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

FINANCIAL STATEMENTS – 31 DECEMBER 2017

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

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(Company No 807705-X)
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BOARD OF DIRECTORS

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

Louisa Cheang Wai Wan
Non-Independent Executive Director *(re-designated on 1 January 2017)*

Mukhtar Malik Hussain
Non-Independent Executive Director

Dr. Mohamed Ashraf bin Mohamed Iqbal
Non-Independent Non-Executive Director *(re-designated on 6 August 2017)*

Adil Ahmad
Independent Non-Executive Director

Lee Choo Hock
Independent Non-Executive Director

Albert Quah Chei Jin
Independent Non-Executive Director

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

Azlan bin Abdullah
Independent Non-Executive Director *(retired on 8 May 2017)*

CORPORATE GOVERNANCE DISCLOSURES

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

Directors

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

Datuk Kamaruddin bin Taib, 60
Independent Chairman/Non-Executive Director
Member of Audit Committee and Nominations and Remuneration Committee: February 2018
Appointed to the Board and as Chairman**:** January 2018

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

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

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

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

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

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

Datuk Kamaruddin does not have any shareholding in the Bank.

Louisa Cheang Wai Wan, 55
Non-Independent Executive Director
Appointed to the Board and as chairman: January 2012
Re-appointed and redesignated as Non-Independent Executive Director since January 2017

Ms Cheang graduated from the University of Hong Kong with a Bachelor Degree in Social Science.

Ms Cheang is currently the Vice-Chairman and Chief Executive Officer of Hang Seng Bank Limited. She is the Group General Manager of HSBC and a Director of The Hongkong and Shanghai Banking Corporation Limited. She joined HSBC in 1999 and has worked across a wide range of Personal Financial Services and Marketing positions. She was appointed as Head of Personal Financial Services Asia-Pacific in 2007; Regional Director of Personal Financial Services, Asia Pacific in 2009; Regional Head of Retail Banking and Wealth Management, Asia Pacific in 2010. Ms Cheang became Group Head of Retail Banking, HSBC in 2014 prior to her appointment as Vice-Chairman and Chief Executive Officer of Hang Seng Bank Limited in 2017.

Ms Cheang currently holds the following appointments as Board Member of The Community Chest of Hong Kong; International Advisor of China Union Pay; Member of the Consulting Committee of Qianhai & Shekou Area of Shenzen, China (Guangdong) Pilot Free Trade Zone and Qianhai Shenzen-Hong Kong Modern Service Industry Cooperation Zone of Shenzen; and Vice President of The Hong Kong Institute of Bankers.

Ms Cheang does not have any shareholding in the Bank. Her interest in the Bank's related corporation is as disclosed in the Directors' Report on page 18.

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

Mukhtar Malik Hussain, 58
Non-Independent Executive Director
Appointed to the Board**:** December 2009

Mr Mukhtar graduated from University of Wales with a Bachelor of Science in Economics. He first joined the HSBC Group in 1982 as a Graduate Trainee in Midland Bank International. He was then appointed as Assistant Director in Samuel Montagu in 1991. After more than 10 years of working in the HSBC Group's London offices, Mr Mukhtar held numerous posts in Dubai including Chief Executive Officer 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 Chief Executive Officer, Corporate and Investment Banking. He headed back to London as the Co-Head of Global Banking in 2005. He was the Global Head of Principal Investments in London from 2006 to 2008. Between 2008 and 2009, he was the Deputy Chairman of HSBC Bank Middle East Limited and Global Chief Executive Officer of HSBC Amanah. He was also the Chief Executive Officer of Global Banking and Markets for Middle East and North Africa.

Mr Mukhtar is a Non independent Director and Chief Executive Officer of HSBC Bank Malaysia Berhad, a HSBC Group General Manager and member of the Executive Committee of HSBC Asia Pacific.

Mr Mukhtar does not have any shareholding in the Bank. His interest in the Bank's related corporation is as disclosed in the Directors' Report on page 18.

Dr. Mohamed Ashraf bin Mohamed Iqbal, 53
Non-Independent Non-Executive Director *(Reappointed and re-designated since August 2017)*
Member of Nominations and Remuneration Committee
Appointed to the Board: August 2008

Dr. Ashraf served as the first Independent Chairman of the Board from January 2017 to August 2017 and since then has been reappointed as Non-Independent Director.

Dr. Ashraf graduated from California State University, United States of America with a Bachelor of Science in Mechanical Engineering and thereafter obtained a Masters in Business Administration from the same institution. In addition he holds a post graduate diploma in Islamic Studies from the International Islamic University, Malaysia. He subsequently obtained his Doctorate of Philosophy in Islamic Finance from International Centre for Education in Islamic Finance in 2016.

His earlier career included a period of over 5 years with Shell Malaysia involved in a variety of human resource and business re-engineering projects. He then moved on to Proton Berhad where he assumed the positions of Managing Director of Proton Cars (UK) Ltd, Executive Director of Proton Cars (Europe) Ltd and Director of Proton Cars (Australia) Ltd. He then assumed the position of Director of Hay Group, Asia from 1999 to 2002 and Managing Director of Federal Auto Holdings Berhad from 2002 to 2005. He was formerly a Partner of CEO Solutions Sdn Bhd and an Advisor to Maestro Planning Solutions Sdn Bhd.

Dr. Ashraf is currently a Director of MindSpring Sdn Bhd, a consulting firm that he started in 2005.

Dr. Ashraf does not have any shareholding in the Bank.

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

Adil Ahmad, 61
Independent Non-Executive Director
Chairman of the Nominations and Remuneration Committee and member of Audit Committee and Risk Committee
Appointed to the Board: May 2014

Mr Adil is the Chairman of Nominations and Remuneration Committee, a member of the Audit Committee, Risk Committee and Connected Party Transactions Committee of the Bank. He holds a Masters in Business Administration (Finance & Accounting) and BA in Economics from Cornell University, Ithaca, New York. He has 30 years of international banking experience and began his career in the 1980s at ANZ Grindlays Bank Pakistan. He was the Director and Head of Global Islamic Finance of ANZ Investment Bank in London from 1993 to 1997 and thereafter Executive, Group Strategy of ANZ Banking Group Ltd in Melbourne from 1997 to 2000. He assumed the position as the 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 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 18.

Lee Choo Hock, 65
Independent Non-Executive Director
Chairman of the Risk Committee and member of the Audit Committee and Nominations and Remuneration Committee
Appointed to the Board: May 2016

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

Mr Lee is an Independent Director of HSBC Bank Malaysia Berhad, Kossan Rubber Industries Berhad and Trustee of Yayasan Kossan.

Mr Lee does not have any shareholding in the Bank.

Albert Quah Chei Jin, 65
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 is the Chairman of Audit Committee, a 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 member of the Institute of Chartered Accountants in England and Wales as well as the Malaysian Institute of Accountants. He was with Touche Ross & Co, Chartered Accountants in London before returning to Malaysia.

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

Mr Albert Quah is a Director of Indah Water Konsortium Sdn Bhd and also Trustee of Methodist Education Foundation.

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

Ho Chai Huey, 58
Independent Non-Executive Director
Member of Risk Committee: February 2018
Appointed to the Board: January 2018.

Ms Ho Chai Huey 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 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.

She 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.

Ms Ho does not have any shareholding in the Bank.

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

BOARD RESPONSIBILITY AND OVERSIGHT

Board of Directors

The objectives of the management structures within the Bank, headed by the Board of Directors and led by the 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 they are also encouraged to have free and open contact with management at all levels. Directors may take independent professional advice if necessary.

At the date of this report, the Board consists of eight (8) members comprising two (2) Non-Independent Executive Directors, one (1) Non-Independent Non-Executive Director and five (5) Independent Directors. The names of the Directors serving at the date of this report and brief biographical particulars for each of them are set out on pages 2 to 5.

Datuk Kamaruddin bin Taib has been appointed as Independent Board Chairman of the Bank effective 2 January 2018. Ho Chai Huey has been appointed as Independent Non-Executive Director effective 2 January 2018.

Azlan Abdullah has retired as Independent Non-Executive Director on 8 May 2017.

Dr Mohamed Ashraf bin Mohamed Iqbal was appointed as Independent Board Chairman of the Bank from January 2017 to August 2017 and was re-designated as Non-Independent Non-Executive Director since August 2017, in replacement of Louisa Cheang Wai Wan who has been re-designated as Non Independent Executive Director of the Bank. Dr Ashraf has since vacated his chairmanship in the Nominations and Remuneration Committee and membership in the Risk Committee in compliance with BNM Corporate Governance requirements.

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.

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 judgement, and there are no relationships or circumstances likely to affect the judgement of the Independent Non-Executive Directors.

BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

Board of Directors (Cont'd)

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

Board and Committee Meetings

Six (6) Board meetings were held in 2017. The table below show each Director's attendance (including attendance via video conferencing) at meetings of all Board and Committees' meetings during 2017. 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.

2017 Board and Committee meeting attendance	Board	Audit Committee	Risk Committee	Nominations and Remuneration Committee[7]
Total number of meetings held	**6**	**4**	**6**	**6**
Independent Chairman				
Dr.Mohamed Ashraf bin Mohamed Iqbal[1]	5	4*	5	5
Non-Independent Executive Directors				
Louisa Cheang Wai Wan[2]	5	-	-	-
Mukhtar Malik Hussain	6	-	-	-
Independent Non-Executive Directors				
Adil Ahmad[3]	6	4	6	6
Albert Quah Chei Jin[4]	6	4	6	6
Lee Choo Hock[5]	6	4	6	6
Azlan bin Abdullah[6]	2	2	-	2

[1] Reappointed and re-designated as Non-Independent Director Non-Executive on 6 August 2017

[2] Re-appointed and re-designated as Non-Independent Executive-Director on 1 January 2017

[3] Appointed as Independent Director on 5 May 2014. Chairman of Nominations and Remuneration Committee since 7 February 2017 and member of Audit Committee and Risk Committee since 5 September 2016

[4] Appointed as Independent Director on 5 September 2016. Chairman of Audit Committee and member of Risk Committee and NRC since 5 September 2016.

[5] Appointed as Independent Director on 30 May 2016. Chairman of Risk Committee since 5 September 2016.

[6] Retired on 8 May 2017

[7] Established on 7 February 2017

* Invitee only

Directors' Emoluments

Details of the emoluments of the Directors of the Bank for 2017, disclosed in accordance with the Companies Act 2016, are shown in Note 32(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 Corporation 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 Corporation 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 presentation on IFRS 9.

BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

Board Committees

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

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

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

1. Audit Committee

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

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

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

During 2017, 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.

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

Board Committees (Cont'd)

2. Risk Committee (Cont'd)

The current members of the Risk Committee, all being Independent Non-Executive Directors, are:

- Lee Choo Hock (Chairman)
- Adil Ahmad
- Albert Quah Chei Jin
- Ho Chai Huey (effective 12 February 2018)

During 2017, the Risk Committee held 6 meetings. Attendance is set out in the table on page 7.

3. Nominations and Remuneration Committee

On 7 February 2017, the Board approved the setting up of a combined Nominations and Remuneration Committee and delegated the non-executive responsibility for (i) leading the process for Board appointments and for identifying and nominating, 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 2017.

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

The members of the Nominations and Remuneration Committee, all being Independent Non-Executive Directors, are:

- Adil Ahmad *(appointed as Chairman on 6 August 2017)*
- Albert Quah Chei Jin
- Lee Choo Hock
- Dr. Mohamed Ashraf bin Mohamed Iqbal *(resigned as Chairman on 5 August 2017)*
- Datuk Kamaruddin bin Taib (effective 12 February 2018)

During 2017, the Nominations and Remuneration Committee held 6 meetings. Attendance is set out in the table on page 7.

4. Shariah Committee

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

The current members of the Shariah Committee are:

- Dr. Ziyaad Mahomed *(appointed as Chairman on 7 February 2017)*
- Assoc. Prof. Dr. Muhammad Yusuf Saleem Ghulam Nabi
- Dr Aida Othman *(appointed on 16 January 2017)*
- Dr Mohamed Ashraf Mohamed Iqbal *(appointed on 1 January 2018)*
- Khairul Anuar Ahmad
- Prof. Dr. Younes Soualhi

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

Board Committees (Cont'd)

Delegations by the Board

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 *(appointed on 19 July 2017)*
- Dr. Mohamed Ashraf bin Mohmaed Iqbal
- Chief Risk Officer
- Head of Wholesale Credit and Market Risk

Executive Committee

The Executive Committee consists of key senior management members meets regularly and operates as a general management committee under the direct authority of the Board, 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 Chief Executive Officer, Arsalaan Ahmed, chairs the Executive Committee.

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

(i) Asset and Liability Management Committee

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

(ii) Risk Management Meeting

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

(iii) Financial Crime Risk Management Committee

The Financial Crime Risk Management Committee is responsible for the management of financial crime risk and to support the Chief Executive Officer 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.

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

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

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

MANAGEMENT REPORTS

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

- Minutes of the Board Committees
- Annual Operating Plan
- Country Operating Report
- Capital Contingency Funding Plan
- Credit Advances Reports
- Credit Transactions and Exposures to Connected Parties
- Financial Crime Compliance: Anti-Money Laundering and Counter Terrorist Financing Reports
- Financial Performance Report
- Internal Capital Adequacy Assessment Process
- Market Risk Limits
- Operational Risk Report
- People Plan
- Regulatory Compliance Report
- Risk Appetite Statement
- Risk Management Reports
- Scenario Stress Testing Results

INTERNAL CONTROL FRAMEWORK

The Board is responsible for maintaining and reviewing the effectiveness of risk management and internal control systems and for determining the aggregate levels and types of risks the Bank is willing to take in achieving its strategic objectives. The Bank has procedures designed to safeguard assets against unauthorised use or disposal, maintain proper accounting records and ensure the reliability and usefulness of financial information whether published or used within the business. These controls are designed to provide effective internal control within the Bank. However, they can only provide reasonable, but not absolute, assurance against material mis-statement, errors, losses or fraud. They have been in place throughout the year and up to 12 February 2018, the date of approval of the audited financial statements of the Bank for the financial year ended 31 December 2017.

Key risk management and internal control procedures include the following:

- **HSBC Group standards**

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

- **Financial reporting**

  The Bank's financial reporting process for preparing the financial statements is in accordance with the Malaysian Financial Reporting Standards, International Financial Reporting Standards, the requirements of the Companies Act 2016 in Malaysia and guidelines issued by BNM. The financial reporting process is further supported by a chart of accounts with detailed instructions and guidance on reporting requirements issued by Global Finance to the Bank in advance of each quarterly reporting period end. The submission of financial information from the Bank is subject to certification by the responsible financial officer, and analytical review procedures at the Bank.

- **Internal audit**

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

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

- **Subsidiary Certifications**

  Half yearly confirmations are provided to the Audit Committee and the Risk Committee from audit and risk committees of principal subsidiary companies regarding whether the financial statements have been prepared in accordance with HSBC Group policies, present fairly the state of affairs of the relevant principal subsidiary and are prepared on a going concern basis.

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

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

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

INTERNAL CONTROL FRAMEWORK (Cont'd)

- **Risk identification and monitoring**

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

- **Changes in market conditions/practices**

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

- **Responsibility for risk management**

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

- **Strategic plans**

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

- **IT operations**

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

- **Global function management**

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

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

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

CORPORATE GOVERNANCE DISCLOSURES (Cont'd)

REMUNERATION POLICY

The remuneration policy for the HSBC Group is aiming 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 2017	• 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 2017.

DIRECTORS

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

- Datuk Kamaruddin bin Taib *(appointed on 2 January 2018)*
- Louisa Cheang Wai Wan
- Mukhtar Malik Hussain
- Dr. Mohamed Ashraf bin Mohamed Iqbal
- Adil Ahmad
- Lee Choo Hock
- Albert Quah Chei Jin
- Ho Chai Huey *(appointed on 2 January 2018)*
- Azlan bin Abdullah *(retired on 8 May 2017)*

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

PRINCIPAL ACTIVITIES

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

FINANCIAL RESULTS

	RM'000
Profit for the financial year attributable to the owner of the Bank	
Profit before tax	**106,313**
Tax expense	**(19,933)**
Profit after tax	**86,380**

RESERVES AND PROVISIONS

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

ISSUE OF SHARES AND DEBENTURES

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

DIRECTORS' BENEFITS

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

Neither during nor at the end of the financial year was the Bank or any of its subsidiaries 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 1.1.2017	Acquired	Disposed	As at 31.12.2017
HSBC Holdings plc				
Ordinary shares of USD0.50				
Mukhtar Malik Hussain [1]	1,240,576	111,001	(67,691)	1,283,886
Louisa Cheang Wai Wan				
- direct	47,691	-	-	47,691
- indirect	165,219	64,797	-	230,016
Adil Ahmad	3,200	-	-	3,200

	Number of Shares			
	Shares held at 1.1.2017	Shares issued during the year	Shares vested during the year	Shares held at 31.12.2017
HSBC Holdings plc				
HSBC Share Plan				
Mukhtar Malik Hussain	398,537	98,184	(138,086)	358,635
Louisa Cheang Wai Wan	284,187	84,252 [1]	(122,261)	246,178

[1] *Includes scrip dividends*

None of the other Directors holding office at 31 December 2017 had any interest in the ordinary shares and options over shares of the Bank and of its related corporations during the financial year.

DIVIDENDS

The dividends declared since the end of the previous financial year were as follows:

The Directors recommend the payment of a final dividend of RM0.10 per share, amounting to net dividend payment of RM10 million in respect of the financial year ended 31 December 2017. 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.

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.

OTHER STATUTORY INFORMATION (Cont'd)

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 2017.

DIRECTORS' REMUNERATION

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

AUDITORS' REMUNERATION

Details of auditors' remuneration are set out in Note 29 to the financial statements.

2017 Business Strategy

The liquidity and capital position of the Bank remain healthy and well above the regulatory requirement throughout 2017. This financial strength is recognised by external parties including RAM Ratings Services Berhad, which in 2017 reaffirmed the Bank and its wholly owned subsidiary, HSBC Amanah Malaysia Berhad'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 2017.

On the retail business, Retail Banking and Wealth Management (RBWM) focused on growing emerging affluent client base, enhancing wealth management business, expanding cards base and strengthening controls. Premier and Advance customer proposition continued to be supported through various customer acquisition campaigns. Wealth penetration was improved with new products offering. Cards market share expanded via new cards acquisition leveraging on different acquisition channels including digital, third party sales agents and in house mobile sales channel.

Towards the end of the 2016, BNM introduced several measures to ensure liquidity and demand of Ringgit remained robust. Wholesale business has worked closely with our corporate customers (both importers and exporters) to manage their exposure accordingly. While corporate flows increased due to the requirement for exporters to convert 75% of their proceeds and subsequent re-conversion, margins were largely compressed due to the regulatory direction. Global Banking & Markets (GBM) continued to seize the advantage of its debt capital market leadership and expertise to secure key deals, enhance cross border connectivity, as well as capture key growth opportunities in ASEAN and Belt and Road Initiative (BRI).

Commercial Banking (CMB) focused on selective growth in quality assets while embedding risk measures to attain sustainable business model that meet Global Standards on financial crime controls. Growth was achieved through cross border collaboration to capture inbound and outbound business opportunities especially with China, Vietnam and Singapore. With strong capabilities around structuring deals and connectivity to HSBC in other countries, CMB offered differentiated product offerings to support clients' business both within and outside Malaysia. Significant progress was also achieved in driving efficiency through continued investment in digital platform and streamlining initiatives.

In 2017, corporate social responsibility was also a key focus area which the Group continued to put high emphasis on. The Bank attained the Best Bank for Corporate Social Responsibility (CSR) in Malaysia award in 2017 from Asia Money. The Bank will continue to invest in the long term future of the community in which we operate by focusing on education, environment, health and wellness initiatives because we believe those areas will provide the fundamental building blocks for creating thriving communities in Malaysia.

Performance Review 2017

The Bank continued to demonstrate its resilience and had recorded an improved profit before tax of RM106.3 million for the financial year ended 31 December 2017, an increase of 5% or RM5 million compared to previous year.

Higher profit was contributed by higher income derived from investment of depositors' funds and others (up by RM 25 million), coupled with higher income derived from investment of shareholder's funds (up by RM10 million). It was partially impacted by higher impairment loses on financing (up by RM32 million).

Income derived from investment of depositors' funds and others increased by RM25 million, mainly due to higher trading income (up by RM19 million) and higher financing income (up by RM6 million). The increase in net financing income was in tandem with the 5% growth of customer financing.

Income derived from investment of shareholder's funds increased by RM10 million, mainly due to higher net fee income from lead arranger fee related income and higher financing income.

Impairment losses on financing increased by RM32 million arising mainly from higher individual impairment provision (up by RM20 million) and higher collective impairment provision (up by RM11 million).

The Bank continued to place high importance on the need to manage its operating expenses by ensuring resources being invested in a sustainable manner. In 2017, operating expenses increased by 2.3%, mainly on personnel expenses, promotion and marketing related expenses, with saving recorded in establishment related expenses. Investments in compliance related costs increased in 2017, reflecting our commitment to invest in people and systems to detect, deter and protect the Bank against financial crime.

Total assets size at 31 December 2017 stood at RM17.8 billion, RM1.5 billion or 9.1% higher compared against 31 December 2016 (RM16.3 billion). The Bank's capital and liquidity ratios continues to remain strong and is well above the regulatory requirements.

Outlook for 2018

Malaysia's real Gross Domestic Product (GDP) expanded 5.9% in 2017 (2016:4.2%), higher than the forecast of 5.2% - 5.7%. The positive trend is forecasted to follow through to 2018 with growth anticipated to be in the range of 5.0% - 5.5%, underpinned by resilient domestic demand and exports. Looking ahead, the strong growth momentum is expected to continue in 2018.

Headline inflation elevated at 3.7% in 2017 (2016: 2.1%). The trending of headline inflation will be dependent on future global oil prices which remain highly uncertain. On 25 January 2018, Bank Negara Malaysia had increased the Overnight Policy Rate (OPR) by 25 basis points to 3.25 percent.

Inflation in 2017 is expected to be at the upper end of the forecast range of 3-4% for 2017. To ensure continuous domestic financial stability supported by healthy business activities, BNM had kept the Overnight Policy Rate (OPR) of 3.00% unchanged since July 2016, at the back of positive growth momentum and moderating headline inflation. However, market expects upward revision in OPR in 2018.

Towards the second half of 2017, the Ringgit has strengthened against the US dollar and most regional currencies, supported mainly by trade and non-resident portfolio inflows. Going forward, the Ringgit will continue to be driven by a confluence of external and domestic factors. This include the timing and pace of monetary policy normalisation by major central banks, global geopolitical development and the domestic economic performance. The attractive valuation of the Ringgit make local assets such as bonds and equities attractive to foreign investors.

Malaysian Financial Reporting Standard 9: Financial Instruments (MFRS 9) comes into effect on 1 January 2018, requires banks to make provisions for expected credit losses over the tenure of the loans, including undrawn balances. Hence, banks' earnings may potentially be impacted due to the higher credit costs moving forward.

From funding perspective, the banking system liquidity is expected to remain robust and sufficient to facilitate financial intermediation. However, competition among lenders for deposits is foreseen to increase, with the upcoming Basel III's Net Stable Funding Ratio measure, to be implemented no earlier than 1 January 2019.

Malaysia will introduce its first Islamic Digital Economy (IDE) framework to claim the leadership role in the global shariah compliant marketplace. The framework is expected to be ready by the first quarter of 2018 and will cover areas such as shariah compliance, funding and financing, Islamic digital economy regulation as well as the shariah compliant business operation frameworks.

The Bank will continue to capitalise on infrastructure related opportunities, especially BRI related. The focus is to capture opportunities along the entire supply chain of Chinese investment into Malaysia infrastructure. Leveraging on HSBC connectivity, we will explore business opportunity based on intra ASEAN corridors and ASEAN government initiatives. The Amanah Platform will continue to be optimised to grow Islamic Commercial Banking business through growing share of wallet of existing clients and enhanced product offerings and services. The Bank will also focus on expanding customers' base to increase market share where it has comparative advantage.

Malaysia continues to be an identified priority market for HSBC Group and is an important footprint for the HSBC Group within ASEAN. The announcement to invest up to USD250 million in the construction of a new Malaysian head office in Tun Razak Exchange in 2017 reflects HSBC long term commitment to its Malaysia franchise.

Awards won during the financial year

1. **Islamic Deal of the Year –** Government of Malaysia US$1.5 billion dual-tranche trust certificates, HSBC Amanah acted as the joint bookrunner and manager, The Asset Triple A Islamic Finance Awards 2017.

2. **Best Sovereign Sukuk** - Government of Malaysia US$1.5 billion dual-tranche trust certificates, HSBC Amanah acted as the joint bookrunner and manager, The Asset Triple A Islamic Finance Awards 2017.

3. **Best Sukuk** - Government of Malaysia US$1.5 billion dual-tranche trust certificates, HSBC Amanah acted as the joint bookrunner and manager, The Asset Triple A Islamic Finance Awards 2017.

4. **Best Government Guaranteed Sukuk –** DanaInfra Nasional Berhad 4.5 billion ringgit murabaha sukuk, HSBC Amanah acted as the joint lead arranger and lead manager, The Asset Triple A Islamic Finance Awards 2017.

5. **Best Corporate Sukuk** – TNB Global Ventures Capital Berhad US$750 million wakala sukuk, HSBC Amanah acted as the joint bookrunner and lead manager, The Asset Triple A Islamic Finance Awards 2017.

6. **Best Local Currency Sukuk –** Cagamas Berhad 375 million ringgit commodity murabaha sukuk, HSBC Amanah acted as shariah adviser, The Asset Triple A Islamic Finance Awards 2017.

7. **Best Islamic Deal, Malaysia** – Government of Malaysia US$1.5 billion dual-tranche trust certificates, HSBC Amanah acted as joint bookrunners and managers, The Asset Triple A Islamic Finance Awards 2017.

AUDITORS

The auditors, PricewaterhouseCoopers PLT (LLP0014401-LCA & AF 1146), have expressed their willingness to accept re-appointment as auditors. PricewaterhouseCoopers PLT (LLP0014401-LCA & AF 1146) was registered on 2 January 2018 and with effect from that date, PricewaterhouseCoopers (AF 1146), a conventional partnership, was converted to a limited liability partnership. 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 12 February 2018.

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

………………….………………….….….	………………….………………….….….
MUKHTAR MALIK HUSSAIN	**ALBERT QUAH CHEI JIN**
Director	Director

Kuala Lumpur, Malaysia
12 February 2018

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

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

In the opinion of the directors:

We, Mukhtar Malik Hussain 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 34 to 132 are drawn up so as to give a true and fair view of the financial position of the Bank as at 31 December 2017 and financial performance of the Bank for the financial year ended 31 December 2017 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:

……………………..……………………..…..….
MUKHTAR MALIK HUSSAIN
Director

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

Kuala Lumpur, Malaysia
12 February 2018

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

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

I, Neoh Elly, 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 34 to 132 are correct, and I make this solemn declaration conscientiously believing the same to be true, and by virtue of the provisions of the Statutory Declarations Act 1960.

Subscribed and solemnly declared by the abovenamed.

in Kuala Lumpur, Malaysia on 12 February 2018.

....
NEOH ELLY

BEFORE ME:

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

SHARIAH COMMITTEE'S REPORT

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

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

Assalamu 'Alaikum Warahmatullahi Wabarakatuh

In carrying out the roles and responsibilities as Shariah Committee of HSBC Amanah Malaysia Berhad as prescribed in the Shariah Governance Framework for Islamic Financial Institutions issued by Bank Negara Malaysia, the Bank's Shariah Governance Policy as well as the Bank's Committee's Terms of Reference, we hereby submit the following report for the financial year ended 31 December 2017:

1. We have conducted nine (9) meetings for the whole year of 2017 and reviewed the principles and the contracts relating to the transactions and applications introduced by the Bank during the financial year ended 31 December 2017 to ensure conformity with Shariah requirements.

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

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

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

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

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

(a) the contracts, transactions, dealings entered into by the Bank during the financial year ended 31 December 2017 have been reviewed by us and are in compliance with Shariah rules and principles;

(b) the allocation of profit and charging of losses relating to the Bank's assets and liabilities conform to the basis that had been approved by us in accordance with Shariah principles;

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

(d) the Bank is not required to pay zakat for the financial year ended 31 December 2017 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 2017 have been conducted in conformity with the Shariah principles.

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

Wassalamu 'Alaikum Warahmatullahi Wabarakatuh

Chairman of the Shariah Committee Dr. Ziyaad Mahomed (Chairman)	…………………………………………….
Member of the Shariah Committee Assoc. Prof. Dr. Muhammad Yusuf Saleem Ghulam Nabi	…………………………………………….
Member of the Shariah Committee Dr. Aida Othman	…………………………………………….
Member of the Shariah Committee Khairul Anuar Ahmad	…………………………………………….
Member of the Shariah Committee Prof. Dr. Younes Soualhi	…………………………………………….

Kuala Lumpur, Malaysia 12 February 2018

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

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Our opinion

In our opinion, the financial statements of HSBC Amanah Malaysia Berhad ("the Bank") give a true and fair view of the financial position of the Bank as at 31 December 2017, 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 2017 of the Bank, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows of the Bank for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, as set out on pages 34 to 132.

Basis for opinion

We conducted our audit in accordance with approved standards on auditing in Malaysia and International Standards on Auditing. Our responsibilities under those standards are further described in the "Auditors' responsibilities for the audit of the financial statements" section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence and other ethical responsibilities

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

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

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

Information other than the financial statements and auditors' report thereon

The directors of the Bank are responsible for the other information. The other information comprises the list of Board of Directors, Corporate Governance Disclosures, Internal Control Framework, 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
TO THE MEMBER OF HSBC AMANAH MALAYSIA BERHAD (CONT'D)
(Incorporated in Malaysia)
(Company No. 807705-X)

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

<u>Auditors' responsibilities for the audit of the financial statements</u>

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.

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

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

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

OTHER MATTERS

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

PRICEWATERHOUSECOOPERS PLT
LLP0014401-LCA & AF 1146
Chartered Accountants

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

Kuala Lumpur
20 February 2018

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

STATEMENTS OF FINANCIAL POSITION AT 31 DECEMBER 2017

	Note	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Assets			
Cash and short-term funds	*6*	**1,465,919**	2,359,591
Financial assets held-for-trading	*7*	**-**	488
Financial investments available-for-sale	*8*	**2,221,044**	1,368,574
Financing and advances	*9*	**13,383,803**	11,743,263
Derivative financial assets	*11*	**278,472**	395,748
Other assets	*12*	**43,359**	80,041
Statutory deposits with Bank Negara Malaysia	*13*	**361,362**	325,462
Equipment	*14*	**5,520**	7,237
Deferred tax assets	*16*	**8,637**	10,395
Tax recoverable	*17*	**7,624**	10,285
Total assets		**17,775,740**	16,301,084
Liabilities			
Deposits from customers	*18*	**10,034,525**	8,726,543
Deposits and placements from banks and other financial institutions	*19*	**3,361,939**	1,951,602
Bills payable		**16,678**	23,632
Derivative financial liabilities	*11*	**265,402**	490,755
Other liabilities	*20*	**644,441**	1,185,135
Multi-Currency Sukuk Programme	*21*	**1,252,829**	1,756,001
Subordinated Commodity Murabahah Financing	*22*	**583,598**	646,265
Total liabilities		**16,159,412**	14,779,933
Equity			
Share capital	*23*	**660,000**	50,000
Reserves	*24*	**956,328**	1,471,151
Total equity attributable to owner of the Bank		**1,616,328**	1,521,151
Total liabilities and equity		**17,775,740**	16,301,084
Restricted investment accounts [1]		**6,007,289**	2,230,065
Total Islamic Banking asset [1]		**23,783,029**	18,531,149
Commitments and contingencies	*35*	**20,501,738**	22,149,853

[1] The disclosure is in accordance with the requirements of Bank Negara Malaysia's Guideline on Financial Reporting for Islamic Banking Institutions dated 5 February 2016.

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

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

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2017

	Note	**31 Dec 2017 RM'000**	31 Dec 2016 RM'000
Income derived from investment of depositors' funds and others	*25*	**711,551**	686,267
Income derived from investment of shareholder's funds	*26*	**146,439**	136,729
Impairment losses on financing	*27*	**(168,603)**	(136,865)
Total distributable income		**689,387**	686,131
Income attributable to depositors	*28*	**(344,360)**	(351,148)
Total net income		**345,027**	334,983
Operating expenses	*29*	**(238,714)**	(233,359)
Profit before tax		**106,313**	101,624
Tax expense	*30*	**(19,933)**	(20,231)
Profit for the financial year		**86,380**	81,393
Other comprehensive income/(expense)			
Items that will subsequently be reclassified to profit or loss when specific conditions are met:			
Own credit reserves:			
Change in fair value		**2,731**	-
Income tax effect		**(655)**	-
Available-for-sale reserve:			
Change in fair value		**8,850**	(8,268)
Net amount transferred to profit or loss		**-**	(6,854)
Income tax effect		**(2,124)**	3,629
Other comprehensive income/(expense) for the financial year, net of tax		**8,802**	(11,493)
Total comprehensive income for the financial year		**95,182**	69,900
Profit attributable to the owner of the Bank		**86,380**	81,393
Total comprehensive income attributable to the owner of the Bank		**95,182**	69,900
Basic earnings per RM0.50 ordinary share	*31*	**86.4 sen**	81.4 sen

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

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

STATEMENTS OF CHANGES IN EQUITY FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2017

	Non-distributable							*Distributable*	
	Share capital	*Share premium*	*Statutory reserve* [1]	*Available-for-sale reserve*	*Own credit reserve* [2]	*Capital contribution reserve*	*Regulatory reserve*	*Retained profits*	*Total*
	RM'000	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**
2017									
Balance at 1 January	**50,000**	**610,000**	**50,000**	**(6,547)**	**-**	**403**	**34,000**	**783,295**	**1,521,151**
Effects of early adopting MFRS 9 on 1 January 2017 [2]	**-**	**-**	**-**	**-**	**(1,846)**	**-**	**-**	**1,846**	**-**
As restated	**50,000**	**610,000**	**50,000**	**(6,547)**	**(1,846)**	**403**	**34,000**	**785,141**	**1,521,151**
Total comprehensive income for the financial year									
Profit for the financial year	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**86,380**	**86,380**
Other comprehensive income, net of tax									
Available-for-sale reserve:									
Net change in fair value	**-**	**-**	**-**	**6,726**	**2,076**	**-**	**-**	**-**	**8,802**
Total other comprehensive income	***-***	***-***	***-***	***6,726***	***2,076***	***-***	***-***	***-***	***8,802***
Total comprehensive income for the financial year	**-**	**-**	**-**	**6,726**	**2,076**	**-**	**-**	**86,380**	**95,182**
Transition to no par value regime on 31 January 2017 [3]	**610,000**	**(610,000)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Transfer in accordance with BNM's requirement [1]	**-**	**-**	**(50,000)**	**-**	**-**	**-**	**-**	**50,000**	**-**
Transactions with the owner, recorded directly in equity									
Share based payment transactions	**-**	**-**	**-**	**-**	**-**	**5**	**-**	**(10)**	**(5)**
Balance at 31 December	**660,000**	**-**	**-**	**179**	**230**	**408**	**34,000**	**921,511**	**1,616,328**

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

[2] With effect from 1 January 2017, the Bank had early applied the requirements for the presentation of gains and losses on financial liabilities designated at fair value through profit or loss in paragraph 5.7.1(c), 5.7.7-5.7.9, 7.2.14 and B5.7.5-B5.7.20 of MFRS 9 Financial Instruments, without applying the other requirements of MFRS 9. Please refer to Note 40 for details.

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

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

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

STATEMENTS OF CHANGES IN EQUITY FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2017 (Cont'd)

	Non-distributable						*Distributable*	
	Share capital	*Share premium*	*Statutory reserve*	*Available-for-sale 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**
2016								
Balance at 1 January	50,000	610,000	50,000	4,946	1,058	34,000	701,902	1,451,906
Total comprehensive income for the financial year								
Profit for the financial year	-	-	-	-	-	-	81,393	81,393
Other comprehensive income, net of tax								
Available-for-sale reserve:								
Net change in fair value	-	-	-	(6,284)	-	-	-	(6,284)
Net amount transferred to profit or loss	-	-	-	(5,209)	-	-	-	(5,209)
Total other comprehensive income	-	-	-	*(11,493)*	-	-	-	*(11,493)*
Total comprehensive income for the financial year	-	-	-	(11,493)	-	-	81,393	69,900
Transactions with the owner, recorded directly in equity								
Share based payment transactions	-	-	-	-	(655)	-	-	(655)
Balance at 31 December	50,000	610,000	50,000	(6,547)	403	34,000	783,295	1,521,151

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

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

STATEMENT OF CASH FLOWS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2017

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Cash Flows from Operating Activities		
Profit before income tax expense	**106,313**	101,624
Adjustments for:		
Equipment written off	**3**	-
Unrealised gains on revaluation of financial assets held-for-trading	**(74)**	(496)
Unrealised losses from dealing in foreign currency	**756**	5,853
Unrealised (gains)/losses on revaluation of derivatives	**(5,048)**	623
Allowance for impairment losses on financing	**202,569**	168,730
Share based payment transactions	**107**	(589)
Depreciation of equipment	**4,015**	5,029
Unrealised (gains)/losses on revaluation of subordinated commodity murabahah financing	**(62,667)**	27,804
Unrealised losses on financial instruments fair value through profit or loss	**761**	6,178
Operating profit before changes in operating assets and liabilities	**246,735**	314,756
Decrease/(Increase) in operating assets		
Financial assets held-for-trading	**562**	10,500
Financing and advances	**(1,843,109)**	56,224
Derivative financial assets	**121,568**	(94,925)
Other assets	**36,553**	155,181
Statutory deposits with Bank Negara Malaysia	**(35,900)**	4,200
Total (increase)/decrease in operating assets	**(1,720,326)**	131,180
(Decrease)/Increase in operating liabilities		
Deposits from customers	**1,307,982**	(659,580)
Deposits and placements from banks and other financial institutions	**1,410,337**	(2,208,487)
Bills payable	**(6,954)**	8,728
Derivative financial liabilities	**(226,555)**	17,524
Other liabilities	**(455,930)**	(204,201)
Total increase/(decrease) in operating liabilities	**2,028,880**	(3,046,016)
Cash generated from/(used in) operating activities	**555,289**	(2,600,080)
Income tax paid	**(18,304)**	(26,659)
Net cash generated from/(used in) operating activities	**536,985**	(2,626,739)

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

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

STATEMENT OF CASH FLOWS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2017 (Cont'd)

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Cash Flows from Investing Activities		
Purchase of financial assets available-for-sale	**(1,598,580)**	(651,495)
Proceeds from disposal of financial assets available-for-sale	**755,089**	975,431
Purchase of equipment	**(2,301)**	(1,978)
Net cash (used in)/generated from investing activities	**(845,792)**	321,958
Cash Flows from Financing Activities		
Profits paid on Multi-Currency Sukuk Programme	**(66,533)**	(69,378)
Profit paid on Subordinated Commodity Murabahah Financing	**(18,332)**	(16,640)
Redemption of Multi-Currency Sukuk Programme	**(500,000)**	-
Net cash used in financing activities	**(584,865)**	(86,018)
Net decrease in Cash and Cash Equivalents	**(893,672)**	(2,390,799)
Cash and Cash Equivalents at beginning of the financial year	**2,359,591**	4,750,390
Cash and Cash Equivalents at end of the financial year	**1,465,919**	2,359,591
Analysis of Cash and Cash Equivalents		
Cash and short-term funds	**1,465,919**	2,359,591

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

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

STATEMENT OF CASH FLOWS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2017 (Cont'd)

Changes in liabilities arising from financing activities

Bank (RM'000)

Cash Flows from Financing Activities	At 1 Jan 2017	Cash inflow / (outflow)	Foreign exchange adjustment	Fair value movement	Profit accrual	At 31 Dec 2017
Multi-Currency Sukuk Programme	1,756,001	(500,000)	-	(3,172)	-	1,252,829
Subordinated Commodity Murabahah Financing	646,265	-	(62,667)	-	-	583,598
Other Liabilities of which:						
Profits paid on Multi-Currency Sukuk Programme	17,637	(66,533)	-	-	61,711	12,815
Profits paid on Subordinated Commodity Murabahah Financing	204	(18,332)	-	-	20,499	2,371

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

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

NOTES TO THE FINANCIAL STATEMENTS

1 General Information

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

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

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

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

The financial statements were approved and authorised for issue by the Board of Directors on 12 February 2018.

2 Basis of Preparation

(a) Statement of compliance

The financial statements of the Bank have 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 2017 are as follows:

- Amendments to MFRS 107 'Statement of Cash Flows – Disclosure Initiative'
- Amendments to MFRS 112 'Income Taxes – Recognition of Deferred Tax Assets for Unrealised Losses'
- Annual Improvements to MFRSs 2014 – 2016 Cycle: MFRS 12 'Disclosures of Interests in Other Entities'

The adoption of the Amendments to MFRS 107 has required additional disclosure of changes in liabilities arising from financing activities. Other than that, the adoption of these amendments did not have any impact on the current year or any prior period and is not likely to affect future periods.

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

The Bank will apply these standards, amendments to published standards from:

a. Financial year beginning on/after 1 January 2018:

- Amendments to MFRS 140 'Classification on 'Change in Use' – Assets transferred to, or from, Investment Properties' clarify that to transfer to, or from investment properties there must be a change in use. A change in use would involve an assessment of whether a property meets, or has ceased to meet, the definition of investment property. The change must be supported by evidence that the change in use has occurred and a change in management's intention in isolation is not sufficient to support a transfer of property.

  The amendments also clarify the same principle applies to assets under construction.

2 Basis of Preparation (Cont'd)

(a) Statement of compliance (Cont'd)

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

a. Financial year beginning on/after 1 January 2018 (Cont'd):

- IC Interpretation 22 'Foreign Currency Transactions and Advance Consideration' applies when an entity recognises a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. MFRS 121 requires an entity to use the exchange rate at the 'date of the transaction' to record foreign currency transactions.

  IC Interpretation 22 provides guidance how to determine 'the date of transaction' when a single payment/receipt is made, as well as for situations where multiple payments/receipts are made.

  The date of transaction is the date when the payment or receipt of advance consideration gives rise to the non-monetary asset or non-monetary liability when the entity is no longer exposed to foreign exchange risk.

  If there are multiple payments or receipts in advance, the entity should determine the date of the transaction for each payment or receipt.

  An entity has the option to apply IC Interpretation 22 retrospectively or prospectively.

- MFRS 9 'Financial Instruments' will replace MFRS 139 'Financial Instruments: Recognition and Measurement', and includes requirements for classification and measurement of financial assets and financial liabilities, impairment of financial assets and hedge accounting. MFRS 9 retains but simplifies the mixed measurement model in MFRS 139 and establishes three primary measurement categories for financial assets: amortised cost, fair value through profit or loss and fair value through other comprehensive income (OCI). The basis of classification depends on the entity's business model and the cash flow characteristics of the financial asset. Investments in equity instruments are always measured at fair value through profit or loss with an irrevocable option at inception to present changes in fair value in OCI (provided the instrument is not held for trading). A debt instrument is measured at amortised cost only if the entity is holding it to collect contractual cash flows and the cash flows represent principal and interest.

  Classification and measurement

  The classification and measurement of financial assets will depend on how these are managed (i.e. the entity's business model) and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income (FVOCI) or fair value through profit or loss (FVPL). The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of financial assets measured at amortised cost or fair value compared with MFRS 139. However, based on an assessment of financial assets performed to date and expectations around changes to balance sheet composition, the Bank expects that the overall impact of any change will not be significant.

  For liabilities, the standard retains most of the MFRS 139 requirements. These include amortised cost accounting for most financial liabilities, with bifurcation of embedded derivatives. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. With effect from 1 January 2017, the Bank has early applied this requirements for the presentation of gains and losses on financial liabilities designated at fair value through profit or loss without applying the other requirements of MFRS 9. The early adoption is applied retrospectively against the opening retained profits at the date of initial application, with no requirements to restate comparative periods. See Note 40 for details.

2 Basis of Preparation (Cont'd)

(a) Statement of compliance (Cont'd)

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

a. Financial year beginning on/ after 1 January 2018 (Cont'd):

Impairment

MFRS 9 introduces an expected credit loss (ECL) model on impairment that replaces the incurred loss impairment model used in MFRS 139. The ECL model is forward-looking and eliminates the need for a trigger event to have occurred before credit losses are recognised.

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, lease receivables and certain loan commitments and financial guarantee contracts. At initial recognition, an impairment allowance (or provision in the case of commitments and guarantees) is required for ECL resulting from default events that are possible within the next 12 months (12-month ECL). In the event of a significant increase in credit risk, an 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'. The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money.

Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks. However, they do not explicitly address macro hedge accounting strategies, which are particularly important for banks. As a result, MFRS 9 includes an accounting policy choice to remain with MFRS 139 hedge accounting.

Disclosures

MFRS 9 requires more extensive disclosures especially in the area of ECL. The required disclosures will be made in the financial statements of the Bank for the financial year ended 31 December 2018.

Transitional impact

With the exception of the provisions relating to the presentation of gains and losses on financial liabilities designated at fair value, which were adopted from 1 January 2017, the requirements of MFRS 9 'Financial Instruments' will be adopted from 1 January 2018. MFRS 9 includes an accounting policy choice to continue with MFRS 139 hedge accounting, which the Bank has exercised, although the Bank will implement the revised hedge accounting disclosures required by the related amendments to MFRS 7 'Financial Instruments: Disclosures'. The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The Bank does not intend to restate comparatives.

The transitioning to MFRS 9 at 1 January 2018 of the Bank is expected to result in a decrease in impairment allowances on financing and advances and other financial assets arising from new impairment requirements, which will result in an increase in the Bank's opening retained profits as of 1 January 2018.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

2 Basis of Preparation (Cont'd)

(a) Statement of compliance (Cont'd)

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

a. Financial year beginning on/after 1 January 2018 (Cont'd):

- MFRS 15 'Revenue from contracts with customers' replaces MFRS 118 'Revenue' and MFRS 111 'Construction contracts' and related interpretations. The core principle in MFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

  Revenue is recognised when a customer obtains control of goods or services, i.e. when the customer has the ability to direct the use of and obtain the benefits from the goods or services.

  A new five-step process is applied before revenue can be recognised:

  - Identify contracts with customers
  - Identify the separate performance obligations
  - Determine the transaction price of the contract;
  - Allocate the transaction price to each of the separate performance obligations; and
  - Recognise the revenue as each performance obligation is satisfied.

  Key provisions of the new standard are as follows:

  - Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements.
  - If the consideration varies (such as for incentives, rebates, performance fees, royalties, success of an outcome etc.), minimum amounts of revenue must be recognised if they are not at significant risk of reversal.
  - The point at which revenue is able to be recognised may shift: some revenue which is currently recognised at a point in time at the end of a contract may have to be recognised over the contract term and vice versa.
  - There are new specific rules on licenses, warranties, non-refundable upfront fees, and consignment arrangements, to name a few.
  - As with any new standard, there are also increased disclosures.

b. Financial year beginning on/after 1 January 2019:

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

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

  MFRS 16 eliminates the classification of leases by the lessee as either finance leases (on balance sheet) or operating leases (off balance sheet). MFRS 16 requires a lessee to recognise a "right-of-use" of the underlying asset and a lease liability reflecting future lease payments for most leases.

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

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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

2 Basis of Preparation (Cont'd)

(a) Statement of compliance (Cont'd)

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

b. Financial year beginning on/after 1 January 2019 (Cont'd):

- IC Interpretation 23 'Uncertainty over Income Tax Treatments' (effective 1 January 2019) provides guidance on how to recognise and measure deferred and current income tax assets and liabilities where there is uncertainty over a tax treatment.

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

  IC Interpretation 23 will be applied retrospectively.

- Amendments to MFRS 9 'Prepayment features with negative compensation' (effective 1 January 2019) allow companies to measure some prepayable financial assets with negative compensation at amortised cost. Negative compensation arises where the contractual terms permit the borrower to prepay the instrument before its contractual maturity, but the prepayment amount could be less than the unpaid amounts of principal and interest. To qualify for amortised cost measurement, the negative compensation must be reasonable compensation for early termination of the contract, and the asset must be held within a 'held to collect' business model.

  The amendments will be applied retrospectively.

- Annual Improvements to MFRSs 2015 – 2017 Cycle:

  - Amendments to MFRS 112 'Income Taxes' (effective from 1 January 2019) clarify that where income tax consequences of dividends on financial instruments classified as equity is recognised (either in profit or loss, other comprehensive income or equity) depends on where the past transactions that generated distributable profits were recognised. Accordingly, the tax consequences are recognised in profit or loss when an entity determines payments on such instruments are distribution of profits (that is, dividends). Tax on dividend should not be recognised in equity merely on the basis that it is related to a distribution to owners.

  - Amendments to MFRS 123 'Borrowing Costs' (effective from 1 January 2019) clarify that if a specific borrowing remains outstanding after the related qualifying asset is ready for its intended use or sale, it becomes part of general borrowings.

The initial application of above standards are not expected to have any material financial impacts to the current and prior year's financial statements of the Bank upon their first adoption, except for MFRS 9.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

2 Basis of Preparation (Cont'd)

(b) Basis of measurement

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

- Trading assets and liabilities
- Financial investments
- Derivatives and hedge accounting

(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 3 on the financial statements. 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 (see Note 5). There are no other significant areas of estimation uncertainty and critical judgments in applying accounting policies that have significant effect on the amounts recognised in the financial statements other than those disclosed above.

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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

3 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 available-for-sale 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 held-for-trading are recognised in 'finance income' and 'income attributable to depositors' in the statement of profit or loss and other comprehensive income on an accrual basis using the effective profit rate method in accordance with the principles of Shariah. The effective profit rate method is a way of calculating the amortised cost of a financial asset or a financial liability (or groups of financial assets or financial liabilities) and of allocating the Islamic financing income or expense over the relevant period.

The effective profit rate is the rate that exactly discounts the estimated future cash payments and 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.

3 Significant Accounting Policies (Cont'd)

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

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

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

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

- profit on financial assets and liabilities measured at amortised costs calculated on an effective profit rate basis;
- profit on available-for-sale 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 3(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 held-for-trading, together with the related profit income and expense.

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 group and derivatives managed in conjunction with those debt securities, which is recognised in 'financing expense' (Note 3(b)).

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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

3 Significant Accounting Policies (Cont'd)

(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 available-for-sale investments 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) 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.

An embedded derivative is recognised separately from the host contract and accounted for as a derivative if, and only if, it is not closely related to the economic characteristics and risks of the host contract and the host contract is not categorised as fair value through profit or loss. The host contract, in the event an embedded derivative is recognised separately, is accounted for in accordance with policy applicable to the nature of the host contract.

(ii) Financial instrument categories and subsequent measurement

The Bank categorises financial assets as follows:
- financing and advances (See Note 3(j));
- financial investments held to maturity (See Note 3(i)(i));
- financial investments available-for-sale (See Note 3(i)(ii)); or
- trading assets (see Note 3(h)).

The Bank classifies its financial liabilities, other than financial guarantees, as measured at amortised cost or trading liabilities. (See accounting policies in Notes 3(h), 3(o), 3(p), 3(r)).

(e) 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) Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective profit method of any difference between the initial amounts recognised and the maturity amount, minus any reduction for impairment.

(vi) Fair value measurement

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

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 5(b)(ii).

(f) 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.

(g) Contracts under Islamic sell and buyback agreements

When 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 for the consideration received.

Securities purchased under commitments to re-sell (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 income and recognised in net profit income over the life of the agreement.

(h) Trading assets and trading liabilities

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

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

Islamic structured products is classified as trading liabilities as they are initiated by the trading desk for trading and not for funding purposes and the market risk of the embedded derivative is actively managed as part of the trading portfolio.

(i) Financial investments

Treasury bills, debt securities and equity securities intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale or held-to-maturity. They are recognised on trade date when the Bank enters into contractual arrangements to purchase those instruments, and are normally derecognised when either the securities are sold or redeemed.

(i) <u>Held-to-maturity</u>

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank positively intends and is able to hold until maturity. These investments 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 impairment losses.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

3 Significant Accounting Policies (Cont'd)

(i) Financial investments (Cont'd)

(ii) Available-for-sale

Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. Available-for-sale financial assets are recognised on the trade date when the bank enters into contractual arrangements to purchase those instruments, and are normally derecognised when either the securities are sold or redeemed. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income in 'Available-for-sale reserves – changes in fair value' until they are either sold or become impaired. When available-for-sale financial assets are sold, cumulative gains or losses previously recognised in other comprehensive income are recognised in the profit or loss as 'Disposal of financial investments available-for-sale'.

Profit earned is recognised on available-for-sale debt securities using the effective profit rate method, calculated over the asset's expected life. Premiums and/or discounts arising on the purchase of dated investment securities are included in the calculation of their effective profit rates. Dividends are recognised in the profit or loss when the right to receive payment has been established.

Available-for-sale financial assets are assessed at each balance sheet date for objective evidence of impairment. Impairment losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets and can be reliably estimated.

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

Impairment losses for available-for-sale debt securities are recognised within 'Financing impairment charges and other credit risk provisions' in the profit or loss and impairment losses for available-for-sale equity securities are recognised within 'Gains/losses from financial investments' in the profit or loss.

- *Available-for-sale debt securities*
  In assessing objective evidence of impairment at the reporting date, the Bank considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in the recovery of future cash flows. These events may include a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial reorganisation, or the disappearance of an active market for the debt security because of financial difficulties relating to the issuer.

  These types of specific event and other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment of a debt security.

- *Available-for-sale equity securities*
  Objective evidence of impairment for available-for sale equity securities may include specific information about the issuer as detailed above, but may also include information about significant changes in technology, markets, economics or the law that provides evidence that the cost of the equity securities may not be recovered.

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

3 Significant Accounting Policies (Cont'd)

(i) Financial investments (Cont'd)

Once an impairment loss has been recognised on an available-for-sale financial asset, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the nature of the available-for-sale financial asset concerned:

- *Available-for-sale debt security*
  A subsequent decline in the fair value of the instrument is recognised in the profit or loss when there is objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised directly in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the profit or loss, the impairment loss is reversed through the profit or loss to the extent of the increase in fair value.

- *Available-for-sale equity security*
  All subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised directly in other comprehensive income. Subsequent decreases in the fair value of the available-for-sale equity security are recognised in the profit or loss, to the extent that further cumulative impairment losses have been incurred in relation to the acquisition cost less cumulative impairment to date of the equity security. Impairment losses recognised on the equity security are not reversed through the profit or loss.

(j) Financing and advances

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

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

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 3(e)(iii) on derecognition of financial assets.

(k) Impairment of financing and advances

Losses for impaired financing and advances are recognised when there is objective evidence that impairment of a financing or portfolio of financing has occurred or when principal or profit or both are past due for more than ninety (90) days, whichever is sooner. Impairment allowances are calculated on individual financing and on groups of financing assessed collectively. Impairment losses are recorded as charges to the profit or loss. The carrying amount of impaired financing on the balance sheet is reduced through the use of impairment allowance accounts. Losses which may arise from future events are not recognised.

The Bank's allowance for impaired financing are in conformity with MFRS 139.

(i) Individually assessed financing and advances

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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

3 Significant Accounting Policies (Cont'd)

(k) Impairment of financing and advances (Cont'd)

(i) Individually assessed financing and advances (Cont'd)

Financing that are determined to be individually significant will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective methodology.

Financing considered as individually significant are typically to corporate and commercial customers, are for larger amounts and are managed on an individual basis. Retail financing portfolios are generally assessed for impairment on a collective basis as the portfolios generally consist of large pools of homogeneous financing.

For all financing that are considered individually significant, the Bank assesses on a case-by-case basis at each balance sheet date to identify whether evidence of impairment exists based on the following criteria:

- known cash flow difficulties experienced by the borrower;
- contractual payments of either principal or profit being past due for more than 90 days;
- the probability that the borrower will enter bankruptcy or other financial realisation;
- a concession granted to the borrower for economic or legal reasons relating to the customer's financial difficulty that results in forgiveness or postponement of principal, profit or fees, where the concession is not insignificant; and
- there has been deterioration in the financial condition or outlook of the customer such that its ability to repay is considered doubtful.

For those financing where objective evidence of impairment exists, impairment losses are determined considering the following factors:

- the Bank's aggregate exposure to the customer;
- the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors' commitments ranking ahead of, or pari passu with, the Bank and the likelihood of other creditors continuing to support the company;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding;
- the ability of the borrower to obtain, and make payments in, the currency of the financing if not denominated in local currency; and
- when available, the secondary market price of the debt.

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

Impairment losses are calculated by discounting the expected future cash flows of a financing, which include expected future receipts of contractual profit, at the financing's original effective profit rate or an approximation thereof, and comparing the resultant present value with the financing's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

(k) Impairment of financing and advances (Cont'd)

(ii) Collectively assessed financing and advances

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

Individually assessed financing for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for a collective impairment assessment. These credit risk characteristics may include country of origination, type of business involved, type of products offered, security obtained or other relevant factors. This assessment captures impairment losses that the Bank has incurred as a result of events occurring before the balance sheet date, which the Bank is not able to identify on an individual financing basis, and that can be reliably estimated when information becomes available which identifies losses on individual financing within the group, those financing are removed from the group and assessed individually.

The collective impairment allowance is determined after taking into account:

- historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, financing grade or product);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual financing; and
- management's experienced judgment as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by local management for each identified portfolio based on economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. The estimated period between a loss occurring and its identification may vary over time as these factors change.

Homogeneous groups of financing and advances

Statistical methods are used to determine impairment losses for homogeneous groups of financing and advances not considered individually significant. Losses in these groups of financing are recorded individually when individual financing are removed from the group and written off. Two methods that are used to calculate collective allowances are:

- When appropriate empirical information is available, the Bank utilises roll-rate methodology which employs statistical analyses of historical data and experience of delinquency and default to reliably estimate the amount of financing that will eventually be written off as a result of the events occurring before the balance sheet date. Individual financing are grouped using ranges past due days and statistical analysis are made of the likelihood that financing in each range will progress through the various stages of delinquency and become irrecoverable. Additionally, individual financing are segmented based on their credit characteristics as described above. Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective profit rate of the portfolio, and the carrying amount of the portfolio.

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

The inherent loss within each portfolio is assessed on the basis of statistical models using historical data observations, which are updated periodically to reflect recent portfolio and economic trends. When the most recent trends in portfolio risk factors arising from changes in economic, regulatory or behavioural conditions are not fully reflected in the statistical models, they are taken into account by adjusting the impairment allowances derived from the statistical models to reflect these changes as at the balance sheet date.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

3 Significant Accounting Policies (Cont'd)

(k) Impairment of financing and advances (Cont'd)

(ii) Collectively assessed financing and advances (Cont'd)

Homogeneous groups of financing and advances (Cont'd)

These additional portfolio risk factors may include recent financing portfolio growth and product mix, unemployment rates, bankruptcy trends, geographic concentrations, financing product features (such as the ability of customers to repay adjustable-rate financing where reset profit rates give rise to increases in profit charges), economic conditions such as national and local trends in housing markets and profit rates, portfolio seasoning, account management policies and practices, current levels of write-offs, adjustments to the period of time between loss identification and write-off, changes in laws and regulations and other factors which can affect customer payment patterns on outstanding financing, such as natural disasters. These risk factors, where relevant, are taken into account when calculating the appropriate level of impairment allowances by adjusting the impairment allowances derived solely from historical loss experience.

Roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

(iii) Write-off of financing and advances

Refer to Note 4(b)(iv) for credit risk management on write-off of financing and advances.

(iv) Reversals of impairment

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

(v) Renegotiated financing

Financing subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as up to date financing, once a minimum number of 12 monthly payments have been received. Financing subject to collective impairment assessment whose terms have been renegotiated are segregated from other parts of the financing portfolio for the purposes of collective impairment assessment, to reflect their risk profile.

Financing subject to individual impairment assessment, whose terms have been renegotiated remain as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future contractual payments, and there are no other indicators of impairment. The renegotiated financing will only be reclassified as unimpaired when restructured payment is received and observed for a minimum period of 12 months.

A financing that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated financing is substantially a different financial instrument. Any new financing that arise following derecognition events will continue to be disclosed as renegotiated financing and are assessed for impairment as above.

(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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

3 Significant Accounting Policies (Cont'd)

(l) Equipment (Cont'd)

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

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

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

(m) Operating leases

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

(n) Intangible assets

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

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

(o) Bills payable

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

(p) Debt securities issued, subordinated Commodity Murabahah financing, multi-currency sukuk programme and deposits by customers and banks

Financial liabilities are recognised when 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, net of directly attributable transaction costs incurred. 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 Commodity Murabahah financing and the multi-currency sukuk programme of the Bank are measured at amortised cost using the effective profit 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 commodity murabahah financing and multi-currency sukuk programme of the Bank are recognised on an accrual basis.

3 Significant Accounting Policies (Cont'd)

(q) Provisions

Provisions recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation which 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 possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the Bank; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

(r) Financial guarantee contracts

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received or present value of the fee receivable. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations.

Fee income recognised on financial guarantee contracts are amortised to profit or loss using a straight-line method over the contractual period or, when there is no specified contractual period, recognised in the profit or loss upon discharge of the guarantee.

(s) 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 initially recognised, and are subsequently remeasured, at fair value. Fair values of exchange traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models. Derivative assets and liabilities arising from different transactions are only offset for accounting purposes if the offsetting criteria are met.

Derivatives may be embedded in other financial instruments, for example, a convertible sukuk with an embedded conversion option. Embedded derivatives are treated as separate derivatives (bifurcated) when their economic characteristics and risks are not clearly and closely related to those of the host non-derivative contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract; and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with changes therein recognised in the profit or loss.

Derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

The method of recognising fair value gains and losses depends on whether derivatives are held for trading or are designated as hedging instruments, and if the latter, the nature of the risks being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the statements of profit or loss and other comprehensive income. When derivatives are designated as hedges, the Bank classifies them as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments (fair value hedges) or (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction (cash flow hedges) or (iii) hedges of net investment in a foreign operation (net investment hedges). Hedge accounting is applied to derivatives designated as hedging instruments in a fair value, cash flow or net investment hedge provided certain criteria are met.

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

Hedge accounting

At the inception of a hedging relationship, the Bank documents the relationship between the hedging instruments and the hedged items, its risk management objective and its strategy for undertaking the hedge. The Bank requires documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments have been and will be highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items. Profit on designated qualifying hedges is included in 'Finance income'.

i) Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the profit or loss, along with changes in the fair value of the hedged assets or liabilities attributable to the hedged risk. If a hedge relationship no longer meets the criteria for hedge accounting, the hedge accounting is discontinued: the cumulative adjustment to the carrying amount of the hedged item is amortised to profit or loss on a recalculated effective profit rate over the residual period to maturity, unless the hedged item has been derecognised, in which case, it is recognised in the profit or loss immediately.

ii) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. Any gain or loss in fair value relating to an ineffective portion is recognised immediately in the profit or loss within 'Other operating income'.

The accumulated gains and losses recognised in other comprehensive income are reclassified to the profit or loss in the same periods in which the hedged item affects the profit or loss. In hedges of forecast transactions that result in recognition of a non-financial asset or a non-financial liability, previous gains and losses recognised in other comprehensive income are removed from equity and included in the initial measurement of the asset or liability.

When a hedge relationship is discontinued, any cumulative gain or loss recognised in other comprehensive income at that time remains in equity until the forecast transaction is eventually recognised in the profit or loss. 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 profit or loss.

(t) Financial instruments designated at fair value

Financial instruments, other than those held for trading, are classified in this category if they meet the criteria set out below and are so designated irrevocably by management on initial recognition. The Bank may designate financial instruments at fair value when the designation:

- eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial instruments, or recognising the gains and losses different bases from related positions. Under this criterion, the main class of financial instruments designated by the Bank are:

  Long-term debt issues. The profit payable on certain fixed-rate long-term debt securities issued has been matched with the profit on 'receive fixed/pay variable' profit swaps as part of a documented profit rate risk management strategy. An accounting mismatch would arise if the debt securities issued were accounted for at amortised cost, because the related derivatives are measured at fair value with changes in the fair value recognised in the profit or loss. By designating the long-term debt at fair value, the movement in the fair value of the long-term debt will also be recognised in the profit or loss;

(t) Financial instruments designated at fair value (Cont'd)

- applies to a groups of financial instruments are managed and their performance evaluated, on a fair value basis, in accordance with a documented risk management or investment strategy, and where information about that groups of financial instruments is reported to management on that basis. The Bank has documented risk management and investment strategies designed to manage and monitor market risk of those assets on net basis, after considering non-linked liabilities. Fair value measurement is also consistent with the regulatory reporting requirements under the appropriate regulations for these insurance operations; and

- relates to financial instruments containing one or more non-closely related embedded derivatives.

Designated financial assets are recognised at fair value when the Bank enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when sold. Subsequent changes in fair values are recognised in the profit or loss in 'Net gain/(loss) from financial instruments fair value through profit and loss'.

In both the current and prior year, financial liabilities are classified as subsequently measured at amortised cost, except for:

- financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in profit or loss;

- financial guarantee contracts and loan commitments.

(u) 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 statements of profit or loss and other comprehensive income as incurred.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

3 Significant Accounting Policies (Cont'd)

(u) Employee benefits (Cont'd)

(iii) Termination benefits

Termination benefits where applicable are payable when employment is terminated by the Bank for mutual or voluntary separation. The Bank recognises 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 a voluntary separation, the termination benefits are estimated based on the number of employees expected to apply and be accepted for the separation.

(v) Share based payments

The Bank's ultimate holding company, HSBC Holdings Plc 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.

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

Fair value is determined by using market prices or appropriate valuation models, taking into account the terms and conditions upon which the equity instruments were granted. Vesting conditions include service conditions and performance conditions; any other features of a share-based payment arrangement are non-vesting conditions.

Market performance conditions and non-vesting conditions are taken into account when estimating the fair value of equity instruments at the date of grant, so that an award is treated as vesting irrespective of whether the market performance condition or non-vesting condition is satisfied, provided all other vesting conditions are satisfied.

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

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

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

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

(w) 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.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management

a) Introduction and overview

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

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

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

Risk management framework

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

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

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

b) Credit risk management

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

A Credit and Risk Management structure under the Chief Risk Officer who reports to the Chief Executive Officer, is in place to ensure a more coordinated management of credit risk and a more independent evaluation of credit proposals. The Chief Risk Officer, who also has oversight of market, operational and environmental risk, has a functional reporting line to the HBMY Country Chief Risk Officer.

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

4 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

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

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

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

The Bank's exposure to credit risk is shown in Note 4(b)(x).

(i) Impairment assessment

Individually impaired financing and securities are financing and advances and investment debt securities for which the Bank determines that there is objective evidence of impairment and it does not expect to collect all principal and profit due according to the contractual terms of the financing/investment security. These financing are graded CRR 9-10 in the Bank's internal credit risk grading system. Please refer to Note 4(b)(x) for further information on the Bank's internal credit risk rating system.

When impairment losses occur, the Bank reduces the carrying amount of financing and advances through the use of an allowance account. When impairment of available-for-sale financial assets occurs, the carrying amount of the asset is reduced directly. For further details, see Note 3(i) (ii) and Note 3(k). Impairment allowances may be assessed and created either for individually significant accounts or, on a collective basis, for groups of individually significant accounts for which no evidence of impairment has been individually identified or for high-volume groups of homogeneous financing that are not considered individually significant. It is the Bank's policy that allowances for impaired financing are created promptly and consistently. Management regularly evaluates the adequacy of the established allowances for impaired financing by conducting a detailed review of the financing portfolio, comparing performance and delinquency statistics with historical trends and assessing the impact of current economic conditions.

(ii) Past due but not impaired financing and investment debt securities

Past due but not impaired financing and investment debt securities are those for which contractual profit or principal payments are past due, but the Bank believes that impairment is not appropriate on the basis of the level of security/collateral available and/or the stage of collection of amounts owed to the Bank.

Examples of exposures past due but not impaired include overdue financing fully secured by cash collateral; house financing that are individually assessed for impairment, and that are in arrears less than 90 days, but where the value of collateral is sufficient to pay both the principal financial obligation and potential profit; and short-term trade facilities past due for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

b) Credit risk management (Cont'd)

(iii) Financing with renegotiated terms

Financing with renegotiated terms are financing that have been restructured due to deterioration in the customer's financial position and where the Bank has made concessions it would not otherwise consider. Once the financing is restructured it remains in this category independent of satisfactory performance after restructuring.

Refer to Note 3(k)(v) Renegotiated financing for related impairment accounting policies.

(iv) Write-off of financing and advances

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

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

- under the residential and real estate business; mortgages over residential and financed properties;
- under certain Islamic specialised financing and leasing transactions (such as vehicle 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 issues 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 cash and 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).

(v) Collateral held as security

The Bank does not disclose the fair value of collateral held as security or other credit enhancements on financing and advances 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 financing for the Bank as at 31 December 2017 are 54.97% (2016: 60.27%). 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 pay the outstanding financing amount. If excess funds arise after the financing has been repaid, they are made available either to pay other secured financiers with lower priority or are returned to the customer. The Bank does not generally occupy repossessed properties for its business use.

(vi) Concentration of credit risk

The Bank monitors concentration of credit risk by sector and geographical location. The analysis of concentration of credit risk from financing and advances to customers is shown in Note 9. The analysis of concentration of credit risk from the Bank's financial assets are shown in Note 4(b)(xi).

4 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

(vii) Financial assets held-for-trading

The Bank does not hold any financial assets held-for-trading as at 31 December 2017 (2016: RM0.5 million). An analysis of the credit quality of the maximum credit exposure, based on the rating agency Standard & Poor's, is as disclosed in Note 7 to the financial statements.

(viii) Stress testing

The Bank's stress testing programme examines the sensitivities and resilience of its capital plans and unplanned demand for regulatory capital under a number of scenarios and ensures that top and emerging risks are appropriately considered. These scenarios include, but are not limited to, adverse macroeconomic events, failures at country, sector and counterparty levels, geopolitical occurrences and a variety of projected major operational risk events. Scenarios are translated into financial impacts to access the sensitivities and resilience of the Bank's capital demand. Action plans are developed to mitigate identified risks. The Bank's Risk Committee is informed and consulted on the Bank's stress testing activities, as appropriate.

Reverse stress testing is run annually. It is used to strengthen the Bank's resilience by identifying potential stresses and vulnerabilities which the group might face and helping to inform early-warning triggers, management actions and contingency plans designed to mitigate their effect, were they to occur.

(ix) Offsetting financial assets and liabilities

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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management (Cont'd)

b) Credit Risk Management (Cont'd)

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

	(i)	(ii)	(iii) = (i) + (ii)	(iv)a	(iv)b	(v) = (iii) - (iv)
				Gross amounts not offset in the statement of financial position		
Description	Gross amounts of recognised assets RM'000	Gross amounts offset in the statement of financial position RM'000	Net amount of assets presented in the statement of financial position RM'000	Financial instruments RM'000	Cash collateral received RM'000	Net amount RM'000
2017						
Bank						
Derivative financial assets	**278,472**	-	**278,472**	-	-	**278,472**
Derivative financial liabilities	**265,402**	-	**265,402**	-	-	**265,402**
2016						
Bank						
Derivative financial assets	395,748	-	395,748	-	-	395,748
Derivative financial liabilities	490,755	-	490,755	-	-	490,755

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

(x) Exposure to credit risk

	31 Dec 2017	
	Financing and advances to customers RM'000	**Financing and advances to banks [1] RM'000**
Carrying amount	**13,383,803**	**1,465,919**
Assets at amortised cost		
Individually impaired:		
Gross amount	**382,049**	-
Allowance for impairment	**(114,899)**	-
Carrying amount	**267,150**	-
Past due but not impaired:		
Carrying amount	**864,623**	-
Past due comprises:		
up to 29 days	**650,697**	-
30 - 59 days	**145,148**	-
60 - 89 days	**68,778**	-
	864,623	-
Neither past due nor impaired:		
Strong	**6,673,656**	**1,465,919**
Medium -good	**3,545,929**	-
Medium-satisfactory	**1,903,168**	-
Substandard	**370,185**	-
Carrying amount	**12,492,938**	**1,465,919**
of which includes accounts with renegotiated terms	***76,021***	-
Collective allowance for impairment	**(240,908)**	-
Carrying amount-amortised cost	**13,383,803**	**1,465,919**

	31 Dec 2017			
	Derivatives Financial Assets RM'000	**Financial Assets held-for-trading RM'000**	**Financial investments available-for-sale RM'000**	**Other Financial Assets RM'000**
Carrying amount	**278,472**	-	**2,221,044**	**26,150**
Neither past due nor impaired:				
Strong	**121,407**	-	**2,171,235**	**26,150**
Medium-good	**146,929**	-	-	-
Medium-satisfactory	**9,045**	-	**49,809**	-
Sub-standard	**1,091**	-	-	-
Carrying amount [2]	**278,472**	-	**2,221,044**	**26,150**
Carrying amount - fair value	**278,472**	-	**2,221,044**	**26,150**

In addition to the above, the Bank had entered into financing commitments and contingencies of RM10,668.3 million. The Bank had also issued financial guarantee contracts for which the maximum amount payable by the Bank, assuming all guarantees are called on, is RM1,541.8 million.

[1] Consists of cash and short term funds and deposits and placements with banks and other financial institutions.

[2] No available-for-sale accounts were renegotiated during the financial year.

4 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

(x) Exposure to credit risk (Cont'd)

	31 Dec 2016	
	Financing and advances to customers RM'000	Financing and advances to banks [1] RM'000
Carrying amount	11,743,263	2,359,591
Assets at amortised cost		
Individually impaired:		
Gross amount	303,526	-
Allowance for impairment	(62,757)	-
Carrying amount	240,769	-
Past due but not impaired:		
Carrying amount	834,641	-
Past due comprises:		
up to 29 days	607,497	-
30 - 59 days	157,441	-
60 - 89 days	69,703	-
	834,641	-
Neither past due nor impaired:		
Strong	5,677,276	2,359,591
Medium -good	2,501,861	-
Medium-satisfactory	2,331,861	-
Substandard	356,870	-
Carrying amount	10,867,868	2,359,591
of which includes accounts with renegotiated terms	*39,984*	-
Collective allowance for impairment	(200,015)	-
Carrying amount-amortised cost	11,743,263	2,359,591

	31 Dec 2016			
	Derivatives Financial Assets RM'000	Financial Assets held-for-trading RM'000	Financial investments available-for-sale RM'000	Other Financial Assets RM'000
Carrying amount	395,748	488	1,368,574	80,041
Neither past due nor impaired:				
Strong	134,617	488	1,368,574	80,041
Medium-good	245,013	-	-	-
Medium-satisfactory	16,118	-	-	-
Sub-standard	-	-	-	-
Carrying amount	395,748	488	1,368,574	80,041
Carrying amount-fair value [2]	395,748	488	1,368,574	80,041

In addition to the above, the Bank had entered into financing commitments and contingencies of RM9,738.2 million. The Bank had also issued financial guarantee contracts for which the maximum amount payable by the Bank, assuming all guarantees are called on, is RM1,760.0 million.

[1] Consists of cash and short term funds and deposits and placements with banks and other financial institutions.

[2] No available-for-sale accounts were renegotiated during the financial year.

4 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

(x) Exposure to credit risk (Cont'd)

The five credit quality classifications set out and defined below describe the credit quality of HSBC’s financing, debt securities portfolios and derivatives. Since 2008, the medium classification has been subdivided into ‘medium-good’ and ‘medium satisfactory’ to provide further granularity. These five classifications each encompass a range of more granular, internal credit rating grades assigned to corporate and retail financing business, as well as the external ratings attributed by external agencies to debt securities. There is no direct correlation between the internal and external ratings at granular level, except to the extent each falls within a single quality classification.

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

[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.

Credit quality of the Bank's corporate financing/derivative financial assets/ deposits and placements with banks and other financial institutions	Internal Credit Rating
Strong	CRR1 - CRR2
Good	CRR3
Satisfactory	CRR4 - CRR5
Sub-standard	CRR6 - CRR8
Impaired	CRR9 - CRR10

Credit quality of the Bank's retail financing	Internal Credit Rating
Strong	EL1 -EL2
Medium-good	EL3
Medium-satisfactory	EL4 - EL5
Sub-standard	EL6 - EL8
Impaired	EL9 - EL10

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

(xi) Concentration by sector and by location [1]

	31 Dec 2017				
	Financing and advances to banks [2] RM'000	**Derivatives Financial Assets RM'000**	**Financial Assets held-for-trading RM'000**	**Financial investments available-for-sale RM'000**	**Other Financial Assets RM'000**
Carrying amount	**1,465,919**	**278,472**	**-**	**2,221,044**	**26,150**
By Sector					
Agricultural, hunting, forestry and fishing	-	-	-	-	-
Mining and quarrying	-	-	-	-	-
Manufacturing	-	**5,687**	-	-	-
Construction	-	**1**	-	-	-
Real estate	-	**1,845**	-	-	-
Wholesale & retail trade, restaurants & hotels	-	**1,738**	-	-	-
Transport, storage and communication	-	**867**	-	-	-
Finance, insurance and business services	**1,465,919**	**263,685**	-	**149,083**	-
Central banks and government related	-	-	-	**2,071,961**	-
Others	-	**4,649**	-	-	**26,150**
	1,465,919	**278,472**	**-**	**2,221,044**	**26,150**
By geographical location					
Within Malaysia	**1,351,940**	**131,543**	-	**2,221,044**	**26,150**
Outside Malaysia	**113,979**	**146,929**	-	-	-
	1,465,919	**278,472**	**-**	**2,221,044**	**26,150**

[1] Concentration by sector and location for financing and advances is disclosed under Note 10(iv) and 10(vi) to the financial statements

[2] Consists of cash and short term funds, deposits and placements with banks and other financial institutions, and other financial assets.

4 Financial risk management (Cont'd)

b) Credit risk management (Cont'd)

(xi) Concentration by sector and by location [1]

	31 Dec 2016				
	Financing and advances to banks [2] RM'000	Derivatives Financial Assets RM'000	Financial Assets held-for-trading RM'000	Financial investments available-for-sale RM'000	Other Financial Assets RM'000
Carrying amount	2,359,591	395,748	488	1,368,574	80,041
By Sector					
Agricultural, hunting, forestry and fishing	-	81	-	-	-
Mining and quarrying	-	126	-	-	-
Manufacturing	-	12,621	-	-	-
Construction	-	1	-	-	-
Real estate	-	2,692	-	-	-
Wholesale & retail trade, restaurants & hotels	-	79	-	-	-
Transport, storage and communication	-	296	-	-	-
Finance, insurance and business services	2,359,591	268,920	-	-	-
Central banks and government related	-	-	488	1,368,574	-
Others	-	110,932	-	-	80,041
	2,359,591	395,748	488	1,368,574	80,041
By geographical location					
Within Malaysia	2,277,933	150,897	488	1,368,574	80,041
Outside Malaysia	81,658	244,851	-	-	-
	2,359,591	395,748	488	1,368,574	80,041

[1] Concentration by sector and location for financing and advances is disclosed under Note 10(iv) and 10(vi) to the financial statements

[2] Consists of cash and short term funds, deposits and placements with banks and other financial institutions, and other financial assets.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management (Cont'd)

c) Liquidity and funding risk management

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

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

Current accounts and savings deposits payable on demand or at short notice form a significant part of HSBC Group's funding, and the Bank 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.

The management of liquidity and funding is primarily carried out in accordance with the BNM's Liquidity Coverage Ratio Framework; and practices and limits set by Asset and Liabilities Management Committee (ALCO) and regional Head Office. These limits vary to take account of the depth and liquidity of the local market in which the Bank operates. The Bank maintains a strong liquidity position and manages the liquidity profile of its assets, liabilities and commitments to ensure that cash flows are appropriately balanced and all obligations are met when due.

The Bank's liquidity and funding management process includes:

- 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;
- managing debt financing plans;
- monitoring of depositor concentration in order to avoid undue reliance on large individual depositors and ensuring 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 implication for the business.

On 1 January 2016, the Bank implemented a new liquidity and funding risk framework (LFRF). It 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 the Bank considers are not adequately reflected by the regulatory framework.

The LFRF is delivered using the following key aspects:

- standalone management of liquidity and funding by operating entity;
- operating entity classification by inherent liquidity risk (ILR) categorisation;
- minimum LCR requirement depending on ILR categorisation;
- minimum NSFR requirement depending on ILR categorisation;
- legal entity depositor concentration limit;
- three-month and 12-month cumulative rolling term contractual maturity limits covering deposits from banks;

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management (Cont'd)

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

- deposits from non-bank financial institutions and securities issued;
- annual individual liquidity adequacy assessment by principal operating entity;
- minimum LCR requirement by currency;
- intraday liquidity; and
- forward-looking funding assessments.

The new internal LFRF and the risk tolerance limits were approved by the Board on the basis of recommendations made by the Group Risk Committee.

4 Financial risk management (Cont’d)

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

i) Liquidity risk

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

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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management (Cont'd)

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

i) Liquidity risk (Cont'd)

	Non-trading book							
31 Dec 2016	Up to 1 month RM'000	>1 - 3 months RM'000	>3 - 12 months RM'000	1 - 5 years	Over 5 years RM'000	Non-specific maturity RM'000	Trading book RM'000	Total RM'000
ASSETS								
Cash and short-term funds	2,359,591	-	-	-	-	-	-	2,359,591
Financial assets held-for-trading	-	-	-	-	-	-	488	488
Financial investments available-for-sale	-	-	180,224	1,168,295	20,055	-	-	1,368,574
Financing and advances	2,160,491	1,740,491	415,573	1,706,522	5,720,186	-	-	11,743,263
Derivative financial assets	-	-	-	-	-	-	395,748	395,748
Others	47,582	-	1,298	8,828	395	375,317	-	433,420
Total Assets	4,567,664	1,740,491	597,095	2,883,645	5,740,636	375,317	396,236	16,301,084
LIABILITIES AND EQUITY								
Deposits from customers	5,700,875	1,767,337	1,225,760	32,571	-	-	-	8,726,543
Deposits and placements from banks and other financial institutions	583,781	86,830	1,248,600	32,391	-	-	-	1,951,602
Bills payable	23,632	-	-	-	-	-	-	23,632
Multi-Currency Sukuk Programme	-	-	500,000	1,256,001	-	-	-	1,756,001
Subordinated Commodity Murabahah Financing	-	-	-	-	646,265	-	-	646,265
Derivative financial liabilities	-	59	-	962	-	-	489,734	490,755
Others	52,421	12,285	23,242	14,161	204	113,413	969,409	1,185,135
Total Liabilities	6,360,709	1,866,511	2,997,602	1,336,086	646,469	113,413	1,459,143	14,779,933
Equity	-	-	-	-	-	1,521,151	-	1,521,151
Total Liabilities and Equity	6,360,709	1,866,511	2,997,602	1,336,086	646,469	1,634,564	1,459,143	16,301,084
Net maturity mismatches	(1,793,045)	(126,020)	(2,400,507)	1,547,559	5,094,167	(1,259,247)	(1,062,907)	-
Off balance sheet liabilities	7,787,944	2,793,902	3,404,638	8,153,424	9,945	-	-	22,149,853

4 Financial risk management (Cont'd)

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

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

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

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

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

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 Dec 2016						
Non-derivative liabilities						
Deposits by customers	3,589,284	3,927,926	1,237,287	28,469	-	8,782,966
Deposits and placements from banks and other financial institutions	-	675,121	1,273,791	35,876	-	1,984,788
Bills payable	23,632	-	-	-	-	23,632
Multi-Currency Sukuk Programme	-	19,761	531,679	1,344,921	-	1,896,361
Subordinated Commodity Murabahah financing	-	4,881	12,817	81,342	704,204	803,244
Other liabilities	69,866	71,048	960,284	1,221,006	83,553	2,405,757
Financing and other credit-related commitments	7,097,593	323,559	553,909	3,136	-	7,978,197
Financial guarantees and similar contracts	111,366	724,837	527,905	385,914	9,945	1,759,967
	10,891,741	5,747,133	5,097,672	3,100,664	797,702	25,634,912
Derivative liabilities						
Gross settled derivatives						
- Inflow	-	(490,907)	(708,050)	(1,008,001)	-	(2,206,958)
- Outflow	-	538,080	879,628	1,261,361	-	2,679,069
Net settled derivatives	-	(11,925)	6,554	14,719	-	9,348

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management (Cont'd)

d) Market risk management

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

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

There were no significant changes to the Bank's policies and practices for the management of market risk in 2017.

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

The management of market risk is principally undertaken using risk limit mandates approved by HSBC's Regional Wholesale and Global 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 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 WMR. Positions are monitored daily and excesses against the prescribed limits are reported immediately to local Senior Management and WMR. The nature of the hedging and risk mitigation strategies performed across the group corresponds to the market risk management instruments available within each operating jurisdiction. These strategies range from the use of traditional market instruments, such as profit rate swaps, to more sophisticated hedging strategies to address a combination of risk factors arising at portfolio level.

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 and value at risk, together with stress testing and concentration limits. 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) Value at risk (VAR)

VAR is a technique that estimates the potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. The use of VAR is integrated into market risk management and is calculated for all trading positions regardless of how the group capitalises those exposures. Where there is no approved internal model, the group uses the appropriate local rules to capitalise exposures. The VAR models used by the Bank are predominantly based on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates such as profit rates and foreign exchange rates.

The models also incorporate the effect of option features on the underlying exposures. The historical simulation models used by the Bank incorporates 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.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management (Cont'd)

d) Market risk management (Cont'd)

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

The nature of the VAR models means that an increase in observed market volatility will lead to an increase in VAR without any changes in the underlying positions. The Bank routinely validates the accuracy of its VAR models by back-testing the actual daily profit and loss results, adjusted to remove non-modelled items such as fees and commissions, against the corresponding VAR numbers. Statistically, the Bank would expect to see losses in excess of VAR only 1 per cent of the time over a one-year period. The actual number of excesses over this period can therefore be used to gauge how well the models are performing.

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

RM'000	**At 31 Dec 2017**	**Average**	**Maximum**	**Minimum**
Foreign currency risk	**36**	**48**	**112**	**8**
Profit rate risk	**22**	**28**	**35**	**4**
Credit spread risk	**-**	**-**	**-**	**-**
Overall	**52**	**62**	**135**	**25**

RM'000	At 31 Dec 2016	Average	Maximum	Minimum
Foreign currency risk	61	44	248	8
Profit rate risk	294	487	673	401
Credit spread risk	-	2	8	-
Overall	311	491	685	35

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

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a 1-day holding period assumes that all positions can be liquidated or the risk offset during that period. This may not fully reflect the market risk arising at times of severe illiquidity, when a 1-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and
- VAR is unlikely to reflect loss potential on exposures that only arise under significant market movements.

The Bank recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures. Stress tests are produced on a monthly basis based on the HSBC Group's stress-testing parameters, and on a half-yearly basis based on Bank Negara Malaysia's parameters to determine the impact of changes in profit rates, exchange rates and other main economic indicators on the Bank's profitability, capital adequacy and liquidity. The stress-testing provides the Board Risk Committee with an assessment of the financial impact of identified extreme events on the market risk exposures of the Bank.

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

Sensitivity measures are used to monitor the market risk positions within each risk type, for example, the present value of a basis point movement in profit rates, for profit rate risk. Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

Derivative financial instruments (principally profit rate swaps) are used for hedging purposes in the management of asset and liability portfolios and structured positions. This enables the Bank to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of the assets and liabilities.

(ii) Exposure to profit rate risk - non-trading portfolio

Market risk in non-trading portfolios arises principally from mismatches between the future yields on assets and their funding cost as a result of profit rate changes. This market risk is transferred to Global Markets, taking into account both the contractual and behavioural characteristics of each product to enable the risk to be managed effectively. Behavioural assumptions for products with no contractual maturity are normally based on a two-year historical trend. These assumptions are important as they reflect the underlying profit rate risk of the products and hence are subject to scrutiny from ALCO, the regional Head Office and regional WMR. The net exposure is monitored against the limits granted by regional WMR for the respective portfolios and, depending on the view on future market movement, economically hedged with the use of financial instruments within agreed limits.

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management (Cont'd)

d) Market risk management (Cont'd)

(iii) Sensitivity of projected finance income

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

	RM'000			
	31-Dec-17		31-Dec-16	
Basis point parallel shift in yield curve	***+100bps***	***-100bps***	*+100bps*	***-100bps***
RM	**(29,797)**	**18,274**	(22,711)	12,490
USD	**8,462**	**(9,966)**	(4,767)	2,204
Others	**(432)**	**(495)**	(482)	(126)
	(21,767)	**7,813**	(27,960)	14,568

The increase or decline in economic value for upward and downward rate shocks for measuring profit rate risk/rate of return risk in the banking book are as follows:

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

	RM'000			
	31-Dec-17		31-Dec-16	
Basis point parallel shift in yield curve	***+200bps***	***-200bps***	*+200bps*	***-200bps***
RM	**(104,620)**	**119,139**	(179,135)	201,096
USD	**(368)**	**(1,732)**	(31,024)	23,763
Others	**18,596**	**(19,751)**	2,844	(850)
	(86,392)	**97,656**	(207,315)	224,009

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

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

	RM'000			
	31-Dec-17		31-Dec-16	
Basis point parallel shift in yield curve	***+100bps***	***-100bps***	*+100bps*	***-100bps***
RM	**(35,388)**	**35,388**	(27,046)	27,046

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management (Cont'd)

d) Market risk management (Cont'd)

v) Profit Rate Risk

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management (Cont’d)

d) Market risk management (Cont’d)

v) Profit Rate Risk (Cont'd)

31 Dec 2016	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	2,251,658	-	-	-	-	107,933	-	2,359,591	3.16
Financial assets held-for-trading	-	-	-	-	-	-	488	488	5.95
Financial investments available-for-sale	-	-	180,224	1,168,295	20,055	-	-	1,368,574	3.51
Financing and advances									
- performing	2,824,706	7,697,033	145,381	813,867	221,522	-	-	11,702,509	5.30
- impaired[1]	-	-	-	-	-	240,769	-	240,769	-
- collective allowance	-	-	-	-	-	(200,015)	-	(200,015)	-
Derivative financial assets	-	-	-	-	-	-	395,748	395,748	-
Other assets	-	-	-	-	-	80,041	-	80,041	-
Total Financial Assets	5,076,364	7,697,033	325,605	1,982,162	241,577	228,728	396,236	15,947,705	
LIABILITIES									
Deposits from customers	5,107,103	1,767,337	1,225,760	32,571	-	593,772	-	8,726,543	2.43
Deposits and placements from banks and other financial institutions	559,368	86,830	1,248,600	32,391	-	24,413	-	1,951,602	2.69
Bills payable	-	-	-	-	-	23,632	-	23,632	-
Multi-Currency Sukuk Programme	-	-	500,000	1,256,001	-	-	-	1,756,001	3.95
Subordinated Commodity Murabahah Financing	-	-	-	-	646,265	-	-	646,265	2.80
Derivative financial liabilities	-	59	-	962	-	-	489,734	490,755	-
Other liabilities	-	-	-	-	-	189,493	969,409	1,158,902	3.07
Total Financial Liabilities	5,666,471	1,854,226	2,974,360	1,321,925	646,265	831,310	1,459,143	14,753,700	
Total profit sensitivity gap	(590,107)	5,842,807	(2,648,755)	660,237	(404,688)	(602,582)	(1,062,907)	1,194,005	

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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management (Cont'd)

d) Market risk management (Cont'd)

(vi) Foreign exchange risk

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

	RM'000			
	31-Dec-17		31-Dec-16	
Appreciation/depreciation	***+1%***	***-1%***	*+1%*	*-1%*
Impact to profit after income tax expense	**26**	**(26)**	(29)	29

Change in foreign exchange rate has no significant impact to other comprehensive income for the financial year ended 31 December 2017 and 31 December 2016.

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.

(vii) Specific issuer risk

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

(viii) Equity risk

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

e) Operational risk management

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

(i) Operational Risk Management Framework

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

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

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

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

Activities to strengthen the Bank's risk culture and better embed the use of ORMF were further implemented in 2017. In particular the use of activity-based "Three Lines of Defence" model sets out roles and responsibilities for managing operational risks on a daily basis.

(ii) Three Lines of Defence

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

The three lines consists of:

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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

4 Financial risk management (Cont'd)

e) Operational risk management (Cont'd)

(iii) Exposures

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

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

(iv) Risk and Control Assessment

Risk and Control assessment (RCA) process facilitates the assessment of risk and the associated control environment. RCAs are required for all material operational risks faced by the Bank. The materiality of each risk is assessed to determine the maximum plausible impact on its business over the next 12 months. The supporting control environment is also assessed for its effectiveness in mitigating the risk. The residual risk, which takes into consideration the extent to which the control environment effectively mitigates that risk, is then rated to determine whether further management actions are required. The Risk Prioritization matrix is used to rate operational risks.

The RCA process provides the Bank with a forward looking view of operational risk across all levels of its organisational structure to help determine proactively whether operational risk are effectively controlled.

(v) Control Management

The Control Management process, part of the RCA, seeks to ensure that the control environment delivers the required level of risk mitigation on an ongoing basis. Control Management directs monitoring effort to those controls mitigating the Bank's most material risks.

An Operational Risk Control Library has been established to provide business and functional managers with a list of controls recommended by the subject matter experts i.e. risk stewards for each operational risk type. The Control library supports consistency in control categorisation to enable effective control management, monitoring, remediation and identification of thematic issues.

(vi) Control Reporting

All operational risk controls and associated risks, RCAs, issues and actions, operational risk events and control monitoring are recorded in HELIOs, the HSBC Operational Risk System of record. This central repository provides single version of truth and forms the basis of operational risk reporting to governance forums and management.

f) Capital management

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

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

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

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

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

(i) Externally imposed capital requirements

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

- Tier 1 capital is divided into Common Equity Tier 1 (CET1) Capital and Additional Tier 1 Capital. CET1 Capital includes ordinary share capital, share premium, capital redemption reserves, retained earnings, statutory reserves and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes. The Bank does not have any Additional Tier 1 Capital as at 31 December 2017.

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

(ii) Basel III

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

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

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

5 Use of estimates and judgments

a) Impairment of financing and advances

The results of the Bank are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. The significant accounting policies used in the preparation of the financial statements are described in Note 3 to the financial statements.

The accounting policies that are deemed critical to the Bank's results and financial position, 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. The Bank's accounting policy for losses arising from the impairment of customer financing and advances is described in Note 3(k) to the financial statements. Financing impairment allowances represent management's best estimate of losses incurred in the financing portfolios at the reporting date.

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

b) Fair value of financial instruments carried at fair value

The accounting policies which determine the classification of financial instruments and the use of assumptions and estimation in valuing them are described in Note 3(e)(vi) to the financial statements. 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 3(e)(iv) to the financial statements.

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.

2017	**Level 1 RM'000**	**Level 2 RM'000**	**Level 3 RM'000**	**Total RM'000**
Financial Investments Available-for-Sale (Note 8)	**2,047,025**	**174,019**	**-**	**2,221,044**
Derivative financial assets (Note 11)	**25**	**278,447**	**-**	**278,472**
	2,047,050	**452,466**	**-**	**2,499,516**
Trading liabilities[1]	**-**	**282,920**	**-**	**282,920**
Derivative financial liabilities (Note 11)	**52**	**265,350**	**-**	**265,402**
Multi-Currency Sukuk Programme (Note 21)	**-**	**1,252,829**	**-**	**1,252,829**
	52	**1,801,099**	**-**	**1,801,151**
2016				
Financial Assets Held-for-Trading (Note 7)	488	-	-	488
Financial Investments Available-for-Sale (Note 8)	1,368,574	-	-	1,368,574
Derivative financial assets (Note 11)	4	395,744	-	395,748
	1,369,066	395,744	-	1,764,810
Trading liabilities[1]	-	969,409	-	969,409
Derivative financial liabilities (Note 11)	4	490,751	-	490,755
Multi-Currency Sukuk Programme (Note 21)	-	1,256,001	-	1,256,001
	4	2,716,161	-	2,716,165

[1] *Trading liabilities consist of Islamic structured products classified as trading, net short position in securities form part of the balance disclosed under Note 20 (Other Liabilities).*

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 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.

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

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

To this end, ultimate responsibility for the determination of fair values lies within the Finance function, which reports functionally to the HSBC Group Finance Director. Finance establishes the accounting policies and procedures governing valuation, and is responsible for ensuring that these comply with all relevant accounting standards.

(ii) Determination of fair value of financial instruments carried at fair value

Fair values are determined according to the following hierarchy:

- Level 1 – Valuation technique using quoted market price

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

- Level 2 – Valuation technique using observable inputs

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

- Level 3 – Valuation technique with significant unobservable inputs

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

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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 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 trading 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 that there are additional factors that would be considered relevant by a market participant that are not incorporated within the valuation model. The Bank classifies fair value adjustments as either 'risk-related' or 'model-related'. The majority of these adjustments are related to Global Banking and Markets.

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, fair value adjustments may no longer be required. Similarly, fair value adjustments will decrease when the related positions are unwound.

5 Use of estimates and judgments (Cont'd)

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

(iv) Fair value adjustments (Cont'd)

- **Risk-related adjustments**

(i) Bid-offer

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

(ii) Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, there exists a range of possible values that the financial instrument or market parameter may assume and an adjustment may be necessary to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the HSBC's Group valuation model.

(iii) Credit valuation adjustment (CVA)

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. Further detail is provided below.

(iv) Debit valuation adjustment (DVA)

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 full market value of the transactions.

(v) Funding fair value adjustment (FFVA)

The FFVA is calculated by applying future market funding spreads to the expected future funding exposure of any uncollateralised component of the OTC derivative portfolio. This includes the uncollateralised component of collateralised derivatives in addition to derivatives that are fully uncollateralised. 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 group or the counterparty. The FFVA and DVA are calculated independently.

- **Model-related adjustments**

(i) Model limitation

Models used for portfolio valuation purposes may be based upon a simplifying set of assumptions that do not capture all material market characteristics. Additionally, markets evolve, and models that were adequate in the past may require development to capture all material market characteristics in current market conditions. In these circumstances, model limitation adjustments are adopted. As model development progresses, model limitations are addressed within the valuation models and a model limitation adjustment is no longer needed.

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

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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 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)

- **Credit valuation adjustment/ debit valuation adjustment methodology**

  The Bank calculates a separate CVA and DVA for each counterparty to which the Bank has exposure. With the exception of certain central clearing parties, the Bank includes all third-party counterparties in the CVA and DVA calculations and does not net these adjustments across the group's 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 expected positive exposure of the Bank 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 to calculate the expected positive exposure to a counterparty. This incorporates a range of potential exposures across the portfolio of transactions with the counterparty over the life of the portfolio. 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'. Wrong-way risk arises when the underlying value of the derivative prior to any CVA is positively correlated to the PD by the counterparty. When there is significant wrong-way risk, a trade-specific approach is applied to reflect this risk in the valuation.

- **Valuation of uncollateralised derivatives**

  In line with evolving industry practice, FFVA reflects the funding of uncollateralised derivative exposure at rates other than overnight indexed swap rate (OIS). As at 31 December 2017, the FFVA was -RM1.1 million (2016: -RM5.0 million) for the Bank, which has a one-off impact on trading revenue. This is an area in which a full industry consensus has not yet emerged. The Bank will continue to monitor industry evolution and refine the calculation methodology as necessary.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 Use of estimates and judgments (Cont'd)

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

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

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

	2017			2016		
	Derivative financial assets	**Derivative financial liabilities**	**Trading Liabilities**	Derivative financial assets	Derivative financial liabilities	Trading Liabilities
RM'000						
Balance at 1 January	-	-	-	-	5,687	91,498
Total gains or losses in profit or loss	-	-	-	-	420[1]	(624)[2]
Issues	-	-	-	-	-	-
Settlements	-	-	-	-	-	(12,146)
Transfer out of Level 3	-	-	-	-	(6,107)	(78,728)
Balance at 31 December	-	-	-	-	-	-

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

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

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

For trading liabilities, transfers out of level 3 resulted from maturity or early termination of the instruments.

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

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

5 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 statements of comprehensive income as follows:

2017 **RM'000**	**Derivative financial assets**	**Derivative financial liabilities**	**Trading 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	-	-	-
2016 RM'000			
Total gains or losses included in profit or loss for the financial year ended:			
-Net trading income	-	-	66,104[1]
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	-	420[1]	(66,728)[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. Since 2016, all Islamic structured products under Level 3 have been transferred out to Level 2.

5 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.

5 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 2017 Carrying amount RM'000	**31 Dec 2017 Fair Value RM'000**	31 Dec 2016 Carrying amount RM'000	31 Dec 2016 Fair Value RM'000
Financial Assets				
Financing and advances	**13,383,803**	**13,394,892**	11,743,263	11,749,726
Financial Liabilities				
Deposits from customers	**10,034,525**	**10,032,492**	8,726,543	8,723,002
Deposits and placements from banks and other financial institutions	**3,361,939**	**3,378,354**	1,951,602	1,951,545
Multi-Currency Sukuk Programme	**-**	**-**	500,000	498,750
Subordinated Commodity Murabahah Financing	**583,598**	**611,776**	646,265	682,055

The methods and assumptions used in estimating the fair values of financial instruments other than those already mentioned in Note 3(e) are as follows:

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

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

Financing and advances
For personal and commercial financing which mature or reprice after six months, fair value is principally estimated by discounting anticipated cash flows (including profit at contractual rates). Performing financing are grouped to the extent possible, into homogenous pools segregated by maturity within each pool. In general, cash flows are discounted using current market rates for instruments with similar maturity, repricing and credit risk characteristics. For impaired financing, the fair value is the carrying value of the financing, net of individual impairment allowances. Collective impairment allowances are deducted from the fair value of financing.

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)

5 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 2017	**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	**-**	**-**	**13,394,892**	**13,394,892**	**13,383,803**
Financial Liabilities					
Deposits from customers	**-**	**10,032,492**	**-**	**10,032,492**	**10,034,525**
Deposits and placements from banks and other financial institutions	**-**	**3,378,354**	**-**	**3,378,354**	**3,361,939**
Subordinated Commodity Murabahah Financing	**-**	**611,776**	**-**	**611,776**	**583,598**
31 Dec 2016					
Financial Assets					
Financing and advances	-	-	11,749,726	11,749,726	11,743,263
Financial Liabilities					
Deposits from customers	-	8,723,002	-	8,723,002	8,726,543
Deposits and placements from banks and other financial institutions	-	1,951,545	-	1,951,545	1,951,602
Multi-Currency Sukuk Programme	-	498,750	-	498,750	500,000
Subordinated Commodity Murabahah Financing	-	682,055	-	682,055	646,265

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

6 Cash and Short-Term Funds

	31 Dec 2017	31 Dec 2016
	RM'000	RM'000
Cash and balances with banks and other financial institutions	**215,919**	189,591
Money at call and interbank placements maturing within one month	**1,250,000**	2,170,000
	1,465,919	2,359,591

7 Financial Assets Held-for-Trading

	31 Dec 2017	31 Dec 2016
	RM'000	RM'000
At fair value		
Money market instruments:		
Malaysian Government Islamic Sukuk	**-**	488
	-	488

8 Financial Investments Available-for-Sale

	31 Dec 2017	31 Dec 2016
At fair value	**RM'000**	RM'000
Money market instruments:		
Malaysian Government Islamic Sukuk	**2,047,025**	1,368,574
Negotiable instruments of deposit	**149,083**	-
Islamic Treasury Bill	**24,936**	-
	2,221,044	1,368,574

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

Maturing within one year	**687,008**	180,224
More than one year to three years	**1,427,803**	732,449
More than three years to five years	**106,233**	435,846
Over five years	**-**	20,055
	2,221,044	1,368,574

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

9 Financing and Advances

(i) By type and Shariah contracts

At amortised cost	Sale-based contracts			Lease-based contracts		Equity-based contracts		
	Commodity Murabahah	Bai Bithaman Ajil	Bai Al-Inah	Ijarah	Ijarah Thumma Al-Bai	Diminishing Musharakah	Ujrah	Total
31 Dec 2017	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**
Cash line-i	**82,183**	**-**	**-**	**-**	**-**	**-**	**-**	**82,183**
Term financing:								
House financing	**-**	**22**	**-**	**-**	**-**	**4,401,553**	**-**	**4,401,575**
Hire purchase receivables	**-**	**-**	**-**	**-**	**169,852**	**-**	**-**	**169,852**
Lease receivables	**-**	**-**	**-**	**1,379**	**-**	**-**	**-**	**1,379**
Syndicated term financing	**2,140,665**	**-**	**-**	**-**	**-**	**-**	**-**	**2,140,665**
Other term financing	**3,181,937**	**1,177**	**89**	**-**	**-**	**988,724**	**-**	**4,171,927**
Trust receipts	**742,082**	**-**		**-**	**-**	**-**	**-**	**742,082**
Claims on customers under acceptance credits	**422,914**	**-**	**-**	**-**	**-**	**-**	**-**	**422,914**
Bills receivables	**109,065**	**-**	**-**	**-**	**-**	**-**	**-**	**109,065**
Staff financing-i	**2,307**	**-**	**107**	**-**	**-**	**2,233**	**-**	**4,647**
Credit cards-i	**-**	**-**	**-**	**-**	**-**	**-**	**925,417**	**925,417**
Revolving credit	**566,256**	**-**	**-**	**-**	**-**	**-**	**-**	**566,256**
Other financing	**-**	**-**	**-**	**-**	**-**	**1,648**	**-**	**1,648**
Gross financing and advances	**7,247,409**	**1,199**	**196**	**1,379**	**169,852**	**5,394,158**	**925,417**	**13,739,610**
Less: Allowance for impaired financing								
Collective allowances for impairment								**(240,908)**
Individual allowances for impairment								**(114,899)**
Total net financing and advances								**13,383,803**

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

9 Financing and Advances (Cont'd)

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

	Sale-based contracts			Lease-based contracts		Equity-based contracts		
	Commodity Murabahah	Bai Bithaman Ajil	Bai Al-Inah	Ijarah	Ijarah Thumma Al-Bai	Diminishing Musharakah	Ujrah	Total
31 Dec 2016	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
Cash line-i	97,840	-	-	-	-	-	-	97,840
Term financing:								
House financing	-	404	-	-	-	4,356,230	-	4,356,634
Hire purchase receivables	-	-	-	-	208,921	-	-	208,921
Lease receivables	-	-	-	2,738	-	-	-	2,738
Syndicated term financing	650,266	-	-	-	-	-	-	650,266
Other term financing	2,834,338	8,115	350	-	-	1,024,700	-	3,867,503
Trust receipts	462,235	-		-	-	-	-	462,235
Claims on customers under acceptance credits	504,375	-	-	-	-	-	-	504,375
Bills receivables	110,272	-	-	-	-	-	-	110,272
Staff financing-i	2,617	-	361	-	-	3,215	-	6,193
Credit cards-i	-	-	-	-	-	-	787,710	787,710
Revolving credit	950,161	-	-	-	-	-	-	950,161
Other financing	-	-	-	-	-	1,187	-	1,187
Gross financing and advances	5,612,104	8,519	711	2,738	208,921	5,385,332	787,710	12,006,035
Less: Allowance for impaired financing								
Collective allowances for impairment								(200,015)
Individual allowances for impairment								(62,757)
Total net financing and advances								11,743,263

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

9 Financing and Advances (Cont'd)

(ii) By type of customer

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Domestic non-bank financial institutions	**564,529**	638,263
Domestic business enterprises:		
Small medium enterprises	**1,962,425**	1,821,064
Others	**3,614,426**	2,397,737
Government and statutory bodies	**7,222**	10,316
Individuals	**6,117,218**	5,901,851
Other domestic entities	**14,641**	1,466
Foreign entities	**1,459,149**	1,235,338
	13,739,610	12,006,035

(iii) By profit rate sensitivity

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Fixed rate:		
House financing	**22**	398
Hire purchase receivables	**169,852**	208,921
Other financing	**3,105,126**	2,784,299
Variable rate:		
BR/BFR plus	**5,457,354**	5,471,227
Cost-plus	**5,007,256**	3,541,190
	13,739,610	12,006,035

(iv) By residual contractual maturity

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Maturing within one year	**5,850,745**	4,356,186
More than one year to three years	**982,143**	654,513
More than three years to five years	**901,874**	1,111,456
Over five years	**6,004,848**	5,883,880
	13,739,610	12,006,035

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

9 Financing and Advances (Cont'd)

(v) By sector

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Agriculture, hunting, forestry & fishing	**97,418**	136,372
Mining and quarrying	**96,376**	218,194
Manufacturing	**1,665,790**	1,187,941
Electricity, gas and water	**63,270**	32,907
Construction	**432,133**	354,645
Real estate	**1,073,840**	821,854
Wholesale & retail trade, restaurants & hotels	**904,765**	816,323
Transport, storage and communication	**549,382**	186,721
Finance, takaful and business services	**993,604**	929,714
Household - Retail	**6,738,960**	6,536,695
Others	**1,124,072**	784,669
	13,739,610	12,006,035

(vi) By purpose

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Purchase of landed property:		
Residential	**4,403,810**	4,359,849
Non-residential	**817,328**	853,008
Purchase of transport vehicles	**1,644**	1,847
Purchase of fixed assets excluding land & building	**-**	366
Consumption credit	**2,070,438**	1,893,592
Construction	**346,798**	343,443
Working capital	**5,254,963**	3,943,120
Other purpose	**844,629**	610,810
	13,739,610	12,006,035

(vii) By geographical distribution

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Northern Region	**1,496,470**	1,405,240
Southern Region	**1,506,660**	1,569,412
Central Region	**10,295,163**	8,565,903
Eastern Region	**441,317**	465,480
	13,739,610	12,006,035

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 and the Federal Territory of Kuala Lumpur.
The Eastern region consists of the states of Sabah, Sarawak and the Federal Territory of Labuan.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

9 Financing and Advances (Cont'd)

(viii) Assets under Management

The details of assets under management in respect of the Syndicated Investment Agency 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 2017 RM'000	31 Dec 2016 RM'000
Total net financing and advances	**4,722,591**	1,733,132
Formal standby facilities and credit lines:		
Maturity not exceeding one year	**1,047,532**	496,933
Maturity exceeding one year	**237,166**	-
Total commitments and contingencies	**1,284,698**	496,933
Risk weighted assets (RWA)	**4,312,606**	1,832,519

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 allowances 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 3(e) on financial instruments in the audited financial statements of the Bank for the financial year ended 31 December 2017.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

10 Impaired Financing

(i) Movements in impaired financing and advances

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Balance at 1 January	**303,526**	235,279
Classified as impaired during the financial year	**436,574**	358,706
Reclassified as performing	**(155,516)**	(122,829)
Amount recovered	**(66,005)**	(49,831)
Amount written off	**(136,530)**	(117,799)
Balance at 31 December	**382,049**	303,526

(ii) Movements in allowance for impaired financing

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Collective allowance for impairment		
Balance at 1 January	**200,015**	140,264
Made during the financial year	**207,831**	211,487
Amount released	**(43,974)**	(58,264)
Amount written off	**(122,964)**	(93,472)
Balance at 31 December	**240,908**	200,015

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Individual allowance for impairment		
Balance at 1 January	**62,757**	68,647
Made during the financial year	**57,300**	30,041
Amount released	**(25,746)**	(18,115)
Amount reinstated/(written off)	**20,588**	(17,816)
Balance at 31 December	**114,899**	62,757

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

10 Impaired Financing (Cont'd)

(iii) By contract

	31 Dec 2017	31 Dec 2016
	RM'000	RM'000
Bai Bithaman Ajil *(deferred payment sale)*	**-**	5
Ijarah Thumma Al-Bai (AITAB) *(hire purchase)*	**9,841**	5,730
Murabahah *(cost-plus)*	**168,021**	127,743
Musharakah (*profit and loss sharing)*	**184,393**	152,729
Bai Al-Inah *(sell and buy back)*	**3**	217
Ujrah *(fee-based)*	**19,791**	17,102
	382,049	303,526

(iv) By sector

	31 Dec 2017	31 Dec 2016
	RM'000	RM'000
Mining and quarrying	**765**	-
Manufacturing	**17,811**	4,038
Construction	**-**	204
Wholesale & retail trade, restaurants & hotels	**9,410**	12,309
Transport, storage and communication	**4,549**	3,665
Finance, takaful and business services	**29,310**	23,346
Household - Retail	**318,716**	259,346
Others	**1,488**	618
	382,049	303,526

(v) By purpose

	31 Dec 2017	31 Dec 2016
	RM'000	RM'000
Purchase of landed property:		
Residential	**162,963**	135,067
Non-residential	**12,805**	10,887
Purchase of transport vehicles	**3**	146
Purchase of fixed assets excluding land & building	**-**	358
Consumption credit	**151,582**	121,217
Construction	**2,786**	204
Working capital	**51,910**	35,647
	382,049	303,526

(vi) By geographical distribution

	31 Dec 2017	31 Dec 2016
	RM'000	RM'000
Northern Region	**58,913**	47,713
Southern Region	**39,334**	30,606
Central Region	**271,572**	212,643
Eastern Region	**12,230**	12,564
	382,049	303,526

11 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 2017	**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	3,275,446	-	-	3,275,446	101,206	-	-	101,206	101,638	-	-	101,638
- Swaps	-	2,345,181	-	2,345,181	-	156,798	-	156,798	-	155,394	-	155,394
- Options	36,534	295,613	-	332,147	736	1,114	-	1,850	736	1,114	-	1,850
Profit rate related contracts												
- Swaps	234,703	2,927,843	253,904	3,416,450	326	8,930	382	9,638	245	5,677	-	5,922
- Options	-	185,887	-	185,887	-	3,449	-	3,449	-	-	-	-
Equity related contracts												
- Options purchased	2,945	85,394	-	88,339	-	5,531	-	5,531	-	107	-	107
Sub- total	3,549,628	5,839,918	253,904	9,643,450	102,268	175,822	382	278,472	102,619	162,292	-	264,911
Hedging Derivatives:												
Fair Value Hedge												
Profit rate related contracts												
- Swaps	110,000	80,000	-	190,000	-	-	-	-	156	335	-	491
Sub- total	110,000	80,000	-	190,000	-	-	-	-	156	335	-	491
Total	3,659,628	5,919,918	253,904	9,833,450	102,268	175,822	382	278,472	102,775	162,627	-	265,402

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

11 Derivative Financial Instruments (Cont'd)

31 Dec 2016	Contract / Notional Amount Up to 1 Year RM'000	Contract / Notional Amount >1 - 5 Years RM'000	Contract / Notional Amount > 5 Years RM'000	Contract / Notional Amount Total RM'000	Positive Fair Value Up to 1 Year RM'000	Positive Fair Value >1 - 5 Years RM'000	Positive Fair Value > 5 Years RM'000	Positive Fair Value Total RM'000	Negative Fair Value Up to 1 Year RM'000	Negative Fair Value >1 - 5 Years RM'000	Negative Fair Value > 5 Years RM'000	Negative Fair Value Total RM'000
Trading derivatives:												
Foreign exchange contracts												
- Forwards	2,582,361	-	-	2,582,361	111,609	-	-	111,609	112,797	-	-	112,797
- Swaps	-	2,159,793	-	2,159,793	-	261,215	-	261,215	-	264,349	-	264,349
- Options	9,718	345,197	-	354,915	1,018	4,789	-	5,807	1,018	4,789	-	5,807
Profit rate related contracts												
- Swaps	1,200,000	4,770,174	-	5,970,174	470	14,075	-	14,545	384	8,906	-	9,290
- Options	-	189,444	-	189,444	-	2,545	-	2,545	-	135	-	135
Equity related contracts												
- Options purchased	765,236	109,766	-	875,002	27	-	-	27	95,176	2,180	-	97,356
Sub- total	4,557,315	7,574,374	-	12,131,689	113,124	282,624	-	395,748	209,375	280,359	-	489,734
Hedging Derivatives:												
Fair Value Hedge												
Profit rate related contracts												
- Swaps	90,000	190,000	-	280,000	-	-	-	-	59	962	-	1,021
Sub- total	90,000	190,000	-	280,000	-	-	-	-	59	962	-	1,021
Total	4,647,315	7,764,374	-	12,411,689	113,124	282,624	-	395,748	209,434	281,321	-	490,755

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

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Gains/(Losses) on hedging instruments	**487**	(1,075)
(Losses)/Gains on the hedged items attributable to the hedged risk	**(44)**	654
Net gains from fair value hedges	**443**	(421)

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

12 Other Assets

	31 Dec 2017	31 Dec 2016
	RM'000	RM'000
Income receivable	**7,631**	6,059
Profit receivable	**17,197**	12,972
Prepayments	**334**	72
Amount due from holding company	**988**	45,132
Other receivables	**17,209**	15,806
	43,359	80,041

13 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)

14 Equipment

2017	**Office equipment, fixtures and fittings**	**Computer equipment**	**Motor vehicles**	**Work in Progress**	**Total**
	RM'000	**RM'000**	**RM'000**	**RM'000**	**RM'000**
Cost					
Balance at 1 January	**37,044**	**18,279**	**299**	**-**	**55,622**
Additions	**1,739**	**562**	**-**	**-**	**2,301**
Written off	**(1,364)**	**(439)**	**-**	**-**	**(1,803)**
Balance at 31 December	**37,419**	**18,402**	**299**	**-**	**56,120**
Accumulated depreciation					
Balance at 1 January	**33,090**	**15,175**	**120**	**-**	**48,385**
Charge for the financial year	**2,314**	**1,641**	**60**	**-**	**4,015**
Written off	**(1,361)**	**(439)**	**-**	**-**	**(1,800)**
Balance at 31 December	**34,043**	**16,377**	**180**	**-**	**50,600**
Net book value at 31 December	**3,376**	**2,025**	**119**	**-**	**5,520**

2016	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	35,069	18,426	299	-	53,794
Additions	1,975	3	-	-	1,978
Written off	-	(150)	-	-	(150)
Balance at 31 December	37,044	18,279	299	-	55,622
Accumulated depreciation					
Balance at 1 January	30,007	13,439	60	-	43,506
Charge for the financial year	3,083	1,886	60	-	5,029
Disposals	-	(150)	-	-	(150)
Balance at 31 December	33,090	15,175	120	-	48,385
Net book value at 31 December	3,954	3,104	179	-	7,237

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

15 Intangible assets

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Computer software		
Cost		
Balance at 1 January	**5,053**	5,053
Written off	**-**	-
Balance at 31 December	**5,053**	5,053
Accumulated amortisation		
Balance at 1 January	**5,053**	5053
Charge for the financial year	**-**	-
Written off	**-**	-
Balance at 31 December	**5,053**	5,053
Net book value at 31 December	**-**	-

16 Deferred Tax Assets

The amounts, prior to offsetting are summarised as follows:

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Deferred tax assets	**9,668**	11,044
Deferred tax liabilities	**(1,031)**	(649)
	8,637	10,395

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 2017 RM'000	31 Dec 2016 RM'000
Deferred tax assets		
- settled more than 12 months	**284**	5,040
- settled within 12 months	**9,384**	6,004
Deferred tax liabilities		
- settled more than 12 months	**(309)**	(298)
- settled within 12 months	**(722)**	(351)
	8,637	10,395

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

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Equipment capital allowances	**(319)**	(649)
Available-for-sale reserve	**(712)**	2,067
Provision for accrued expenses	**7,080**	6,462
Deferred income	**2,380**	2,449
Lease receivables	**208**	66
	8,637	10,395

16 Deferred Tax Assets (Cont'd)

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

2017	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
Available-for-sale reserve	**2,067**	**-**	**(2,067)**	**-**
Provision for accrued expenses	**6,462**	**618**	**-**	**7,080**
Deferred income	**2,449**	**(69)**	**-**	**2,380**
Lease receivables	**66**	**142**	**-**	**208**
Deferred Tax Assets	**11,044**	**691**	**(2,067)**	**9,668**
Equipment capital allowances	**(649)**	**330**	**-**	**(319)**
Available-for-sale reserves	**-**	**-**	**(712)**	**(712)**
Deferred Tax Liabilities	**(649)**	**330**	**(712)**	**(1,031)**
Net Deferred Tax Assets	**10,395**	**1,021**	**(2,779)**	**8,637**
2016				
Available-for-sale reserve	-	-	2,067	2,067
Provision for accrued expenses	7,457	(995)	-	6,462
Deferred income	-	2,449	-	2,449
Lease receivables	-	66	-	66
Other temporary differences	124	(124)	-	-
Deferred Tax Assets	7,581	1,396	2,067	11,044
Equipment capital allowances	(449)	(200)	-	(649)
Lease receivables	(22)	22	-	-
Available-for-sale reserves	(1,562)	-	1,562	-
Deferred Tax Liabilities	(2,033)	(178)	1,562	(649)
Net Deferred Tax Assets	5,548	1,218	3,629	10,395

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

17 Tax Recoverable

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Tax recoverable	**7,624**	10,285

18 Deposits From Customers

(i) By type of deposit

At amortised cost	**31 Dec 2017 RM'000**	31 Dec 2016 RM'000
Non-Mudharabah Fund		
Demand deposits		
- Wadiah	**2,114,167**	1,902,318
Savings deposits		
- Wadiah	**1,644,028**	1,627,182
Term deposits		
- Murabahah	**6,195,246**	5,007,808
- Qard	**81,084**	129,452
Islamic repurchase agreements		
- Bai Al-Inah	**-**	59,783
	10,034,525	8,726,543

The maturity structure of term deposits is as follows:

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Due within six months	**4,897,455**	4,376,774
More than six months to one year	**1,239,371**	735,158
More than one year to three years	**110,069**	19,710
More than three years to five years	**29,435**	5,618
	6,276,330	5,137,260

(ii) By type of customer

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Government and statutory bodies	**5,623**	6,429
Business enterprises	**2,220,541**	2,026,165
Individuals	**5,411,494**	4,583,883
Others	**2,396,867**	2,110,066
	10,034,525	8,726,543

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

19 Deposits and Placements from Banks and Other Financial Institutions

	31 Dec 2017	31 Dec 2016
	RM'000	RM'000
Non-Mudharabah Fund		
Licensed banks	**2,441,124**	1,923,186
Bank Negara Malaysia	**26,557**	28,416
Other financial institutions	**894,258**	-
	3,361,939	1,951,602

Included in deposits and placements from banks and other financial institutions are placements from the Bank's parent company, HSBC Bank Malaysia Berhad, of RM2.4 billion (31 Dec 2016: RM1.9 billion).

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

20 Other Liabilities

	Note	**31 Dec 2017 RM'000**	31 Dec 2016 RM'000
At amortised cost			
Settlements		**2,945**	-
Amounts due to holding company		**169,489**	36,472
Profit payable			
- Structured products		**-**	4,182
- Others		**74,428**	61,262
Deferred income		**10,716**	11,286
Marginal deposit		**13,092**	22,761
Accrued expenses		**29,044**	26,235
Other creditors	(a)	**64,752**	53,528
		364,466	215,726
At fair value			
Structured products, at fair value			
- Wakalah with Commodity Wa'ad		**279,975**	969,409
		644,441	1,185,135

Structured products are measured at fair value over the life of the instruments. Structured products are deposits with embedded derivatives, of which both profit paid and fair valuation on the structured products are recorded in other operating income, as per accounting policy in Note 3(h), and respective fair value on trading liabilities is shown in Note 5(b) in the audited financial statements of the Bank for the financial year ended 31 December 2017.

(a) Other creditors and accruals

Included in other creditors and accruals is excess compensation balance and profit earned from inadvertent Shariah non-compliant activities. The contribution was distributed to the Non-Governmental Organisations approved by the Shariah Committee during the financial year. There had not been any case on Shariah non-compliant event during the financial year (2016: Nil).

Source and use of charity funds

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Source of charity funds		
Balance at 1 January	**4**	70
Shariah non-compliant income for the financial year [1]	**13**	114
Use of charity funds		
Contribution to non-profit organisations	**(16)**	(93)
Tax expense on Shariah non-compliant income	**-**	(87)
Balance at 31 December	**1**	4

[1] Income received from transactions via Nostro Accounts.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

21 Multi-Currency Sukuk Programme

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Multi-Currency Sukuk Programme (MCSP)	**1,252,829**	1,756,001

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

Issuance under MCSP	**Nominal Value RM'000**	**Issue Date**	**Maturity Date**	**Carrying Value 31 Dec 2017 RM'000**	Carrying Value 31 Dec 2016 RM'000
At amortised cost					
1st series at amortised cost	500,000	28 Sept 2012	28 Sept 2017	**-**	500,000
At fair value					
2nd series	500,000	16 Oct 2014	16 Oct 2019	**501,201**	502,835
3rd series	750,000	27 Mar 2015	27 Mar 2020	**751,628**	753,166
	1,250,000			**1,252,829**	1,256,001
	1,750,000			**1,252,829**	1,756,001

Movement in MCSP

	2nd series 31 Dec 2017 RM'000	2nd series 31 Dec 2016 RM'000	**3rd series 31 Dec 2017 RM'000**	3rd series 31 Dec 2016 RM'000
Balance at 1 January	**502,835**	500,641	**753,166**	749,182
Change in fair value other than from own credit risk	**(504)**	4,282	**64**	7,565
Change in fair value from own credit risk	**(1,130)**	(2,088)	**(1,602)**	(3,581)
Balance at 31 December	**501,201**	502,835	**751,628**	753,166

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
The cumulative change in fair value due to changes in own credit risk	**(2,732)**	(5,669)

22 Subordinated Commodity Murabahah Financing

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Subordinated Commodity Murabahah Financing, at amortised costs		
- First tranche issued on 25 June 2014	**314,714**	348,508
- Second tranche issued on 30 June 2015	**268,884**	297,757
	583,598	646,265

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)

23 Share Capital

	31 Dec 2017		31 Dec 2016	
	Number of Ordinary Shares ('000)	**RM'000**	Number of Ordinary Shares ('000)	RM'000
Authorised Share Capital				
Ordinary shares of RM0.50 each	**-**	**-**	600,000	300,000
Ordinary Shares Issued and Fully Paid				
At 1 January - ordinary shares of RM0.50 each	**100,000**	**50,000**	100,000	50,000
Transition to no par value regime on 31 January 2017 under the Companies Act 2016 (See Note 24[2])	**-**	**610,000**	-	-
At 31 December - ordinary shares with no par value (2016: par value of RM0.50 each)	**100,000**	**660,000**	100,000	50,000

24 Reserves

	31 Dec 2017 RM'000	31 Dec 2016 RM'000 (Restated)
Non-distributable		
Share premium [2]	**-**	610,000
Statutory reserve [1]	**-**	50,000
Available-for-sale reserve	**179**	(6,547)
Own credit reserve	**230**	(1,846)
Capital contribution reserve [3]	**408**	403
Regulatory reserves [4]	**34,000**	34,000
	34,817	686,010
Distributable		
Retained profits	**921,511**	785,141
	956,328	1,471,151

[1] The statutory reserve is maintained in compliance with Section 12 of the Islamic Financial Services Act 2013 and is not distributable as cash dividends. The Bank is no longer required to maintain this statutory reserves with effect from 3 May 2017 pursuant to BNM's guideline on Capital Funds.

[2] Prior to 31 January 2017, the application of the share premium account was governed by Sections 60, 61 and 67A of the Companies Act 1965. In accordance with the transitional provisions set out in Section 618 (2) of the new Companies Act 2016, on 31 January 2017 any amount standing to the credit of the share premium account has become part of the Bank's share capital.

[3] 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.

[4] The regulatory reserve is maintained in compliance with paragraph 13 of BNM's policy document on classification and impairment provisions and impairment for financing and subsequent circular issued in February 2014, to maintain, in aggregate, collective impairment allowance and regulatory reserve of no less than 1.2% of gross financing and advances, net of individual impairment allowance. The regulatory reserve is debited against retained profits.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

25 Income Derived from Investment of Depositors' Funds and Others

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Income derived from investment of:		
(i) general investment deposits	**448,502**	442,956
(ii) specific investment deposits	**51,602**	31,151
(iii) others	**211,447**	212,160
	711,551	686,267

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
(i) Income derived from investment of general investment deposits		
Finance income:		
Financing and advances		
- Profit earned other than recoveries from impaired financing	**364,310**	351,682
- Recoveries from impaired financing	**12,515**	10,407
Financial investments available-for-sale	**38,484**	31,211
Money at call and deposit with financial institutions	**22,783**	54,394
	438,092	447,694
Other operating income		
Realised gains from dealing in foreign currency	**16,837**	19,610
Unrealised losses from dealing in foreign currency	**(461)**	(3,569)
(Losses)/gains from sale of financial assets held-for-trading and other financial instruments	**(32)**	873
Unrealised gains from revaluation of financial assets held-for-trading	**45**	304
Net profit paid for financial assets held-for-trading and other financial instruments	**(11,675)**	(24,125)
Realised gains from trading in derivatives	**2,352**	2,809
Unrealised gains/(losses) from trading in derivatives	**3,074**	(382)
Other income/(expense)	**270**	(258)
	10,410	(4,738)
	448,502	442,956

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

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

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
(ii) Income derived from investment of specific investment deposits		
Finance income:		
Financing and advances		
- Profit earned other than recoveries from impaired financing	**50,757**	27,384
	50,757	27,384
Other operating income		
Fees and commission	**688**	1,013
Realised gains from dealing in foreign currency	**156**	2,787
Unrealised gains/(losses) from dealing in foreign currency	**1**	(33)
	845	3,767
	51,602	31,151
The above fees and commissions were derived from the following major contributors:		
Guarantee fees	**8**	357
Service charges and fees	**597**	554
(iii) Income derived from investment of others		
Finance income:		
Financing and advances		
- Profit earned other than recoveries from impaired financing	**171,755**	168,443
- Recoveries from impaired financing	**5,900**	4,985
Financial investments available-for-sale	**18,143**	14,949
Money at call and deposit with financial institutions	**10,741**	26,053
	206,539	214,430
Other operating income		
Realised gains from dealing in foreign currency	**7,938**	9,392
Unrealised losses from dealing in foreign currency	**(217)**	(1,709)
(Losses)/gains from sale of financial assets held-for-trading and other financial instruments	**(15)**	418
Unrealised gains from revaluation of financial assets held-for-trading	**21**	146
Net profit paid from financial assets held-for-trading and other financial instruments	**(5,504)**	(11,555)
Realised gains from trading in derivatives	**1,109**	1,345
Unrealised gains/(losses) from trading in derivatives	**1,449**	(183)
Other income/(expense)	**127**	(124)
	4,908	(2,270)
	211,447	212,160

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

26 Income Derived from Investment of Shareholder's Funds

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Finance income:		
Financing and advances		
- Profit earned other than recoveries from impaired financing	**62,241**	53,406
- Recoveries from impaired financing	**2,138**	1,580
Financial investments available-for-sale	**6,575**	4,740
Money at call and deposit with financial institutions	**3,893**	8,260
	74,847	67,986
Other operating income		
Fees and commission	**67,761**	55,290
Realised gains from dealing in foreign currency	**2,877**	2,978
Unrealised losses from dealing in foreign currency	**(79)**	(542)
(Losses)/gains from sale of financial assets held-for-trading and other financial instruments	**(6)**	133
Unrealised gains from revaluation of financial assets held-for-trading	**8**	46
Net profit paid from financial assets held-for-trading and other financial instruments	**(1,995)**	(3,664)
Realised gains from trading in derivatives	**402**	427
Unrealised gains/(losses) from trading in derivatives	**525**	(58)
Shared-service fees from holding company	**2,761**	3,023
Net gains on disposal of financial assets available-for-sale	**-**	6,853
Net (losses)/gains on financial instruments designated at fair value through profit or losses	**(761)**	4,187
Other income	**99**	70
	71,592	68,743
	146,439	136,729

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

Service charges and fees	**22,863**	19,470
Cards	**26,910**	24,178
Agency fees	**11,060**	7,242

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

27 Impairment Losses on Financing

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Impairment charges on financing:		
(a) Individual impairment		
- Made during the financial year	**57,300**	30,041
- Written back during the financial year	**(25,746)**	(18,115)
(b) Collective impairment		
- Made during the financial year	**207,831**	211,487
- Written back during the financial year	**(43,974)**	(58,264)
Impaired financing		
- Recovered during the year	**(33,966)**	(31,865)
- Written back during the financial year	**7,158**	3,581
	168,603	136,865

28 Income Attributable to Depositors

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Non-Mudharabah Fund		
- Deposits from customers	**191,425**	203,120
- Deposits and placements of banks and other financial institutions	**65,025**	58,862
- Others	**87,910**	89,166
	344,360	351,148

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

29 Operating Expenses

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Personnel expenses	**46,047**	41,047
Promotion and marketing related expenses	**10,996**	10,200
Establishment related expenses	**18,511**	19,006
General administrative expenses	**163,160**	163,106
	238,714	233,359
Personnel expenses		
Salaries, allowances and bonuses	**36,192**	32,483
Employees Provident Fund contributions	**6,285**	5,655
Share based payment	**107**	(589)
Other staff related costs	**3,463**	3,498
	46,047	41,047
Promotion and marketing related expenses	**10,996**	10,200
Establishment related expenses		
Depreciation of equipment	**4,015**	5,029
Information technology costs	**2,490**	2,669
Rental of premises	**7,631**	7,922
Equipment written off	**3**	-
Utilities	**2,080**	1,897
Others	**2,292**	1,489
	18,511	19,006
General administrative expenses		
Group recharges	**127,811**	132,606
Auditors' remuneration		
- Statutory audit fees	**126**	100
- Regulatory related fees	**158**	198
- Non-audit fees	**8**	8
Professional fees	**1,881**	1,748
Communication	**1,872**	1,230
Others	**31,304**	27,216
	163,160	163,106

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

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Fees	**411**	404
Dr. Ziyaad Mahomed	**85**	-
Assoc. Prof. Dr. Muhammad Yusuf Saleem Ghulam Nabi	**75**	81
Dr. Aida Othman	**61**	-
Khairul Anuar bin Ahmad	**75**	78
Prof. Dr. Younes Soualhi	**77**	91
Prof. Dr. Abdul Rahim Abdul Rahman [1]	**19**	77
Prof. Dr. Obiyathulla Ismath Bacha [1]	**19**	77

[1] Term ended on 31 March 2017

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

30 Income Tax Expense

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Malaysian income tax		
- Current year	**22,682**	21,850
- Prior year	**(1,728)**	(401)
Total current tax recognised in profit or loss	**20,954**	21,449
Deferred tax:		
Origination and reversal of temporary differences		
- Current year	**(1,021)**	(1,218)
Total income tax expense	**19,933**	20,231

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	**106,313**	101,624
Income tax using Malaysian tax rates	**25,515**	24,390
Non-deductible expenses	**2,846**	3,096
Tax exempt income	**(6,700)**	(6,854)
Over provision in respect of prior years	**(1,728)**	(401)
Tax expense	**19,933**	20,231

31 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)

32 Significant Related Party Transactions and Balances

For the purpose of these financial statements, parties are considered to be related to the Bank if:

a. the Bank has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial or operational decisions, or vice versa, or

b. where the Bank and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

The related parties of the Bank comprise:

i the Bank's immediate parent bank, holding bank, and ultimate holding company (hereinafter collectively referred to as parent);

ii subsidiary and associated companies of the Bank's parent companies; and

iii key management personnel who are defined as those person having authority for planning, directing and controlling the activities of the Bank. Key personnel include all members of the Board of Directors of HSBC Amanah Malaysia Berhad. and certain members of Senior Management of the Bank. Transactions, arrangements and agreement are entered into by the Bank with companies that may be controlled/jointly controlled by Key Management Personnel of the Bank and their close family members.

(a) The significant transactions and outstanding balances of the Bank with parent banks and other related companies are as follows:

	31 Dec 2017			31 Dec 2016		
	Parent	***Other related companies***	***Key management personnel***	*Parent*	*Other related companies*	*Key management personnel*
	RM'000	**RM'000**	**RM'000**	RM'000	RM'000	RM'000
Income						
Finance income from financing and advances	**-**	**-**	**10**	-	-	2
Fees and commission	**-**	**6,200**	**-**	-	5,621	-
Other income	**2,761**	**9**	**-**	3,023	5	-
	2,761	**6,209**	**10**	3,023	5,626	2
Expenditure						
Profit attributable to deposits and placements from banks and other financial institutions	**78,172**	**8,669**	**-**	73,542	3,025	-
Profit attributable to deposits from customers	**-**	**-**	**-**	-	-	4
Fees and commission	**-**	**446**	**-**	30	285	-
Operating expenses	**122,260**	**5,551**	**-**	128,375	4,231	-
	200,432	**14,666**	**-**	201,947	7,541	4
Amount due from						
Deposits and placements with banks and other financial institutions	**-**	**111,089**	**-**	-	79,553	-
Financing and advances	**-**	**-**	**124**	-	-	2,889
Derivative financial assets	**111,422**	**-**	**-**	18,806	4	-
Other assets	**988**	**926**	**-**	45,132	-	-
	112,410	**112,015**	**124**	63,938	79,557	2,889
Amount due to						
Deposits and placements from banks and other financial institutions	**3,024,695**	**944,364**	**-**	2,569,451	59,091	-
Deposits from customers	**-**	**-**	**100**	-	-	1,023
Derivative financial liabilities	**166,830**	**-**	**-**	477,434	2	-
Other liabilities	**183,269**	**3,253**	**-**	40,377	1,374	-
	3,374,794	**947,617**	**100**	3,087,262	60,467	1,023

All transactions between the Bank and its related parties are made in the ordinary course of business.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

32 Significant Related Party Transactions and Balances (Cont'd)

(b) Key Management Personnel Compensation

The key management personnel compensation are as follows:

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Directors of the Bank:		
- Fees	**513**	470
Total short-term employee benefits	**513**	470
Total Directors' Remuneration	**513**	470

During the financial years ended 31 December 2017 and 31 December 2016, 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.

Other key management personnel:		
- Short-term employee benefits	**1,513**	935
Total key management personnel compensation	**2,026**	1,405

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

32 Significant Related Party Transactions and Balances (Cont'd)

(b) Key Management Personnel Compensation (Cont'd)

i) Directors/CEO' Remuneration

2017

RM'000	Salaries and bonuses	Other short-term employee benefits	Benefits-in-kind	Fees	Total
Non-Independent Executive Director					
Louisa Cheang Wai Wan [1]	-	-	-	-	-
Mukhtar Malik Hussain	-	-	-	-	-
Independent Non-Executive Directors					
Adil Ahmad	-	-	-	**117**	**117**
Albert Quah Chei Jin	-	-	-	**118**	**118**
Azlan bin Abdullah [2]	-	-	-	**36**	**36**
Lee Choo Hock	-	-	-	**119**	**119**
Dr. Mohamed Ashraf bin Mohamed Iqbal [3]	-	-	-	**123**	**123**
	-	**-**	**-**	**513**	**513**
CEO					
Arsalaan Ahmed	**1,061**	**427**	**25**	**-**	**1,513**

[1] Re-Appointed and Re-Designated on 1 January 2017

[2] Retired 8 May 2017

[3] Re-Appointed and Re-Designated on 6 August 2017

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

32 Significant Related Party Transactions and Balances (Cont'd)

(b) Key Management Personnel Compensation (Cont'd)

i) Directors/CEO' Remuneration

2016

RM'000	Salaries and bonuses	Other short-term employee benefits	Benefits-in-kind	Fees	Total
Non-Independent Executive Director					
Louisa Cheang Wai Wan	-	-	-	-	-
Mukhtar Malik Hussain	-	-	-	-	-
Independent Non-Executive Directors					
Dr. Mohamed Ashraf bin Mohamed Iqbal	-	-	-	106	106
Adil Ahmad	-	-	-	98	98
Albert Quah Chei Jin [1]	-	-	-	38	38
Azlan bin Abdullah	-	-	-	101	101
Lee Choo Hock [2]	-	-	-	69	69
Mohamed Ross bin Mohd Din [4]	-	-	-	34	34
Seow Yoo Lin [3]	-	-	-	24	24
	-	-	-	470	470
CEO					
Arsalaan Ahmed [5]	205	106	4	-	315

[1] Appointed on 5 September 2016

[2] Appointed on 30 May 2016

[3] Resigned on 14 March 2016

[4] Retired on 13 April 2016

[5] Appointed on 17 October 2016

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

32 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 2017		31 Dec 2016	
	Unrestricted RM'000	**Deferred RM'000**	Unrestricted RM'000	Deferred RM'000
Fixed remuneration				
Cash	**1,151**	**-**	491	**-**
Variable remuneration				
Cash	**698**	**-**	160	**-**
Shares and share-linked instruments	**-**	**78**	**-**	**-**
	698	**78**	160	**-**
	1,849	**78**	651	**-**

Number of officers having received a variable remuneration during the financial year: 1 (2016: 2)

	31 Dec 2017		31 Dec 2016	
	Number	**Amount RM'000**	Number	Amount RM'000
Outstanding deferred remuneration				
Cash	**-**	**-**	-	-
Shares and share-linked instruments	**-**	**-**	-	-
		-		-
Deferred remuneration paid out	**-**	**-**	-	-

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

33 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 2017 RM'000	31 Dec 2016 RM'000
Aggregate value of outstanding credit exposures to connected parties	**945,354**	836,894
As a percentage of total credit exposures	**5.5%**	5.2%
Aggregate value of outstanding credit exposures to connected parties which is non-performing or in default	**-**	-
As a percentage of total credit exposures	**-**	-

34 Capital Adequacy

	31 Dec 2017 RM'000	31 Dec 2016 RM'000
Tier 1 capital		
Paid-up ordinary share capital	**660,000**	50,000
Share premium	**-**	610,000
Retained profits	**921,511**	783,296
Other reserves	**34,945**	75,789
Regulatory adjustments	**(47,023)**	(46,978)
Total Common Equity Tier 1 (CET1) and Tier 1 capital	**1,569,433**	1,472,107
Tier 2 capital		
Subordinated Commodity Murabahah financing	**583,598**	646,265
Collective impairment allowance (unimpaired portion) & regulatory reserves	**149,254**	135,261
Total Tier 2 capital	**732,852**	781,526
Capital base	**2,302,285**	2,253,633
Inclusive of proposed dividend		
CET1 and Tier 1 Capital ratio	**12.203%**	12.553%
Total Capital ratio	**17.902%**	19.218%
Net of proposed dividend		
CET 1 and Tier 1 Capital ratio	**12.125%**	12.553%
Total Capital ratio	**17.824%**	19.218%

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 2017 RM'000	31 Dec 2016 RM'000
Total RWA for credit risk	**11,940,340**	10,820,917
Total RWA for market risk	**9,450**	11,396
Total RWA for operational risk	**910,994**	894,490
	12,860,784	11,726,803

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

35 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 2017 RM'000**	31 Dec 2016 RM'000
Direct credit substitutes	**494,387**	535,818
Transaction-related contingent items	**996,770**	1,113,122
Short-term self-liquidating trade-related contingencies	**49,645**	111,027
Formal standby facilities and credit lines		
- Maturity not exceeding one year	**1,739,249**	3,685,008
- Maturity exceeding one year	**2,130,614**	2,041,247
Other unconditionally cancellable[1]	**2,233,191**	-
Unutilised credit card lines	**3,024,432**	2,251,942
Equity related contracts		
- Less than one year	**2,945**	765,236
- One year to less than five years	**85,394**	109,766
Profit rate related contracts		
- Less than one year	**344,703**	1,290,000
- One year to less than five years	**3,193,730**	5,149,618
- Over five years	**253,904**	-
Foreign exchange related contracts		
- Less than one year	**3,311,980**	2,592,079
- One year to less than five years	**2,640,794**	2,504,990
	20,501,738	22,149,853

[1] Related to the standalone trade facilities commitments which meets the unconditionally cancellable criteria within Capital Adequacy Framewok (Basel II) - Risk Weighted Assets guideline, which allows for 0% credit conversion factor (CCF). These were reclassified from "formal standby facilities and credit lines" effective 30 September 2017. The reclassification is applied prospectively.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

36 Collateral

In the normal course of business, the Bank sells assets to raise liabilities and accepts assets for resale. Assets sold and received are mainly via repurchase agreements and reverse repurchase agreements. Collateral is accepted and pledged on derivative contracts, mainly in the form of cash.

	31 Dec 2017	31 Dec 2016
	RM'000	RM'000
Carrying amount of assets pledged as collateral		
- Collateral pledged for repurchase agreements	**-**	59,783

37 Lease commitments

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

	31 Dec 2017	31 Dec 2016
	RM'000	RM'000
Less than one year	**5,291**	6,951
Between one and three years	**3,333**	2,736
Between three and five years	**16**	2
	8,640	9,689

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

38 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. *Savings-Related Share Option Schemes*

The Savings-Related Share Option Schemes aims to align the interests of all employees with the creation of shareholder value. under which eligible HSBC employees are granted options to acquire HSBC Holdings ordinary shares. Employees may make monthly contributions up to £250 (or its equivalent in RM) over a period of one, three or five years with the option to use the savings to acquire shares. Alternatively the employee may elect to have the savings repaid in cash. The last grant of options under this plan was in 2012. The options are exercisable within three months following the first anniversary of the commencement of a one-year savings contract or within six months following either the third or the fifth anniversary of the commencement of three-year or five-year savings contracts, respectively. The exercise price is set at a 20% discount to the market value immediately preceding the date of invitation. The cost of the awards is amortised over the vesting period.

	31 Dec 2017	31 Dec 2016
	RM'000	RM'000
Compensation cost recognised during the financial year	**-**	(13)

The weighted average remaining contractual life for the share options is nil for both 2017 and 2016, as no options outstanding at the end of the financial year ended 31 December 2017.

b. *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 2017	31 Dec 2016
	Number	Number
	('000)	('000)
Balance at 1 January	**6**	24
Granted in the financial year	**3**	3
Exercised in the financial year	**(1)**	-
Released in the financial year	**(2)**	-
Cancelled in the financial year	**(1)**	(21)
Transferred out in the financial year	**(1)**	-
Balance at 31 December	**4**	6
Compensation cost recognised during the financial year	**(107)**	(576)

The weighted average purchase price for all shares purchased by HSBC for awards under the Restricted Share Plan and the Share Match Schemes is £6.59 (2016: £4.89). The weighted average fair value of the HSBC share at 31 December 2017 was £5.84 (2016: £5.50). The weighted average remaining vesting period as at 31 December 2017 for shares granted during the year was 1.27 years (2016: 1.82 years).

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

39 Shariah Advisors

In line with Bank Negara Malaysia's Guideline on Shariah Governance Framework for Islamic Financial Institution, the following Shariah Scholars were appointed:

1) Dr. Ziyaad Mahomed
   Dr. Ziyaad Mahomed is currently an Assistant Professor at International Centre for Education of Islamic Finance (INCEIF). He holds a PhD in Islamic Finance from INCEIF, BA (Hons) Business (Finance) from Anglia Ruskin University, United Kingdom, and a Chartered Islamic Finance Professional (CIFP) holder from INCEIF. He is also an MBA and Certificate in Islamic Law holder from MANCOSA and University of Kwazulu Natal, South Africa, respectively.

2) Assoc. Prof. Dr. Muhammad Yusuf Saleem Ghulam Nabi
   Assoc. Prof. Dr. Muhammad Yusuf Saleem Ghulam Nabi is currently Associate Professor in International Centre for Education of Islamic Finance (INCEIF). He holds a Bachelor of Law (LLB), Master of Comparative Law and Doctor of Philosophy (Law) from IIUM.

3) Dr. Aida Othman
   Dr. Aida Othman is currently a Partner at Zaid Ibrahim & Co. She is also a Director with ZICO Shariah Advisory Services Sdn. Bhd. She holds a PhD in Comparative Law & Middle Eastern Studies from Harvard University, a Masters of Law from Cambridge University and a Bachelor of Laws and Bachelor of Islamic Law (Syariah) (both with First Class Honours), from IIUM.

4) Dr Mohamed Ashraf bin Mohamed Iqbal
   Dr. Mohamed Ashraf Mohamed Iqbal is currently a Director of MindSpring Sdn Bhd, a consulting firm that he started in 2005. In addition he has been a non-executive director for HSBC Amanah since 2008. 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 PhD in Islamic Finance from INCEIF in 2016.

5) Khairul Anuar bin Ahmad
   Khairul Anuar bin Ahmad is currently Lecturer in Selangor International Islamic University College. He holds a Bachelor and Master of Shariah from University of Malaya.

6) Prof. Dr. Younes Soualhi
   Prof. Dr. Younes Soualhi is currently a Senior Researcher in 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.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

40 Comparative Figures

Restatement of Comparative Figures

The presentation and classification of items in the financial statements are consistent with the previous financial year except those listed below. Comparatives for own credit reserve and retained profits were restated due to the early adoption of MFRS 9 relating to the presentation of gains and losses as financial liabilities designated at fair value through profit and loss. There was no significant impact to the financial performance and ratios in relation to the financial period ended 31 December 2017. The Bank's "Own Credit Reserves" and "Retained Profits" as at 1 January 2017 has been restated as follows:

	Statements for Changes in Equity	1 January 2017	
		RM'000	RM'000
		As restated	As previously
a)	**Own Credit Reserve**	(1,846)	-
b)	**Retained Profits**	785,141	783,295