensitive to changes in forecasts of future economic conditions if the LGD of a particular portfolio was sensitive to these changes.

There is a particularly high degree of estimation uncertainty in numbers representing tail risk scenarios when assigned a 100% weighting.

For wholesale credit risk exposures, the sensitivity analysis excludes ECL and financial instruments related to defaulted obligors because the measurement of ECL is relatively more sensitive to credit factors specific to the obligor than future economic scenarios, and it is impracticable to separate the effect of macro-economic factors in individual assessments.

For retail credit risk exposures, the sensitivity analysis includes ECL for financing and advances to customers related to defaulted obligors as the retail ECL is sensitive to macroeconomic variables which are incorporated into the future economic scenarios. The population of stage 3 financings at the balance sheet date is determined at that point in time. The impact on ECL of exposures moving from stage 1 (12-month provisioning) to a lifetime provisioning stage (and vice versa) as well as changes in ECL for existing stages 1 and 2 financings as a result of changes in forecasts of future economic conditions is captured in sensitivity analysis by recalculating the ECL for stages 1 and 2, reflecting changes in the population of financings in each stage and their PD.

b) Credit risk management (Cont'd)

(v) Credit deterioration of financial instruments (Cont'd)

For retail credit risk exposures, the sensitivity analysis includes ECL for financing and advances to customers related to defaulted obligors as the retail ECL is sensitive to macroeconomic variables which are incorporated into the future economic scenarios. The population of stage 3 financings at the balance sheet date is determined at that point in time. The impact on ECL of exposures moving from stage 1 (12-month provisioning) to a lifetime provisioning stage (and vice versa) as well as changes in ECL for existing stages 1 and 2 financings as a result of changes in forecasts of future economic conditions is captured in sensitivity analysis by recalculating the ECL for stages 1 and 2, reflecting changes in the population of financings in each stage and their PD.

Wholesale analysis

MFRS 9 ECL sensitivity to future economic conditions [1]

ECL coverage of financial instruments subject to significant measurement uncertainty [2]	**31 Dec 2019**	31 Dec 2018
Reported ECL (RM'000)	10,864	9,571
Gross carrying/nominal amount [3] (RM'000)	17,934,219	17,761,327
Reported ECL Coverage (%)	0.06 %	0.05 %
Coverage Ratios by Scenario (%)		
Consensus central scenario	0.06 %	0.05 %
Consensus upside scenario	0.06 %	0.05 %
Consensus downside scenario	0.07 %	0.06 %

[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.

ECL coverage rates reflect the underlying observed credit defaults, the sensitivity to economic environment, extent of security and the effective maturity of the book.

Retail analysis

MFRS 9 ECL sensitivity to future economic conditions [1]

ECL coverage of financing and advances[2]	**31 Dec 2019**	31 Dec 2018
Reported ECL (RM'000)	200,597	184,650
Gross Carrying Amount (RM'000)	6,339,638	6,345,715
Reported ECL Coverage (%)	3.16 %	2.91 %
Coverage Ratios by Scenario (%)		
Consensus central scenario	3.16 %	2.89 %
Consensus upside scenario	2.84 %	2.60 %
Consensus downside scenario	3.57 %	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 changes in sensitivity from 31 December 2018 is reflective of changes in lending volumes, credit quality and movements in foreign exchange.

5 Risk (Cont'd)

b) Credit risk management (Cont'd)

(v) Credit deterioration of financial instruments (Cont'd)

Post-model adjustments

In the context of MFRS 9, post-model adjustments are short-term increases or decreases to the expected credit loss at either a customer or portfolio level to account for model deficiencies, expert credit judgment applied following management review and challenge and for any late breaking events. Internal governance is in place to regularly monitor post-model adjustments and where possible to reduce the reliance on these through model recalibration or redevelopment as appropriate.

(vi) Credit quality

Credit quality of financial instruments

The Bank assess 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 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 in the table below.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Risk (Cont'd)

b) Credit Risk Management (Cont'd)

(vi) Credit quality (Cont'd)

Distribution of financial assets by credit quality

(RM'000)	Gross Carrying Amount						ECL	Carrying amount (net of
	Strong	Good	Satisfactory	Sub-standard	Credit Impaired	Total	allowances	impairment provision)
At 31 December 2019								
Cash and short-term funds	**4,781,970**	**-**	**-**	**-**	**-**	**4,781,970**	**(6)**	**4,781,964**
Deposits and placements with banks and other financial institutions	**139,153**	**-**	**-**	**-**	**-**	**139,153**	**-**	**139,153**
Financial assets at FVOCI	**2,719,975**	**-**	**-**	**-**	**-**	**2,719,975**	**-**	**2,719,975**
Financing and advances to customers held at amortised cost	**3,267,622**	**4,814,554**	**4,361,508**	**471,231**	**385,303**	**13,300,218**	**(257,265)**	**13,042,953**
of which:								
- retail	***1,626,803***	***2,396,952***	***2,171,400***	***234,605***	***290,282***	***6,720,042***	**(205,771)**	***6,514,271***
- corporate and commercial	***1,640,819***	***2,417,602***	***2,190,108***	***236,626***	***95,021***	***6,580,176***	**(51,494)**	***6,528,682***
Derivatives financial assets	**78,979**	**41,786**	**4,909**	**-**	**-**	**125,674**	**-**	**125,674**
Other financial assets	**33,317**	**-**	**-**	**-**	**-**	**33,317**	**-**	**33,317**
Irrevocable financing commitments and financial guarantees	**4,219,000**	**1,061,000**	**1,844,000**	**92,000**	**2,000**	**7,218,000**	**(2,552)**	**7,215,448**

(RM'000)	Gross Carrying Amount						ECL	Carrying amount (net of
	Strong	Good	Satisfactory	Sub-standard	Credit Impaired	Total	allowances	impairment provision)
At 31 December 2018								
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	3,546,096	5,224,863	4,733,208	511,391	356,312	14,371,870	(234,533)	14,137,337
of which:								
- retail	*1,635,331*	*2,409,517*	*2,182,784*	*235,835*	*263,050*	*6,726,517*	(188,342)	*6,538,175*
- corporate and commercial	*1,910,765*	*2,815,346*	*2,550,424*	*275,556*	*93,262*	*7,645,353*	(46,191)	*7,599,162*
Derivatives financial assets	81,907	9	160,325	43	-	242,284	-	242,284
Other financial assets	33,097	-	-	-	-	33,097	-	33,097
Irrevocable financing commitments and financial guarantees	3,296,000	2,321,000	1,284,000	133,000	3,000	7,037,000	(2,859)	7,034,141

b) Credit risk management (Cont'd)

(vi) Credit quality (Cont'd)

Credit impaired financings (Stage 3)

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

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

Collateral and other credit enhancements

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 financing and advances and past due but not impaired, or on individually assessed financing and advances 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 2019 are 50.9% (2018: 48.1%). 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.

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 Risk (Cont'd)

b) Credit Risk Management (Cont'd)

(vi) Credit quality (Cont'd)

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 master agreement or master Wa'ad referred to in para (ix) above do not meet the criteria for offsetting in the statement of financial position. The master agreement or master Wa'ad referred to in para (ix) above create 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:

	(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 RM'000**	**Net amount RM'000**
2019						
Bank						
Derivative financial assets	**125,674**	-	**125,674**	-	-	**125,674**
Derivative financial liabilities	**79,721**	-	**79,721**	-	-	**79,721**
2018						
Bank						
Derivative financial assets	242,284	-	242,284	-	-	242,284
Derivative financial liabilities	227,330	-	227,330	-	-	227,330

c) Liquidity and funding risk management

Liquidity risk is the risk that the Bank does not have sufficient financial resources to meet their obligations as they fall due or that it can only be done at an excessive cost. Liquidity risk arises 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 illiquid asset positions cannot be funded 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 places 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 are 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 are considered not adequately reflected by the regulatory framework.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Risk (Cont'd)

c) Liquidity and funding risk management

(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 2019	**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	4,781,964	-	-	-	-	-	-	4,781,964
Deposits and placements with banks and other financial institutions	-	139,153	-	-	-	-	-	139,153
Financial investments at FVOCI	-	-	1,700,589	1,019,386	-	-	-	2,719,975
Financing and advances	2,707,709	1,274,278	468,944	2,740,686	5,851,336	-	-	13,042,953
Derivative financial assets	-	-	-	-	-	-	125,674	125,674
Others	3,778	241	13,080	26,298	8,191	377,724	-	429,312
Total Assets	7,493,451	1,413,672	2,182,613	3,786,370	5,859,527	377,724	125,674	21,239,031
LIABILITIES AND EQUITY								
Deposits from customers	8,490,873	2,242,725	2,271,553	314,809	373	-	-	13,320,333
Deposits and placements from banks and other financial institutions	1,451,008	300,623	387,778	200,545	-	-	-	2,339,954
Structured liabilities designated as FVTPL	18,429	123,786	441,044	682,341	29,758	-	-	1,295,358
Bills payable	22,036	-	-	-	-	-	-	22,036
Multi-Currency Sukuk Programme	-	751,732	-	514,197	-	-	-	1,265,929
Subordinated Commodity Murabahah Financing	-	-	-	317,957	271,655	-	-	589,612
Derivative financial liabilities	-	-	-	-	-	-	79,721	79,721
Others	81,937	30,448	24,147	13,999	58	204,718	96	355,403
Total Liabilities	10,064,283	3,449,314	3,124,522	2,043,848	301,844	204,718	79,817	19,268,346
Equity	-	-	-	-	-	1,970,685	-	1,970,685
Total Liabilities and Equity	10,064,283	3,449,314	3,124,522	2,043,848	301,844	2,175,403	79,817	21,239,031
Net maturity mismatches	(2,570,832)	(2,035,642)	(941,909)	1,742,522	5,557,683	(1,797,679)	45,857	-
Off balance sheet liabilities	11,099,980	2,719,656	4,802,513	2,215,888	15,990	-	-	20,854,027

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Risk (Cont'd)

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

(i) Liquidity risk (Cont'd)

31 December 2018	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	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 Risk (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 2019						
Non-derivative liabilities						
Deposits by customers	**5,377,847**	**5,415,068**	**2,307,458**	**346,466**	**-**	**13,446,839**
Deposits and placements from banks and other financial institutions	**-**	**1,781,942**	**368,056**	**216,106**	**3,929**	**2,370,033**
Structured liabilities designated at fair value through profit or loss (FVTPL)	**16,811**	**113,367**	**508,846**	**695,156**	**-**	**1,334,180**
Bills payable	**22,036**	**-**	**-**	**-**	**-**	**22,036**
Multi-Currency Sukuk Programme	**-**	**760,571**	**21,559**	**564,500**	**-**	**1,346,630**
Subordinated Commodity Murabahah financing	**-**	**7,121**	**21,785**	**421,639**	**281,109**	**731,654**
Other liabilities	**83,866**	**47,049**	**26,305**	**26,990**	**156,760**	**340,970**
Financing and other credit-related commitments	**7,115,715**	**118,261**	**925,846**	**224,871**	**-**	**8,384,693**
Financial guarantees and similar contracts	**198,355**	**235,188**	**872,149**	**485,408**	**15,990**	**1,807,090**
	12,814,630	**8,478,567**	**5,052,004**	**2,981,136**	**457,788**	**29,784,125**
Derivative liabilities						
Gross settled derivatives						
- Inflow	**-**	**(3,898,629)**	**(1,181,213)**	**-**	**-**	**(5,079,842)**
- Outflow	**-**	**3,919,090**	**1,241,944**	**124**	**-**	**5,161,158**
Net settled derivatives	**-**	**144**	**361**	**827**	**-**	**1,332**

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

d) *Market risk management*

Market risk is the risk that movements in market risk factors, such as foreign exchange rates, profit rates, credit spreads, equity prices and commodity prices, will reduce the Bank's income or the value of its portfolios. Exposure to market risk is separated into two portfolios: trading portfolios and non-trading portfolios.

Where appropriate, the Bank applies similar risk management policies and measurement techniques to both trading and non-trading 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 HSBC Group's established risk appetite.

There were no material changes to the Bank's policies and practices for the management of market risk in 2019.

The management of market risk is principally undertaken using risk limit mandates approved by HSBC's Regional and Global Wholesale Market Risk Management (WMR), 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 WMR.

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. Sensitivity measures are used to monitor the market risk positions within each risk type.

Granular sensitivity limits are set primarily for trading desks with consideration of market liquidity, customer demand and capital constraints, among other factors.

(ii) Value at risk (VAR)

VAR is a technique for estimating 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.

In addition, 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.

d) Market risk management (Cont'd)

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

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.

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

RM'000	**At 31 December 2019**	**Average**	**Maximum**	**Minimum**
Foreign currency risk	**41**	**39**	**188**	**5**
Profit rate risk	**117**	**112**	**294**	**46**
Credit spread risk	**-**	**2**	**325**	**-**
Overall	**115**	**122**	**404**	**48**

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

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 market moves may not encompass all potential market events, particularly those that are extreme in nature;
- the use of a one-day holding period for risk management purposes of trading and non-trading books assumes that this short period is sufficient to hedge or liquidate all positions.
- 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 reflect intra-day exposures.

d) Market risk management (Cont'd)

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

Banking book profit rate risk is the risk of an adverse impact to earnings or capital due to changes in market profit rates. 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. In its management of the risk, the Bank aims to mitigate the impact of future profit rate movements which could reduce future net finance income, while balancing the cost of hedging activities to the current revenue stream. Monitoring the sensitivity of projected net finance income under varying profit rate scenarios is a key part of this.

In order to manage structural profit rate risk, non-traded assets and liabilities are transferred to Balance Sheet Management (BSM) 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. BSM manages the banking book profit rate positions transferred to it within the approved limits. Local ALCOs are responsible for monitoring and reviewing their overall structural profit rate risk position. Profit rate behaviouralisation policies have to be formulated in line with the Bank's behaviouralisation policies.

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.

Sensitivity of net profit income reflects sensitivity of earnings due to changes in market profit rates. The Bank forecast net finance income sensitivities across a range of profit rate scenarios based on a static balance sheet assumption. This includes business line profit rate pass-on assumptions, re-investment of maturing assets and liabilities at market rates per shock scenario and prepayment risk. BSM is modelled based on no management actions i.e. the risk profile at the month end is assumed to remain constant throughout the forecast horizon.

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

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 19		31 Dec 18	
Basis point parallel shift in yield curve	***+100bps***	***-100bps***	*+100bps*	***-100bps***
RM	**17,680**	**(35,001)**	(14,977)	8,821
USD	**(12,692)**	**10,457**	12,756	(15,108)
Others	**6,228**	**(5,880)**	6,692	(8,568)
	11,216	**(30,424)**	4,471	(14,855)

d) Market risk management (Cont'd)

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

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 19		31 Dec 18	
Basis point parallel shift in yield curve	***+200bps***	***-200bps***	*+200bps*	***-200bps***
RM	**(88,221)**	**104,135**	(66,400)	82,614
USD	**1,017**	**(1,588)**	3,242	(5,433)
Others	**(2,078)**	**1,770**	564	10
	(89,282)	**104,317**	(62,594)	77,191

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 FVOCI portfolios and cash flow hedges to parallel movements of plus or minus 100 basis points in all yield curves.

	RM'000			
	31 Dec 19		31 Dec 18	
Basis point parallel shift in yield curve	***+100bps***	***-100bps***	*+100bps*	***-100bps***
RM	**(25,449)**	**25,449**	(36,330)	36,330

Foreign exchange risk

Foreign exchange risk arises as a result of movements in the relative value of currencies. 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 19		31 Dec 18	
Appreciation/depreciation	***+1%***	***-1%***	*+1%*	***-1%***
Impact to profit after income tax expense	**(53)**	**53**	93	(93)

Change in foreign exchange rate has no significant impact to other comprehensive income for the financial year ended 31 December 2019 and 31 December 2018.

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 Risk (Cont'd)

d) Market risk management

(iv) 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 2019	**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	4,637,701	-	-	-	-	144,269	-	4,781,970	3.01
- impairment allowances	-	-	-	-	-	(6)	-	(6)	-
Deposits and placements with banks and other financial institutions	-	139,153	-	-	-	-	-	139,153	3.08
Financial investments at FVOCI	-	-	1,700,589	1,019,386	-	-	-	2,719,975	3.49
Financing and advances									
- performing	3,879,643	7,809,694	256,266	585,246	384,066	-	-	12,914,915	5.31
- impaired	-	-	-	-	-	385,303	-	385,303	-
- impairment allowances	-	-	-	-	-	(257,265)	-	(257,265)	-
Derivative financial assets	-	-	-	-	-	-	125,674	125,674	-
Other assets	-	-	-	-	-	33,317	-	33,317	-
Total Financial Assets	8,517,344	7,948,847	1,956,855	1,604,632	384,066	305,618	125,674	20,843,036	
LIABILITIES									
Deposits from customers	7,208,562	2,242,725	2,271,553	314,809	373	1,282,311	-	13,320,333	2.55
Deposits and placements from banks and other financial institutions	1,458,888	300,623	362,778	200,545	-	17,120	-	2,339,954	1.95
Structured liabilities designated as FVTPL	18,429	123,786	441,044	682,341	29,758	-	-	1,295,358	3.59
Bills payable	-	-	-	-	-	22,036	-	22,036	-
Multi-Currency Sukuk Programme	-	751,732	-	514,197	-	-	-	1,265,929	3.96
Subordinated Commodity Murabahah Financing	-	-	-	317,957	271,655	-	-	589,612	4.58
Derivative financial liabilities	-	-	-	-	-	-	79,721	79,721	-
Other liabilities									
- provision for credit commitments	-	-	-	-	-	2,552	-	2,552	-
- others	-	-	-	-	-	183,902	96	183,998	-
Total Financial Liabilities	8,685,879	3,418,866	3,075,375	2,029,849	301,786	1,507,921	79,817	19,099,493	
Total profit sensitivity gap	(168,535)	4,529,981	(1,118,520)	(425,217)	82,280	(1,202,303)	45,857	1,743,543	

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Risk (Cont'd)

d) Market risk management (Cont'd)

(iv) Profit Rate Risk (Cont'd)

31 December 2018	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	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	-	-	-	-	-	356,312	-	356,312	-
- impairment allowances	-	-	-	-	-	(234,533)	-	(234,533)	-
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									
- provision for credit commitments	-	-	-	-	-	2,859	-	2,859	-
- others	-	-	-	-	-	208,460	-	208,460	-
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	

d) *Market risk management (Cont'd)*

(v) Stress testing

Stress testing is an important procedure that is integrated into our market risk management framework to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. In such scenarios, losses can be much greater than those predicted by VaR modelling.

Stress testing is implemented at the legal entity level with the scenarios tailored to capture the relevant potential events or market movements. The risk appetite around potential stress losses is set and monitored against referral limits.

Market risk reverse stress tests are designed to identify vulnerabilities in our portfolios by looking for scenarios that lead to loss levels considered severe for the relevant portfolio. These scenarios may be quite local or idiosyncratic in nature, and complement the systematic top-down stress testing.

Stress testing and reverse stress testing provide management with insights regarding the 'tail risk' beyond VaR, for which our appetite is limited

(vi) Back-testing

The accuracy of VaR models are routinely validated by backtesting them with both actual and hypothetical profit and loss against the corresponding VaR numbers. Hypothetical profit and loss excludes non-modelled items such as fees, commissions and revenue of intra-day transactions.

The actual number of profits or losses in excess of VaR over this period can be used to gauge how well the models are performing. A VaR model is deemed satisfactory if it experiences less than five profit or loss exceptions in a 250-day period.

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e) *Resilience risk*

(i) Overview

Resilience risk is the risk that we are unable to provide critical services to customers, affiliates and counterparties, as a result of sustained and significant operational disruption.

Resilience risk arises from failures or inadequacies in processes, people, systems or external events. These may be driven by rapid technological innovation, changing behaviours of consumers, cyber-threats, cross-border dependencies and third-party relationships.

(ii) Resilience risk management

Key developments in 2019

In May 2019, in line with the simplified risk taxonomy, HSBC Group, including the Bank formed a new Resilience Risk sub-function to ensure operations continue functioning when an operational disturbance occurs. The resilience strategy is focused on the establishment of robust backup plans, detailed response methods, alternative delivery channels and recovery options. Resilience risk was formed to simplify interaction with stakeholders and to deliver clear, consistent and credible responses globally. Investment in information technology ('IT') Resilience is central to this commitment. Designing and implementing IT Systems that continue to be available to use, in the face of adverse conditions is a key objective. We seek to ensure we understand the root cause of IT failures and learn lessons both from our own experiences and those of others.

e) Resilience risk (Cont'd)

(ii) Resilience risk management (Cont'd)

Key developments in 2019 (Cont'd)

A number of initiatives to develop and embed the new sub-function:

- HSBC Group recruited and consolidated personnel from several previously independent risk functions, in Information and Cyber Security, Protective Security, Business Continuity and Incident Management, Third-party and Systems, Data Integrity and Transaction Processing.

- We adopted a new organisational structure that allows us to deliver our strengths and expertise more efficiently.

- We developed a Target Operating Model to set out our desired state for the function. We identified areas where we need to develop the resilience risk vision.

- We used internal and external channels to recruit a leadership team that is aligned to our core values of being open, dependable and connected.

Governance and structure

Resilience Risk provides guidance and stewardship to our businesses and global functions about how we can prevent, adapt, and learn from resilience-related threats when something goes wrong. We view resilience through six lenses: strategic change and emerging threats; third-party risk; information and data resilience; payments and processing resilience; systems and cyber resilience; and protective security risk. The Global Resilience Risk Executive Committee oversees resilience risk and has accountability to the Global Risk Management Board. The Global Resilience Risk Executive Committee is supported by its subcommittees that provide oversight over each of the respective Resilience Risk sub-teams within HSBC Group.

Key risk management processes

Operational resilience is our ability to adapt operations to continue functioning when an operational disturbance occurs. We measure resilience in terms of the maximum disruption period or their impact tolerance that we are willing to accept for a business service. Resilience risk cannot be managed down to zero, so we concentrate on critical business and strategic change programmes that have the highest potential to threaten our ability to provide continued service to our customers. Our resilience strategy is focused on the establishment of robust back-up plans, detailed response methods, alternative delivery channels and recovery options.

The Resilience Risk team oversees the identification, management and control of resilience risks.

f) Regulatory Compliance Risk

(i) Overview

Regulatory compliance risk is the risk of failure to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice, and incur fines and penalties and suffer damage to our business as a consequence.

Regulatory compliance risk arises from the risks associated with breaching the Bank's duty to customers and other counterparties, inappropriate market conduct and breaching other regulatory requirements.

(ii) Regulatory compliance risk management

Key developments in 2019

There were no material changes to the practices for the management of regulatory compliance risk in 2019, except for the initiatives that was undertook to raise our standards in relation to the conduct of business, as described below under 'Conduct of business'.

Governance and structure

The Regulatory Compliance sub-function provides independent, objective oversight and challenge, and promotes a compliance-orientated culture that supports the business in delivering fair outcomes for customers, maintaining the integrity of financial markets and achieving our strategic objectives.

Regulatory Compliance is part of the Compliance function, which is headed by the HSBC Group Chief Compliance Officer. Regulatory Compliance is structured as a global function with regional and country Regulatory Compliance teams, which support and advise each global business and global function.

Key risk management processes

Policies and procedures are regularly reviewed. Global policies and procedures require the prompt identification and escalation of any actual or potential regulatory breach to Regulatory Compliance. Reportable events are escalated to the RMM and the Risk Committee, as appropriate.

Conduct of business

In 2019, good conduct through people's behaviour and decision making continued to be promoted and encouraged in order to deliver fair outcomes for customers, and to maintain financial market integrity. During 2019:

- We continued to focus on the needs of vulnerable customers in our product and process design. In specific markets, we provided awareness and training initiatives, and we also deployed staff with specialist knowledge of conditions such as dementia. Financial inclusion initiatives progressed in specific markets, combatting financial abuse and developing financial education schemes for older customers.

- We further defined roles and responsibilities for our people as part of the enterprise risk management framework across the Bank to consider the customer in decision making and action.

- We delivered our fifth annual global mandatory training course on conduct, and reinforced the importance of conduct by highlighting examples of good conduct.

- We continued the expansion of recognition programmes across business areas for our people when they deliver exceptional service, when working directly with customers or in supporting roles.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Risk (Cont'd)

g) Financial crime and fraud risk

(i) Overview

Financial crime and fraud risk is the risk that we knowingly or unknowingly help parties to commit or to further potentially illegal activity. Financial crime and fraud risk arises from day-to-day banking operations.

(ii) Financial crime and fraud risk management

Key developments in 2019

During 2019, we continued to increase our efforts to strengthen our ability to combat financial crime. We integrated into our day-to-day operations the majority of the financial crime risk core capabilities delivered through the Global Standards programme, which we set up in 2013 to enhance our risk management policies, processes and systems. The global programme infrastructure closed in 2019 and we have begun several initiatives to define the next phase of financial crime risk management.

- We continued to strengthen our anti-fraud capabilities, focusing on threats posed by new and existing technologies, and have delivered a comprehensive fraud training programme to our people.
- We continued to invest in the use of artificial intelligence (AI) and advanced analytics techniques to develop a financial crime risk management framework for the future.
- We launched industry-leading anti-money laundering (AML) and sanctions automation systems to detect and disrupt financial crime in international trade. These systems will strengthen our ability to fight financial crime through the identification of criminal activity and networks.

Governance and structure

Since establishing a global framework of Financial Crime Risk Management Committees in the first quarter of 2018, we have continued to strengthen and review the effectiveness of our governance framework to manage financial crime risk. Formal governance committees is held and chaired by the chief executive officer. They help to enable compliance with the letter and the spirit of all applicable financial crime compliance laws and regulations, as well as our own standards, values and policies relating to financial crime risks.

Key risk management processes

We continued to deliver an anti-bribery and corruption transformation programme to further enhance the policies and controls around identifying and managing the risks of bribery and corruption across our business. Our transformation programme continued to focus on our anti-fraud and anti-tax evasion capabilities. Further enhancements have been made to our governance and policy frameworks, and to our management information reporting on standardised financial crime controls.

We are investing in the next generation of capabilities to fight financial crime by applying advanced analytics and AI. We remain committed to enhancing our risk assessment capabilities and aim to deliver more proactive risk management and improve the customer experience.

Working in partnership with the public sector and other financial institutions is vital to managing financial crime risk. We are a strong proponent of public-private partnerships and participates in information-sharing initiatives around the world to better understand these risks so that they can be mitigated more effectively.

f) Model risk

(i) Overview

Model risk is the potential for adverse consequences from business decisions informed by models, which can be exacerbated by errors in methodology, design or the way they are used. Model risk arises in both financial and non-financial contexts whenever business decision making includes reliance on models.

(ii) Key developments in 2019

In September 2019, a number of initiatives were undertaken to further develop and embed the new Model Risk Management sub-function, including:

- Appointing Head of Model Risk Management.
- Refining the model risk policy to enable a more risk-based approach to model risk management.
- Conducting a full review of model governance arrangements overseeing model risk across the HSBC Group, resulting in a range of enhancements to the underlying structure to improve effectiveness and increase business engagement.
- Designing a new target operating model for Model Risk Management, referring to internal and industry best practice.

(iii) Governance and structure

We have placed greater focus on our model risk activities during 2019. To reflect this, HSBC Group has created the role of Chief Model Risk Officer, which is undertaken by the Head of Model Risk Management. Model Risk Management is structured as a sub-function within Regional Risk Strategy. Regional Model Risk Management support and advise all areas of the HSBC Group, headed by the Regional Model Risk Steward.

As part of country's model risk governance framework, the Chief Risk Officer assumes the role of the Model Risk Steward and together with regional Model Risk Management, provides oversight, challenge and ensures compliance to HSBC's model risk management policies.

(iv) Key risk management processes

Regular reviews are conducted for model risk management policies and procedures and the first line of defence is required to demonstrate a set of comprehensive and effective controls based on a library of model risk controls provided by Model Risk Management.

Model Risk Management report on model risk to senior management on a regular basis through use of the risk map and regular key updates. The effectiveness of these processes is reviewed on a regular basis to ensure that appropriate understanding and ownership of model risk is embedded in the businesses and functions.

6 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.

6 Capital management (Cont'd)

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.

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, retained earnings 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 2019.

- Tier 2 capital, which includes qualifying subordinated liabilities and subordinated term financing, impairment allowances equal to 12-months and lifetime expected credit losses for non-credit impaired financing (commonly known as Stage 1 and 2 provisions), regulatory reserve, and the element of the fair value reserve relating to revaluation of property which are disclosed as regulatory adjustments.

a) Externally imposed capital requirements

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.

b) Basel III

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%, 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.

c) 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)

7 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). The calculation of the Bank's ECL under MFRS 9 requires a number of judgements, assumptions and estimates to be made. The most significant are set out below:

Judgements:
- Defining what is considered to be a significant increase in credit risk
- Determining the lifetime and point of initial recognition of overdrafts and credit cards
- Selecting and calibrating the PD, LGD and EAD models, which support the calculations, including making reasonable and supportable judgements about how models react to current and future economic conditions
- Selecting model inputs and economic forecasts, including determining whether sufficient and appropriately weighted economic forecasts are incorporated to calculate unbiased expected loss

Estimates:
- Note 5(b)(v) sets out the assumptions used in determining ECL and provide an indication of the sensitivity of the result to the application of different weightings being applied to different economic assumptions

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.

2019	**Level 1 RM'000**	**Level 2 RM'000**	**Level 3 RM'000**	**Total RM'000**
Financial investments at FVOCI (Note 10)	**2,719,975**	**-**	**-**	**2,719,975**
Derivative financial assets (Note 14)	**867**	**119,444**	**5,363**	**125,674**
	2,720,842	**119,444**	**5,363**	**2,845,649**
Structured liabilities designated at FVTPL(Note 22)	**-**	**1,082,565**	**212,793**	**1,295,358**
Derivative financial liabilities (Note 14)	**1,374**	**78,239**	**108**	**79,721**
Multi-Currency Sukuk Programme (Note 24)	**-**	**1,265,929**	**-**	**1,265,929**
	1,374	**2,426,733**	**212,901**	**2,641,008**
2018				
Financial investments at FVOCI (Note 10)	2,526,369	199,314	-	2,725,683
Derivative financial assets (Note 14)	281	241,856	147	242,284
	2,526,650	441,170	147	2,967,967
Structured liabilities designated at FVTPL(Note 22)	-	866,063	18,814	884,877
Derivative financial liabilities (Note 14)	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

7 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.

7 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.

7 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)

<u>Bid-offer</u>

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.

<u>Uncertainty</u>

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.

<u>Credit valuation adjustment (CVA) and Debit valuation adjustment (DVA)</u>

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 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.

<u>Funding fair value adjustment (FFVA)</u>

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.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

7 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 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.

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.

(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:

	2019			2018		
	Derivative financial assets	**Derivative financial liabilities**	**Structured liabilities**	Derivative financial assets	Derivative financial liabilities	Structured liabilities
RM'000						
Balance at 1 January	**147**	-	**18,814**	-	-	-
Total gains or losses						
-in profit or loss	**5,216**	**108**	**(236)**	147	-	(774)
-in OCI	-	-	**(82)**			
Issues	-	-	**194,597**	-	-	19,588
Settlements	-	-	**(300)**	-	-	-
Transfer out of Level 3	-	-	-	-	-	-
Balance at 31 December	**5,363**	**108**	**212,793**	147	-	18,814

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".

7 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 profit or loss as follows:

2019 **RM'000**	**Derivative financial assets**	**Derivative financial liabilities**	**Structured liabilities**
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	**5,216[2]**	**108[1]**	**(236)[2]**
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]

[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	**2019: 6.03%-10.82%** **2018: 13.37%**

7 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.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

7 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 2019 Carrying amount RM'000	**31 Dec 2019 Fair value RM'000**	31 Dec 2018 Carrying amount RM'000	31 Dec 2018 Fair value RM'000
Financial Assets				
Financing and advances	**13,042,953**	**13,059,556**	14,137,337	14,131,279
Financial Liabilities				
Deposits from customers	**13,320,333**	**13,318,332**	11,444,577	11,395,286
Deposits and placements from banks and other financial institutions	**2,339,954**	**2,339,739**	3,299,964	3,349,428
Subordinated Commodity Murabahah Financing	**589,612**	**620,133**	595,987	614,451

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.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

7 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 2019	**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	-	-	**13,059,556**	**13,059,556**	**13,042,953**
Financial Liabilities					
Deposits from customers	-	**13,318,332**	-	**13,318,332**	**13,320,333**
Deposits and placements from banks and other financial institutions	-	**2,339,739**	-	**2,339,739**	**2,339,954**
Subordinated Commodity Murabahah Financing	-	**620,133**	-	**620,133**	**589,612**
31 Dec 2018					
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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

8 Cash and Short-Term Funds

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Cash and balances with banks and other financial institutions	**215,943**	165,396
Money at call and interbank placements maturing within one month	**4,566,021**	2,639,098
	4,781,964	2,804,494

Money at call and interbank placements maturing within one month is within Stage 1 allocation (12-months ECL) with RM6,000 impairment allowance as at 31 December 2019 (31 December 2018: RM2,000).

9 Deposits and Placements with Banks and Other Financial Institutions

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Central bank	**139,153**	-

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

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Money market instruments:		
Malaysian Government Islamic Sukuk	**2,719,975**	2,526,369
Islamic Treasury Bill	**-**	199,314
	2,719,975	2,725,683

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

Maturing within one year	**1,700,589**	940,445
More than one year to three years	**1,019,386**	1,554,002
More than three years to five years	**-**	231,236
	2,719,975	2,725,683

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

11 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 Thumma Al-Bai	Diminishing Musharakah	Ujrah	Total
31 Dec 2019	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
Cash line-i	73,131	-	-	-	-	73,131
Term financing:						
House financing	-	-	-	4,164,372	-	4,164,372
Hire purchase receivables	-	-	194,049	-	-	194,049
Syndicated term financing	728,298	-	-	-	-	728,298
Other term financing	2,867,908	39	-	971,127	-	3,839,074
Trust receipts	525,826	-	-	-	-	525,826
Claims on customers under acceptance credits	323,272	-	-	-	-	323,272
Bills receivables	470,920	-	-	-	-	470,920
Staff financing-i	1,041	30	-	1,173	-	2,244
Credit cards-i	-	-	-	-	1,258,564	1,258,564
Revolving financing	1,716,165	-	-	-	-	1,716,165
Other financing	-	-	-	4,303	-	4,303
Gross financing and advances	6,706,561	69	194,049	5,140,975	1,258,564	13,300,218
Less: Impairment allowance						(257,265)
Total net financing and advances						13,042,953

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

11 Financing and Advances (Cont'd)

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

	Sale-based contracts		Lease-based contracts		Equity-based contracts		
31 Dec 2018	Commodity Murabahah 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	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	3,307,216	62	-	-	1,010,142	-	4,317,420
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	7,755,587	114	539	195,636	5,344,360	1,075,634	14,371,870
Less: Impairment allowance							(234,533)
Total net financing and advances							14,137,337

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

11 Financing and Advances (Cont'd)

(ii) By type of customer

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Domestic non-bank financial institutions	**494,886**	619,421
Domestic business enterprises:		
Small medium enterprises	**937,397**	1,983,223
Others	**4,221,026**	3,781,656
Government and statutory bodies	**1,917**	4,527
Individuals	**6,263,102**	6,142,634
Other domestic entities	**1,137**	1,258
Foreign entities/individuals	**1,380,753**	1,839,151
	13,300,218	14,371,870

(iii) By profit rate sensitivity

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Fixed rate:		
Hire purchase receivables	**194,049**	195,636
Other financing	**3,443,551**	3,300,541
Variable rate:		
Base Rate/Base Financing Rate plus	**5,197,432**	5,392,670
Cost-plus	**4,465,186**	5,483,023
	13,300,218	14,371,870

(iv) By residual contractual maturity

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Maturing within one year	**4,541,871**	5,895,827
More than one year to three years	**1,755,409**	1,166,130
More than three years to five years	**1,012,833**	1,289,364
Over five years	**5,990,105**	6,020,549
	13,300,218	14,371,870

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

11 Financing and Advances (Cont'd)

(v) By sector

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Agriculture, hunting, forestry & fishing	**16,715**	18,986
Mining and quarrying	**184,190**	231,674
Manufacturing	**1,203,233**	1,495,092
Electricity, gas and water	**199,311**	128,262
Construction	**1,051,079**	783,688
Real estate	**759,769**	1,135,507
Wholesale & retail trade, restaurants & hotels	**824,314**	995,569
Transport, storage and communication	**177,572**	214,291
Finance, takaful and business services	**868,309**	1,040,672
Household - Retail	**6,785,186**	6,706,145
Others	**1,230,540**	1,621,984
	13,300,218	14,371,870

(vi) By purpose

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Purchase of landed property:		
Residential	**4,165,546**	4,330,789
Non-residential	**799,749**	835,867
Purchase of transport vehicles	**771**	1,255
Consumption credit	**2,382,777**	2,127,277
Construction	**817,249**	567,385
Working capital	**4,273,540**	5,229,130
Other purpose	**860,586**	1,280,167
	13,300,218	14,371,870

(vii) By geographical distribution

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Northern Region	**1,557,283**	1,497,309
Southern Region	**1,570,904**	1,464,169
Central Region	**9,793,026**	11,010,829
Eastern Region	**379,005**	399,563
	13,300,218	14,371,870

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)

11 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 2019 RM'000	31 Dec 2018 RM'000
Financial assets at fair value through profit or loss [1]	**600,054**	-
Total gross financing and advances	**3,071,768**	3,381,964
Less: Impairment allowance	**(347)**	(896)
Total net financing and advances	**3,071,421**	3,381,068
Maturity not exceeding one year	**35,000**	794,750
Maturity exceeding one year	**437,750**	-
Total commitments and contingencies	**472,750**	794,750
Risk weighted assets (RWA)	**3,298,355**	2,939,702

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(g).

[1] These are held for the purpose selling in the near term.

12 Impaired Financing

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

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Gross carrying amount as at 1 January	**356,312**	282,049
Transfer within stages	**59,449**	71,690
Net remeasurement due to changes in credit risk	**70,641**	115,711
Written-off	**(101,099)**	(113,156)
Others	**-**	18
Gross carrying amount as at 31 December	**385,303**	356,312

12 Impaired Financing (Cont'd)

(ii) By contract

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Ijarah Thumma Al-Bai (AITAB) *(hire purchase)*	**1,117**	6,368
Commodity Murabahah *(cost-plus)*	**248,763**	201,946
Diminishing Musharakah (*profit and loss sharing)*	**128,582**	140,036
Bai Al-Inah *(sell and buy back)*	**32**	32
Ujrah *(fee-based)*	**6,809**	7,930
	385,303	356,312

(iii) By sector

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Mining and quarrying	**-**	704
Manufacturing	**16,247**	17,354
Construction	**4,199**	3,142
Real estate	**35**	-
Wholesale & retail trade, restaurants & hotels	**18,004**	11,139
Transport, storage and communication	**369**	4,153
Finance, takaful and business services	**28,721**	28,661
Household - Retail	**292,565**	265,333
Others	**25,163**	25,826
	385,303	356,312

(iv) By purpose

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Purchase of landed property:		
Residential	**105,991**	124,989
Non-residential	**18,307**	11,824
Purchase of transport vehicles	**32**	146
Consumption credit	**185,059**	138,227
Construction	**2,724**	2,402
Working capital	**50,381**	53,902
Others	**22,809**	24,822
	385,303	356,312

(v) By geographical distribution

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Northern Region	**33,178**	37,748
Southern Region	**39,561**	39,453
Central Region	**305,637**	273,061
Eastern Region	**6,927**	6,050
	385,303	356,312

13 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 2019	**43,988**	**64,464**	**126,081**	-	-	**234,533**
Changes due to financial assets recognised in the opening balance that have:						
- Transferred to Stage 1	**21,747**	**(18,175)**	**(3,572)**	-	-	-
- Transferred to Stage 2	**(4,295)**	**8,351**	**(4,056)**	-	-	-
- Transferred to Stage 3	**(443)**	**(3,831)**	**4,274**	-	-	-
New financial assets originated or purchased	**17,655**	-	-	-	-	**17,655**
Net remeasurement due to changes in credit risk	**(31,931)**	**17,194**	**121,131**	-	-	**106,394**
Asset written-off	-	-	**(101,099)**	-	-	**(101,099)**
Others	**(218)**	-	-	-	-	**(218)**
Balance at 31 December 2019	**46,503**	**68,003**	**142,759**	-	-	**257,265**
Balance at 1 January 2018 [1]	-	-	-	74,265	240,908	315,173
- adoption of MFRS 9 [1]	61,134	65,520	110,136	(74,265)	(240,908)	(78,383)
Balance restated [1]	61,134	65,520	110,136	-	-	236,790
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	-	-	-
Changes due to modification not derecognised	-	-	-	-	-	-
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 [1]	(596)	-	241	-	-	(355)
Balance at 31 December 2018 [1]	43,988	64,464	126,081	-	-	234,533

The Bank measures the expected credit losses (ECL) using the three-stage approach. 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.

The total ECL allowances increased by RM 22.7 million compared to the balance at the beginning of the year. This net increase was mainly contributed by net remeasurement due to changes in credit risk (RM 106.4 million) and new financial assets originated or purchased (RM 17.7 million), partly offset by asset written-off (RM 101.1 million).

- 12-months ECL not credit impaired (Stage 1) - increased by RM2.5 million, primarily due to increase in new financial assets originated or purchased, migration of financings from Stage 2 and Stage 3 and partially offset by remeasurement driven by changes in credit risk.
- Lifetime ECL not credit-impaired (Stage 2) - increased by RM3.5 million, primarily due to increase in remeasurement driven by changes in credit risk and partially offset by migration of financings to Stage 1 and Stage 3.
- Lifetime ECL credit-impaired (Stage 3) - increased by RM16.7 million, primarily due to increase in remeasurement driven by changes in credit risk, and partially offset by asset written-off and migration of financings to Stage 1 and Stage 2.

[1] Balances have been restated as disclosed in Note 43

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

13 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 2019	**1,109**	**925**	**825**	**2,859**
Changes due to financial assets recognised in the opening balance that have:				
- Transferred to Stage 1	**81**	**(81)**	**-**	**-**
- Transferred to Stage 2	**(88)**	**88**	**-**	**-**
- Transferred to Stage 3	**-**	**-**	**-**	**-**
New financial assets originated or purchased	**653**	**-**	**-**	**653**
Net remeasurement due to changes in credit risk	**(471)**	**(58)**	**(423)**	**(952)**
Others	**(8)**	**-**	**-**	**(8)**
Balance at 31 December 2019	**1,276**	**874**	**402**	**2,552**
Balance at 1 January 2018	-	-	-	-
- adoption of MFRS 9	946	1,880	997	3,823
Balance restated	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.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

14 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			
31 Dec 2019	**Up to 1 Year RM'000**	**>1 - 5 Years RM'000**	**> 5 Years RM'000**	**Total RM'000**	**Up to 1 Year RM'000**	**>1 - 5 Years RM'000**	**> 5 Years RM'000**	**Total RM'000**	**Up to 1 Year RM'000**	**>1 - 5 Years RM'000**	**> 5 Years RM'000**	**Total RM'000**
Trading derivatives:												
Foreign exchange contracts												
- Forwards	**6,829,354**	**-**	**-**	**6,829,354**	**35,968**	**-**	**-**	**35,968**	**36,232**	**-**	**-**	**36,232**
- Swaps	**642,318**	**-**	**-**	**642,318**	**41,737**	**-**	**-**	**41,737**	**41,568**	**-**	**-**	**41,568**
Profit rate related contracts												
- Swaps	**1,048,000**	**863,428**	**-**	**1,911,428**	**1,097**	**11,565**	**-**	**12,662**	**-**	**1,601**	**-**	**1,601**
- Options	**170,519**	**245,982**	**-**	**416,501**	**2,620**	**1,960**	**-**	**4,580**	**-**	**-**	**-**	**-**
Equity related contracts												
- Options purchased	**466,444**	**396,199**	**-**	**862,643**	**16,084**	**14,643**	**-**	**30,727**	**196**	**124**	**-**	**320**
Sub- total	**9,156,635**	**1,505,609**	**-**	**10,662,244**	**97,506**	**28,168**	**-**	**125,674**	**77,996**	**1,725**	**-**	**79,721**
Total	**9,156,635**	**1,505,609**	**-**	**10,662,244**	**97,506**	**28,168**	**-**	**125,674**	**77,996**	**1,725**	**-**	**79,721**

The Bank does not have any hedging instrument as at 31 December 2019.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)
14 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 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

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

	31 Dec 2019	31 Dec 2018
	RM'000	RM'000
Gain on hedging instruments	**13**	348
Loss on the hedged items attributable to the hedged risk	**(29)**	(366)
Net loss from fair value hedges	**(16)**	(18)

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

15 Other Assets

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Settlements	**-**	3,431
Income receivable	**6,234**	7,733
Profit receivable	**24,990**	21,383
Prepayments	**-**	190
Amount due from holding company	**2,093**	360
ROU assets [1]	**24,504**	-
Other receivables	**10,820**	17,567
	68,641	50,664

[1] ROU assets comprise solely of properties. There are no additions during the financial year.

Lease related expenses and cash outflows during the financial year:

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Finance expense	**1,417**	-
Expense related to short-term leases (Included in establishment related expenses)	**222**	-
Cash outflow for leases payments	**7,357**	-

16 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)

17 Equipment

2019	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	**36,132**	**19,706**	**299**	**1,506**	**57,643**
Additions	**1,330**	**597**	**301**	**-**	**2,228**
Disposals	**-**	**-**	**(299)**	**-**	**(299)**
Written off	**(1,071)**	**(85)**	**-**	**-**	**(1,156)**
Reclassification	**1,506**	**-**	**-**	**(1,506)**	**-**
Balance at 31 December	**37,897**	**20,218**	**301**	**-**	**58,416**
Accumulated depreciation					
Balance at 1 January	**33,023**	**17,512**	**240**	**-**	**50,775**
Charge for the financial year	**1,160**	**718**	**84**	**-**	**1,962**
Written off	**(1,068)**	**(85)**	**-**	**-**	**(1,153)**
Disposals	**-**	**-**	**(269)**	**-**	**(269)**
Balance at 31 December	**33,115**	**18,145**	**55**	**-**	**51,315**
Net book value at 31 December	**4,782**	**2,073**	**246**	**-**	**7,101**

2018	Office equipment, fixtures and fittings	Computer equipment	Motor vehicles	Work in Progress	Total
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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

18 Intangible assets

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Computer software		
Cost		
Balance at 1 January	**5,053**	5,053
Written off	**(1)**	-
Balance at 31 December	**5,052**	5,053
Accumulated amortisation		
Balance at 1 January	**5,053**	5,053
Written off	**(1)**	-
Balance at 31 December	**5,052**	5,053
Net book value at 31 December	**-**	-

19 Deferred Tax Assets

The amounts, prior to offsetting are summarised as follows:

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Deferred tax assets	**26,164**	17,676
Deferred tax liabilities	**(2,256)**	(313)
	23,908	17,363

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 2019 RM'000	31 Dec 2018 RM'000
Deferred tax assets		
- settled more than 12 months	**8,588**	6,153
- settled within 12 months	**17,576**	11,523
Deferred tax liabilities		
- settled more than 12 months	**(929)**	(103)
- settled within 12 months	**(1,327)**	(210)
	23,908	17,363

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

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Equipment capital allowances	**(322)**	(210)
FVOCI reserve	**(1,934)**	(103)
Own credit reserve	**2,607**	943
Provision for accrued expenses	**7,175**	7,938
Deferred income	**9,302**	2,838
Lease receivables	**215**	218
Financing and advances	**6,865**	5,739
	23,908	17,363

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

19 Deferred Tax Assets (Cont'd)

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

2019	**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**	**1,126**	**-**	**6,865**
Own Credit reserve	**943**	**-**	**1,664**	**2,607**
Provision for accrued expenses	**7,938**	**(763)**	**-**	**7,175**
Deferred income	**2,838**	**6,464**	**-**	**9,302**
Lease receivables	**218**	**(3)**	**-**	**215**
Deferred Tax Assets	**17,676**	**6,824**	**1,664**	**26,164**
Equipment capital allowances	**(210)**	**(112)**	**-**	**(322)**
Financial investment at FVOCI	**(103)**	**-**	**(1,831)**	**(1,934)**
Deferred Tax Liabilities	**(313)**	**(112)**	**(1,831)**	**(2,256)**
Net Deferred Tax Assets	**17,363**	**6,712**	**(167)**	**23,908**
2018				
Financing and advances	-	5,739	-	5,739
Own Credit reserve	-	-	943	943
Provision for accrued expenses	7,080	858	-	7,938
Deferred income	2,380	458	-	2,838
Lease receivables	208	10	-	218
Deferred Tax Assets	9,668	7,065	943	17,676
Equipment capital allowances	(319)	109	-	(210)
Own Credit reserve	(805)	583	222	-
Financial investment at FVOCI	(57)	-	(46)	(103)
Deferred Tax Liabilities	(1,181)	692	176	(313)
Net Deferred Tax Assets	8,487	7,757	1,119	17,363

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

20 Deposits From Customers

(i) By type of deposit

At amortised cost	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Non-Mudharabah Fund		
Demand deposits		
- Qard	**3,451,211**	1,770,373
Savings deposits		
- Qard	**1,872,649**	1,689,423
Term deposits		
- Commodity Murabahah	**7,942,487**	7,789,088
- Qard	**53,986**	195,693
	13,320,333	11,444,577

The maturity structure of term deposits is as follows:

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Due within six months	**6,590,085**	6,602,418
More than six months to one year	**1,099,780**	1,042,883
More than one year to three years	**174,180**	264,450
More than three years to five years	**132,428**	75,030
Over five years	**-**	-
	7,996,473	7,984,781

(ii) By type of customer

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Government and statutory bodies	**12,986**	3,780
Business enterprises	**2,753,651**	2,349,937
Individuals	**6,222,474**	6,284,101
Foreign entities/individuals	**3,945,963**	2,511,888
Others	**385,259**	294,871
	13,320,333	11,444,577

21 Deposits and Placements from Banks and Other Financial Institutions

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Non-Mudharabah Fund		
Licensed banks	**427,197**	579,301
Bank Negara Malaysia	**20,412**	27,971
Other financial institutions	**1,892,345**	2,692,692
	2,339,954	3,299,964

Included in deposits and placements from banks and other financial institutions are placements from the Bank's parent company, HSBC Bank Malaysia Berhad, of RM0.4 billion (31 Dec 2018: RM0.6 billion).

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

22 Structured Liabilities Designated as Fair Value through profit or loss (FVTPL)

At fair value	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Structured liabilities		
- Wakalah with Commodity Wa'ad	**205,951**	228,954
- Tawarruq	**1,089,407**	655,923
	1,295,358	884,877

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.

23 Other Liabilities

	Note	31 Dec 2019 RM'000	31 Dec 2018 RM'000
At amortised cost			
Settlements		**96**	-
Amounts due to holding company		**57,735**	73,163
Profit payable		**85,652**	87,846
Deferred income		**38,760**	11,824
Marginal deposit		**3,765**	4,245
Accrued expenses		**26,971**	32,928
Lease liabilities		**25,054**	-
Other creditors	(a)	**102,811**	58,095
Provision on financing and credit related commitments		**2,552**	2,859
		343,396	270,960

(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. One (1) actual Shariah non-compliant event has been identified during the financial year (2018: Nil) and rectified in accordance with the requirements of Shariah Governance Framework.

Source and use of charity funds	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Balance at 1 January	**14**	1
Shariah non-compliant income for the financial year [1]	**27**	16
Contribution to non-profit organisations	**(15)**	-
Tax expense on Shariah non-compliant income	**(23)**	(3)
Balance at 31 December	**3**	14

[1] Income received from transactions in Financing and Advances and Nostro Accounts.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

24 Multi-Currency Sukuk Programme

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Multi-Currency Sukuk Programme (MCSP)	**1,265,929**	1,755,281

The Bank issued the following series of 5-year unsecured Sukuk under its RM3.0 billion MCSP.

				Carrying Value	
Issuance under MCSP	Value RM'000	Issue Date	Maturity Date	31 Dec 2019 RM'000	31 Dec 2018 RM'000
At fair value					
2nd series [1]	500,000	16 Oct 2014	16 Oct 2019	**-**	501,173
3rd series	750,000	27 Mar 2015	27 Mar 2020	**751,732**	751,993
4th series	500,000	2 Oct 2018	2 Oct 2023	**514,197**	502,115
	1,750,000			**1,265,929**	1,755,281

Movement in MCSP

	2nd series 31 Dec 2019 RM'000	3rd series 31 Dec 2019 RM'000	4th series 31 Dec 2019 RM'000
2019			
Balance at 1 January	**501,173**	**751,993**	**502,115**
Change in fair value other than from own credit risk	**(917)**	**(1,455)**	**8,446**
Change in fair value from own credit risk	**(256)**	**1,194**	**3,636**
Redemption of Multi-Currency Sukuk	**(500,000)**	**-**	**-**
Balance at 31 December	**-**	**751,732**	**514,197**

	2nd series 31 Dec 2018 RM'000	3rd series 31 Dec 2018 RM'000	4th series 31 Dec 2018 RM'000
2018			
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

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
The cumulative change in fair value due to changes in own credit risk	**4,574**	2,764

[1] Redeemed on 16 October 2019.

25 Subordinated Commodity Murabahah Financing

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Subordinated Commodity Murabahah Financing, at amortised costs		
- First tranche issued on 25 June 2014	**317,957**	321,395
- Second tranche issued on 30 June 2015	**271,655**	274,592
	589,612	595,987

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.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

26 Share Capital

	31 Dec 2019		31 Dec 2018	
	Number of Ordinary Shares ('000)	**RM'000**	Number of Ordinary Shares ('000)	RM'000
At 1 January/31December - ordinary shares of RM0.50 each				
Ordinary Shares Issued and Fully Paid	**100,000**	**660,000**	100,000	660,000

27 Reserves

	31 Dec 2019	31 Dec 2018
	RM'000	RM'000
Non-distributable		
Financial investment at FVOCI	**6,294**	479
Own credit reserve [1]	**(8,257)**	(2,987)
Capital contribution reserve [2]	**537**	499
Regulatory reserves [3]	**53,100**	91,100
	51,674	89,091
Distributable		
Retained profits	**1,259,011**	1,073,174
	1,310,685	1,162,265

[1] Changes in fair value relating to the Bank's own credit risk are recognised in other comprehensive income. This is arising from structured product and multi-currency sukuk program.

[2] 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.

[3] The regulatory reserve is maintained in compliance with paragraph 10.9 of BNM's policy document on Financial Reporting and Financial Reporting for Islamic Banking Institutions issued on 27 September 2019, 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 2019 RM'000	31 Dec 2018 RM'000
Income derived from investment of:		
(i) Term deposit	**608,238**	624,035
(ii) Other deposits	**217,900**	199,318
	826,138	823,353

During the year, the Income Derived from Investment of Depositors' Funds and Others have been recategorised from i) General Investment Deposits, ii) Specific Investment Deposits and iii) Others, to just two broad category, ie. i) Term Deposits and ii) Other Deposits, to be in line with industry practice. Accordingly, the 2018 comparatives has been restated to reflect the change.

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
(i) Income derived from investment of term deposits deposits		
Finance income:		
Financing and advances		
- Profit earned other than recoveries from impaired financing	**473,262**	493,204
- Recoveries from impaired financing	**17,831**	18,249
Financial investments at FVOCI	**74,733**	58,444
Money at call and deposit with financial institutions	**62,179**	50,009
	628,005	619,906
Other operating income		
Fee commission	**-**	694
Realised gains from dealing in foreign currency	**15,931**	11,273
Unrealised (loss)/gain from dealing in foreign currency	**(360)**	235
Gain from sale of financial assets designated as FVTPL and other financial instruments	**864**	1,436
Unrealised gain/(loss) from revaluation of financial assets designated as FVTPL	**1,416**	(623)
Net profit received for financial assets designated as FVTPL and other financial instruments	**-**	1
Realised gain from trading in derivatives	**1,498**	2,728
Unrealised gain/(loss) from trading in derivatives	**290**	(1,298)
Net expenses from financial liabilities designated at FVTPL	**(39,395)**	(10,305)
Other expense	**(11)**	(12)
	(19,767)	4,129
	608,238	624,035
The above fees and commissions were derived from the following major contributors:		
Service charges and fees	**-**	694

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
(ii) Income derived from investment of other deposits		
Finance income:		
Financing and advances		
- Profit earned other than recoveries from impaired financing	**159,231**	153,612
- Recoveries from impaired financing	**5,999**	6,797
Financial investments at FVOCI	**25,144**	21,769
Money at call and deposit with financial institutions	**20,921**	15,141
	211,295	197,319

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

28 Income Derived from Investment of Depositors' Funds and Others (Cont'd)

(ii) Income derived from investment of other deposits (Cont'd)

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Other operating income		
Realised gain from dealing in foreign currency	**5,360**	4,917
Unrealised (loss)/gain from dealing in foreign currency	**(121)**	88
Gain from sale of financial assets designated as FVTPL and other financial instruments	**291**	535
Unrealised gain/(loss) from revaluation of financial assets at FVTPL	**476**	(232)
Realised gain from trading in derivatives	**504**	1,016
Unrealised gain/(loss) from trading in derivatives	**98**	(483)
Net expenses from financial liabilities designated at FVTPL	**-**	(3,838)
Other expense	**(3)**	(4)
	6,605	1,999
	217,900	199,318

29 Income Derived from Investment of Shareholder's Funds

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Finance income:		
Financing and advances		
- Profit earned other than recoveries from impaired financing	**62,856**	64,295
- Recoveries from impaired financing	**2,368**	2,845
Financial investments at FVOCI	**9,926**	9,112
Money at call and deposit with financial institutions	**8,258**	6,337
	83,408	82,589
Other operating income		
Fees and commission	**67,324**	61,920
Realised gains from dealing in foreign currency	**2,116**	2,058
Unrealised (loss)/gain from dealing in foreign currency	**(48)**	37
Gain from sale of financial assets designated as FVTPL and other financial instruments	**115**	224
Unrealised gain/(loss) from revaluation of financial assets FVTPL	**188**	(97)
Realised gains from trading in derivatives	**199**	425
Unrealised gain/(loss) from trading in derivatives	**39**	(202)
Shared-service fees from holding company	**2,328**	2,400
Net expenses from financial liabilities designated at FVTPL	**-**	(1,938)
Gain on disposal of financial investments at FVOCI	**6,605**	-
Other income	**177**	19
	79,043	64,846
	162,451	147,435

The above fees and commissions were derived from the following major contributors:

Service charges and fees	**23,312**	16,028
Credit cards	**28,902**	30,668
Agency fees	**7,482**	9,361

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

30 Impairment Allowance/Provisions

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
New and increased allowance/provisions (net of releases)	**123,768**	110,389
Recoveries	**(48,332)**	(40,983)
Written off	**47**	38
Total charge to statement of profit or loss	**75,483**	69,444

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)	**124,049**	111,254
Recoveries	**(48,332)**	(40,983)
Written off	**47**	38
Total charge to statement of profit or loss	**75,764**	70,309

(ii) Money at call and interbank placements maturing within one month

New and increased allowance (net of releases)	**4**	1
Total charge to statement of profit or loss	**4**	1

(iii) Financing commitments

New and increased allowance (net of releases)	**(299)**	(891)
Total charge to statement of profit or loss	**(299)**	(891)

(iv) Financial investment at FVOCI

New and increased allowance (net of releases)	**14**	25
Total charge to statement of profit or loss	**14**	25

31 Income Attributable to Depositors

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Non-Mudharabah Fund		
- Deposits from customers	**295,756**	288,598
- Deposits and placements of banks and other financial institutions	**48,219**	64,907
- Lease liabilities	**1,418**	-
- Others	**93,242**	80,841
	438,635	434,346

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

32 Operating Expenses

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Personnel expenses	**48,790**	48,962
Promotion and marketing related expenses	**9,666**	15,701
Establishment related expenses	**16,019**	17,316
General administrative expenses	**35,707**	39,424
Related company expenses	**134,899**	134,026
	245,081	255,429
Personnel expenses		
Salaries, allowances and bonuses	**37,438**	38,832
Employees Provident Fund contributions	**6,634**	6,888
Share based payment	**728**	187
Other staff related costs	**3,990**	3,055
	48,790	48,962
Promotion and marketing related expenses	**9,666**	15,701
Establishment related expenses		
Depreciation of equipment	**1,962**	2,324
Depreciation of ROU assets	**6,674**	-
Information technology costs	**2,567**	2,983
Hire of equipment	**313**	-
Rental of premises	**318**	8,151
Equipment written off	**3**	1
Utilities	**2,064**	2,008
Others	**2,118**	1,849
	16,019	17,316
General administrative expenses		
Auditors' remuneration		
- Statutory audit fees	**156**	156
- Regulatory related fees	**160**	210
- Non-audit fees	**-**	8
Professional fees	**1,779**	1,819
Communication	**1,416**	1,497
Others	**32,196**	35,734
	35,707	39,424

Included in professional fees are fees paid to the Shariah Committee members of the Bank:

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Fees	**410**	410
Asst Prof Dr Ziyaad Mahomed	**89**	91
Dr Aida binti Othman	**82**	75
Dr Khairul Anuar bin Ahmad	**81**	78
Prof Dr Younes Soualhi	**76**	73
Dr Mohamed Ashraf bin Mohamed Iqbal	**82**	76
Assoc. Prof. Dr. Muhammad Yusuf Saleem Ghulam Nabi	**-**	17

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

32 Operating Expenses (Cont'd)

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Related company charges	**134,899**	134,026
Of which by:		
Type of service		
- Information technology related cost	**7,840**	7,048
- Non information technology related cost	**127,059**	126,978
Countries		
- Malaysia	**133,846**	133,262
- United Kingdom	**1,053**	764

33 Income Tax Expense

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Malaysian income tax		
- Current year	**54,806**	51,641
- Prior year	**(6,525)**	4,985
Total current tax recognised in profit or loss	**48,281**	56,626
Deferred tax:		
Origination and reversal of temporary differences		
- Current year	**(6,712)**	(7,757)
Total deferred tax recognised in profit or loss	**(6,712)**	(7,757)
Total income tax expense	**41,569**	48,869

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	**229,390**	211,569
Income tax using Malaysian tax rate	**55,054**	50,777
Non-deductible expenses	**1,980**	847
Tax exempt income	**(8,940)**	(7,740)
(Over)/under provision in respect of prior years	**(6,525)**	4,985
Tax expense	**41,569**	48,869

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 holding bank (hereinafter referred to as parent), and ultimate holding company;

ii subsidiary and associated companies of the Bank's ultimate holding 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 agreements 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 2019			31 Dec 2018		
	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
Fees and commission	**2,449**	**6,698**	**-**	-	5,280	-
Net trading income/expense	**64,106**	**(21,011)**	**-**	(115,375)	(24,038)	-
Other income	**2,328**	**5**	**-**	2,400	22	-
	68,883	**(14,308)**	**-**	(112,975)	(18,736)	12
Expenditure						
Profit attributable to deposits and placements from banks and other financial institutions	**37,465**	**38,390**	**-**	49,991	41,493	-
Fees and commission	**-**	**443**	**-**	-	320	-
Operating expenses	**125,210**	**9,689**	**-**	126,184	7,842	-
	162,675	**48,522**	**-**	176,175	49,655	-
Amount due from						
Deposits and placements with banks and other financial institutions (including cash and short term funds)	**-**	**63,962**	**-**	-	63,559	-
Financing and advances	**-**	**-**	**109**	-	-	153
Derivative financial assets	**77,080**	**-**	**-**	37,844	-	-
Other assets	**2,093**	**767**	**-**	360	-	-
	79,173	**64,729**	**109**	38,204	63,559	153
Amount due to						
Deposits and placements from banks and other financial institutions	**427,197**	**514,597**	**-**	579,301	1,926,092	-
Deposits from customers	**-**	**-**	**44**	-	-	47
Derivative financial liabilities	**48,454**	**-**	**-**	207,763	-	-
Other liabilities	**58,954**	**2,729**	**-**	73,965	5,897	-
Subordinated commodity murabahah financing	**589,612**	**-**	**-**	595,987	-	-
	1,124,217	**517,326**	**44**	1,457,016	1,931,989	47

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 2019 RM'000	31 Dec 2018 RM'000
Directors of the Bank:		
- Fees	**692**	668
Total short-term employee benefits	**692**	668
Total Directors' Remuneration	**692**	668

During the financial years ended 31 December 2019 and 31 December 2018, 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 2019 RM'000	31 Dec 2018 RM'000
Other key management personnel:		
- Short-term employee benefits	**2,212**	2,247
- Share-based payments	**23**	-
Total key management personnel compensation	**2,904**	2,915

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

2019	**Salaries and bonuses**	**Other short-term employee benefits**	**Shared-based payment**	**Fees**	**Total**
RM'000					
Non-Independent Executive Directors					
Mukhtar Malik Hussain	**-**	**-**	**-**	**-**	**-**
Stuart Paterson Milne	**-**	**-**	**-**	**-**	**-**
Independent Non-Executive Directors					
Adil Ahmad	**-**	**-**	**-**	**136**	**136**
Albert Quah Chei Jin	**-**	**-**	**-**	**136**	**136**
Ho Chai Huey	**-**	**-**	**-**	**121**	**121**
Datuk Kamaruddin Taib	**-**	**-**	**-**	**166**	**166**
Non-Independent Non-Executive Director					
Lee Choo Hock [1]	**-**	**-**	**-**	**133**	**133**
	-	**-**	**-**	**692**	**692**
CEO					
Arsalaan Ahmed	**1,658**	**554**	**23**	**-**	**2,235**

[1] Re-designated as Non-Independent Non-Executive Director on 30 May 2019. He was previously an Independent Non-Executive Director.

2018	Salaries and bonuses	Other short-term employee benefits	Shared-based payment	Fees	Total
RM'000					
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	559	-	-	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

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 2019		31 Dec 2018	
	Unrestricted RM'000	**Deferred RM'000**	Unrestricted RM'000	Deferred RM'000
Fixed remuneration				
Cash	**1,171**	**-**	1,151	-
Variable remuneration				
Cash	**270**	**180**	488	-
Shares and share-linked instruments	**270**	**180**	-	122
	540	**360**	488	122
	1,711	**360**	1,639	122

Number of officers having received a variable remuneration during the financial year: 1 (2018: 1)

	31 Dec 2019		31 Dec 2018	
	Number	**Amount RM'000**	Number	Amount RM'000
Outstanding deferred remuneration				
Cash	**-**	**-**	-	-
Shares and share-linked instruments	**1**	**223**	1	79
		223		79
Deferred remuneration paid out	**1**	**26**	-	-

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 2019 RM'000	31 Dec 2018 RM'000
Aggregate value of outstanding credit exposures to connected parties	**941,338**	973,888
As a percentage of total credit exposures	**5.6%**	5.4%
Aggregate value of outstanding credit exposures to connected parties which is non-performing or in default	-	-
As a percentage of total credit exposures	-	-

37 Capital Adequacy

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Tier 1 capital		
Paid-up ordinary share capital	**660,000**	660,000
Retained profits	**1,259,011**	1,073,174
Other reserves	**51,001**	88,251
Regulatory adjustments	**(71,428)**	(94,783)
Total Common Equity Tier 1 (CET1) and Tier 1 capital	**1,898,584**	1,726,642
Tier 2 capital		
Subordinated Commodity Murabahah financing	**589,612**	595,987
Impairment allowance (unimpaired portion) & regulatory reserves	**145,014**	152,771
Total Tier 2 capital	**734,626**	748,758
Capital base	**2,633,210**	2,475,400
Inclusive of proposed dividend		
CET1 and Tier 1 Capital ratio	**14.974%**	13.025%
Total Capital ratio	**20.768%**	18.673%
Net of proposed dividend		
CET1 and Tier 1 Capital ratio	**14.580%**	12.723%
Total Capital ratio	**20.374%**	18.371%

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 2019 RM'000	31 Dec 2018 RM'000
Total RWA for credit risk	**11,601,150**	12,221,665
Total RWA for market risk	**81,799**	91,851
Total RWA for operational risk	**996,092**	943,049
	12,679,041	13,256,565

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 2019 RM'000	31 Dec 2018 RM'000
Direct credit substitutes	**488,882**	491,803
Transaction-related contingent items	**1,281,201**	1,138,590
Short-term self-liquidating trade-related contingencies	**37,007**	63,111
Formal standby facilities and credit lines		
- Maturity not exceeding one year	**670,474**	1,374,867
- Maturity exceeding one year	**2,330,664**	2,156,256
Other unconditionally cancellable	**1,640,484**	1,541,548
Unutilised credit card lines	**3,743,071**	3,452,850
Equity related contracts		
- Less than one year	**466,444**	116,883
- One year to less than five years	**396,199**	362,229
Profit rate related contracts		
- Less than one year	**1,218,519**	2,077,822
- One year to less than five years	**1,109,410**	1,671,166
- Over five years	**-**	232,745
Foreign exchange related contracts		
- Less than one year	**7,471,672**	7,837,019
- One year to less than five years	**-**	646,019
	20,854,027	23,162,908

39 Lease commitments

The Bank has lease commitments in respect of rented premises. A summary of the non-cancellable long term commitments net of sub-leases (if any) are as follows:

	31 Dec 2019 RM'000	31 Dec 2018 RM'000
Less than one year	**7,122**	7,225
Between one and three years	**4,944**	6,088
Between three and five years	**235**	91
	12,301	13,404

40 Capital commitments

	31 Dec 2019 RM'000	31 Dec 2018 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 2019 Number ('000)	31 Dec 2018 Number ('000)
Balance at 1 January	**5**	4
Granted in the financial year	**9**	5
Exercised in the financial year	**(1)**	-
Released in the financial year	**(1)**	(2)
Cancelled in the financial year	**(1)**	(1)
Transferred out in the financial year	**-**	(1)
Balance at 31 December	**11**	5
Compensation cost recognised during the financial year	**728**	187

The weighted average purchase price for all shares purchased by HSBC for awards under the Restricted Share Plan and the Share Match Schemes is £6.05 (2018: £7.16). The weighted average fair value of the HSBC share at 31 December 2019 was £6.34 (2018: £6.99). The weighted average remaining vesting period as at 31 December 2019 for shares granted during the year was 1.3 years (2018: 1.26 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) Asst Prof Dr Ziyaad Mahomed
Asst Prof Dr Ziyaad 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 also holds an MBA and Certificate in Islamic Law from The Management College of Southern Africa (MANCOSA) and University of Kwazulu Natal, South Africa, respectively.

2) Dr Aida binti Othman
Dr Aida 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) Dr Khairul Anuar bin Ahmad
Dr Khairul is currently a Senior Lecturer and Deputy Dean of Faculty of Syariah and Law, 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 Younes 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 a certified financial planner registered under Malaysian Financial Planning Council (MFPC).

5) Dr Mohamed Ashraf bin Mohamed Iqbal
Dr Ashraf 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. Dr Ashraf is currently an Independent Non-executive Director of Bank Pembangunan and Chairman of Pembangunan Leasing and Credit. 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.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

43 Comparative Figures

Presentation and classification of items in the financial statements are consistent with those in previous financial year except for those listed below. The Bank's prior year profit and loss and retained profits brought forward are not affected by these reclassifications.

(i) Comparatives for financing and advances, impaired financings, and ECL allowances were restated to exclude retail unsecured financing which have been written off but subsequently rescheduled and reinstated. Until 31 December 2018, such financings were recognised in the statement of financial position with full provision, with no impact to profit or loss. With effect from the financial year ended 31 December 2019, these financings are no longer being recognised in the statement of financial position to be in line with industry practice.

Notes to the Financial Statements
31 December 2018

(a) Financing and Advances

	31 Dec 2018	
	RM'000 As restated	RM'000 As previously stated
Gross financing and advances	14,371,870	14,445,871
Less: Impairment allowance	(234,533)	(308,534)
Total net financing and advances	14,137,337	14,137,337

(of which the affected components are disclosed below)

By type and Shariah contracts

	Sale-based Contracts	
	Commodity Murabahah	
	RM'000 As restated	RM'000 As previously stated
Term financing:		
Other term financing	3,307,216	3,381,217

By type of customer

	RM'000 As restated	RM'000 As previously stated
Individuals	6,142,634	6,216,584
Foreign entities/individuals	1,839,151	1,839,202

By profit rate sensitivity		
Fixed rate:		
Other financing	3,300,541	3,341,460
Variable rate:		
Cost-plus	5,483,023	5,516,105

By residual contractual maturity		
Maturing within one year	5,895,827	5,895,995
More than one year to three years	1,166,130	1,167,759
More than three years to five years	1,289,364	1,298,607
Over five years	6,020,549	6,083,510

43 Comparative Figures (Cont'd)

(a) Financing and Advances (Cont'd)

	31 Dec 2018	
	RM'000	RM'000
	As restated	As previously stated
By sector		
Household - Retail	6,706,145	6,780,146
By purpose		
Consumption credit	2,127,277	2,201,278
By geographical distribution		
Northern Region	1,497,309	1,499,020
Southern Region	1,464,169	1,464,999
Central Region	11,010,829	11,081,704
Eastern Region	399,563	400,148

(b) Impaired Financing

(of which the affected components are disclosed below)

	31 Dec 2018	
	RM'000	RM'000
	As restated	As previously stated
Gross carrying amount movement of financing and advances classified as credit impaired:		
Gross carrying amount as at 1 January	282,049	322,683
Others	18	33,385
Gross carrying amount as at 31 December	356,312	430,313
By contract		
Commodity Murabahah *(cost-plus)*	201,946	275,947
By sector		
Household - Retail	265,333	339,334
By purpose		
Consumption credit	138,227	212,228
By geographical distribution		
Northern Region	37,748	39,459
Southern Region	39,453	40,283
Central Region	273,061	343,936
Eastern Region	6,050	6,635

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

43 Comparative Figures (Cont'd)

(c) ECL allowances
(of which the affected components are disclosed below)

Movements in ECL allowances for financing and advances

	Stage 3		Stage 3	
	Lifetime ECL credit impaired RM'000 As restated	Lifetime ECL credit impaired Specific provision RM'000 As restated	Lifetime ECL credit impaired RM'000 As previously stated	Lifetime ECL credit impaired Specific provision RM'000 As previously stated
Balance at 1 January 2018	-	74,265	-	114,899
- adoption of MFRS 9	110,136	(74,265)	150,770	(114,899)
Balance restated	110,136	-	150,770	-
Others	241	-	33,608	-
Balance 31 December 2018	126,081	-	200,082	-

(ii) Comparatives for Income attributable to depositors and other operating expenses were restated to reclassify deposit protection insurance costs from Income attributable to depositors to other operating expenses. This cost represents an annual holding cost for deposits to customers as opposed to an initial transaction cost incurred in accepting the deposit.

Statement of Profit or Loss
31 December 2018

	RM'000 As restated	RM'000 As previously stated
a) Income attributable to depositors	434,346	440,676
(of which the affected components are disclosed below)		
Non-Mudharabah Fund		
- Others	80,841	87,171
b) Operating Expenses	255,429	249,099
(of which the affected components are disclosed below)		
General administrative expenses	39,424	33,094
- Others	35,734	29,404