

REGISTRATION DOCUMENT DATED 19 JUNE 2019



HSBC UK BANK PLC

(a company incorporated with limited liability in England with registered number 09928412)

This document (the "**Registration Document**") has been prepared for the purpose of providing disclosure information with regard to HSBC UK Bank plc (the "**Issuer**" or "**HSBC UK**") and has been approved by the United Kingdom Financial Conduct Authority ("**FCA**"), which is the competent authority in the United Kingdom for the purposes of Directive 2003/71/EC (as amended or superseded, the "**Prospectus Directive**") and relevant implementing measures in the United Kingdom, as a registration document issued in compliance with the Prospectus Directive and relevant implementing measures in the United Kingdom for the purpose of providing information with regard to the Issuer of debt or derivative securities during the period of twelve months after the date hereof.

This Registration Document includes details of the long-term and short-term credit ratings assigned to the Issuer by S&P Global Ratings Europe Limited ("**S&P**") and Fitch Ratings Limited ("**Fitch**"). Each of S&P and Fitch is established in the European Union and is registered as a Credit Rating Agency under Regulation (EU) No. 1060/2009, as amended (the "**CRA Regulation**"). As such, each of S&P and Fitch is included in the list of credit rating agencies published by the European Securities and Markets Authority on its website in accordance with the CRA Regulation.

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RISK FACTORS

All references in this section of this Registration Document to "**Issuer**" refer to HSBC UK Bank plc, all references to the "**Group**" refer to HSBC UK Bank plc and its subsidiary undertakings, and all references to the "**HSBC Group**" refer to HSBC Holdings plc ("**HSBC Holdings**") and its subsidiary undertakings.

Prospective investors in any debt or derivative securities ("**Securities**") issued by the Issuer should carefully consider risk factors associated with the business of the Issuer and the industry in which it operates together with all other information contained in this Registration Document, including, in particular, the risk factors referred to in this section, which the Issuer considers to be the principal risk factors relating to the Issuer that may affect the Issuer's ability to fulfil its obligations under its Securities. References to the Issuer in this section "Risk Factors" should be taken to mean the Issuer, together with its subsidiary undertakings, unless the context requires otherwise.

The risk factors relating to the Issuer specified in this section "Risk Factors" do not comprise an exhaustive list or explanation of all risks relating to the Issuer which investors may face when making an investment in Securities issued by the Issuer and should be used as guidance only. Additional risks and uncertainties relating to the Issuer that are not currently known to the Issuer, or that the Issuer currently deems immaterial, also may have, individually or cumulatively, a material adverse effect on the business, prospects, results of operations and/or financial position of the Issuer and, if any such risk should occur, the price of any Securities issued by the Issuer may decline and investors could lose all or part of their investment.

Risks Relating to the Issuer

A description of the risk factors relating to the Issuer that may affect the ability of the Issuer to fulfil its obligations to investors in relation to any of its Securities is set out below.

Macroeconomic and geopolitical risk

Current economic and market conditions may adversely affect the Issuer's results.

The Issuer's earnings are affected by global and local economic and market conditions.

In the UK, rising inflation led to the Monetary Policy Committee ("**MPC**") increasing the base rate by 0.25%, for only the second time in over a decade. UK economic data continues to be mixed with both positive and negative trends evidenced.

Uncertain and at times volatile economic conditions can create a challenging operating environment for banks such as the Issuer. In particular, the Issuer may face the following challenges to its operations and operating model in connection with these factors:

- retail sales growth in the UK continues to be subdued with increased reports of tightening discretionary spending;
- the demand for borrowing from creditworthy customers may diminish if economic activity slows or remains subdued;
- if interest rates rise further, consumers and businesses may struggle with the additional debt burden, which could lead to increased delinquencies and expected credit losses ("**ECLs**");
- the Issuer's ability to engage in funding transactions may be adversely affected by market disruption; and
- market developments may depress consumer and business confidence beyond expected levels. If economic growth is subdued, for example, asset prices and payment patterns may be adversely affected, leading to greater than expected increases in the Issuer's delinquencies, default rates and ECLs. However, if growth is too rapid, new asset valuation bubbles could appear, particularly in the real estate sector, with potentially negative consequences for financial institutions such as the Issuer.

The occurrence of any of these events or circumstances could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects and customers.

The UK's withdrawal from the European Union may adversely affect the Issuer's operating model and financial results.

The circumstances of the United Kingdom's ("UK") anticipated withdrawal from the European Union ("EU") will likely have a significant impact on general economic conditions in the UK and the EU. The UK's future relationship with the EU and its trading relationships with the rest of the world will likely take a number of years to resolve. This may result in a prolonged period of uncertainty, unstable economic conditions and market volatility, including currency fluctuations. See "*Current economic and market conditions may adversely affect the Issuer's results*".

The Issuer also expects the UK's withdrawal to have implications for the cross-border businesses of the Issuer and its customers, to the extent they rely on unrestricted access to the European financial services market. In addition, the UK's departure from the EU is likely to impact the Issuer's clients' operating models, including their supply chains, working capital requirements, investment decisions and financial markets access. The extent of these implications will depend on the outcome of negotiations. To ensure continuity of service, independent of the outcome of negotiations, the Issuer assumes a scenario whereby the UK exits the EU without the existing passporting or regulatory equivalence framework that supports cross-border business. This scenario would impact (i) the Issuer's surplus euro cash arrangements managed through the Issuer's Dublin branch, (ii) the Issuer's product offering, (iii) the Issuer's clients and (iv) the Issuer's employees.

The Issuer is taking steps to prepare for the UK leaving the EU in 2019. This process involves execution risks, many of them linked to the uncertain outcome of negotiations and potentially tight timelines to implement changes to the Issuer's UK and European operating models. If these risks materialise, some of the Issuer's clients and employees are likely to be affected. The exact impact on the Issuer's clients will depend on their individual circumstances and, in a worst-case scenario, could include disruption to the provision of products and services.

The Issuer is subject to political, social and other risks in the UK.

The Issuer's operations are subject to potentially unfavourable political, social, environmental and economic developments in the UK, which may include:

- acts of terrorism;
- political instability;
- social instability;
- currency fluctuations;
- climate change and acts of God, such as natural disasters and epidemics; and
- infrastructure issues, such as transportation or power failures.

These risk events may give rise to disruption to the Issuer's services and result in physical damage to its operations and/or risks to the safety of its personnel and customers.

Physical risks from natural disasters such as floods could also impact credit risk-weighted assets, while the financial losses caused by these events could impair asset values and the creditworthiness of customers.

These events may also have a detrimental impact on the Issuer's customers and any financial losses caused thereby could affect the creditworthiness of those customers.

Such developments may result in a material adverse effect on the Issuer's business, financial condition, results of operations, prospects and strategy.

Macro-prudential, regulatory and legal risks to the Issuer's business model.

UK banking structural reform legislation could materially adversely affect the Issuer, as well as the market value of the Issuer's Securities.

The ring-fencing of HSBC Bank plc's ("HBEU") UK retail banking activities was completed on 1 July 2018, six months in advance of the legal requirement coming into force, resulting in the transfer of

approximately 14.5 million qualifying UK Retail Banking and Wealth Management ("**RBWM**"), Commercial Banking ("**CMB**") and Global Private Banking ("**GPB**") customers from HBEU to the Issuer (including the transfer of relevant retail banking subsidiaries). The two banking entities operate alongside each other, supported by services received from HSBC Global Services (UK) Limited ("**UK ServCo**").

The Issuer is exposed to the following risks related to its structure and the applicable UK banking structural reform legislation:

- As a result of ring-fencing, customers were moved to the Issuer from HBEU and certain customers are required to deal with both HBEU and the Issuer to obtain the full range of products and services. The Issuer is unable to predict how some customers may still react to these and other required changes.
- In order to comply with the ongoing requirements of the UK ring-fencing regime, the Issuer must ensure that its operations and infrastructure comply with the requirements set out in the UK ring-fencing legislation and rules such as independence, prohibition of "excluded activities", no exposure to relevant financial institutions, shared services and resolvability amongst others, which may involve associated operational risk and may result in increased costs and higher risk of breach of rules and regulations. Arrangements between HBEU and the Issuer also need to meet these requirements and the requirement that all such transactions take place on an arm's length basis. The duplication of certain infrastructure or functions between HBEU and the Issuer that are required to comply with the UK ring-fencing legislation and rules and inefficiencies resulting therefrom have in turn resulted in additional costs and/or changes to the Issuer's business and operations.
- In order to comply with the ongoing requirements of the UK ring-fencing regime, separate segregated sections have been introduced into the Issuer's defined benefit pension plan for entities outside the ring-fence. The Issuer is subject to ongoing operational risks related to ensuring that all parties comply with the new processes and that no entities outside the ring-fence participate in the same section as HSBC UK.

Any of these factors or a combination of them could have a material adverse effect on the Issuer's business, its financial condition, results of operations and prospects, as well as on the market value of the Securities.

The Issuer is subject to unfavourable legislative or regulatory developments and changes in the policy of regulators or governments and the Issuer may fail to comply with all applicable regulations, particularly any changes thereto.

The Issuer's businesses are subject to ongoing regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies, voluntary codes of practice and interpretations in the UK and the EU. This is particularly the case given the current post-financial crisis regulatory and economic environment, where the Issuer expects government and regulatory intervention in the banking sector to remain high for the foreseeable future. Additionally, many of these changes have an effect beyond the country in which they are enacted, as regulators deliberately enact regulation with extra-territorial impact.

In recent years, regulators in the UK and the EU have focused on reforming both the prudential regulation of the financial services industry and the ways in which the business of financial services is conducted. Measures include enhanced capital, liquidity and funding requirements, the separation or prohibition of certain activities by banks, changes in the operation of capital markets activities, the introduction of tax levies and transaction taxes, changes in compensation practices and more detailed requirements on how business is conducted. Regulators in the UK or the EU may intervene further in relation to areas of industry risk already identified, or in new areas, which could adversely affect the Issuer.

Specific areas where regulatory changes could have a material effect on the Issuer's business, financial condition, results of operations, prospects, capital position, and reputation include, but are not limited to:

- regulatory initiatives in the UK focused on the ways in which banks operate, including the Competition and Markets Authority's directions on Open Banking ("**Open Banking**"), FCA's "Retail Distribution Review", "Mortgage Market Review" and proposed reforms to the way banks, including the Issuer, charge for overdrafts as part of its "High-Cost Credit Review" (which includes proposed simplification of pricing and ending higher prices for unarranged overdrafts; the FCA expects to publish a final decision on its proposed reforms in June 2019, with any rules coming into force by December 2019);

- general changes in government, central bank, regulatory or competition policy, or changes in regulatory regimes that may influence investor decisions. For example, the UK Financial Policy Committee ("**FPC**") has the ability to require UK banks to hold additional capital for lending to sectors perceived as higher risk and to increase the amount of capital that banks are required to hold when threats to financial stability are judged to be emerging;
- the potential for developments in, and the consequences for breaches of, the relatively recent and untested Financial Services (Banking Reform) Act 2013, which requires (amongst other matters) the legal separation of core deposits from wholesale and investment banking activities (commonly referred to as ring-fencing);
- requirements flowing from arrangements for the resolution strategy of the Group and its individual operating entities;
- the implementation of extra-territorial laws, including initiatives to share tax information such as the Common Reporting Standard introduced by the Organisation for Economic Co-operation and Development;
- the abolition of certain interbank offered rate ("**Ibor**") reference rates across the world and the transition to new replacement rates (as discussed further under "*The Issuer may not manage risks associated with the replacement of benchmark indices effectively*");
- the UK's anticipated withdrawal from the EU, and the transposition of existing EU financial services regulation into UK regulation;
- the treatment of 'third countries' under EU law (which may have an adverse impact on the UK in the absence of, or subject to the terms of, a withdrawal agreement between the UK and the EU);
- the implementation of: (i) Directive (EU) 2019/879 amending Directive (EU) 2014/59/EU which establishes a framework for the recovery and resolution of credit institutions ("**BRRD**"); (ii) Regulation (EU) 2019/876 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms and amending regulation (EU) No 648/2012 (as amended, supplemented or replaced from time to time, the "**CRR**"); and (iii) Directive (EU) 2019/878 amending Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms ("**CRD IV**") (all together, the "**Risk Reduction Measures**"). The Risk Reductions Measures implement various amendments to the EU prudential framework and the subsequent implementation of these changes in the UK. The Risk Reduction Measures are designed, among others, to implement the Financial Stability Board standards for Total Loss Absorbing Capacity, which in the EU is implemented through the "Minimum Requirements for own funds and Eligible Liabilities" ("**MREL**"), together with various agreed reforms to the Basel prudential framework (including the final leverage ratio and net stable funding ratio requirements included in the Basel Committee on Banking Supervision's ("**Basel Committee**") package of reforms to strengthen global capital and liquidity rules ("**Basel III**"), and substantial changes to the market risk framework). The Risk Reduction Measures also include a new requirement for global systemically important banks and certain other banking groups with two or more institutions in the EU, but whose ultimate parent is outside the EU, to establish an EU intermediate financial holding company, that would be subject to consolidated prudential supervision in the EU. The Risk Reduction Measures have been published in the Official Journal of the European Union on 7 June 2019 and will enter into force on 27 June 2019. With respect to the BRRD and CRD IV, EU member states are required to adopt national legislative measures necessary to comply with the relevant amendments by 28 December 2020. With respect to the CRR, the relevant amendments will apply from 28 June 2021, although certain measures, such as the revisions to MREL and disclosure requirements, will apply immediately from 27 June 2019. Moreover, discussions have started at EU level on the implementation of the remaining elements of the Basel III framework as endorsed by the Group of Central Bank Governors and Heads of Supervision in December 2017. These reforms would include, among others, a revised standardised approach for credit risk, revisions to the internal ratings-based approach for credit risk, revisions to the credit risk valuation adjustment framework, the adoption of an aggregate output floor and amendments to the leverage ratio. The additional reforms will be implemented in the EU through additional amendments to the CRR which are expected to be proposed in early 2020. However, the precise timeframe remains subject to further changes. It remains unclear, particularly in light of the UK's withdrawal from the EU, how these requirements will be implemented into UK law and, therefore, how they will affect the Issuer;

- the completion of the outstanding work by the Basel Committee in relation to the regulatory treatment of sovereign risk;
- the completion of the outstanding work by the Basel Committee in relation to the long-term regulatory treatment for International Financial Reporting Standard 9, Financial Instruments ("**IFRS 9**") provisions within the Basel prudential framework. See "*Changes in accounting standards may have a material impact on how the Issuer reports its financial results and financial condition*";
- the implementation of more stringent capital, liquidity and funding requirements, and adjustments in the use of models for measuring risk, particularly if capital requirements are increased;
- the increased focus by regulators and authorities on the operational resilience capabilities of the wider financial services sector;
- the financial effects of climate changes being incorporated within the global prudential framework, including the transition risks resulting from a shift to a low carbon economy;
- a continuing interest in financial services activities by competition authorities at the UK and European level when enforcing laws against anticompetitive practices (in the UK, the FCA and the Payment Systems Regulator are competition law enforcers). This is also being accompanied by a rise in private damages litigation relating to alleged competition law infringements. Currently, much of this is brought in the UK, for example, ongoing litigation by UK retailers regarding consumer credit and debit card interchange fee levels under the Visa and MasterCard schemes;
- restrictions on the structure of remuneration and increasing requirements to detail management accountability within the Group (e.g. the requirements of the Senior Managers and Certification Regime in the UK);
- the focus globally on data (including on data processing and subject rights/transfer of information), financial technology risks, operational resilience, crypto assets and cybersecurity and the introduction of new and/or enhanced standards in this area (as discussed further under "*The Issuer remains susceptible to a wide range of cyber risks that impact and/or are facilitated by technology*", "*The Issuer's operations are highly dependent on the HSBC Group's information technology systems*" and "*The Issuer's data management policies and processes may not be sufficiently robust*");
- external bodies applying or interpreting standards or laws differently to the Issuer;
- further requirements relating to financial reporting, corporate governance and employee compensation; and
- the application and enforcement of anti-money laundering investigations and sanctions and economic sanctions, including those with extra-territorial effect.

The Issuer may not manage risks associated with the replacement of benchmark indices effectively.

The expected discontinuation of certain key Ibors such as the London Interbank Offered Rate ("**Libor**"), and the adoption of alternative risk-free benchmark rates ("**RFRs**") by the market, introduces a number of risks for the Issuer, its clients, and the financial services industry more widely. These include, but are not limited to:

- Legal risks, as changes to documentation for new and existing transactions may be required;
- Financial risks, arising from any changes in the valuation of financial instruments linked to RFRs;
- Pricing risks, as changes to RFRs could impact pricing mechanisms on some instruments;
- Operational risks, due to the potential need to adapt IT systems, trade reporting infrastructure, operational processes and controls to accommodate one or more RFRs; and
- Conduct risks, through potentially material adverse impacts on customers or financial markets.

The benchmark specifications, together with the timetable and mechanisms for discontinuation of existing Ibors and implementation of RFRs, have not yet been agreed across the industry and regulatory authorities. Accordingly, it is not currently possible to determine whether, or to what extent, any such changes would affect the Issuer. However, the discontinuation of existing Ibors and implementation of RFRs could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects and customers.

The Issuer may fail to meet the requirements of regulatory stress tests.

The Issuer is subject to regulatory stress testing, which is described under "*Report of the Directors – Risk Management – Our risk management framework – Stress testing*" on page 19 of the Issuer's Annual Report and Accounts 2018 (the "**2018 Annual Report and Accounts**") (a copy of which forms part of this Registration Document). These exercises are designed to assess the resilience of banks to potential adverse economic or financial developments and ensure that they have robust, forward-looking capital planning processes that account for the risks associated with their business profile. Assessment by regulators is on both a quantitative and qualitative basis, the latter focusing on the Issuer's data provision, stress testing capability and internal management processes and controls.

Failure to meet quantitative or qualitative requirements of regulatory stress test programmes, or the failure by regulators to approve the Issuer's stress test results and capital plans, could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects, capital position and reputation.

The Securities and the Issuer will be subject to certain bank resolution powers under the Banking Act.

The BRRD provides an EU-wide framework for the recovery and resolution of credit institutions and their parent companies and other group companies. The BRRD is designed to provide relevant authorities with a set of tools to intervene sufficiently early and quickly in an unsound or failing institution so as to ensure the continuity of the institution's critical financial and economic functions, while minimising the impact of an institution's failure on the economy and financial system. In the UK the Banking Act 2009, as amended from time to time ("**Banking Act**"), implements the provisions of the BRRD.

Statutory intervention powers

The Issuer is subject to the Banking Act, which gives wide powers in respect of UK banks and their parent and other group companies to HM Treasury, the Bank of England ("**BoE**"), the Prudential Regulation Authority ("**PRA**") and/or the FCA (each a "**relevant UKRA**") in circumstances where a UK bank has encountered or is likely to encounter financial difficulties. These powers include powers to: (a) transfer all or some of the securities issued by a UK bank or its parent, or all or some of the property, rights and liabilities of a UK bank or its parent (which would include Securities issued by the Issuer), to a commercial purchaser or, in the case of securities, to HM Treasury or an HM Treasury nominee, or, in the case of property, rights or liabilities, to an entity owned by the BoE; (b) override any default provisions, contracts, or other agreements, including provisions that would otherwise allow a party to terminate a contract or accelerate the payment of an obligation; (c) commence certain insolvency procedures in relation to a UK bank; and (d) override, vary or impose contractual obligations, for reasonable consideration, between a UK bank or its parent and its group undertakings (including undertakings which have ceased to be members of the group), in order to enable any transferee or successor bank of the UK bank to operate effectively. The Banking Act also gives power to HM Treasury to make further amendments to the law for the purpose of enabling it to use the special resolution regime powers effectively, potentially with retrospective effect.

Write-down and conversion of capital instruments powers and/or bail-in powers

The powers granted to the relevant UKRA under the Banking Act also include powers to vary or extinguish the claims of certain creditors. In the case of the BoE, these powers include a "write-down and conversion of capital instruments" power and a "bail-in" power.

The write-down and conversion of capital instruments power may be used where the relevant UKRA has determined that the institution concerned has reached the point of non-viability, but that no bail-in of instruments other than capital instruments is required (however the use of the write-down power does not preclude a subsequent use of the bail-in power) or where the conditions to resolution are met. Any write-down effected using this power must reflect the insolvency priority of the written-down claims (and, therefore, common equity must be written off in full before subordinated debt is affected). Where the write-down and conversion of capital instruments power is used, the write-down is permanent and investors receive no compensation (save that common equity tier 1 ("**CET1**") instruments may be required to be

issued to holders of written-down instruments). The write-down and conversion of capital instruments power is not subject to the "no creditor worse off" safeguard.

The bail-in power gives the relevant UKRA the power to cancel all or a portion of the principal amount of, or interest on, certain unsecured liabilities (which could include the Securities) of a failing financial institution or its holding company, to convert certain debt claims (which could be amounts payable under the Securities) into another security, including ordinary shares of the surviving entity, if any and/or to amend or alter the terms of such claims, including the maturity of the Securities or amendment of the amount of interest payable on the Securities, or the date on which interest becomes payable, including by suspending payment for a temporary period. The Banking Act requires the relevant UKRA to apply the bail-in power in accordance with a specified preference order which differs from the ordinary insolvency order. In particular, the relevant UKRA must write-down or convert debts in the following order: (i) additional tier 1, (ii) tier 2, (iii) other subordinated claims and (iv) eligible senior claims. The claims of some creditors whose claims would rank equally with those of the Securityholders may be excluded from bail-in. The more of such creditors there are, the greater will be the impact of bail-in on the Securityholders.

Although the exercise of bail-in power under the Banking Act is subject to certain pre-conditions, there remains uncertainty regarding the specific factors (including, but not limited to, factors outside the control of the Issuer or not directly related to the Issuer) which the relevant UKRA would consider in deciding whether to exercise such power with respect to the Issuer and its securities (including the Securities). Moreover, as the relevant UKRA may have considerable discretion in relation to how and when it may exercise such power, holders of the Issuer's securities (including the Securities) may not be able to refer to publicly available criteria in order to anticipate a potential exercise of such power and consequently its potential effect on the Issuer and its securities, including the Securities.

Powers to direct the restructuring of the Group

As well as a write-down and conversion of capital instruments power and a bail-in power, the powers of the relevant UKRA under the Banking Act include the power to (i) direct the sale of the relevant financial institution or the whole or part of its business on commercial terms without requiring the consent of the shareholders or complying with the procedural requirements that would otherwise apply, (ii) transfer all or part of the business of the relevant financial institution to a "bridge institution" (an entity created for such purpose that is wholly or partially in public control) and (iii) separate assets by transferring impaired or problem assets to one or more publicly owned asset management vehicles to allow them to be managed with a view to maximising their value through eventual sale or orderly wind-down (this can be used together with another resolution tool only). In addition, the Banking Act gives the relevant UKRA power to amend the maturity date and/or any interest payment date of debt instruments or other eligible liabilities of the relevant financial institution and/or impose a temporary suspension of payments and/or discontinuing the listing and admission to trading of debt instruments.

The exercise by the relevant UKRA of any of the above powers under the Banking Act may limit the Issuer's capacity to meet its repayment obligations under the Securities and the exercise of any such powers (including especially the bail-in power) could lead to the holders of the Securities losing some or all of their investment.

Moreover, trading behaviour in relation to the securities of the Issuer (including the Securities), including market prices and volatility, may be affected by the use of, or any suggestion of the use of, these powers and accordingly, in such circumstances, the Securities are not necessarily expected to follow the trading behaviour associated with other types of securities. There can be no assurance that the taking of any actions under the Banking Act by the relevant UKRA or the manner in which its powers under the Banking Act are exercised will not materially adversely affect the rights of holders of the Securities, the market value of an investment in the Securities and/or the Issuer's ability to satisfy its obligations under the Securities.

Although the BRRD also makes provision for public financial support to be provided to an institution in resolution subject to certain conditions, it provides that the financial public support should only be used as a last resort after the relevant UKRA has assessed and exploited, to the maximum extent practicable, all the resolution tools, including the bail-in power. Accordingly, it is unlikely that investors in the Securities will benefit from such support even if it were provided.

The Issuer is subject to the risk of current and future legal, regulatory or administrative actions and investigations, the outcomes of which are inherently difficult to predict.

The Issuer faces significant legal and regulatory risks in its business. The volume and amount of damages claimed in litigation, regulatory proceedings, investigations, administrative actions and other adversarial proceedings against financial institutions are increasing for many reasons, including a substantial increase in the number of regulatory changes taking place globally, increased media attention and higher expectations from regulators and the public. In addition, criminal prosecutions of financial institutions for, among other things, alleged conduct breaches, breaches of anti-money laundering ("AML"), anti-bribery/corruption, sanctions and counter-terrorist financing regulations, antitrust violations, market manipulation, and aiding and abetting tax evasion, have become more commonplace and may increase in frequency due to increased media attention and higher expectations from prosecutors and the public. Any such legal, regulatory or administrative action or investigation against the Issuer or one or more of its subsidiaries could result in, among other things, substantial fines, civil penalties, criminal penalties, cease and desist orders, forfeitures, the suspension or revocation of key licences, requirements to exit certain businesses, other disciplinary actions and/or withdrawal of funding from depositors and other stakeholders. Additionally, the Issuer's financial statements reflect provisioning for legal proceedings and regulatory matters. Provisions for legal proceedings and regulatory matters typically require a higher degree of judgement than other types of provisions, and the actual costs of any disciplinary action discussed above may exceed existing provisioning. Any threatened or actual litigation, regulatory proceeding, administrative action, investigation or other adversarial proceeding against the Issuer or one or more of its subsidiaries could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects and reputation.

The Issuer and its affiliates continue to be subject to a number of material legal proceedings, regulatory actions and investigations including, for example in relation to the HSBC Group's historical foreign exchange sales and trading activities, which concluded with the entry by HSBC Holdings into a deferred prosecution agreement with the Criminal Division of the U.S. Department of Justice (the "FX DPA") (see Note 27 ("*Legal proceedings and regulatory matters*") on pages 102 to 103 of the 2018 Annual Report and Accounts for further details). It is inherently difficult to predict the outcome of many of the legal, regulatory and other adversarial proceedings involving the Issuer's businesses, particularly those cases in which the matters are brought on behalf of various classes of claimants, seek damages of unspecified or indeterminate amounts or involve novel legal claims. Additionally, potential consequences of breaching the FX DPA could include the imposition of additional terms and conditions on the Issuer, an extension of the agreement or the criminal prosecution of members of the HSBC Group, which could, in turn, entail further financial penalties and collateral consequences. Moreover, the Issuer may face additional legal proceedings, investigations or regulatory actions in the future, including in other jurisdictions and/or with respect to matters similar to, or broader than, the existing legal proceedings, investigations or regulatory actions. An unfavourable result in one or more of these proceedings could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects and reputation.

The Issuer is subject to tax-related risks.

The Issuer is subject to the substance and interpretation of UK tax laws and is subject to routine review and audit by tax authorities in relation thereto. The Issuer's interpretation or application of these tax laws may differ from those of the relevant tax authorities, and the Issuer provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities. The amounts ultimately paid may differ materially from the amounts provided depending on the ultimate resolution of such matters. In general, changes to tax laws and tax rates, including as a result of policy changes by governments and/or regulators, and penalties for failing to comply, could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects, capital position and reputation.

The Issuer may be subject to increased regulation regarding culture and accountability.

Financial institutions remain under considerable scrutiny by regulators, international bodies, organisations and unions regarding conduct of business, particularly in relation to fair outcomes for customers, including those who are or who could be identified as vulnerable, promoting effective competition in the interest of customers, driving higher standards of both personal and corporate conduct and ensuring the orderly and transparent operation of global financial markets. As a result, the Issuer and its personnel may be subject to increased regulation in connection with institutional culture, employee behaviour and whistleblowing, including measures arising from ongoing thematic reviews into the workings of the SME and wholesale banking sectors and the provision of financial advice to consumers (particularly the FCA's Senior Managers

and Certification Regime and the continued focus in the UK on the progress being made in implementing wider recommendations made by the Parliamentary Commission on Banking Standards).

Regulators, prosecutors, the media and the public all have heightened expectations as to the behaviour and conduct of financial institutions, and any shortcomings or failure to demonstrate adequate controls are in place to mitigate such risks, particularly risks associated with the mis-selling of financial products (such as payment protection insurance policies) or the mis-handling of customer complaints, could result in regulatory sanctions, fines or an increase in civil litigation, and could have a material adverse effect on the Issuer's business, financial condition, results of operations and reputation.

Risks related to the Issuer's business, operations, governance and internal control systems

The Issuer's operations are highly dependent on the HSBC Group's information technology systems.

The reliability and security of the HSBC Group's information and technology infrastructure, and customer databases are crucial to maintaining the service availability of banking applications and processes and to protecting the HSBC brand. The proper functioning of the HSBC Group's payment systems, financial control, risk management, credit analysis and reporting, accounting, customer service and other information technology systems, as well as the communication networks between the Issuer's branches and main data processing centres, are critical to the Issuer's operations.

Critical system failure, any prolonged loss of service availability or any material breach of data security, particularly involving confidential customer data, could cause serious damage to the Issuer's ability to service its clients, could breach regulations under which it operates and could cause long-term damage to its business and brand that could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects and reputation.

The Issuer remains susceptible to a wide range of cyber risks that impact and/or are facilitated by technology.

The threat from cyber-attacks remains a concern for the Issuer's organisation, and failure to protect the Issuer's operations from internet crime or cyber-attacks may result in financial loss, business disruption and/or loss of customer services and data or other sensitive information that could undermine its reputation and its ability to attract and keep customers.

Destructive malware (including ransomware), distributed denial of service ("**DDOS**") attacks and organised cyber criminals targeting payments are increasingly dominant threats across the industry. In 2018, the HSBC Group was subjected to a small number of DDOS attacks on its external facing websites that were successfully mitigated across the HSBC Group with no destructive malware (including ransomware) or payment infrastructure attacks reported. Although cyber-attacks in 2018 had a negligible effect on the Issuer's customers, services or firm, due to the increasing sophistication of cyber-attacks there is the potential for future attacks to have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects and reputation.

The Issuer's data management policies and processes may not be sufficiently robust.

Critical business processes across the Group rely on large volumes of data from a number of different systems and sources. If data governance (including data retention and deletion, data quality and data architecture policies and procedures) is not sufficiently robust, manual intervention, adjustments and reconciliations may be required to reduce the risk of error in the Group's external reports or in reporting to senior management or regulators. Inadequate policies and processes may also affect the Issuer's ability to use data within the Group to service customers more effectively and/or improve the Issuer's product offering. Moreover, financial institutions that fail to comply with in-country (local) and global regulatory and compliance requirements may face supervisory measures. In addition, failure to comply with emerging and recently implemented laws and regulations concerning data privacy and localisation in a number of jurisdictions across the globe may result in regulatory sanctions. Any of these failures could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects and reputation.

The Issuer could incur losses or be required to hold additional capital as a result of model limitations or failure.

The Issuer uses models for a range of purposes in managing its business, including regulatory capital calculations, stress testing, credit approvals, calculation of ECLs on an IFRS 9 basis, financial crime and fraud risk management and financial reporting. The Issuer could face adverse consequences as a result of

decisions that may lead to actions by management, based on models that are poorly developed, implemented or used, or as a result of the modelled outcome being misunderstood or the use of such information for purposes for which it was not designed.

Regulatory scrutiny and supervisory concerns over banks' use of models is considerable, particularly the internal models and assumptions used by banks in the calculation of regulatory capital. If regulatory approval for key capital models is not achieved in a timely manner or if those models are subject to review and challenge, the Issuer could be required to hold additional capital.

Evolving regulatory requirements have resulted in changes to the Issuer's approach to model risk management, which poses execution challenges. The adoption of more sophisticated modelling approaches and technology by both the Issuer and the financial services industry could also lead to increased model risk.

Risks arising from use of models, including reputational, could have a material adverse effect on the Issuer's business, financial condition, results of operations and prospects.

The Issuer's operations utilise third-party suppliers and service providers.

The Issuer relies on third parties to supply goods and services. The use of third-party service providers by financial institutions is of particular focus to global regulators, including with respect to how outsourcing decisions are made and how key relationships are managed. The inadequate management of third-party risk could impact the Issuer's ability to meet strategic, regulatory and client expectations. This may lead to a range of effects, including regulatory censure, civil penalties or damage to the Issuer's reputation, which could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects and strategy.

The Issuer relies on recruiting, retaining and developing appropriate senior management and skilled personnel.

The demands being placed on the human capital of the Issuer are unprecedented. The cumulative workload arising from a regulatory reform programme that is often extra-territorial and regularly evolving consumes significant human resources, placing increasingly complex and conflicting demands on a workforce that operates in an employment market where expertise in key markets is often in short supply and mobile.

The Issuer's continued success depends in part on the retention of key members of its management team and wider employee base. The ability to continue to attract, train, motivate and retain highly qualified professionals is a key element of the Issuer's strategy. The successful implementation of the Issuer's growth strategy depends on the availability of skilled management in each of its business units, which may depend on factors beyond the Issuer's control, including economic, market and regulatory conditions.

If one of the Issuer's business units fails to staff its operations appropriately or loses one or more of its key senior executives and fails to successfully replace them in a satisfactory and timely manner, or fails to implement successfully the organisational changes required to support the Issuer's business, this could place the Issuer at a significant competitive disadvantage and prevent it from successfully implementing its strategy, which could have a material adverse effect on the Issuer's financial condition, results of operations and prospects, including control and operational risks.

The Issuer may suffer losses due to employee misconduct.

The Issuer's businesses are exposed to risk from potential non-compliance with the HSBC Group's policies and related behaviours and employee misconduct such as fraud or negligence, all of which could result in regulatory sanctions and/or reputational or financial harm. In recent years, a number of multinational financial institutions have suffered material losses due to the actions of 'rogue traders' or other employees. It is not always possible to deter employee misconduct, and the precautions the Issuer takes to prevent and detect this activity may not always be effective. Employee misconduct or regulatory sanctions if a regulator deems the Issuer's actions to deter such activity to be insufficient could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects and reputation.

The Issuer may not achieve any of the expected benefits of its strategic initiatives and the delivery of the Issuer's strategic actions is subject to execution risk.

The Issuer's strategy is built around four strategic priorities – customer experience, people engagement, profitable growth and simplification. The development and implementation of the Issuer's strategy requires

difficult, subjective and complex judgements, including forecasts of customer needs and economic conditions in the UK, as well as development and deployment of modernised platforms, architecture and products. The Issuer may fail to correctly identify the trends it seeks to exploit and the relevant factors in making decisions as to deployment of resources.

The Issuer's ability to execute its strategy may be limited by its operational capacity and the increasing complexity of the regulatory environment in which the Issuer operates. Effective management of transformation projects is required to effectively deliver the Issuer's strategic priorities, involving delivering both on externally driven programmes (e.g. regulatory), as well as key business initiatives. Additionally, the cumulative impact of the collective change initiatives underway within the HSBC Group is significant and has direct implications on resourcing. See *"The Issuer relies on recruiting, retaining and developing appropriate senior management and skilled personnel."* The magnitude, complexity and, at times, concurrent demands of the projects required to meet these can result in heightened execution risk.

In addition, factors beyond the Issuer's control, including but not limited to economic and market conditions, could limit the Issuer's ability to achieve any of the expected benefits of these strategic initiatives. The global economic outlook is more uncertain, particularly with regard to UK economic risks, global trade tensions and revised interest rate expectations. There remains a risk that, in the absence of an improvement in economic conditions, the Issuer's cost and investment actions may not be sufficient to achieve the expected benefits.

Key to achieving the Issuer's profitable growth strategy is increasing its assets and deposit market share. Furthermore, the Issuer will focus on driving synergies across the HSBC Group's global businesses to grow revenue and earnings. There are key opportunities to drive business synergies across the RBWM, CMB and GPB businesses. However, these are business areas where many competitors of the HSBC Group also focus, which may limit the Issuer's ability to increase its market share or influence its ability to sell its products at lower prices, thereby reducing its net interest income and revenue. Additionally, as part of the ring-fencing exercise in 2018, the GB&M business was generally retained by HBEU and the Issuer is only able to offer selected GB&M products to its customer base within specific parameters, which could limit the Issuer's broader synergy opportunities and ability to grow revenue and earnings.

Failure to achieve any of the expected benefits of the Issuer's strategic initiatives could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects and reputation.

The Issuer operates in markets that are highly competitive.

The Issuer competes with other financial institutions in a highly competitive industry that continues to undergo significant change as a result of financial regulatory reform, including the EU's Second Payment Services Directive (PSD2) and Open Banking in the UK, as well as increased public scrutiny stemming from the financial crisis and continued challenging economic conditions.

The Issuer targets clients based on their outlook and attitudes towards financial health. The Issuer generally competes on the basis of the quality of its customer service, the wide variety of products and services that the Issuer can offer its customers, the ability of those products and services to satisfy its customers' needs, the extensive distribution channels available for its customers, its innovation and its reputation. Continued and increased competition in any one or all of these areas may negatively affect its market share and/or cause the Issuer to increase its capital investment in its businesses in order to remain competitive. Additionally, the Issuer's products and services may not be accepted by its targeted clients.

In many markets, there is increased competitive pressure to provide products and services at current or lower prices. Consequently, the Issuer's ability to reposition or reprice its products and services from time to time may be limited, and could be influenced significantly by the actions of its competitors who may or may not charge similar fees for their products and services. Any changes in the types of products and services that the Issuer offers its customers, and/or the pricing for those products and services, could result in a loss of customers and market share.

Further, new entrants to the market or new technologies could require the Issuer to spend more to modify or adapt its products to attract and retain customers. The Issuer may not respond effectively to these competitive threats from existing and new competitors, and may be forced to increase its investment in its business to modify or adapt its existing products and services or develop new products and services to respond to its customers' needs.

Any of these factors could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects and reputation.

Concentration of credit and market risk could increase the Issuer's potential for losses.

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or are engaged in similar activities, or operate in the same geographical areas/industry sectors, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. The Issuer has exposure to concentration risk where its business activities focus particularly on a single obligor or a similar type of customer, product, industrial sector or geographic location.

In particular, the Issuer has significant exposure to UK residential mortgages and retail banking. The Issuer's UK mortgage and retail banking portfolios are strongly linked to the UK economy, and any deterioration in the UK's economic environment could materially and adversely affect the credit quality of such portfolios. See "*Current economic and market conditions may adversely affect the Issuer's results*" and "*The UK's withdrawal from the European Union may adversely affect the Issuer's operating model and financial results.*" Additionally, any decreases in property values may also reduce the collateral values against the mortgage portfolios, which could negatively impact recovery values in default situations and lead to higher impairment charges.

The Issuer's efforts to diversify or manage its credit portfolio against concentration risks may not be successful and any concentration of credit risk could increase the potential for significant losses in its credit portfolio. Any of these factors could have a material adverse effect on the Issuer's business, financial condition, results of operations and prospects.

The Issuer's risk management measures may not be successful.

The management of risk is an integral part of all the Issuer's activities. Risk constitutes the Issuer's exposure to uncertainty and the consequent variability of return. Specifically, risk equates to the adverse effect on profitability or financial condition arising from different sources of uncertainty, including wholesale credit risk, market risk, non-traded market risk, operational risk, concentration risk, liquidity and funding risk, litigation risk, conduct risk, reputational risk, strategic risk, pension risk and regulatory risk.

While the Issuer employs a broad and diversified set of risk monitoring and mitigation techniques, such methods and the judgements that accompany their application cannot anticipate every unfavourable event or the specifics and timing of every outcome. Failure to manage risks appropriately or regulatory sanctions if a regulator deems the Issuer's risk management measures to be insufficient, could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects, strategy and reputation.

Operational risks are inherent in the Issuer's business, including the risk of fraudulent activity.

The Issuer is exposed to many types of operational risk that are inherent in banking operations, including fraudulent and other criminal activities (both internal and external), breakdowns in processes or procedures and systems failure or non-availability. These risks are also present when the Issuer relies on outside suppliers or vendors to provide services to the Issuer and its customers.

In particular, fraudsters may target any of the Issuer's products, services and delivery channels, including lending, internet banking, payments, bank accounts and cards. This may result in financial loss to the Issuer and/or its customers, an adverse customer experience, reputational damage and potential litigation, regulatory proceeding, administrative action or other adversarial proceeding in any jurisdiction in which the Issuer operates, depending on the circumstances of the event. The cost to the Issuer resulting from adoption of the Authorised Push Payment (APP) Scams Steering Group's recently released Code of good practice to protect bank customers from APP scams is still unknown but could be significant.

These operational risks could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects, strategy and reputation. Notwithstanding anything in this risk factor, this risk factor should not be taken as implying that the Issuer will necessarily be unable to comply with its obligations as a company with securities to be admitted to the Official List or as a supervised firm regulated by the FCA and the PRA.

The Issuer's operations have inherent reputational risk.

Reputational risk is the risk of failing to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by the Issuer or a member of the HSBC Group, the Issuer's employees or those with whom the Issuer is associated. Any material lapse in standards of integrity, compliance, customer service or operating efficiency may represent a potential reputational risk. Stakeholder expectations constantly evolve, and so reputational risk is dynamic and varies between regions, groups and individuals.

Modern technologies, in particular online social media channels and other broadcast tools that facilitate communication with large audiences in short time frames and with minimal costs, may significantly enhance and accelerate the distribution and effect of damaging information and allegations. Reputational risk could also arise from negative public opinion about the actual, or perceived, manner in which the Issuer conducts its business activities, or the Issuer's financial performance, as well as actual or perceived practices in banking and the financial services industry generally. Negative public opinion may adversely affect the Issuer's ability to retain and attract customers, in particular, depositors, and to retain and motivate staff, and could have a material adverse effect on the Issuer's business, financial condition, results of operations, and prospects.

The Issuer's financial statements are based in part on judgements, estimates and assumptions that are subject to uncertainty.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, particularly those involving the use of complex models, actual results reported in future periods may be based upon amounts that differ from those estimates. Estimates, judgements, assumptions and models are continually evaluated, and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The accounting policies deemed critical to the Issuer's results and financial position, based upon materiality and significant judgements and estimates, include interest income (effective interest rate), hedge accounting, impairment of loans and advances and provisions, which constitute "Critical accounting estimates and judgements" with respect to the Issuer's financial statements.

If the judgements, estimates and assumptions the Issuer uses in preparing its consolidated financial statements are subsequently found to be materially different from those assumed using information available at the reporting date, it could have a material adverse effect on the Issuer's business, financial condition, results of operations and prospects.

Changes in accounting standards may have a material impact on how the Issuer reports its financial results and financial condition.

The Issuer prepares its consolidated financial statements in accordance with International Financial Reporting Standards ("IFRSs") as issued by the International Accounting Standards Board ("IASB"), including interpretations issued by the IFRS Interpretations Committee, and as endorsed by the EU. From time to time, the IASB or the IFRS Interpretations Committee may issue new accounting standards or interpretations that could materially impact how the Issuer reports and discloses its financial results and financial condition as well as affect the calculation of the Issuer's capital ratios, including the CET1 ratio. The Issuer could also be required to apply new or revised standards retrospectively, resulting in the Issuer's restating prior period financial statements in material amounts.

Third parties may use the Issuer as a conduit for illegal activities without the Issuer's knowledge.

The Issuer is required to comply with applicable AML laws and regulations, and has adopted various policies and procedures, including internal control and 'know your customer' procedures, aimed at preventing use of its products and services for the purpose of committing or concealing financial crime. A major focus of U.S. and UK government policy relating to financial institutions in recent years has been combating money laundering and enforcing compliance with U.S. and EU economic sanctions. This focus is reflected in part by agreements between members of the HSBC Group and U.S. and UK authorities relating to various investigations regarding past inadequate compliance with AML and sanctions laws. These consent orders do not preclude additional enforcement actions by bank regulatory, governmental or law enforcement agencies or private litigation.

A number of remedial actions have been taken as a result of the matters related to HSBC Holdings' expired U.S. deferred prosecution agreement with the U.S. Department of Justice, which are intended to ensure that the HSBC Group's businesses are better protected in respect of these risks. However, there can be no assurance that these will be completely effective.

Moreover, in relevant situations, and where permitted by regulation, the Issuer may rely upon certain counterparties to maintain and properly apply their own appropriate AML procedures. While permitted by regulation, such reliance may not be effective in preventing third parties from using the Issuer (and the Issuer's relevant counterparties) as a conduit for money laundering, including illegal cash operations, without the Issuer's knowledge (and that of the Issuer's relevant counterparties). Becoming a party to money laundering, association with, or even accusations of being associated with, money laundering will damage the Issuer's reputation and could make it subject to fines, sanctions and/or legal enforcement. Any one of these outcomes could have a material adverse effect on the Issuer's business, financial condition, results of operations, prospects and reputation.

Market fluctuations may reduce the Issuer's income or the value of its portfolios.

The Issuer's businesses are inherently subject to risks in financial markets and in the wider economy, including changes in, and increased volatility of, interest rates, inflation rates, credit spreads, foreign exchange rates, commodity, equity, bond and property prices, and the risk that the Issuer's customers act in a manner inconsistent with its business, pricing and hedging assumptions.

Market movements will continue to significantly affect the Issuer in a number of key areas. For example, banking and trading activities are subject to interest rate risk, foreign exchange risk, inflation risk and credit spread risk. Changes in interest rate levels, interbank spreads over official rates and yield curves affect the interest rate spread realised between lending and borrowing costs. A change in the interest rate environment could affect prepayment activity and this could change the weighted average lives of the Issuer's interest-earning assets, which could in turn have a material adverse effect on the Issuer. The potential for future volatility and margin changes remains.

Competitive pressures on fixed rates or product terms in existing customer products sometimes restrict the Issuer's ability to change interest rates applying to customers in response to changes in official and wholesale market rates.

The Issuer's pension plan is exposed to market risk from their assets and liabilities. The liability discount rate provides exposure to interest rate risk and credit spread risk, which are only partially offset by fixed interest assets and swaps. It is difficult to predict with any degree of accuracy changes in market conditions, and such changes could have a material adverse effect on the Issuer's business, financial condition, results of operations and prospects.

Liquidity, or ready access to funds, is essential to the Issuer's businesses.

The Issuer's ability to borrow on a secured or unsecured basis, and the cost of doing so, can be affected by increases in interest rates or credit spreads, the availability of credit, regulatory requirements relating to liquidity or the market perceptions of risk relating to the Issuer or the banking sector, including the Issuer's perceived or actual creditworthiness.

Current accounts and savings deposits payable on demand or at short notice form a significant part of the Issuer's funding, and the Issuer places considerable importance on maintaining their stability. For deposits, stability depends upon preserving investor confidence in the Issuer's capital strength and liquidity, and on comparable and transparent pricing. Although deposits have been a stable source of funding historically, this may not continue.

The Issuer also plans to increase its access to wholesale markets in order to align asset and liability maturities and currencies, and to maintain a presence in local markets.

An inability to obtain financing in the unsecured long-term or short-term debt capital markets, or to access the secured lending markets, could have a material adverse effect on the Issuer's liquidity.

Unfavourable macroeconomic developments, market disruptions or regulatory developments may increase the Issuer's funding costs or challenge the Issuer's ability to raise funds to support or expand the Issuer's businesses.

If the Issuer is unable to raise funds through deposits and/or in the capital markets, the Issuer's liquidity position could be adversely affected, and the Issuer might be unable to meet deposit withdrawals on demand or at their contractual maturity, to repay borrowings as they mature, to meet the Issuer's obligations under committed financing facilities or to fund new loans, investments and businesses. The Issuer may need to liquidate unencumbered assets to meet the Issuer's liabilities. In a time of reduced liquidity, the Issuer may be unable to sell some of the Issuer's assets, or the Issuer may need to sell assets at reduced prices, which in either case could materially adversely affect the Issuer's business, financial condition, results of operations and prospects.

Any reduction in the credit rating assigned to the Issuer or any of its Securities could increase the cost or decrease the availability of the Issuer's funding and materially adversely affect the Issuer's liquidity position and net interest margin.

Credit ratings affect the cost and other terms upon which the Issuer is able to obtain market funding. Rating agencies regularly evaluate the Issuer, as well as its Securities. Their ratings are based on a number of factors, including their assessment of the relative financial strength of the Issuer, as well as conditions affecting the financial services industry generally. There can be no assurance that the rating agencies will maintain the Issuer's current ratings or outlook, particularly given the rating agencies' current review of their bank rating methodologies and the potential impact on the Issuer's ratings. See "*UK banking structural reform legislation and proposals could materially adversely affect the Issuer, as well as the market value of the Issuer's Securities.*"

On 1 March 2019 Fitch placed the Long-Term Issuer Default Ratings of the Issuer and certain of its affiliates on Rating Watch Negative ("**RWN**"). The RWN reflects the heightened uncertainty over the ultimate outcome of the UK's withdrawal from the EU, and the increased risk that the UK may leave the EU without a withdrawal agreement in place, which could result in a negative rating action.

Any reductions in these ratings and outlook could increase the cost of the Issuer's funding, limit access to capital markets and require additional collateral to be placed and, consequently, materially adversely affect the Issuer's interest margins and its liquidity position.

Risks concerning borrower credit quality are inherent in the Issuer's businesses.

Risks arising from changes in credit quality and the recoverability of loans and amounts due from borrowers and counterparties are inherent in a wide range of the Issuer's businesses. Adverse changes in the credit quality of the Issuer's borrowers and counterparties arising from a general deterioration in economic conditions or systemic risks in the financial systems could reduce the recoverability and value of the Issuer's assets, and require an increase in the Issuer's ECLs.

The Issuer estimates and recognises ECLs in the Issuer's credit exposure. This process, which is critical to the Issuer's results and financial condition, requires difficult, subjective and complex judgements, including forecasts of how the economic conditions might impair the ability of the Issuer's borrowers to repay their loans and the ability of other counterparties to meet their obligations. This assessment considers multiple alternative forward-looking economic conditions and incorporates this into the ECL estimates to meet the measurement objective of IFRS 9. As is the case with any such assessments, the Issuer may fail to estimate accurately the effect of factors that it identifies or fail to identify relevant factors. Further, the information the Issuer uses to assess the creditworthiness of its counterparties may be inaccurate or incorrect. Any failure by the Issuer to accurately estimate the ability of its counterparties to meet their obligations could have a material adverse effect on the Issuer's business, financial condition, results of operations and prospects.

The Issuer may be required to make substantial contributions to its pension plan.

The Issuer operates a pension plan which has a defined benefit section and a defined contribution section. Defined benefit pension obligations fluctuate with changes in long-term interest rates, inflation, salary levels and the longevity of scheme members. They can also be affected by operational and legal risks. The level of contributions the Issuer makes to its pension plan has a direct effect on its cash flow. To the extent plan assets are insufficient to cover existing liabilities, higher levels of contributions will be required.

As a result, deficits in the pension plan could have a material adverse effect on the Issuer's business, financial condition, results of operations and prospects.

On 26 October 2018, the High Court of Justice of England and Wales issued a judgment in a claim between Lloyds Banking Group Pension Trustees Limited as claimant and Lloyds Bank plc and others as defendants

regarding the rights of men and women to equal treatment in relation to their benefits from certain pension schemes. The judgment concluded that the claimant is under a duty to amend the schemes to equalise benefits for men and women in relation to Guaranteed Minimum Pension ("**GMP**") benefits. The judgment also provided comments on the method to be adopted to equalise benefits, on the period during which a member can claim in respect of previously underpaid benefits, and on what should be done in relation to benefits that have been transferred into, and out of, the relevant schemes. Equalising benefits in respect of GMPs for the Issuer's pension plan will result in an increase in the plan's liabilities.

The use of pro forma financial information may not be indicative of the financial position or future performance of the Issuer.

The unaudited pro forma financial information presented on page 25 to 32 (inclusive) has been prepared to illustrate the effect of the business and subsidiary transfers made by HBEU to the Issuer as part of the ring-fencing of the HSBC Group's UK retail banking operations (see "*Background*"), as if such transfers had taken place on 1 January 2018. The unaudited pro forma financial information is based on available information and assumptions that management believes were reasonable at the date of preparation. However, the Issuer cannot make any assurances that such assumptions will prove to be accurate over time, or that any assumptions on which any future pro forma financial information is presented will prove to be accurate over time.

The unaudited pro forma financial information has been prepared for illustrative purposes only, and, due to the nature of such information, should not be used as the basis of projections of the Issuer's results of operations, financial condition or performance.

IMPORTANT NOTICES

The Issuer accepts responsibility for the information contained in this Registration Document. To the best of the knowledge of the Issuer, which has taken all reasonable care to ensure that such is the case, the information contained in this Registration Document is in accordance with the facts and does not omit anything likely to affect the import of such information.

The Issuer confirms that the information appearing in Part (C) of the section entitled "Additional Financial Information" has been accurately reproduced and that, as far as the Issuer is aware and is able to ascertain, no facts have been omitted which would render the reproduced information inaccurate or misleading.

No person has been authorised to give any information or to make any representation not contained in or not consistent with this Registration Document and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer, any trustee or any dealer appointed in relation to any issue of Securities by the Issuer.

This Registration Document should not be considered as a recommendation by the Issuer, any trustee or any dealer appointed in relation to any issue of Securities by the Issuer that any recipient of this Registration Document should purchase any Securities issued by the Issuer. Each investor contemplating subscribing for or purchasing Securities issued by the Issuer should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer. No part of this Registration Document constitutes an offer or invitation by or on behalf of the Issuer, any trustee or any dealer appointed in relation to any issue of Securities by the Issuer or any of them to any person to subscribe for or to purchase any of the Securities issued by the Issuer.

None of the delivery of this Registration Document or any prospectus prepared by the Issuer ("**Prospectus**"), other offering document referring to this Registration Document or any relevant Final Terms or Pricing Supplement or the offering, sale or delivery of any Securities shall, in any circumstances, create any implication that there has been no change in the affairs of the Issuer since the date hereof, or that the information contained in this Registration Document is correct at any time subsequent to the date hereof or that any other written information delivered in connection herewith or therewith is correct as of any time subsequent to the date indicated in such document. Any dealer or trustee appointed in relation to any issue of Securities by the Issuer expressly does not undertake to review the financial condition or affairs of the Issuer or its subsidiary undertakings during the life of such Securities.

The distribution of this Registration Document and the offer or sale of Securities issued by the Issuer may be restricted by law in certain jurisdictions. Persons into whose possession this Registration Document or any Securities issued by the Issuer come must inform themselves about, and observe, any such restrictions. For a description of certain restrictions on offers, sales and deliveries of Securities issued by the Issuer and on the distribution of this Registration Document see the applicable description of arrangements relating to subscription and sale of the relevant Securities in the relevant Prospectus or other offering document.

In this Registration Document and in relation to any Securities issued by the Issuer, references to the "**relevant dealers**" are to whichever of the dealers enters into an agreement for the issue of such Securities issued by the Issuer as described in the applicable description of arrangements relating to subscription and sale of the relevant Securities in the relevant Prospectus or other offering document and references to the "**relevant Final Terms**" are to the Final Terms or Pricing Supplement relating to such Securities.

THE ISSUER AND ITS SUBSIDIARIES

Introduction

History and Development of the Issuer

The Issuer and its subsidiaries (together, the "**Group**") largely comprise Retail Banking and Wealth Management, Commercial Banking and Private Banking. The Issuer forms part of the HSBC Group (being HSBC Holdings and its subsidiaries). These businesses were transferred from HBEU on 1 July 2018, following the Court approval of the ring-fenced transfer scheme to meet the regulatory ring-fencing requirements in accordance with the Financial Services (Banking Reform) Act 2013 and related legislation.

The Issuer is a public limited company registered in England and Wales under registration number 09928412. The liability of its members is limited. It has its registered and head office at 1 Centenary Square, Birmingham, B1 1HQ, United Kingdom; telephone number +44 3456 040 626. The Issuer was incorporated on 23 December 2015 under the Companies Act 2006 as a private limited company and then re-registered as a public limited company on 8 August 2017.

As at 31 December 2018, HSBC UK had total consolidated assets of £238,939 million, and total consolidated shareholders' equity of £22,273 million.

As at 31 December 2018, HSBC UK, had 14.5 million customers being served by 22,000 employees across the UK, supported by a further 11,000 employees based in its UK service company HSBC Global Services (UK) Limited who provide services to HSBC UK and the wider HSBC Group.

Legislation

The Issuer is subject to primary and secondary legislation relating to financial services and banking regulation in the United Kingdom, including, *inter alia*, the Financial Services and Markets Act 2000 (the "**FSMA**"), for the purposes of which the Issuer is an authorised person carrying on the business of financial services provision. In addition, as a public limited company, the Issuer is subject to the Companies Act 2006 (as amended).

Principal activities and markets

HSBC UK manages its products and services through its four businesses: RBWM, CMB, GPB and GB&M.

RBWM serves customers in the UK through two main business areas: Retail Banking and Wealth Management. For customers who have simpler everyday banking needs, RBWM offers a full range of banking products and services. RBWM also caters for customers under the HSBC UK Premier and Advance propositions, which is targeted at mass affluent and emerging affluent individuals, who value international connectivity. Four brands sit under the HSBC UK RBWM umbrella: HSBC UK, first direct, M&S Bank and John Lewis Financial Services. RBWM makes a significant contribution to the overall success of HSBC UK and the HSBC Group as a whole, with close collaboration with other business lines. For example, the foreign exchange and wealth management needs of RBWM clients create opportunities for GB&M. RBWM's focus is on supporting customers and growing the business through relationship-led lending and wealth management, whilst transforming customer experience and the cost base, through investment in digital infrastructure.

CMB customers range from small enterprises focused primarily on their domestic markets, through to large corporates operating globally. CMB supports its customers with tailored financial products and services to allow them to operate efficiently and to grow. CMB provides working capital, term loans, payment services and international trade facilitation. Through close collaboration with GB&M, CMB can also offer expertise in mergers and acquisitions, and provide access to the capital markets. CMB collaborates closely across HSBC UK to fully support its customers at various points in their lifecycle; for example, GPB can support the owners of CMB companies looking to exit and grow their wealth, and CMB works closely with RBWM to offer employee banking services for its clients. In parallel, GB&M provides capital finance expertise to CMB clients, and HSBC Global Insurance and HSBC Global Asset Management capabilities also benefit UK CMB clients. CMB is focused on growing long-term value from its network and is investing heavily in digital and technology, particularly within its core Global Liquidity and Cash Management and Global Trade and Receivables Finance propositions. CMB is also focused on serving its client base in an increasingly simple and efficient manner.

GPB serves high net worth individuals and families, including those with international banking needs. GPB supports clients with investment management, incorporating advisory, discretionary and brokerage services; private wealth solutions, comprising trusts and estate planning, designed to protect wealth and preserve it for future generations; and a full range of private banking services. GPB products can be relevant for clients across HSBC UK and globally, with GPB clients also benefitting from asset management, research, insurance, trade finance and capital financing, capabilities within its other business lines. GPB aspires to build on HSBC's commercial banking heritage and be the leading private bank for high net worth business owners and principals.

In compliance with ring-fencing regulation, the Issuer is able to offer selected GB&M products to its customer base within specific parameters. For example, the Issuer maintains a small treasury and markets team that helps to support the sale of eligible markets products to its Commercial Banking clients.

The principal activities and markets of the Group are described in more detail on page 4 of the 2018 Annual Report and Accounts.

As at 31 December 2018, the Issuer's principal subsidiary undertakings and their country of incorporation were:

<i>Name of Subsidiary Undertaking</i>	<i>Location</i>
HSBC Equipment Finance (UK) Limited	England
HSBC Invoice Finance (UK) Limited	England
HSBC Private Bank (UK) Limited	England
HSBC Trust Company (UK) Limited	England
Marks and Spencer Financial Services plc	England

The subsidiaries, joint ventures and associates of the Issuer are described in more detail on pages 106 to 107 of the 2018 Annual Report and Accounts.

Organisational Structure

The ordinary shares of the Issuer are wholly-owned by HSBC UK Holdings Limited. HSBC UK Holdings Limited is a wholly and directly owned subsidiary of HSBC Holdings.

Ratings

The Issuer has been assigned the following long-term credit ratings:

- AA- by S&P. This means that S&P is of the opinion that the Issuer has a very strong capacity to meet its financial commitments; and
- AA- by Fitch. This means that Fitch is of the opinion that the Issuer poses expectations of very low credit risk, indicates very strong capacity for payment of financial commitments and this capacity is not significantly vulnerable to foreseeable events.

The Issuer has also been assigned the following short-term credit ratings:

- A-1+ by S&P. This means that S&P is of the opinion that the Issuer's capacity to meet its financial commitments on its short-term obligations is strong; and
- F1+ by Fitch. This means that Fitch is of the opinion that the Issuer has the strongest intrinsic capacity for timely payment of short-term financial commitments.

Each of S&P and Fitch is established in the European Union and is registered as a Credit Rating Agency under the CRA Regulation.

A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

Capital

The following table sets out certain key capital numbers relating to the Group as at 31 December 2018.

	As at 31 December 2018
Available capital and MREL eligible liabilities (£m)	
Common equity tier 1 capital	11,700
Additional tier 1 capital	2,196
Tier 1 capital	13,896
Tier 2 capital	2,930
Subordinated loan instruments not eligible for inclusion in regulatory capital ¹	2,000
Capital Ratios (%)	
Common equity tier 1 ²	12.7
Total tier 1	15.1
Total capital	18.3
Leverage ratio (CRD IV fully-phased in)	5.6

¹ Since 31 December 2018, the Issuer has raised the following additional funds under subordinated loan instruments not eligible for inclusion in regulatory capital:

- GBP 1,000 million under 3.000% subordinated loan due July 2028
- USD 3,000 million under 3.973% subordinated loan due May 2030
- GBP 750 million under 3.000% subordinated loan due May 2030

² The following table presents the Group's common equity tier 1 requirement as at 31 December 2018 on a CRD IV end point basis.

	As at 31 December 2018
Common equity tier 1 CRD IV end point requirement (%)	
Pillar 1	4.5
Pillar 2A	2.6
Capital conservation buffer	2.5
Systemic risk buffer	1.0
Countercyclical buffer	1.0
Total	11.6

DIRECTORS OF THE ISSUER

The directors of the Issuer, each of whose business address is 1 Centenary Square, Birmingham, B1 1HQ, United Kingdom, their functions in relation to the Group and their principal outside activities (if any) of significance to the Group are as follows:

<i>Name</i>	<i>Function(s) within the Group</i>	<i>Principal Outside Activities</i>
Dame Clara Furse	<p>Chairman</p> <p>Independent non-executive Director</p> <p>Chairman of the Chairman's Nominations and Remuneration Committee</p>	<p>Non-executive director of Vodafone Group plc and Amadeus IT Group, S.A. Member of the Panel of Senior Advisors to Chatham House and of Bocconi University's International Advisory Council.</p>
John David Stuart (known as Ian Stuart)	<p>Executive Director and Chief Executive Officer</p> <p>Chairman of the Executive Committee</p>	<p>Group Managing Director of HSBC Holdings plc. Board member of UK Finance, the financial services industry association and attendee of the Economic Crime Strategic Board.</p>
Jonathan James Calladine (known as James Calladine)	<p>Executive Director and Chief Risk Officer</p> <p>Member of the Executive Committee</p>	<p>N/A</p>
James Coyle	<p>Independent non-executive Director</p> <p>Chairman of the Audit Committee and</p> <p>Member of the Risk Committee and Chairman's Nominations and Remuneration Committee</p>	<p>Chairman of Marks & Spencer Unit Trust Management Limited and non-executive director of Marks and Spencer Financial Services plc (together the M&S Bank) and member of the Audit & Risk Committee of the M&S Bank. Chairman of HSBC Trust Company (UK) Limited and a non-executive director and member of the Audit and Risk Committee of HSBC Private Bank (UK) Limited. Non-executive director and chairman of the Audit and Risk Committee of Scottish Water, a non-executive director and chairman of the Audit and Risk Committee of Honeycomb Investment Trust plc, director and chairman of the Audit and Risk Committee of World First and an independent non-executive member of Deloitte UK Oversight Board.</p>
Mridul Hegde CB	<p>Independent non-executive Director</p>	<p>N/A</p>

<i>Name</i>	<i>Function(s) within the Group</i>	<i>Principal Outside Activities</i>
	Chairman of the Risk Committee	
	Member of the Audit Committee and the Chairman's Nominations and Remuneration Committee	
Dame Denise Holt	Independent non-executive Director	Chairman of Marks and Spencer Financial Services plc. Non-executive director of Iberdrola SA and Chairs the Council of the University of Sussex and the Cañada Blanch Centre for Contemporary Spanish Studies at the London School of Economics.
	Member of the Audit Committee	
Alan Keir	Non-executive Director	Non-executive director of Sumitomo Mitsui Bank Europe and Majid Al Futtaim Holdings.
	Member of the Audit Committee and Risk Committee	
Rosemary Leith	Independent non-executive Director	Non-executive director of YouGov plc and chairs the Remuneration Committee and is a member of the Audit Committee. Non-executive director of the World Wide Web Foundation and Trustee of the National Gallery where she chairs the Digital Advisory Board. Member of the Advisory Councils of Glasswing Ventures, Motive Partners and the Queens University School of Business. She is a Fellow at Harvard University's Berkman Klein Centre.
	Member of the Risk Committee	
David Lister	Independent non-executive Director	Chairman of HSBC Private Bank (UK) Limited. Non-executive director of FDM Group (Holdings) plc and Interxion Holding N.V.; and a member of the board of governors at Nuffield Health.
	Member of the Audit Committee and Risk Committee.	
Philippe Leslie Van de Walle	Independent non-executive Director	The senior independent director and chairman of the Remuneration Committee of DCC plc and a non-executive director and deputy chairman of Crest Nicholson Holdings plc.
	Member of the Risk Committee and Chairman's Nominations and Remuneration Committee	
David Watts	Executive Director and Chief Financial Officer	N/A
	Member of the Executive Committee	

Management Committees

Executive Committee

The Issuer's Executive Committee, whose business address is 1 Centenary Square, Birmingham, B1 1HQ, United Kingdom, meets regularly and operates as a management committee under the direct authority of the board of directors of the Issuer. The members of the Executive Committee and their functions in relation to the Issuer's Executive Committee and their principal outside activities (if any) of significance to the Issuer are as follows:

<i>Name</i>	<i>Function(s) within the Group</i>	<i>Principal Outside Activities</i>
John David Stuart (known as Ian Stuart)	Chief Executive Officer and Chairman of the Committee	Group Managing Director, HSBC Holdings plc. Board member of UK Finance and member of the Economic Crime Strategic Board.
Ian Banks	Head of Global Markets and Balance Sheet Management	—
Nicola Black	Company Secretary	—
Charles Boulton	Chief Executive Officer, UK Private Bank	Director (CEO), HSBC Private Bank (UK) Limited
Emma Bunnell	Chief Operating Officer	—
Lynne Burns	Head of HR	—
Jonathan James Calladine (known as James Calladine)	Chief Risk Officer	—
Allan Clare	Head of Financial Crime Compliance	Member of the UK Finance Economic Crime Board and Private Sector Steering Group
Kate Epworth	Head of Communications	—
Stuart Haire	Head of Retail Banking and Wealth Management	Director, Marks and Spencer Financial Services plc.; Group General Manager, HSBC Holdings plc Chair of UK Finance Personal Finance Product and Service Board
Esmond Kensington	Chief of Staff and Head of Strategy	—
Amanda Murphy	Head of Commercial Banking	Group General Manager, HSBC Holdings plc
Christopher Pitt	Head of Marketing	—
Hugh Pugsley	General Counsel	Director, HSBC Bank Pension Trust (UK) Limited
David Watts	Chief Financial Officer	—
Lucy Williams	Head of Regulatory Compliance	Member of the Board of Trustees of the Institute of Business Ethics

Conflicts of interest

There are no existing or potential conflicts of interest between any duties owed to the Issuer by its directors or its Executive Committee (each as described above) and the private interests and/or external duties owed by these individuals.

ADDITIONAL FINANCIAL INFORMATION

(A) UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION IN RESPECT OF THE ISSUER FOR THE YEAR ENDED 31 DECEMBER 2018

Notes on the unaudited pro forma financial information

Background

Basis of preparation of unaudited pro forma consolidated financial information

The unaudited pro forma consolidated financial information of the Issuer for the 12 months ended 31 December 2018, set out below, has been prepared to illustrate the effect of the business and subsidiary transfers to the Issuer as described below in "Structural Reform and Ring-Fencing Implementation", as if such transfers had taken place on 1 January 2018.

The unaudited pro forma consolidated financial information of the Issuer for the 12 months ended 31 December 2018 has been prepared for illustrative purposes only and, because of its nature, addresses a hypothetical situation and, therefore, does not and will not represent the Issuer's actual financial results. The unaudited pro forma consolidated financial information of the Issuer for the 12 months ended 31 December 2018 does not constitute financial statements within the meaning of Section 434 of the Companies Act 2006.

While the unaudited pro forma consolidated financial information has been prepared to capture the results of the transferred businesses and entities that constitute the Issuer and these reflect the internal management information used to assess performance, prior to 1 July 2018 certain assumptions and simplifications were necessary to arrive at the results. The key assumptions are set out further below:

- The majority of the HBEU UK RBWM and UK CMB businesses were transferred to the Issuer.
- It has been necessary to perform allocations in respect of certain elements of Corporate Centre for periods prior to 1 July 2018. Primarily these relate to:
 - Balance Sheet Management: allocation assumptions have been used to identify the net profit or loss on treasury-related balances.
 - Service Company charges: These are based on an estimated allocations for services not able to be directly attributed.
- Allocation assumptions have also been required in respect of GB&M Global Foreign Exchange revenues for the periods prior to 1 July 2018.
- 100 per cent. of the cost of ring-fencing and an apportionment of the cost to achieve that has not been assigned to a specific global business have been included in the unaudited pro forma consolidated financial information.

Investors should read the whole of this Registration Document and not rely solely on the unaudited pro forma consolidated financial information set out below. PricewaterhouseCoopers LLP's report on the unaudited pro forma consolidated financial information of the Issuer for the 12 months ended 31 December 2018 is set out in Part (B) below.

An extract from Note 35 (*Discontinued Operations*) to HBEU's audited consolidated financial statements for the year ended 31 December 2018, which sets out the results for the six months to 30 June 2018 and for the year ended 31 December 2017 for the Transferred Business (as defined below), is set out in Part (C) below.

Structural Reform and Ring-Fencing Implementation

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

The HSBC Group completed the ring-fencing of its UK retail banking activities on 1 July 2018, transferring approximately 14.5 million qualifying RBWM, CMB and GPB customers from HBEU to the Issuer. This included the transfer of relevant retail banking subsidiaries. HBEU, which is the HSBC Group's non-ring-fenced bank in the United Kingdom, has retained the non-qualifying components, primarily the UK Global Banking and Markets business and the overseas branches and subsidiaries. The two banking entities operate alongside each other, supported by services received from HSBC Global Services (UK) Limited.

The primary means of transferring HBEU's qualifying customers and subsidiaries to the Issuer was through a court-approved ring-fencing transfer scheme as provided for in Part VII, section 106 of the FSMA (as amended). In addition to these transfers, certain items were transferred through other legal arrangements.

ISSUER PRO FORMA RESULTS 2018

Pro forma reported results

Summary consolidated income statement - Total

	Reported results⁽¹⁾ 12 months to 31 Dec 2018	Adjustment for ring- fencing transfers to the Issuer⁽²⁾	Pro forma 12 months to 31 Dec 2018
		<i>£(m)</i>	
Net interest income.....	2,456	2,298	4,754
Net fee income.....	648	586	1,234
Other income.....	253	247	500
Net operating income before change in expected credit losses and other credit impairment charges.....	3,357	3,131	6,488
Change in expected credit losses and other credit impairment charges.....	(305)	(94)	(399)
Net operating income.....	3,052	3,037	6,089
Total operating expenses.....	(1,988)	(1,894)	(3,882)
Operating profit.....	1,064	1,143	2,207
Profit before tax.....	1,064	1,143	2,207

Notes

- (1) The reported consolidated income statement of the Issuer for the 12 months ended 31 December 2018 has been directly extracted from the audited consolidated financial statements of the Issuer for the year ended 31 December 2018 included in the 2018 Annual Report and Accounts.
- (2) This adjustment reflects the transfer from HBEU to the Issuer of HBEU's combined retail operations in the UK (excluding the Channel Islands and Isle of Man) and includes the qualifying components of HBEU's UK Retail Banking and Wealth Management, Commercial Banking and Global Private Banking businesses, relevant Corporate Centre activities and qualifying subsidiaries, notably Marks and Spencer Financial Services plc, HSBC Private Bank (UK) Limited and a number of asset finance entities (together, the "**Transferred Businesses**"). The transfer was completed on 1 July 2018. The financial information used in this adjustment has been extracted from internal management information used to assess the performance of the Transferred Businesses both prior to and following the transfer.

Pro forma adjusted results

The pro forma results are presented on both a 'reported' and an 'adjusted' basis. The pro forma reported results are contained in the table above. The Issuer's adjusted pro forma results are computed by adjusting the reported pro forma results (as set out above) for the year-on-year effects of significant items that distort year-on-year comparisons. Adjusted profit before tax reflects the Issuer's segment performance measure under IFRS 8.

The Issuer uses significant items to describe collectively the group of individual adjustments excluded from the pro forma results when arriving at the adjusted results which follow in the tables below. These significant items, which are detailed in the "Significant items" tables that follow, are ones that the Issuer's management and investors would ordinarily identify and consider separately when assessing performance to understand better the underlying trends in the business. The Issuer considers that adjusted performance provides useful information for investors by aligning internal and external reporting, identifying and

quantifying items the Issuer's management believes to be significant and providing insight into how the Issuer's management assesses year-on-year performance.

Results by operating segment

The Issuer manages its products and services through four businesses: RBWM, CMB, GPB and GB&M. Certain central operations of the Issuer's business lines are managed through the Corporate Centre. A description of these businesses is provided on page 3 of the 2018 Annual Report and Accounts. These business lines are the Issuer's reportable operating segments under IFRS 8 and the business line results are assessed on the basis of adjusted performance. The Issuer therefore presents its business line/operating segment pro forma results in the tables that follow on an adjusted basis.

The Issuer's operations are closely integrated and, accordingly, the presentation of data includes internal allocations of certain items of income and expense. These allocations include the costs of certain support services and functions to the extent that they can be meaningfully attributed to operational business lines. While such allocations have been made on a systematic and consistent basis, they necessarily involve a degree of subjectivity. Costs which are not allocated to business lines are included in Corporate Centre. The Issuer presents the pro forma results of the Corporate Centre in the tables below on an adjusted basis.

Where relevant, income and expense amounts presented include the results of inter-segment funding along with inter-company and inter- business line transactions. All such transactions are undertaken on arm's length terms. The intra-group elimination items are presented in the Corporate Centre.

Please note that all numbers presented in the tables that follow are 'adjusted' numbers.

Pro forma adjusted profit - Total

	Adjusted results⁽¹⁾ 12 months to 31 Dec 2018	Adjustment for ring- fencing transfers to the Issuer⁽²⁾	Pro forma adjusted profit - Total 12 months to 31 Dec 2018
		<i>£(m)</i>	
Net interest income.....	2,452	2,263	4,715
Net fee income	649	585	1,234
Other income.....	251	249	500
Net operating income before change in expected credit losses and other credit impairment charges.....	3,352	3,097	6,449
Change in expected credit losses and other credit impairment charges	(305)	(94)	(399)
Net operating income	3,047	3,003	6,050
Total operating expenses	(1,748)	(1,762)	(3,510)
Operating profit	1,299	1,241	2,540
Profit before tax.....	1,299	1,241	2,540

Notes

- (1) The adjusted consolidated income statement information of the Issuer for the 12 months ended 31 December 2018 is identical to the adjusted information presented in the 2018 Annual Report and Accounts of the Issuer and has been computed by adjusting the reported consolidated income statement information of the Issuer for the 12 months ended 31 December 2018 (as set out in the table above entitled "Summary consolidated income statement - Total") to take into account the pro forma significant items during the same period (as set out in the table below entitled "Pro forma significant items").
- (2) This adjustment reflects the transfer from HBEU to the Issuer of the Transferred Businesses. The financial information used in this adjustment has been extracted from internal management information used to assess the performance of the Transferred Businesses and has been computed by adjusting the financial information included within the column "Adjustment for ring-fencing transfers to the Issuer" from the table above entitled "Summary consolidated income statement - Total" to take into account the pro forma significant items during the same period (as set out in the table below entitled "Pro forma significant items").

Pro forma significant items

	Adjusted results ⁽¹⁾ 12 months to 31 Dec 2018	Adjustment for ring- fencing transfers to the Issuer ⁽²⁾ £(m)	Pro forma significant items 12 months to 31 Dec 2018
Significant revenue items	(5)	(34)	(39)
- customer redress programmes	(5)	(34)	(39)
Significant cost items	240	132	372
- costs of structural reform	14	58	72
- customer redress programmes	46	74	120
- guaranteed minimum pension benefits equalisation	187	-	187
- other	(7)	-	(7)
Total impact of significant items on Profit before tax	235	98	333

Notes

- (1) The consolidated significant items information of the Issuer for the 12 months ended 31 December 2018 is extracted from the 2018 Annual Report and Accounts.
- (2) This adjustment reflects the transfer from HBEU to the Issuer of the Transferred Businesses. The financial information used in this adjustment has been extracted from internal management information used to assess the performance of the Transferred Businesses.

Pro forma adjusted profit - RBWM

	Adjusted results ⁽¹⁾ 12 months to 31 Dec 2018	Adjustment for ring- fencing transfers to the Issuer ⁽²⁾ £(m)	Pro forma adjusted profit - RBWM 12 months to 31 Dec 2018
Net interest income.....	1,391	1,264	2,655
Net fee income	341	289	630
Other income.....	34	40	74
Net operating income before change in expected credit losses and other credit impairment charges.....	1,766	1,593	3,359
Change in expected credit losses and other credit impairment charges	(164)	(102)	(266)
Net operating income	1,602	1,491	3,093
Total operating expenses	(1,125)	(1,104)	(2,229)
Operating profit	477	387	864
Profit before tax.....	477	387	864

Notes

- (1) The adjusted consolidated income statement information for the Issuer's RBWM operating segment for the 12 months ended 31 December 2018 is extracted from the Issuer's internal management information which includes the consolidated financial information on a reportable segment basis pursuant to IFRS 8. The information is reported on an adjusted basis, taking into account the significant items during the same period (as set out in the table below entitled "*Pro forma significant items - RBWM*").
- (2) This adjustment reflects the transfer from HBEU to the Issuer of the RBWM components of the Transferred Businesses. The financial information used in this adjustment has been extracted from internal management information used to assess the performance of the Transferred Businesses. The information is reported on an adjusted basis, taking into account the significant items during the same period (as set out in the table below entitled "*Pro forma significant items - RBWM*").

Pro forma significant items - RBWM

	Adjusted results ⁽¹⁾ 12 months to 31 Dec 2018	Adjustment for ring- fencing transfers to the Issuer ⁽²⁾ £(m)	Pro forma significant items - RBWM 12 months to 31 Dec 2018
Significant cost items	61	68	129
- costs of structural reform	1	-	1
- customer redress programmes	60	68	128
Total impact of significant items on Profit before tax	61	68	129

Notes

- (1) The consolidated significant items information of the Issuer's RBWM operating segment for the 12 months ended 31 December 2018 is extracted from the 2018 Annual Report and Accounts.
- (2) This adjustment reflects the transfer from HBEU to the Issuer of the Transferred Businesses. The financial information used in this adjustment has been extracted from internal management information used to assess the performance of the Transferred Businesses.

Pro forma adjusted profit - CMB

	Adjusted results ⁽¹⁾ 12 months to 31 Dec 2018	Adjustment for ring- fencing transfers to the Issuer ⁽²⁾ £(m)	Pro forma adjusted profit - CMB 12 months to 31 Dec 2018
Net interest income.....	979	921	1,900
Net fee income	378	390	768
Other income.....	21	-	21
Net operating income before change in expected credit losses and other credit impairment charges.....	1,378	1,311	2,689
Change in expected credit losses and other credit impairment charges	(145)	7	(138)
Net operating income	1,233	1,318	2,551
Total operating expenses	(530)	(503)	(1,033)
Operating profit	703	815	1,518
Profit before tax.....	703	815	1,518

Notes

- (1) The adjusted consolidated income statement information for the Issuer's CMB operating segment for the 12 months ended 31 December 2018 is extracted from the Issuer's internal management information which includes the consolidated financial information on a reportable segment basis pursuant to IFRS 8. The information is reported on an adjusted basis, taking into account the significant items during the same period (as set out in the table below entitled "*Pro forma significant items - CMB*").
- (2) This adjustment reflects the transfer from HBEU to the Issuer of the CMB components of the Transferred Businesses. The financial information used in this adjustment has been extracted from internal management information used to assess the performance of the Transferred Businesses. The information is reported on an adjusted basis, taking into account the significant items during the same period (as set out in the table below entitled "*Pro forma significant items - CMB*").

Pro forma significant items - CMB

	Adjusted results⁽¹⁾ 12 months to 31 Dec 2018	Adjustment for ring- fencing transfers to the Issuer⁽²⁾	Pro forma significant items - CMB 12 months to 31 Dec 2018
	<i>£(m)</i>		
Significant revenue items	(5)	(34)	(39)
- customer redress programmes	(5)	(34)	(39)
Significant cost items	(12)	6	(6)
- costs of structural reform	2	—	2
- customer redress programmes	(14)	6	(8)
Total impact of significant items on Profit before tax	(17)	(28)	(45)

Notes

- (1) The consolidated significant items information of the Issuer's CMB operating segment for the 12 months ended 31 December 2018 is extracted from the 2018 Annual Report and Accounts.
- (2) This adjustment reflects the transfer from HBEU to the Issuer of the Transferred Businesses. The financial information used in this adjustment has been extracted from internal management information used to assess the performance of the Transferred Businesses.

Pro forma adjusted profit - GB&M

	Adjusted results⁽¹⁾ 12 months to 31 Dec 2018	Adjustment for ring- fencing transfers to the Issuer⁽²⁾	Pro forma adjusted profit – GB&M 12 months to 31 Dec 2018
	<i>£(m)</i>		
Net interest income	(3)	-	(3)
Net fee income	(98)	(105)	(203)
Other income	173	173	346
Net operating income before change in expected credit losses and other credit impairment charges	72	68	140
Change in expected credit losses and other credit impairment charges	-	-	-
Net operating income	72	68	140
Total operating expenses	(69)	(56)	(125)
Operating profit	3	12	15
Operating profit	3	12	15

Notes

- (1) The adjusted consolidated income statement information for the Issuer's GB&M operating segment for the 12 months ended 31 December 2018 is extracted from the Issuer's internal management information which includes the consolidated financial information on a reportable segment basis pursuant to IFRS 8. The information is reported on an adjusted basis, taking into account the significant items during the same period. Please note that there were no significant items impacting the GB&M operating segment during the period.
- (2) This adjustment reflects the transfer from HBEU to the Issuer of the GB&M components of the Transferred Businesses. The financial information used in this adjustment has been extracted from internal management information used to assess the performance of the Transferred Businesses. The information is reported on an adjusted basis, taking into account the significant items during the same period. Please note that there were no significant items impacting the GB&M operating segment during the period.

Pro forma adjusted profit - GPB

	Adjusted results ⁽¹⁾ 12 months to 31 Dec 2018	Adjustment for ring- fencing transfers to the Issuer ⁽²⁾ £(m)	Pro forma adjusted profit - GPB 12 months to 31 Dec 2018
Net interest income.....	57	57	114
Net fee income.....	14	13	27
Other income.....	7	6	13
Net operating income before change in expected credit losses and other credit impairment charges.....	78	76	154
Change in expected credit losses and other credit impairment charges.....	4	-	4
Net operating income.....	82	76	158
Total operating expenses.....	(54)	(57)	(111)
Operating profit.....	28	19	47
Profit before tax.....	28	19	47

Notes

- (1) The adjusted consolidated income statement information for the Issuer's GPB operating segment for the 12 months ended 31 December 2018 is extracted from the Issuer's internal management information which includes the consolidated financial information on a reportable segment basis pursuant to IFRS 8. The information is reported on an adjusted basis, taking into account the significant items during the same period. Please note that there were no significant items impacting the GPB operating segment during the period.
- (2) This adjustment reflects the transfer from HBEU to the Issuer of the GPB components of the Transferred Businesses. The financial information used in this adjustment has been extracted from internal management information used to assess the performance of the Transferred Businesses. The information is reported on an adjusted basis, taking into account the significant items during the same period. Please note that there were no significant items impacting the GPB operating segment during the period.

Pro forma adjusted profit – Corporate Centre

	Adjusted results ⁽¹⁾ 12 months to 31 Dec 2018	Adjustment for ring- fencing transfers to the Issuer ⁽²⁾ £(m)	Pro forma adjusted profit – Corporate Centre 12 months to 31 Dec 2018
Net interest income.....	28	21	49
Net fee income.....	14	(2)	12
Other income.....	16	30	46
Net operating income before change in expected credit losses and other credit impairment charges.....	58	49	107
Change in expected credit losses and other credit impairment charges.....	-	1	1
Net operating income.....	58	50	108
Total operating expenses.....	30	(42)	(12)
Operating profit.....	88	8	96
Profit before tax.....	88	8	96

Notes

- (1) The adjusted consolidated income statement information for the Issuer's Corporate Centre operating segment for the 12 months ended 31 December 2018 is extracted from the Issuer's internal management information which includes the consolidated financial information on a reportable segment basis pursuant to IFRS 8. The information is reported on an adjusted basis, taking into account the significant items during the same period (as set out in the table below entitled "*Pro forma significant items - Corporate Centre*").
- (2) This adjustment reflects the transfer from HBEU to the Issuer of the Corporate Centre components of the Transferred Businesses. The financial information used in this adjustment has been extracted from internal management information used to assess the performance of the Transferred Businesses. The information is reported on an adjusted basis, taking into account the significant items during the same period (as set out in the table below entitled "*Pro forma significant items - Corporate Centre*").

Pro forma significant items – Corporate Centre

	Adjusted results⁽¹⁾ 12 months to 31 Dec 2018	Adjustment for ring- fencing transfers to the Issuer⁽²⁾	Pro forma significant items – Corporate Centre 12 months to 31 Dec 2018
		<i>£(m)</i>	
Significant cost items	191	58	249
- costs of structural reform	11	58	69
- guaranteed minimum pension benefits equalisation	187	-	187
- other	(7)	-	(7)
Total impact of significant items on Profit before tax	191	58	249

Notes

- (1) The consolidated significant items information of the Issuer's Corporate Centre operating segment for the 12 months ended 31 December 2018 is extracted from the 2018 Annual Report and Accounts.
- (2) This adjustment reflects the transfer from HBEU to the Issuer of the Transferred Businesses. The financial information used in this adjustment has been extracted from internal management information used to assess the performance of the Transferred Businesses.

**(B) ACCOUNTANT'S REPORT ON UNAUDITED PRO FORMA FINANCIAL INFORMATION
OF THE ISSUER FOR THE YEAR ENDED 31 DECEMBER 2018**



The Directors
HSBC UK Bank plc
1 Centenary Square
Birmingham B1 1HQ
United Kingdom

19 June 2019

Dear Sirs

HSBC UK Bank plc (the “Company”)

We report on the unaudited pro forma financial information (the “Pro Forma Financial Information”) set out in section A of Additional Financial Information of the Company’s registration document dated 19 June 2019 (the “Registration Document”), which has been prepared on the basis described in the notes to the Pro Forma Financial Information, for illustrative purposes only, to provide information about how the effect of the ring-fencing transfers of qualifying components of the relevant businesses from HSBC Bank plc to the Company, as if such transfers had taken place on 1 January 2018, might have affected the financial information presented on the basis of the accounting policies adopted by the Company in preparing the financial statements for the period ended 31 December 2018. This report is required by item 7 of Annex II to the PD Regulation and is given for the purpose of complying with that PD Regulation and for no other purpose.

Responsibilities

It is the responsibility of the directors of the Company to prepare the Pro Forma Financial Information in accordance with Annex II of the PD regulation.

It is our responsibility to form an opinion, as required by item 7 of Annex II to the PD Regulation as to the proper compilation of the Pro Forma Financial Information and to report our opinion to you.

In providing this opinion we are not updating or refreshing any reports or opinions previously made by us on any financial information used in the compilation of the Pro Forma Financial Information, nor do we accept responsibility for such reports or opinions beyond that owed to those to whom those reports or opinions were addressed by us at the dates of their issue.

Save for any responsibility which we may have to those persons to whom this report is expressly addressed and for any responsibility arising under item 5.5.4R(2)(f) of the Prospectus Rules to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with item 13.1 of Annex IX to the PD Regulation, consenting to its inclusion in the Prospectus.

**Basis of opinion**

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. The work that we performed for the purpose of making this report, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the Pro Forma Financial Information with the directors of the Company.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Pro Forma Financial Information has been properly compiled on the basis stated and that such basis is consistent with the accounting policies of the Company.

Our work has not been carried out in accordance with auditing standards or other standards and practices generally accepted in the United States of America and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

Opinion

In our opinion:

- a) the Pro Forma Financial Information has been properly compiled on the basis stated; and
- b) such basis is consistent with the accounting policies of the Company.

Declaration

For the purposes of Prospectus Rule 5.5.4 R(2)(f), we are responsible for this report as part of the Prospectus and we declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with item 1.2 of Annex IX to the PD Regulation.

Yours faithfully

PricewaterhouseCoopers LLP
Chartered Accountants

(C) EXTRACT FROM NOTE 35 (DISCONTINUED OPERATIONS) TO HSBC BANK PLC'S AUDITED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

The following information has been extracted from Note 35 (Discontinued Information) to HBEU's audited financial statements for the year ended 31 December 2018 and is covered by the report on the audit of such financial statements. Such financial statements have not been audited by PricewaterhouseCoopers LLP, Chartered Accountants and Statutory Auditors ("PwC") acting in their capacity as the Issuer's auditors, but by PwC acting in their capacity as HBEU's auditors.

The 2018 discontinued operations results, in each case, of the Transferred Businesses represent the six months to 30 June 2018, and the 2017 results are for the year ended 31 December 2017.

	<u>2018</u>	<u>2017</u>
	<u>£(m)</u>	<u>£(m)</u>
Net operating income ^{1, 2}	3,037	5,767
Total operating expenses ^{2, 3}	(1,894)	(4,635)
Operating profit	1,143	1,132
Profit before tax	1,143	1,132
Tax expense	(323)	(330)
Profit for the year	820	802
Profit from discontinued operations attributable to shareholders of the parent company	820	802
Profit/(loss) for the year attributable to non-controlling interests	-	-

Notes

- (1) Includes operating income for RBWM, CMB and GPB, adjusted to exclude CMB operating income for customers not transferred to the Issuer.
- (2) Includes a portion of Global Foreign Exchange ("GFX") and 50% of Balance Sheet Management ("BSM") operating income and operating expenses for 2017 and the first four months of 2018; until the establishment of separate BSM and GFX functions for the Issuer.
- (3) Includes 100% of costs to establish the UK ring-fenced bank of £251m in 2017 and an apportionment of the costs to achieve not assigned to a specific global business. Costs of establishment apportioned to the Issuer are on the basis that they were incurred to launch the retail and commercial business of the Issuer in the UK, in order to meet regulatory requirements on ring-fencing.

GENERAL INFORMATION

1. There has been no significant change in the financial or trading position of the Group nor any material adverse change in the prospects of the Issuer since 31 December 2018.
2. Save as disclosed in Note 19 (*Provisions*) on pages 94 to 95 and in Note 27 (*Legal proceedings and regulatory matters*) on pages 102 to 103 of the 2018 Annual Report and Accounts, there are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened against the Issuer or any of its subsidiary undertakings of which the Issuer is aware) during the 12 month period before the date of this Registration Document which may have, or have had in the recent past, significant effects on the financial position or profitability of the Issuer and/or the Group.
3. The Issuer prepares its consolidated financial statements in accordance with IFRS.
4. PricewaterhouseCoopers LLP, Chartered Accountants and Statutory Auditors, of 1 Embankment Place, London WC2N 6RH, United Kingdom has audited without qualification the financial statements contained in the Annual Report and Accounts of the Issuer for the financial year ended 31 December 2018.
5. PricewaterhouseCoopers LLP is a member firm of the Institute of Chartered Accountants in England and Wales and has given and has not withdrawn its written consent to the inclusion of its report in Part (B) of "Additional Financial Information", in the form and context in which it appears, and has authorised the contents of its report for the purposes of Rule 5.5.4R(2)(f) of the FCA's Prospectus Rules. A written consent under the FCA's Prospectus Rules is different from a consent filed with the U.S. Securities and Exchange Commission under Section 7 of the U.S. Securities Act of 1933, as amended (the "**Securities Act**"). As the Securities to which this Registration Document relates are not expected to be registered under the Securities Act, PricewaterhouseCoopers LLP has not filed a consent under Section 7 of the Securities Act.
6. For so long as the Issuer may issue Securities with respect to which this Registration Document forms part of a prospectus prepared by the Issuer relating to such Securities, (a "**Prospectus**"), the following documents may be inspected during normal business hours at the registered office of the Issuer:
 - (a) the memorandum and articles of association of the Issuer;
 - (b) the 2018 Annual Report and Accounts; and
 - (c) the Issuer's audited financial statements for the year ended 31 December 2017.
7. The Issuer will, at its registered office, and at the specified offices of the Principal Paying Agent, make available for inspection during normal office hours of the Principal Paying Agent, free of charge, upon oral or written request, a copy of this Registration Document and any Prospectus (as defined above). Written or oral requests for inspection of such documents should be directed to the specified office of the Principal Paying Agent.
8. The Legal Entity Identifier (LEI) code of the Issuer is 21380081EP12LC86CB82.

FINANCIAL INFORMATION OF THE ISSUER

(A) THE ISSUER'S ANNUAL REPORT AND ACCOUNTS 2018

(Note: the proforma financial information presented on pages 2, 8, 9, 10, 11, 12 and 25 of the Annual Report and Accounts 2018 do not form part of this Registration Document)

HSBC UK Bank plc

Annual Report and Accounts 2018

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Presentation of information

This document comprises the *Annual Report and Accounts 2018* for HSBC UK Bank plc ('the bank') and its subsidiaries (together 'HSBC UK' or 'the group'). 'We', 'us' and 'our' refer to HSBC UK Bank plc together with its subsidiaries. It contains the Strategic Report, the Report of the Directors, the Statement of Directors' Responsibilities and Financial Statements, together with the Independent Auditors' Report, as required by the UK Companies Act 2006. References to 'HSBC Group' or 'the Group' within this document mean HSBC Holdings plc together with its subsidiaries.

HSBC UK Bank plc is exempt from publishing information required by The Capital Requirements Country-by-Country Reporting Regulations 2013, as this information is published by its ultimate parent, HSBC Holdings plc. This information will be available in June 2019 on HSBC's website: www.hsbc.com.

Pillar 3 disclosures for HSBC UK are also available on www.hsbc.com, under Investor Relations.

All narrative disclosures, tables and graphs within the Strategic Report and Report of the Directors are unaudited unless otherwise stated.

Our reporting currency is £ sterling. Unless otherwise specified, all \$ symbols represent US dollars.

Cautionary statement regarding forward-looking statements

The Annual Report and Accounts 2018 contains certain forward-looking statements with respect to HSBC UK's financial condition, strategy, plans, current goals, results of operations and business, including strategic priorities and financial, investment and capital targets described herein.

Statements that are not historical facts, including statements about HSBC UK's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'targets', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential' and 'reasonably possible', variations of these words and similar expressions are intended to identify forward-looking statements.

These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made. HSBC UK makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statements.

Written and/or oral forward-looking statements may also be made in offering circulars and prospectuses, press releases and other written materials, and in oral statements made by HSBC UK's Directors, officers or employees to third parties. Forward-looking statements involve inherent risks and uncertainties because they relate to future events and circumstances. Readers are cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward-looking statement. These include, but are not limited to:

- Changes in general economic conditions in the UK and internationally such as instability in the global financial markets, including Eurozone instability and instability as a result of the UK withdrawal from the European Union ('EU'), continuing or deepening recessions and fluctuations in employment beyond those factored into forecasts; changes in foreign exchange rates and interest rates; volatility in equity markets; lack of liquidity in wholesale funding markets; illiquidity and downward price pressure in real estate; adverse changes in central banks' policies with respect to the provision of liquidity support to financial markets; heightened market concerns over sovereign creditworthiness; adverse changes in the funding status of public or private defined benefit pensions; and consumer perception as to the continuing availability of credit and price competition in the market segments we serve and deviations from the market and economic assumptions that form the basis for our measurements;
- Changes in government policy and regulation, including the monetary, interest rate and other policies of central banks and other regulatory authorities; initiatives to change the size, scope of activities and interconnectedness of financial institutions in connection with the implementation of stricter regulation of financial institutions in key markets worldwide; revised capital and liquidity benchmarks which could serve to deleverage bank balance sheets and lower returns available from the current business model and portfolio mix; imposition of levies or taxes; the practices, pricing or responsibilities of financial institutions serving their consumer markets; expropriation, nationalisation, confiscation of assets and changes in legislation relating to foreign ownership; changes in bankruptcy legislation in the UK, EU and the principal markets in which HSBC UK operates and the consequences thereof; general changes in government policy that may significantly influence investor decisions; extraordinary government actions as a result of current market turmoil; other unfavourable political or diplomatic developments producing social instability or legal uncertainty which in turn may affect demand for our products and services; the costs, effects and outcomes of product regulatory reviews; regulatory or competition scrutiny, legal, regulatory or competition investigations; actions or litigation, including any additional compliance requirements;

Strategic Report

and the effects of competition in the UK, EU and the markets where HSBC UK operates including increased competition from non bank financial services companies.

- Factors specific to HSBC UK, including our success in adequately identifying the risks we face, such as the incidence of loan losses or delinquency, and managing those risks (through account management, hedging and other techniques). Effective risk management depends on, among other things, our ability through stress testing and other techniques to prepare for events that cannot be captured by the statistical models it uses; and our success in addressing operational, legal and regulatory, and litigation challenges; and other risks and uncertainties we identify in 'Top and emerging risks'.

About us

About HSBC UK

HSBC UK largely comprises Retail Banking and Wealth Management ('RBWM'), Commercial Banking ('CMB') and Private Banking ('GPB'). HSBC UK Bank plc and its subsidiaries form part of the HSBC Group.

These businesses were transferred from HSBC Bank plc on 1 July 2018, following the court approval of the ring-fenced transfer scheme to meet the regulatory ring-fencing requirements in accordance with the Financial Services (Banking Reform) Act 2013 and related legislation.

Ring-fenced bank

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

Ring-fencing implementation

The HSBC Group completed the ring-fencing of its UK retail banking activities on 1 July 2018, transferring circa 14.5 million qualifying RBWM, CMB and GPB customers from HSBC Bank plc to the bank. This included the transfer of relevant retail banking subsidiaries. HSBC Bank plc, which is HSBC Group's non-ring-fenced bank, has retained the non-qualifying components, primarily the UK Global Banking and Markets ('GB&M') business and the overseas branches and subsidiaries. The two banking entities will operate alongside each other, supported by services received from HSBC Global Services (UK) Limited ('UK ServCo').

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

Our ambition, role and values

HSBC UK Shared Ambition

The UK bank Shared Ambition sits at the heart of what we do; "Deeply rooted in the UK and providing a unique gateway to the world, we are investing in growth and innovation to make banking simple, safe and sustainable, and be the bank of choice for our customers, colleagues and communities through the generations".

Our role in society

How we do business is as important as what we do. Our responsibilities to our customers, employees and shareholders, as well as to wider society, go far beyond simply being profitable. We

seek to build trusting and lasting relationships with our many stakeholders to generate value in society.

Our values

Our values define who we are as an organisation and what makes us distinctive.

Dependable

- We are dependable, standing firm for what is right and delivering on commitments.

Open

- We are open to different ideas and cultures and value diverse perspectives.

Connected

- We are connected to our customers, communities, regulators and each other, caring about individuals and their progress.

Our UK presence

HSBC UK, headquartered from our new Birmingham head office, has 14.5m customers being served by 22,000 employees across the country, supported by a further 11,000 employees based in our UK service company HSBC Global Services (UK) Limited who provide services to HSBC UK and the wider HSBC Group.

HSBC UK remains well connected to the rest of the HSBC Group and leverages this network to grow revenue and support customers across key trade corridors around the world.

Highlights

	2018	2017
For the year (£m)		
Reported Profit before tax	1,064	—
Reported Profit attributable to shareholders of the parent company	763	—
Pro forma adjusted revenue	6,449	6,009
Pro forma adjusted Profit before tax	2,540	2,388
At year-end (£m)		
Total equity attributable to shareholders of the parent company	22,273	15
Total assets	238,939	15
Risk-weighted assets	91,839	—
Loans and advances to customers (net of impairment allowances)	174,807	—
Customer accounts	204,837	—
Capital ratios (%)		
Common equity tier 1	12.7	N/A
Tier 1	15.1	N/A
Total capital	18.3	N/A

Presentation of pro forma information

The 2018 results, and the 2017 comparatives as disclosed in the Financial Statements and Notes on the Financial Statements on pages 62 to 107, and the audited sections within the Strategic Report and Report of the Directors reflect the transfer of businesses to HSBC UK at 1 July 2018. For these sections the 2017 comparatives are as presented in the bank's *Annual Report and Accounts 2017*, and the 2018 results represent 6 months of banking operations. The transferred businesses were in operation in HSBC Bank plc prior to the transfer to the bank, and pro forma information is presented in the Strategic Report where indicated, for illustrative purposes only, to enable an understanding of the performance of the transferred businesses. For the basis of preparation, see page 70.

Product and services

HSBC UK manages its products and services through its four businesses: Retail Banking and Wealth Management ('RBWM'); Commercial Banking ('CMB'), Private Banking ('GPB') and Global Banking and Markets ('GB&M'). Finally, certain central operations of the HSBC UK business lines are managed through the Corporate Centre.

Retail Banking and Wealth Management ('RBWM')

Customers

HSBC UK RBWM serves customers in the UK through two main business areas: Retail Banking and Wealth Management.

Products and services

For customers who have simpler everyday banking needs, RBWM offers a full range of banking products and services. RBWM also caters for customers under the HSBC UK Premier and Advance propositions, which is targeted at mass affluent and emerging affluent individuals, who value international connectivity. Four brands sit under the HSBC UK RBWM umbrella; HSBC UK, first direct, M&S Bank and John Lewis Financial Services.

Business synergies

RBWM makes a significant contribution to the overall success of HSBC UK and the Group as a whole, with close collaboration with other business lines. For example, the foreign exchange and wealth management needs of RBWM clients create opportunities for GB&M.

Areas of focus

RBWM's focus is on supporting customers and growing the business through relationship-led lending and wealth management, whilst transforming customer experience and the cost base, through investment in digital infrastructure.

Commercial Banking ('CMB')

Customers

CMB customers range from small enterprises focused primarily on their domestic markets, through to large corporates operating globally.

Products and services

CMB supports our customers with tailored financial products and services to allow them to operate efficiently and to grow. We provide working capital, term loans, payment services and international trade facilitation. Through close collaboration with GB&M, we can also offer expertise in mergers and acquisitions, and provide access to the capital markets.

Business synergies

CMB collaborates closely across HSBC UK to fully support our customers at various points in their lifecycle; for example, GPB can support the owners of CMB companies looking to exit and grow their wealth, and CMB works closely with RBWM to offer employee banking services for our clients. In parallel, GB&M provide capital finance expertise to CMB clients, and HSBC Global Insurance and HSBC Global Asset Management capabilities also benefit UK CMB clients.

Areas of focus

CMB is focused on growing long-term value from its network and is investing heavily in digital and technology, particularly within its core Global Liquidity and Cash Management ('GLCM') and Global Trade and Receivables Finance ('GTRF') propositions. CMB is also focused on serving its client base in an increasingly simple and efficient manner.

Global Private Banking ('GPB')

Customers

GPB serves high net worth individuals and families, including those with international banking needs.

Products and services

GPB supports clients with investment management, incorporating advisory, discretionary and brokerage services; Private Wealth solutions, comprising trusts and estate planning, designed to protect wealth and preserve it for future generations; and a full range of Private Banking services.

Business synergies

GPB products can be relevant for clients across HSBC UK and globally, with GPB clients also benefitting from asset management, research, insurance, trade finance and capital financing, capabilities within our other business lines.

Areas of focus

GPB aspires to build on HSBC's commercial banking heritage and be the leading private bank for high net worth business owners and principals.

Global Banking and Markets ('GB&M')

In compliance with ring-fencing regulation, we are able to offer selected Global Banking and Markets products to our customer base through close collaboration. For example, we maintain a small treasury and markets team that help to support the sale of eligible markets products to our Commercial Banking clients.

Corporate Centre

Corporate Centre comprises Central Treasury, including Balance Sheet Management ('BSM'), interests in a joint venture, and central stewardship costs that support our businesses.

Purpose and strategy

Our purpose

The HSBC Group purpose is to be where the growth is, connecting customers to opportunities. We enable businesses to thrive and economies to prosper, helping people to fulfil their hopes and dreams and realise their ambitions.

Our strategy

The launch of HSBC Group's ring-fenced bank, HSBC UK, marked the beginning of a new chapter for HSBC's strategy in the UK. In launching HSBC UK, more than 1,000 roles have moved from London to Birmingham, and in October 2018, we celebrated the opening of our new Birmingham head office. The operational launch of HSBC UK was successfully completed in July 2018, representing the culmination of 3 years work that saw more than 250 IT systems successfully separated, and 400,000 bank accounts receiving new HSBC UK sort codes.

Coinciding with the launch of HSBC UK in July 2018, a refreshed strategy was agreed to capture value from our UK network over the coming years. This strategy aligns to the wider HSBC Group strategy, which focuses on delivering sustainable growth from areas of strength, including HSBC UK.

Our UK strategy is built around 4 key strategic priorities that underpin delivery of the HSBC UK vision, enabling us to be simple, safe and sustainable.

Customer experience

- We aim to create compelling customer journeys and digital experiences whilst continuing to invest in a future channel model.

People engagement

- We want to build an agile and inclusive culture, developing the 'Healthiest Human System' in the UK, whilst also improving our 'ways of working'.

Profitable growth

- Building from positions of existing strength, as well as supporting emerging customer needs, we will grow our business in a safe and sustainable way. This will include targeted growth in market share for key products, including mortgages.

Simplification

- We strive to continually enhance our platforms and architecture, simplify our products and features and transform processes to enable and empower our people to deliver outstanding customer service.

Progress in 2018

Since July 2018, HSBC UK has made encouraging progress in delivering against these strategic ambitions. We first achieved the top spot in the Competition and Markets Authority ('CMA') rankings for customer service in August 2018, and the HSBC UK Retail Banking & Wealth Management brand has seen improvements in Customer Recommendation Index ('CRI') scoring. This progress reflects our top-rated digital platforms and the launch of Connected Money, the HSBC UK response to Open Banking.

HSBC UK Commercial Banking has also seen good progress with customer satisfaction in 2018; in the most recent Charterhouse survey, we saw positive improvement in Net Promoter Scores ('NPS') across our Relationship Management segments, with our Mid-Market Enterprise ('MME') segment achieving its highest ever score. To further support our customers, CMB has also launched a new £12bn SME lending fund (our largest to date), including a specific £1bn to help exporters.

Some improvement has been made with colleague engagement at HSBC UK, with improving trends in the annual Banking Standards Board ('BSB') Assessment, and internal Snapshot results. We held

our first HSBC UK Wellbeing Week in 2018, which saw colleagues across the country coming together to discuss physical, financial and emotional wellbeing.

Distinctive advantages

Access to an exceptional global presence

Our access to the HSBC Group's global presence enables our clients to participate in international growth opportunities, and helps us build deeper and more enduring relationships with businesses and individuals with increasingly international needs.

Universal banking model

We serve our banking customers through our three core businesses; Retail Banking and Wealth Management, Commercial Banking and Private Banking, serving individual savers through to large multinational corporations. This universal banking model enables us to effectively meet our clients' diverse financial needs, support a strong capital and funding base, reduce risk profile and volatility, and generate stable returns for shareholders.

Process of UK withdrawal from the European Union

The UK is due to formally leave the EU in March 2019. However, there is no certainty on the future relationship between the UK and the EU or indeed an implementation period. This creates market volatility and economic risk, particularly in the UK. While there may be some changes to the provision of products and services for our clients and employees based in the UK, we are taking mitigating actions to help minimise any potential disruption. Our priority is to ensure we continue to support our clients through this period of uncertainty, and help them minimise the impact of these potential risks. We continue to stay very close to our clients, via proactive communications and dedicated channels to respond to customer queries. Through sectoral analysis, portfolio reviews and stress-testing scenarios, we have developed a range of contingency plans to ensure we continue to support our clients and minimise potential disruption. For further information, please refer to our top and emerging risks on page 15 and 'Areas of special interest' on page 18.

In spite of this significant external uncertainty, we remain confident in our strategy, and will continue to build on positive progress, and our strong UK foundations, to deliver our ambition of making banking simple, safe and sustainable.

Value of the network

HSBC UK's network of businesses covers the UK, but also remains well connected to the HSBC Group's wider geographical coverage model.

Services around the UK

We provide products and services to meet our clients' diverse financial needs. Our business in the UK includes 777 HSBC UK and M&S Bank branches, bureaux and offices, 120 commercial centres, and 10 contact centres. The HSBC Group's geographic reach and network of clients allows greater insight into the trade and capital flows across supply chains.

Business synergies

We share resources and product capabilities across our businesses and leverage these synergies when serving our customers. In compliance with ring-fencing regulations, we are able to provide selected global markets products, for example, to large multinationals as well as to small businesses. Working carefully with selected partners, we offer insurance products to individuals and corporations alike. Many of our private banking clients are business owners whom we also serve as corporate clients.

How we do business

We conduct our business in a way that ensures we support the sustained success of our people, customers and communities. We see investment in our capabilities, employees and processes as a source of long-term competitive advantage.

Customers

We have made significant improvements to the way we listen to our customers, and their feedback has helped improve our products and services. However, there's always more we can do to simplify processes, improve the customer experience and ensure we deliver fair outcomes to all our customers.

Acting on feedback

Listening to customers and asking their opinions on our service is core to understanding their needs and concerns. Here, we highlight some examples of how customer feedback has driven improvements across our businesses in 2018:

Digital

In an increasingly digital market, customers want to interact with their bank in a way that works best for them and puts them in control. This means we need to give them a choice of channels and convenient access to support when they need it. In 2018, we have introduced many improvements to our digital offerings. Retail and Commercial customers now have access to mobile/web chat, complementing our traditional telephone and branch channels. We are also using innovative Artificial Intelligence (AI) solutions, including Virtual Assistants to understand what is causing problems for our customers. By analysing exit survey and app store feedback, we are also able to shape future digital improvements around what our customers want and need.

Simplification

Our customers tell us that they want us to be easy to do business with, as well as safe and secure. We have worked hard in 2018 to reduce complexity and streamline our processes. In RBWM, we have significantly reduced the time taken to offer a mortgage through our direct channels. We have increased our broker availability across the UK, giving our customers the choice of both direct or intermediary channels. We are using assisted digital processes, and upskilling our people, to reduce the time it takes our customers to open accounts and access our products, across all of our brands.

In our Private Bank, the introduction of 'Live Sign' has led to an encouraging reduction in the average turnaround time for new products; the introduction of a streamlined documentation process has also reduced the account opening time.

CMB have focused on making it simpler and faster for new corporate customers to on-board with HSBC. We have done this by investing in centres of excellence and specialists across the UK, ensuring our people have the time to truly understand customer needs and expectations. Our customers are also beginning to benefit from the introduction of 'parallel processing', which allows multiple products and accounts to be on-boarded concurrently. These initiatives have both significantly reduced on-boarding time and increased customer satisfaction scores.

Enhancing our propositions and journeys

As we strive to be the bank of choice for customers, we are committed to making improvements to our customer journeys and propositions. For example, in CMB, we have implemented an innovative 'screen sharing' solution to allow our customers and colleagues to work more together virtually, more effectively. The introduction of the Universal Banker programme in our Retail Banking branches has enhanced the overall branch experience, allowing customers to be better served at their first point of contact, with an increasingly seamless combination of digital and physical services. Our Private Bank is piloting the HSBC Group's 'Next Generation' proposition, which looks to explore the transfer

of wealth by Ultra High Net Worth customers, to millennials over the next 10 years.

Taking responsibilities for the experiences we deliver

We define conduct as delivering fair outcomes for customers and not disrupting the orderly and transparent operation of financial markets. This is central to our long-term success and ability to serve customers. We have clear policies, frameworks and governance in place to protect customers. These cover the way we behave, design products and services, train and incentivise employees, and interact with customers and each other. Our Conduct Framework guides activities to strengthen our business and increases our understanding of how the decisions we make affect customers and other stakeholders. Details on our Conduct Framework are available at www.hsbc.com.

Engaging our employees

Our people are critical to our success. We believe in listening to them and encouraging them to speak up. We are committed to fostering a culture that encourages and promotes the right behaviour, where employees feel empowered to voice their opinions and concerns. We believe diversity and inclusion across the organisation will help to create an environment where employees can thrive in their own careers, and enable us to better support our customers and the communities we serve.

Creating an inclusive workforce

To be truly effective we must create an environment that is diverse and inclusive, where everyone feels they can thrive. Continued success will require a workforce that reflects our customers and the societies we serve. Our definition of diversity and inclusion goes broader than inherent characteristics to include other differences that make individuals unique, such as cultural fluency, global experience and work styles. We encourage diversity of thought from our leaders and our employees so we can deliver on our purpose.

Gender balance is an important part of creating a diverse and inclusive environment. HSBC UK is supporting the 30% Club's CEO Campaign, which strives for a target of 30% women in senior leadership roles (classified as 0-3 in our global career band structure) by the end of 2020. HSBC UK is proud to have already achieved a figure of 30.7% in 2018.

Listening to our people

We have a structured communications approach that uses leadership communications, campaigns and a regular flow of news to help colleagues to make sense of our strategy, focus employees on our commercial priorities and provide clarity on issues. We build a sense of pride and purpose by recognising our colleagues' contributions to our business and celebrating the achievements of HSBC UK.

Understanding how our employees feel about HSBC is vital. It helps us ensure that we are giving them the right support to fulfil their potential and do the right thing for our customers.

Employees are asked for feedback and encouraged to speak up. We continue to test the views of a representative sample of our people on a range of topics via our employee research, 'Snapshot', which was run every quarter in 2018. Snapshot results are presented to the HSBC UK Executive Committee and HSBC UK Board, and other relevant committees of the functions and businesses. This ensures the attitudes and sentiments of our people inform decision-making at all levels of HSBC, and action can then be taken to tackle areas of concern.

Feedback from HSBC UK 'Exchanges' is also an important way of listening to our people; Exchange sessions are safe forum meetings, without agendas, attended by employees from across the organisation. They can discuss what matters to them, share views and suggest ideas, while managers and leaders attend to listen. Our insight shows us that where our people participate in Exchange they are generally more positive about their experience

at HSBC. They feel better able to speak up, are more trusting of managers and leaders, and report higher levels of well-being. It is our intention that all of our people have the opportunity to take part in an Exchange meeting each quarter.

Whistleblowing

Having a culture where our employees feel able to speak up is important. Though individuals are actively encouraged to raise concerns about wrongdoing or unethical conduct through the usual reporting and escalation, we understand that in some circumstances employees would prefer a more discreet way to raise their concerns. HSBC Confidential, provides a platform that enables all employees to raise concerns on any issues, outside the usual escalation channels, in confidence and without fear of retaliation. Multiple channels have been established to raise issues, including telephone hotlines, online and email, and these channels deal with a broad range of concerns at different severity levels.

HSBC UK does not condone or tolerate any acts of retaliation against anyone who reasonably believes that the concern that they have raised is true. Concerns raised are investigated thoroughly and independently.

The Group Audit Committee has overall responsibility for reviewing the Group's whistleblowing policy and procedures, and receives regular updates on relevant concerns raised under these procedures, together with management actions taken in response.

A responsible business culture

HSBC UK's ambition is to be a leading UK financial institution, that is safe, simple and sustainable; this reflects our responsibility to protect our customers, our communities and the integrity of the financial system.

Non-financial risks

We use a range of tools to monitor and manage our non-financial risks including our risk appetite, risk map, top and emerging risks and stress-testing processes.

Cybersecurity

Cybersecurity continues to be a focus area for the Board and is routinely reported to ensure appropriate visibility, governance and executive support for our ongoing cybersecurity activities. We continue to strengthen and invest significantly in both business and technical controls in order to prevent, detect and respond to an increasingly hostile cyber threat environment. These include enhancing controls to protect against advanced malware, data leakage, infiltration of payments systems and denial of service attacks.

Financial crime compliance

HSBC UK has a responsibility to help protect the integrity of the global financial system. In order to fulfil that responsibility, we have made, and continue to make, significant investments in our ability to detect, deter, and prevent financial crime. We have exited customers where we deemed the financial crime risk too high to manage. We are also working with the UK government and other banks to advance our collective interests in this area. These steps are enabling us to much more effectively reduce the risk of financial crime.

Our risk appetite has been set formally. Further details may be found in the Risk section on page 19.

Anti-bribery and corruption

HSBC UK is committed to high standards of ethical behaviour and operates a zero tolerance approach to bribery and corruption. We consider such activity to be unethical and contrary to good corporate governance and require compliance with all anti-bribery and corruption laws in all markets in which we operate. We have a global Anti-Bribery & Corruption Policy which gives practical effect to global initiatives such as the Organisation of Economic Co-Operation and Development (OECD) Convention on Combating Bribery of Foreign Public Officials in International Business

Transactions and Principle 10 of the United Nations Global Compact.

Tax

We apply the spirit as well as the letter of the law in all relevant territories and have adopted the UK Code of Practice for the Taxation of Banks. As a consequence, we believe that we pay our fair share of tax. We continue to strengthen our processes to help ensure our banking services are not associated with any arrangements known or suspected to facilitate tax evasion. HSBC Group continues to apply global initiatives, with which HSBC UK is required to comply, to improve tax transparency such as:

- the US Foreign Account Tax Compliance Act ('FATCA');
- the OECD Standard for Automatic Exchange of Financial Account Information (also known as the Common Reporting Standard);
- the Capital Requirements Directive IV ('CRD IV') Country by Country Reporting;
- the UK legislation on the corporate criminal offence ('CCO') of failing to prevent the facilitation of tax evasion; and
- the OECD Base Erosion and Profit Shifting ('BEPS') initiative.

We do not expect the BEPS or similar initiatives adopted by national governments to adversely impact our results.

Human rights

HSBC Group's commitment to respecting human rights, principally as they apply to our employees, our suppliers and through our lending, is set out in our 2015 Group Statement on Human Rights. This statement, along with our ESG Updates and our statements under the UK's Modern Slavery Act ('MSA'), which includes further information, is available on www.hsbc.com/our-approach/measuring-our-impact. The next MSA statement will be published in April 2019.

Supporting sustainable growth

We recognise our wider obligations to the communities in which we operate, and understand economic growth must also be sustainable. We will continue to engage with our stakeholders, and set policies that change in line with technology, science and societal expectations.

Our sustainable growth initiatives are set out in an integrated strategy aligned to our HSBC Group strategy and our global business operations. These initiatives are managed across three pillars: sustainable finance; sustainable networks and entrepreneurship; and future skills. These are underpinned by our sustainability risk policies and approach to sustainable operations. Now more than ever, there is a need to develop the skills, business innovation and low-carbon solutions needed to secure long-term prosperity for all. For HSBC UK, these are the key elements of sustainable growth which we can influence.

Our global progress update on our sustainability strategy is published annually in the HSBC Holdings plc ESG (Environmental, Social and Governance) Update. <https://www.hsbc.com/our-approach/measuring-our-impact>.

Sustainable finance

We define sustainable finance as any form of financial service that integrates environmental, social and governance ('ESG') criteria into business or investment decisions. It covers the financing and investment activities needed to support the United Nations Sustainable Development Goals ('SDGs'), and the Paris Agreement.

A key objective for HSBC UK is to provide financing to enable the transition to a low-carbon economy and to help clients manage transition risk, provide credit and lending facilities, as well as advisory services and access to capital markets. In 2018, HSBC UK launched a commercial Green Loan product and two multi-

asset portfolios that back global companies with high ESG scores for sustainable practices.

In 2018, the HSBC UK Pension scheme also committed to invest £250 million in sustainable infrastructure such as solar and wind farms that will generate enough energy to power the city of Oxford for a year.

Sustainable finance case study

In 2018, HSBC UK acted as Green Coordinator, Mandated Lead Arranger and Hedging Counterparty for a £400m development facility provided to the Kings Cross Central Limited Partnership ('KCCLP') for the construction of two of the world's greenest office buildings in London's Kings Cross. HSBC UK provided £150m to support this venture, alongside two other banks

The funding was aligned to the new Green Loan Principles ('GLP') which were published in March 2018 by the EMEA and Asia-Pacific Loan Market Associations and represents one of the first GLP compliant loans used for the development of a commercial office building in the UK. Both buildings are targeting the highest level of green building certification, "BREAM Outstanding".

Sustainability training programme

To raise awareness of the transition to a low-carbon economy, HSBC UK runs a Sustainability training programme in conjunction with Earthwatch, an environmental charity. In 2018, we ran 6 off-site training programmes, 66 employees attended a 2-day offsite Sustainability Training Programme and 20 senior leaders attended a 3-day Sustainability Leadership Programme. In addition, we launched on-line training in collaboration with the Cambridge Institute of Sustainability Leadership on our HSBC University platform.

Sustainable operations

HSBC UK plays a key part in supporting the transition to a low-carbon economy, both via our own operations and by supporting customers in their transition strategies.

We are already making great progress on our commitment to source 100% of our electricity from renewable sources by 2030. 71% of our electricity comes from renewables through power purchase agreements for two wind and one solar farm.

Reduce programme

We have committed to reduce our waste by 75% and recycle 100% of our office and electronic waste. By the end of 2018, we reduced waste by 57% and recycled 75% of our waste, these figures are for all HSBC Group buildings in the UK. We have prioritised the removal of all our single use plastic by the end of 2019 and all employees will receive a water bottle, which will remove 9 million plastic cups per annum from our waste in the UK.

HSBC UK office building in Birmingham

The design and features of our new building in Birmingham benefit from the latest research and developments on sustainability. We are proud to be on target to achieve LEED (Leadership in Energy and Environmental Design) Gold certification.

How we do business in the community:

Future Skills

As part of HSBC UK's sustainability strategy the group is focusing on Future Skills - for our customers, employees and for the people in our local communities. This is being achieved by concentrating on two key areas: employability and financial capability.

Employability

HSBC UK's charitable partnerships help people develop employment-related skills. We are working with The Prince's Trust to build on our support through a Future Skills partnership that has assisted young people to develop their employability skills. HSBC UK provides job opportunities for these young people through a 4-week work experience programme run in partnership with The Prince's Trust. We support Young Enterprise and their Company

Programme, which enables young people to set up and run a Student Company and make the connection between school and the preparation for the world of work, enabling them to develop the knowledge and attitudes they need to succeed. A new award for the best Sustainable Business was introduced into the programme in 2018. With our help, over 10,000 young people will be supported through the programme to develop employability and entrepreneurship skills.

Financial capability

We are helping people secure their financial futures through building financial capability. Providing our customers, our communities and our employees with the skills and knowledge needed to thrive in the global economy. We have helped over 13,085 employees, young people and clients understand their financial needs and make the most of their money through over 477 financial Well-being sessions.

Community investment

We recognise our wider obligations to the communities where we operate and donated £2.8million to charities in the UK. Our local charitable funding supports vulnerable people through the generations. These employee-led projects range from £3,000 to £50,000 and we supported 34 local charities in 2018. There is also a fund to match employee fundraising or volunteering in their own time for up to three charities. Thousands of HSBC UK employees volunteer every year with our charitable partnerships and programmes. All employees can take two days per annum to volunteer for a charity of their choice in work time.

Community investment case study

Supporting our vulnerable communities.

St Basil's is a Birmingham based charity that has been operating across the West Midlands for the last 25 years. The charity works with young people aged between 16-25 who are homeless or at risk of homelessness. They help approximately 5,000 young people per year through their services with over 1,500 using the 34 supported accommodation schemes.

In 2018, we continued to support the St Basil's Accredited Life Skills Programme, which will reach 750 young people. This programme includes a number of modules such as budgeting, cv writing, household skills and first aid. The participants can choose the most suitable modules for their needs or aspirations. Once modules are completed they are collated and forwarded to the Open College Network for external examination and accreditation giving the young people real and tangible certification which can then be carried forward in their futures.

Key Performance Indicators

The Board of Directors tracks HSBC UK's progress in implementing its strategy with a range of financial and non-financial measures or key performance indicators ('KPIs'). Progress is assessed by comparison with the group strategic priorities, operating plan targets and historical performance.

HSBC UK reviews its KPIs regularly in light of its strategic objectives and may adopt new or refined measures to better align the KPIs to HSBC Group's strategy and strategic priorities.

The businesses were in operation in HSBC Bank plc prior to the transfer to the bank on 1 July 2018. Pro forma information is presented to enable an understanding of year-on-year performance. KPIs below therefore include pro forma results for 2017 and the first six months of 2018.

Financial KPIs

	Pro forma 2018	Pro forma 2017
Profit before tax (£m)	2,207	1,132
Profit before tax (adjusted) (£m)	2,540	2,388
Jaws (adjusted) (%)	3.8	N/A
Cost efficiency ratio (%)	59.8	77.3
Cost efficiency ratio (adjusted) (%)	54.4	56.5

Adjusted profit before tax adjusts the pro forma profit for the effect of significant items as detailed on pages 11 to 12.

Profit before tax was higher year-on-year for all businesses. This was driven by higher revenue and lower significant items which were offset by higher operating expenses and 2018 expected credit losses and other credit impairment charges ('ECLs') being higher than 2017 loan impairment charges and other credit risk provisions ('LICs'). Adjusted profit before tax increased driven by higher revenue offset by higher operating expenses and 2018 ECL's being higher than 2017 LICs.

Adjusted jaws measures the difference between adjusted revenue and adjusted cost growth rates (excluding the effects of significant items as detailed on pages 11 to 12). Our target is to grow revenues faster than operating expenses on an adjusted basis. This is referred to as positive jaws. In 2018, we grew adjusted revenue by 7.3% and our adjusted operating expenses increased at a rate of 3.5%. Jaws was therefore positive 3.8%.

Cost efficiency ratio is measured as total operating expenses divided by net operating income before ECLs. In 2018, pro forma revenue increased by 8.2% while pro forma operating expenses decreased by 16.2%. The pro forma cost efficiency ratio improved by 17.5%. The adjusted cost efficiency ratio improved by 2.1%.

Financial KPIs for return on tangible equity (%), return on average risk weighted assets (%) and common equity tier 1 capital ratio (%) will be presented in future annual reports. They have not been included in this annual report as HSBC UK has only been operational since 1 July 2018.

Non-financial KPIs

We also monitor a range of non-financial KPIs focusing on customers, people, culture and values including customer service satisfaction, employee involvement and engagement, and diversity and sustainability. For details on customer service and satisfaction please refer below; for the remaining non-financial KPIs refer to the Corporate Governance section on pages 49 to 50.

Customer service and satisfaction

For RBWM the principal customer metric is the Customer Recommendation Index, measuring customers' likelihood to recommend HSBC UK products and services to friends or family. This measure is tracked relative to competitors, aiming for a positive gap to the market average.

Scores for HSBC UK RBWM have improved during 2018, now scoring 75 for the year (compared to 72 in 2017). Accelerators of this score include improvements in the digital space, both in terms of capability and with the help of our frontline colleagues becoming digital experts. Experience of our overall customer service has also improved year-on-year.

first direct continues to be a market leader for customer recommendation, and in August 2018 were ranked 1st in the Competition and Markets Authority rankings whereby banks are scored by customers on the quality of service. Excellent customer service remains a key brand strength, as does accessibility.

M&S Bank's CRI score has broadly remained flat year-on-year, with a score of 77. This is only 1 point away from the average score across all competitor banks measured.

The focus for RBWM in 2019 continues to be on providing great customer service and demonstrating that the bank understands its customers and their needs. A Customer Service Acceleration Programme Plan is enhancing key customer journeys and delivering improvements to address service issues. An important element of this is improving digital services, and the relaunch of the HSBC UK Mobile app as well as the launch and continued development of the Connected Money app which will help support this. In addition, we continue to introduce new features to our app such as remote cheque deposit.

Our digital enhancements have also been driven through the training of our frontline colleagues to assist customers in using digital channels. In branch or on the phone, they help our customers how to complete their task digitally, and 85% of new customers opened accounts through a supported digital experience.

We also expanded the volume of overdraft alerts, which we first introduced in 2017, sending more than 26 million alerts in 2018.

We have continued to simplify our mortgage process. Through automatic valuations, improved credit policies and increased underwriter availability, applications can be approved within 10 days and complaints have reduced by 19% as a result of journey improvements.

HSBC UK's Commercial Banking uses Net Promoter Score ('NPS') as the principal customer metric, measuring customers' likelihood to recommend their bank to other businesses, which is carried out by an independent third party (Charterhouse). We have seen strong progress within our Relationship Managed segments with our MME segment score improving 9-points between 4Q17 and 4Q18 (based on 352 customers across UK with between £6.5m-£250m turnover). This is UK CMB's highest score ever for the MME segment, reflecting our continued focus to ensure we are building close relationships through regular contact with our customers.

We continue to support our customers, enabling them to grow their businesses both domestically and internationally. Commercial Banking continues to be ranked the number 1 bank in the *Charterhouse Survey* for supporting UK businesses trading internationally. Our international trade credentials were further endorsed with HSBC being named the market leader in global trade finance for the second year running in the *Euromoney Trade Finance Survey 2019*.

Our priorities for 2019 continue to be around simplifying customer processes across key journeys building on investment made thus far, particularly geared around improving speed and ease of access to our people, including:

- The introduction of voice identification which has reduced call times, improved security and made it easier for customers to use Business Telephone Banking
- The introduction of tablets to Small Business Centres so that customer appointments can be made on the same day via "sametime"
- Increasing the number of people available for customers in our Live Chat teams and contact centres.

Economic background and outlook

UK

The UK economy delivered a mixed performance in 2018, which reflects the continuing economic uncertainty, coupled with broadly strong fundamentals. Office of National Statistics ('ONS') data showed that UK growth slowed in 2018 versus the previous year, with GDP growth falling from 1.8% to 1.4%. This slowdown was principally driven by reduced consumption and investment, with net trade also dragging down growth, as imports grew more rapidly than exports. Notwithstanding the slowing of UK growth, unemployment continued to fall over the course of the year, reaching its lowest rate since 1975. This continued growth in

employment was accompanied by encouraging signs of sustained pay growth, which rose at the fastest rate since 2008. Despite this wage growth, inflation decelerated in 2018, ending the year at 1.8% (versus 3.0% in 2017). Reflecting the uncertain environment, and the mixed economic data, the Bank of England raised rates in August 2018 to 0.75%, but kept policy unchanged thereafter.

HSBC Global Research forecasts assume that the UK avoids leaving the EU without an exit deal and begins to move towards agreement on a multiyear transition period. Under this assumption, growth is forecasted to edge up to 1.6% in 2019 and 2020, versus 1.4% in 2018. The unemployment rate is forecast to remain low, at around the 4% mark. CPI inflation is expected to dip below 2%, driven by recent oil price falls and soft underlying price pressures. Given outstanding uncertainties, mainly relating to the UK withdrawal from the European Union, the central forecast is for no Bank Rate rises through 2019 and 2020.

Financial summary

The businesses were in operation in HSBC Bank plc prior to the transfer to the bank on 1 July 2018. Pro forma information is presented in the Strategic Report to enable an understanding of year-on-year performance. Pro forma results for 2017 and the first six months of 2018 have been provided.

Summary consolidated income statement for the year ended

	Pro forma Unaudited	Audited	Pro forma Unaudited	Pro forma Unaudited
	2018	6 months to 31 December 2018	6 months to 30 June 2018	2017
	£m	£m	£m	£m
Net interest income	4,754	2,456	2,298	4,152
Net fee income	1,234	648	586	1,205
Net income from financial instruments held for trading or managed on a fair value basis	433	198	235	449
Gains less losses from financial investments	22	22	–	41
Other operating income	45	33	12	149
Total operating income¹	6,488	3,357	3,131	5,996
Net operating income before change in expected credit losses and other credit impairment charges	6,488	3,357	3,131	5,996
Change in expected credit losses and other credit impairment charges	(399)	(305)	(94)	N/A
Loan impairment charges and other credit risk provisions	N/A	N/A	N/A	(229)
Net operating income	6,089	3,052	3,037	5,767
Total operating expenses ¹	(3,882)	(1,988)	(1,894)	(4,635)
Operating profit	2,207	1,064	1,143	1,132
Profit before tax	2,207	1,064	1,143	1,132

¹ Total operating income and expenses includes significant items as detailed on pages 11 to 12.

Pro forma performance

Pro forma profit before tax was £2,207m, £1,075m higher than 2017.

Net interest income ('NII') increased by £602m, 14%, driven by RBWM with strong performance in current accounts and savings from both balance and margin growth and CMB balance sheet growth from loans and advances and deposit margin improvement.

Net fee income increased by £29m, 2%, from higher balances and volumes in current accounts and savings along with higher fees earned from cards.

Net income from financial instruments held for trading or managed on a fair value basis decreased by £16m, 4%, driven by the transition from IAS 39 to IFRS 9.

Gains less losses from financial investments decreased by £19m, 46%, driven by reduced opportunities in Balance Sheet Management, leading to lower disposals in 2018.

Other operating income decreased by £104m, 70%, which included Vocalink sales proceeds received in 2017.

The 2018 change in expected credit losses and other credit impairment charges ('ECLs') is £399m, higher than the 2017 loan

impairment charges and other credit risk provisions ('LICs') of £229m.

ECLs in the six months to 31 December 2018 ('2H') are £211m higher than the six months to 30 June 2018 ('1H'), driven by charges in 2H relating to UK economic uncertainty and provision releases in 1H.

Total operating expenses decreased by £753m, 16%, driven by a number of significant items including:

- A decrease of £181m in costs of structural reform compared with 2017.
- The cessation of the costs to achieve programme which incurred costs of £483m in 2017.
- UK customer redress provisions reduced by £387m in 2018.
- Offset by an increase in pension costs of £187m following the October 2018 High Court judgement on Guaranteed Minimum Pension equalisation ('GMP').

Excluding these items, operating expenses increased by £118m due to investment in front line capacity, higher operations and technology costs.

For further details of significant items affecting revenue and costs, please refer to significant revenue/cost items by business segment on pages 11 and 12.

Pro forma basis of preparation and non-GAAP financial measures

Within the Strategic Report we use pro forma information to reflect performance of the businesses and subsidiaries transferred from HSBC Bank plc on 1 July 2018 for the periods prior to the legal transfer. We also present performance on an adjusted basis, which is our segment measure for our reportable segments under IFRS 8 but constitutes a non-GAAP financial measure when otherwise presented.

Pro forma basis of preparation

The results and commentary within the Strategic Report are presented on a pro forma basis where indicated. Pro forma results have been calculated for illustrative purposes only for 2017 and 2018 to enable an understanding of the year on year performance of the businesses and subsidiaries transferred to HSBC UK on 1 July 2018. Because of its nature, the pro forma financial information addresses a hypothetical situation and, therefore, does not represent HSBC UK's actual financial results. The pro forma results for 2017 and the first half of 2018 are the same as those presented in the audited financial statements in the HSBC Bank plc *Annual Report and Accounts* in accordance with IFRS 5, 'Non-current Assets Held for Sale and Discontinued Operations' in respect of the business and subsidiaries transferred to HSBC UK.

While the pro forma information has been prepared to capture the results of the transferred businesses and entities that constitute HSBC UK and these reflect the internal management information used to assess performance, prior to 1 July 2018 certain assumptions and simplifications were necessary to arrive at the results. The key assumptions are set out further below.

- The majority of the HSBC Bank plc UK RBWM and UK CMB businesses were transferred to the bank. However, the pro forma results have been adjusted for areas not permitted to be transferred to the bank under ring-fencing rules.
- It has been necessary to perform allocations in respect of certain elements of Corporate Centre for periods prior to 1 July 2018. Primarily these relate to:
 - Balance Sheet Management: allocation assumptions have been used to identify the net profit or loss on treasury-related balances.
 - Service Company charges: These are based on an estimated allocations for services not able to be directly attributed.
- Allocation assumptions have also been required in respect of GB&M Global Foreign Exchange ('GFX') revenues for the periods prior to 1 July 2018.
- 100% of the cost of ring-fencing and an apportionment of the cost to achieve ('CTA') not assigned to a specific global business have been included in the pro forma numbers.

Adjusted performance

Adjusted performance is computed by adjusting the pro forma results for the year-on-year effects of significant items that distort year-on-year comparisons.

We use significant items to describe collectively the group of individual adjustments excluded from the pro forma results when arriving at adjusted performance. These items, which are detailed on pages 11 and 12, are ones that management and investors would ordinarily identify and consider separately when assessing performance to understand better the underlying trends in the business. We consider adjusted performance provides useful information for investors by aligning internal and external reporting, identifying and quantifying items management believes to be significant and providing insight into how management assesses year-on-year performance.

Segmental reporting

Global businesses are our reportable segments under IFRS 8.

The HSBC Group Chief Executive, supported by the rest of the GMB, is considered the Chief Operating Decision Maker ('CODM') for the purposes of identifying the HSBC Group's reportable segments. The global business results are assessed by the CODM on the basis of adjusted performance that removes the effects of significant items from pro forma results. We therefore present these results on an adjusted basis.

Our operations are closely integrated and, accordingly, the presentation of data includes internal allocations of certain items of income and expense. These allocations include the costs of certain support services and global functions to the extent that they can be meaningfully attributed to operational business lines. While such allocations have been made on a systematic and consistent basis, they necessarily involve a degree of subjectivity. Costs which are not allocated to global businesses are included in Corporate Centre.

Where relevant, income and expense amounts presented include the results of inter-segment funding along with inter-company and inter-business line transactions. All such transactions are undertaken on arm's length terms. The intra-group elimination items are presented in the Corporate Centre.

A description of the Global businesses is provided in the Strategic Report, page 3.

Pro forma adjusted profit for the year ended

	RBWM	CMB	GB&M	GPB	Corporate Centre	Total
	£m	£m	£m	£m	£m	£m
31 Dec 2018						
Net interest income	2,655	1,900	(3)	114	49	4,715
Net fee income	630	768	(203)	27	12	1,234
Other income	74	21	346	13	46	500
Net operating income before change in expected credit losses and other credit impairment charges	3,359	2,689	140	154	107	6,449
Change in expected credit losses and other credit impairment charges	(266)	(138)	–	4	1	(399)
Net operating income	3,093	2,551	140	158	108	6,050
Total operating expenses	(2,229)	(1,033)	(125)	(111)	(12)	(3,510)
Operating profit	864	1,518	15	47	96	2,540
Adjusted profit before tax	864	1,518	15	47	96	2,540
31 Dec 2017						
Net interest income	2,442	1,604	–	111	75	4,232
Net fee income	600	790	(210)	25	–	1,205
Other income	56	63	353	30	70	572
Net operating income before change in expected credit losses and other credit impairment charges	3,098	2,457	143	166	145	6,009
Loan impairment charges and other credit provision	(103)	(115)	–	(11)	–	(229)
Net operating income	2,995	2,342	143	155	145	5,780
Total operating expenses	(2,151)	(931)	(134)	(130)	(46)	(3,392)
Operating profit	844	1,411	9	25	99	2,388
Adjusted profit before tax	844	1,411	9	25	99	2,388

Pro forma significant revenue items by business segment

	RBWM	CMB	GB&M	GPB	Corporate Centre	Total
	£m	£m	£m	£m	£m	£m
31 Dec 2018						
Revenue	3,359	2,728	140	154	107	6,488
Significant revenue items	–	(39)	–	–	–	(39)
– customer redress programmes	–	(39)	–	–	–	(39)
Adjusted revenue	3,359	2,689	140	154	107	6,449
31 Dec 2017						
Revenue	3,096	2,380	143	166	211	5,996
Significant revenue items	2	77	–	–	(66)	13
– customer redress programmes	2	77	–	–	–	79
– disposals, acquisitions and investment in new businesses	–	–	–	–	(66)	(66)
Adjusted revenue	3,098	2,457	143	166	145	6,009

Pro forma significant cost items by business segment

	RBWM	CMB	GB&M	GPB	Corporate Centre	Total
	£m	£m	£m	£m	£m	£m
31 Dec 2018						
Operating expenses	(2,358)	(1,027)	(125)	(111)	(261)	(3,882)
Significant cost items	129	(6)	–	–	249	372
– costs of structural reform	1	2	–	–	69	72
– customer redress programmes	128	(8)	–	–	–	120
– guaranteed minimum pension benefits equalisation	–	–	–	–	187	187
– other	–	–	–	–	(7)	(7)
Adjusted operating expenses	(2,229)	(1,033)	(125)	(111)	(12)	(3,510)
31 Dec 2017						
Operating expenses	(2,706)	(950)	(134)	(129)	(716)	(4,635)
Significant cost items	555	19	–	(1)	670	1,243
– costs of structural reform	5	2	–	–	246	253
– costs to achieve	55	5	–	(1)	424	483
– customer redress programmes	495	12	–	–	–	507
Adjusted operating expenses	(2,151)	(931)	(134)	(130)	(46)	(3,392)

Pro forma net impact on profit before tax by business segment

	RBWM	CMB	GB&M	GPB	Corporate Centre	Total
	£m	£m	£m	£m	£m	£m
31 Dec 2018						
Profit/(loss) before tax	735	1,563	15	47	(153)	2,207
Net Impact on reported profit and loss	129	(45)	–	–	249	333
– significant revenue items	–	(39)	–	–	–	(39)
– significant cost items	129	(6)	–	–	249	372
Adjusted profit before tax	864	1,518	15	47	96	2,540
31 Dec 2017						
Profit/(loss) before tax	287	1,315	9	26	(505)	1,132
Net Impact on reported profit and loss	557	96	–	(1)	604	1,256
– significant revenue items	2	77	–	–	(66)	13
– significant cost items	555	19	–	(1)	670	1,243
Adjusted profit before tax	844	1,411	9	25	99	2,388

Pro forma adjusted performance

Our adjusted profit before tax increased by £152m, 6%, compared with 2017. This reflected higher revenue partially offset by higher operating expenses and higher 2018 expected credit losses and other credit impairment charges ('ECLs') than 2017 loan impairment charges and other credit risk provisions ('LICs')

Adjusted revenue increased by £440m, 7%, with increases in RBWM from margin improvement and balance growth and CMB driven from growth in loans and advances and deposit margin improvement.

Adjusted operating expenses increased by £118m, 3%, driven by investment in front line capacity, operations and technology costs.

Retail Banking and Wealth Management

Adjusted profit before tax of £864m was £20m or 2% higher than 2017, driven by higher revenue offset by higher operating expenses and 2018 ECLs being higher than 2017 LICs.

Revenue increased by £261m, 8%, primarily due to strong performance in current accounts and savings driven by balance and margin growth, partially offset by margin compression in mortgages.

Operating expenses increased by £78m, 4%, due to increased digital investment and fraud costs.

Commercial Banking

Adjusted profit before tax of £1,518m was £107m, 8%, higher than 2017, due to higher revenue offset by higher operating expenses and 2018 ECLs being higher than 2017 LICs.

Revenue increased by £232m, 9% driven from balance sheet growth predominately in Loans and Advances and deposit margin improvement.

Operating expenses increased by £102m, 11%, due to a remediation provision release in 2017, higher staff costs from further investment in front line capacity and wage inflation and investments in Operations and Technology.

Global Banking and Markets

GB&M in HSBC UK reflects the transacting of foreign currency exchange for RBWM and CMB customers. The majority of the foreign exchange revenue is passed over to RBWM and CMB, with an element retained in GB&M. The 2018 results are broadly in line with 2017, with adjusted profit before tax of £15m, revenue of £140m and operating expenses of £125m.

Global Private Banking

Adjusted profit before tax of £47m was £22m, 88%, higher than 2017 due to 2018 ECLs being lower than 2017 LICs and lower operating expenses offset by lower revenue.

Revenue decreased by £12m, 7%, driven by lower onward recharges of Global costs to non bank Private Banking entities.

Operating expenses decreased by £19m due to lower Global recharges, which are charged onwards to non HSBC UK Private

Banking entities, and the implementation of a revised cost share agreement with a non bank entity.

Corporate Centre

Adjusted profit before tax of £96m was £3m, 3%, lower than 2017.

Revenue has decreased by £38m due to lower Balance Sheet Management income from fewer interest rate opportunities in 2018.

Operating expenses have decreased by £34m due to net income on the IAS 19 pension surplus, which has been partially offset by service company mark-up being charged to HBSC UK from 2018.

Dividends

The consolidated reported profit for the year attributable to the shareholders of the bank was £763m.

No interim dividend was paid or declared on the ordinary share capital during the year and up to the date when the financial statements were authorised for issue.

Further information about the results is given in the consolidated income statement on page 62.

Summary consolidated balance sheet as at

	Audited 31 Dec 2018	Unaudited Movement for 6 months 2018	Unaudited 1 Jul 2018 ¹	Audited 31 Dec 2017
	£m	£m	£m	£m
Total assets	238,939	4,983	233,956	15
– cash and balances at central banks	33,193	(7,570)	40,763	–
– items in the course of collections from other banks	603	(410)	1,013	–
– financial assets designated and otherwise mandatory measured at fair value	35	27	8	–
– derivative assets	66	17	49	–
– loans and advances to banks	1,263	(591)	1,854	2
– loans and advances to customers	174,807	7,844	166,963	–
– Reverse repurchase agreements – non trading	3,422	3,422	–	–
– financial investments	13,203	2,503	10,700	13
– prepayment, accrued income and other assets	8,537	(330)	8,867	–
– goodwill and intangible assets	3,810	71	3,739	–
Total liabilities	216,606	4,616	211,990	–
– deposits by banks	1,027	(543)	1,570	–
– customer accounts	204,837	4,645	200,192	–
– Repurchase agreements – non trading	639	639	–	–
– items in the course of transmission to other banks	233	(118)	351	–
– derivative liabilities	346	91	255	–
– accruals, deferred income and other liabilities	2,409	(2,027)	4,436	–
– current and deferred tax liabilities	1,548	102	1,446	–
– provisions	630	(193)	823	–
– subordinated liabilities	4,937	2,020	2,917	–
Total equity	22,333	367	21,966	15
– total shareholders' equity ²	22,273	367	21,906	15
– non-controlling interests	60	–	60	–

¹ As presented in the 2018 Interim Report of HSBC Bank plc.

² Total shareholders' equity includes share capital, share premium, additional Tier 1 instruments and reserves. Reserves include accounting reserves relating to the recognition of goodwill and the pension asset net of deferred tax which do not form part of regulatory capital.

The commentary below compares the balance sheet at 31 December 2018 to that transferred to HSBC UK on 1 July 2018.

The group maintained a strong and liquid balance sheet. The ratio of customer advances to customer accounts increased to 85.3% compared to 83.4% at 1 July 2018.

Assets

Cash and balances at central banks decreased by 19% as a result of deploying surplus deposits from customers and reflecting a partial move of the liquid asset portfolio from cash into bonds.

Liabilities

Customer accounts increased by 2% due to growth in commercial and retail balances.

Subordinated liabilities increased by 69% due to debt issued to HSBC Holdings plc for Minimum Requirements for own funds and Eligible Liabilities ('MREL') compliance.

Equity

Total shareholders' equity increased by 2%. The increase was due to retained earnings from profit generated for the period offset by adjustments to actuarial assumptions.

Risk overview

We continuously identify and monitor risks. This process, which is informed by our risk factors and the results of the stress testing programme, gives rise to the classification of certain principal risks. Changes in the assessment of principal risks may result in adjustments to our business strategy and, potentially, our risk appetite.

Our banking risks include credit risk, operational risk, market risk, liquidity and funding risk, compliance risk and reputational risk.

In addition to these banking risks, we have identified top and emerging risks with the potential to have a material impact on our

financial results or reputation and the sustainability of our long-term business model.

The exposure to our risks and risk management of these are explained in more detail in the Risk section of the Report of the Directors on pages 15 to 43.

The below table sets out the top and emerging risks and any material change to the risks from the related risks previously reported by HSBC Bank plc in its *2017 Annual Report and Accounts* in respect of the businesses transferred to HSBC UK Bank plc on 1 July 2018.

Risk	Mitigants
Externally driven	
Geopolitical risk	▲ We continually assess the impact of geopolitical events on our businesses and exposures across HSBC UK. The UK is due to leave the EU in March 2019 and negotiations are ongoing. We will continue to work with regulators, governments and our customers to manage the risks of the UK's exit from the EU (and the current period of uncertainty) as they arise, particularly across those sectors most impacted.
Turning of the credit cycle	▶ We continue to undertake detailed reviews of our portfolios and are also proactively assessing customers and sectors likely to come under stress as a result of geopolitical or macroeconomic events, reducing limits where appropriate.
Regulatory developments	▶ We proactively engage with regulators and policy makers, wherever possible, to help ensure that new regulatory requirements are considered fully and can be implemented in an effective manner.
Information Security risk and Cyber Crime	▲ We continue to strengthen our cyber control framework in line with the changing threat environment and improve our resilience and cybersecurity capabilities, including threat detection and analysis, access control, payment system controls, data protection, network controls and backup and recovery.
IBOR transition	● The industry accord concerning the transition from Interbank Offered Rates (IBORs), including LIBOR (London Interbank Offered Rate), continues to evolve. HSBC UK is part of the HSBC Group programme to evaluate the impact on products, services and processes, with the intention of minimising disruption through appropriate mitigating actions.
Internally driven	
People risk	▶ We continue to increase our focus on resource planning and employee retention and to equip line managers with the skills to both manage change, and support their employees.
IT systems infrastructure and resilience	▶ We continue to monitor and improve service resilience across our technology infrastructure, enhancing our problem diagnosis/resolution and change execution capabilities, reducing service disruption to our customers.
Execution risk	▶ We continue to strengthen our prioritisation and governance processes for significant strategic, regulatory and compliance projects.
Model risk	▲ We have strengthened our model risk governance framework by establishing an independent second line of defence Model Risk Management sub function, and by enhancing our existing policy and standards, in order to address evolving regulatory, external and internal requirements.
Conduct and Customer Detriment	▶ We continue to enhance our management of conduct in a number of areas, including the treatment of potentially vulnerable customers, governance of product arrangements, and encouragement of a 'Speak Up' culture.
Financial Crime Compliance	▶ We have integrated the majority of the Global Standards programme financial crime risk core capabilities into our day-to-day operations in 2018, and expect to complete the transition to business and function management in the first half of 2019. We continue to take further steps to refine and strengthen our defences against financial crime by applying advanced analytics and artificial intelligence.
Data management	▲ We continue to improve our insights, consistency of data aggregation, reporting and decisions through ongoing enhancement of our data governance, data quality, data privacy and architecture framework.

▲ Risk has heightened during 2018

▶ Risk remains at the same level as 2017

● New risk introduced in 2018

The Strategic Report comprising pages 2 to 14 was approved by the Board on 18 February 2019 and is signed on its behalf by

John David Stuart

Director

HSBC UK Bank plc

Registered number: 9928412

Risk

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Our conservative risk appetite

We maintain a conservative risk profile. This is central to our business and strategy. The following principles guide HSBC UK's overarching risk appetite and determine how its businesses and risks are managed:

Financial position

- Strong capital position, defined by regulatory and internal ratios.
- Liquidity and funding management for each entity on a stand-alone basis.

Operating model

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

Business practice

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

Enterprise-wide application

Our risk appetite encapsulates consideration of financial and non-financial risks and is expressed in both quantitative and qualitative terms. It applies across all our business lines.

Top and emerging risks

Top and emerging risks are those that may impact on our financial results, reputation or business model. If these risks were to occur, they could have a material effect on HSBC UK.

The exposure to these risks and our risk management approach are explained in more detail below.

Externally driven

Geopolitical risk

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

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

- Clients: the UK's departure from the EU is likely to impact our clients operating models, including their supply chains, working capital requirements, investment decisions and financial markets infrastructure access. Some EEA incorporated clients may also need to be migrated from the UK to HBFR (or another EEA entity).
- People: the potential loss of freedom of movement could impact our EEA staff resident in the UK and UK staff resident in an EEA country.

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

Changes to the UK's current trade relationships could require changes to our banking model to ensure we continue to comply with law and regulation in meeting the needs of our customers and conducting our business. In addition, any negative impact on the economy, demand for borrowing and capital flows as a result of the aforementioned uncertainty, volatility or result of UK negotiations could have a consequential negative impact on HSBC UK.

Mitigating actions

We have undertaken a comprehensive impact assessment to understand the range of potential implications for our customers, our products and our business. Where necessary, we have identified actions, including evolving our business models, to ensure we can continue to serve our customers.

- We actively monitor our portfolio to identify areas of stress, supported by stress testing analyses. Vulnerable sectors are subject to additional management review to determine if any adjustments to risk policy or appetite are required.
- We continue to stay very close to our clients, via proactive communications and dedicated channels to respond to customer queries.
- We will be supporting our EEA staff resident in the UK with their settlement applications.
- We will continue to work with regulators, governments and our clients in an effort to manage risks as they arise, particularly across the most impacted sectors.

Turning of the credit cycle

While geopolitical events in 2018 have not materially impacted our loss rates, they have created a climate of uncertainty with regards to trade and investment.

In the UK, rising inflation led to the Monetary Policy Committee ('MPC') increasing the base rate by 0.25%, for only the second time in over a decade. UK economic data continues to be mixed with both positive and negative trends evidenced. Uncertainty also exists concerning the process of the UK's withdrawal from the EU and the potential impacts of re-negotiated trade related arrangements with the EU and its member countries. Retail sales

growth in the UK continues to be subdued with increased reports of tightening discretionary spending.

Continental Europe continued to see economic growth in 2018, albeit a slow down is anticipated due to concerns over trade tensions with the United States as well as increasing oil prices and the likely impact that this will have on the eurozone's inflation rate.

While impairment charges increased in 2018 they remained within our risk appetite for the full year.

Mitigating actions

- We closely monitor economic developments in key markets and sectors and undertake scenario analysis. This enables us to take portfolio actions where necessary, including enhanced monitoring, amending our risk appetite and/or reducing limits and exposures. We also continue to monitor certain high risk portfolios such as retail, construction, commercial real estate and service companies within oil and gas.
- We stress test portfolios of particular concern to identify sensitivity to loss under a range of scenarios, with management actions being taken to rebalance exposures and manage risk appetite where necessary.
- Reviews of key portfolios are undertaken regularly to ensure that individual customer or portfolio risks are understood and our ability to manage the level of facilities offered through any downturn are appropriate. In 2018, we have undertaken specific reviews of portfolios showing vulnerability such as construction and commercial real estate. For our Retail portfolios, detailed performance monitoring is reviewed on a monthly basis, which includes early warning indicators and a view of concentration risks.

Regulatory developments

Financial service providers continue to operate to stringent regulatory and supervisory requirements, particularly in the areas of capital and liquidity management, conduct of business, financial crime, internal control frameworks, the use of models and the integrity of financial services delivery. Regulatory changes, including any resulting from the UK's exit from the EU, may affect the activities of HSBC UK.

A key development during 2018 was the preparation for the ring-fencing of the qualifying UK businesses of HSBC Bank plc to become HSBC UK Bank plc. These preparations were completed ahead of the 1 January 2019 deadline. Additionally, the FCA is proposing reforms to the way banks, including HSBC UK, charge for overdrafts as part of its High-Cost Credit Review. Proposals include simplification of pricing and ending higher prices for unarranged overdrafts. The FCA expects to publish a final decision on its proposed reforms in June 2019, with any rules coming into force by December 2019.

Mitigating actions

- We are fully engaged with the government and regulators in the UK to help ensure that new requirements, such as the FCA's proposed overdrafts reforms, are properly considered by regulators and the financial sector and can be implemented in an effective manner.
- We hold regular meetings with UK authorities to discuss strategic contingency plans covering a wide range of scenarios relating to the UK's exit from the EU.

Information Security risk and Cyber Crime

HSBC UK, together with other public and private organisations, continue to be the targets of increasingly sophisticated cyber attacks. Ransomware and distributed denial of service attacks appear to be an increasingly dominant threat to the financial industry, which may result in disruption to our operations and customer-facing websites, financial loss or loss of customer data.

Mitigating actions

- We continue to strengthen our capabilities to protect against increasingly sophisticated malware, denial of service attacks and loss of data, as well as enhancing our security event

detection and incident response processes. As well as technological improvement there is an increasing awareness of the cyber threat within our business, supported by formal training and the implementation of a number of specific cyber related working groups leading to an improving control environment around the end user and third party environment.

- Cyber risk is a top priority of our Board and is regularly reported to ensure appropriate visibility, governance and executive support for our ongoing cybersecurity programme.
- We participate in intelligence sharing with both law enforcement and industry schemes to help improve our understanding of, and ability to respond to, the evolving threats faced by us and our peers.

IBOR transition

IBORs including LIBOR are used to set interest rates on hundreds of trillions of US dollars' worth of different types of financial transactions and are used extensively for valuation purposes, risk measurement and performance benchmarking.

Following the recommendations of the Financial Stability Board, a fundamental review and reform of the major interest rates benchmarks, including IBORs, are underway across the world's largest financial markets. In some cases, the reform will include replacing interest rate benchmarks with alternative Risk Free Rates ('RFRs'). This replacement process is at different stages, and is progressing at different speeds, across several major currencies. There is therefore uncertainty as to the basis, method and timing of transition and their implications on the participants in the financial markets.

The HSBC Group has identified a number of potential prudential, conduct and systemic risks associated with the transition.

Mitigating Actions

- The HSBC Group has established a Global Programme to coordinate HSBC's transition activities and to assess the potential risks and impacts of any transition.
- The HSBC Group will continue to engage with industry participants and the regulators to support an orderly transition.
- We will continue to contribute to the ongoing Global programme work to determine the volume and value of customer exposures potentially impacted by the transition from IBORs.

Internally driven

People risk

Our people are critical to our success and it is important that we identify, manage and mitigate any risks that might have an impact on our people feeling empowered and able to thrive in their careers, as well as being able to support our customers and the communities they serve. We aim to foster a culture that proactively promotes the right colleague behaviours and conduct, and that we have the right number of people with the right skills, knowledge and capabilities to be able to do the right thing for customers.

We proactively engage with regulators and policy makers wherever possible to help ensure that new regulatory requirements are considered fully and can be implemented in an effective manner. Potential capability issues associated with the changes announced by the Government relating to the use of personal service companies (IR35) is emerging and we are undergoing regular analysis understand the potential impact upon the business.

We continue to increase our focus on resource planning and employee retention to ensure we mitigate any risks around capacity and capability, as well as equipping line managers with the skills to both manage change and support their employees to ensure we engender a strong positive culture.

Mitigating actions

- We have processes in place to identify where behaviours and conduct give us cause for concern and can mitigate the risk accordingly.
- HSBC University is focused on the development of our colleagues and supporting our leaders to create an environment for success. This is critical to retaining high-calibre individuals with the values, skills and experience for current and future roles.
- We are reviewing the impacts of the government regulation regarding the use of personal service companies and will be creating appropriate action plans to mitigate any impact on capacity or capability.

IT systems infrastructure and resilience

The HSBC Group continues to invest in the reliability and resilience of its IT systems and crucial services many of which are relied upon by HSBC UK. The failure of these systems could result in customer detriment, reputational and regulatory damage.

Mitigating actions

- Strategic initiatives are transforming how technology is developed, delivered and maintained, with a particular focus on providing high quality, stable and secure services. As part of this, we are concentrating on materially improving system resilience and service continuity testing.
- During 2018, we continued to monitor and upgrade our IT systems, simplifying our service provision and replacing older IT infrastructure and applications.

Execution risk

In order to deliver our strategic objectives and meet mandatory regulatory requirements, it is important for the bank to maintain a strong focus on execution risk. This requires robust management of significant resource intensive and time sensitive programmes. Risks arising from the magnitude and complexity of change may include regulatory censure, reputational damage or financial losses. Current major initiatives include managing the operational implications of the UK's vote to leave the EU on HSBC UK.

Mitigating actions

- Our prioritisation and governance processes for significant projects are monitored by the HSBC UK Executive Committee.
- In 2018, we continued to manage execution risk through closely monitoring the punctual delivery of critical initiatives, internal and external dependencies, and key risks, to allow better portfolio management.

Model risk

We use models for a range of purposes in managing our business, including regulatory capital calculations, stress testing, credit approvals, financial crime risk management and financial reporting. Internal and external factors have had a significant impact to our approach to model risk management, with our models regularly subject to independent review and challenge. Moreover the adoption of more sophisticated techniques and technology across the industry could also lead to increased model risk.

Mitigating actions

- We have established a model risk management sub-function in the second line of defence within the UK, to strengthen governance and oversight of this risk type.
- We have enhanced our model risk governance framework whilst partnering with the lines of business in order to enable more effective management of model risk in a commercial context. As we adopt new modelling technologies, we are updating our model risk management framework and governance standards to help drive the evolution of the overall governance framework to ensure best practice.

Conduct and Customer Detriment

Financial institutions remain under considerable scrutiny regarding conduct of business, particularly in relation to fair outcomes for customers and orderly and transparent operations in financial markets. Regulators, prosecutors, the media and the public all have heightened expectations as to the behaviour and conduct of financial institutions, and any shortcomings or failure to demonstrate adequate controls are in place to mitigate such risks could result in regulatory sanctions, fines or an increase in civil litigation.

Mitigating actions

- We have continued to enhance our management of conduct in areas including our governance of product arrangements, the treatment of potentially vulnerable customers and encouragement of a 'Speak Up' culture.

Financial crime compliance

Financial institutions remain under considerable regulatory scrutiny regarding their ability to prevent and detect financial crime. Financial crime threats continue to evolve, often in tandem with geopolitical developments. The highly speculative, volatile and opaque nature of virtual currencies as well as the pace of new currencies and associated technological developments creates challenges in effectively managing financial crime risks. The evolving regulatory environment continues to present execution challenge. An increasing trend towards greater data privacy requirements may affect our ability to effectively manage financial crime risks.

In December 2012, among other agreements, HSBC Holdings plc ('HSBC Holdings') consented to a cease-and-desist order with the US Federal Reserve Board ('FRB') and agreed to an undertaking with the UK Financial Conduct Authority ('FCA') to comply with certain forward-looking AML and sanctions-related obligations. HSBC Holdings also agreed to retain an independent compliance monitor - who is for FCA purposes a 'Skilled Person' under section 166 of the Financial Services and Markets Act, and for FRB purposes an 'Independent Consultant' - to produce annual assessments of the Group's AML and sanctions compliance programme. HSBC Holdings entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions. The Skilled Person/Independent Consultant will continue to conduct country reviews and provide periodic reports for a period of time at the FCA's and FRB's discretion. The role of the Skilled Person/Independent Consultant is discussed on page 26.

Mitigating actions

- The HSBC Group continues to enhance financial crime risk management capabilities; investing in tools to fight financial crime through the application of advanced analytics and artificial intelligence.
- The HSBC Group is developing procedures and controls to manage the risks associated with direct and indirect exposure to virtual currencies.
- HSBC UK continues to collaborate with government and law enforcement utilising information sharing mechanisms and the HSBC Group continues to work with jurisdictions and relevant bodies to address data privacy challenges through international standards, guidance, and legislation to enable effective management of financial crime risk.
- HSBC UK continues to take steps designed to ensure that the reforms we have put in place are both effective and sustainable over the long term.

Data management

HSBC UK uses a large number of systems and applications to support key business processes and operations. As a result, we often need to reconcile multiple data sources, including customer data sources, to reduce the risk of error. We, along with other organisations, need to respond to the increasing

external and regulatory expectations regarding data privacy and protection capabilities across our customer data systems.

Mitigating actions

- We continue to improve data quality across a large number of systems. Our data management, aggregation and oversight continues to strengthen and enhance the effectiveness of internal systems and processes. We are implementing data controls for critical processes in the 'front-office' systems to improve our data capture at the point of entry. The HSBC Group has achieved its objective of meeting a 'largely compliant' rating in support of the Basel Committee for Banking Supervision (BCBS 239) principles.
- Through HSBC Group's Global Data Management Framework, we have embedded governance processes to proactively monitor critical customer, product and transaction data and resolving associated data issues in a timely manner. We have also implemented data controls in order to improve the reliability of data used by our customers and staff.
- To address global data privacy and protection regulations, the HSBC Group is leveraging outcomes from the Global Data Protection Regulations (GDPR) initiative to roll-out and implement a global and consistent data privacy framework, while tailoring it to address any country specific regulations, where required.
- We have also initiated efforts to modernise our data architecture and infrastructure through adoption of big data, cloud, machine learning, advanced analytics and visualisation technologies.

Areas of special interest

During 2018, a number of areas have been identified and considered as part of our top and emerging risks because of the effect they may have on HSBC UK. We have placed particular focus on the UK withdrawal from the EU in this section.

Process of UK withdrawal from the European Union

The UK is due to formally leave the EU in March 2019. Before then, the UK and the EU have to finalise the Article 50 Withdrawal Agreement, which will need to be approved by their respective parliaments. A comprehensive trade deal will not be concluded within this time frame. A period of transition until 31 December 2020 has been agreed between the UK and the EU. However, there will be no legal certainty until this is enshrined in the Withdrawal Agreement. To ensure continuity of service independent of the outcome of negotiations, our contingency plan is based on the assumption of a scenario whereby the UK exits the EU without the existing passporting or regulatory equivalence framework that supports cross-border business.

Legal entity restructuring

Changes in legal entity structure are likely to be minor and limited to our existing branch in Ireland. Our Irish branch is currently used for the placement of excess EUR deposits and relies on passporting out of the UK. This may no longer be possible post the UK's exit from the EU. We are therefore reviewing the operating model of its Irish branch and looking at alternative ways of deploying EUR deposits.

Product Offering

HSBC France (HBFR) will become the HSBC Group's continental European hub post the UK's exit from the EU. To accommodate for customer migrations, HBFR are improving their existing product offering and building new capabilities (e.g. Securities Services, Euro clearing). Euro clearing capabilities in HBFR are now live but most other launches are scheduled for later in 2019.

Customer migrations

Whilst our intention is to minimise the level of change for our customers, some of our CMB customers may no longer be able to be serviced out of the UK and may need to be migrated to HBFR

(or another EEA entity). There has been ongoing communication with impacted customers and we are working with them on an appropriate migration plan.

Employees

We will support our EEA staff resident in the UK with their settlement applications.

We have made good progress in terms of ensuring we are prepared for the UK leaving the EU in the first quarter of 2019 under the terms described above. However, there remain execution risks, many of them linked to the uncertain outcome of negotiations and potentially tight timelines to implement significant changes to our operating model.

Risk management

As a provider of banking and financial services, we actively manage risk as a core part of our day-to-day activities. We continue to maintain a strong liquidity position and are well positioned for the evolving regulatory landscape. We also maintained our conservative risk profile in 2018.

Our risk management framework

An established risk governance framework and ownership structure ensures oversight of, and accountability for, the effective management of risk. Our risk management framework fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions. Integral to our risk management framework are risk appetite, stress testing and the identification of emerging risks.

Our Risk Committee focuses on risk governance and provides a forward-looking view of risks and their mitigation. The Risk Committee is a committee of the Board and has responsibility for oversight and advice to the Board on, *inter alia*, the bank's risk appetite, tolerance and strategy, systems of risk management, internal control and compliance. Additionally, members of the Risk Committee attend meetings of the Chairman's Nominations and Remuneration Committee at which the alignment of the reward structures to risk appetite is considered.

In carrying out its responsibilities, the Risk Committee is closely supported by the Chief Risk Officer, the Chief Financial Officer, the Head of Internal Audit and the Heads of Compliance, together with other business functions on risks within their respective areas of responsibility.

Three lines of defence

To create a robust control environment to manage risks, we use an activity-based three lines of defence model, whereby the activity a member of staff undertakes drives which line of defence they reside within. This model delineates management accountabilities and responsibilities for risk management and the control environment.

The model underpins our approach to risk management by clarifying responsibility, encouraging collaboration and enabling efficient coordination of risk and control activities. The three lines are summarised below:

- 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 place to mitigate them.
- The second line of defence sets the policy and guidelines for managing specific risk areas, provides advice and guidance in relation to the risk, and challenges the first line of defence on effective risk management.
- The third line of defence is our Internal Audit function, which provides independent and objective assurance of the adequacy of the design and operational effectiveness of the group's risk management framework and control governance process.

Our risk culture

Risk culture refers to our norms, attitudes and behaviours related to risk awareness, risk taking and risk management.

We recognise the importance of a strong risk culture, the fostering of which is a key responsibility of senior executives. Our risk culture is reinforced by the Group Values and Global Standards programme. It is instrumental in aligning the behaviours of individuals with our attitude to assuming and managing risk, which helps to ensure that our risk profile remains in line with our risk appetite.

We use clear and consistent employee communication on risk to convey strategic messages and set the tone from senior management and our Board. We also deploy mandatory training on risk and compliance topics to embed skills and understanding in order to strengthen our risk culture and reinforce the attitude to risk in the behaviour expected of employees, as described in our risk policies.

The risk culture is reinforced by our approach to remuneration. Individual awards, including those for senior executives, are based on compliance with the Group values and the achievement of both financial and non-financial objectives, that are aligned to our risk appetite and global strategy.

Whistleblowing

The Group operate a whistleblower platform, HSBC Confidential, allowing staff to report matters of concern confidentially that are escalated to the Board. The Group also maintain an external email address for concerns about accounting and internal financial controls or auditing matters (accountingdisclosures@hsbc.com).

For further details, see page 6 of the How we do Business section.

Risk appetite

Our Risk Appetite Statement describes the types and levels of risk that we are prepared to accept in executing our strategy. Quantitative and qualitative metrics are assigned to 15 key categories, including: earnings, capital (including leverage measures), liquidity and funding, interest rate risk in the banking book, credit risk, traded risk, operational risk, people risk and regulatory compliance risk.

Measurement against the metrics:

- guides underlying business activity;
- informs risk-adjusted remuneration;
- enables the key underlying assumptions to be monitored and, where necessary, adjusted through subsequent business planning cycles; and
- promptly identifies business decisions needed to mitigate risk.

The Risk Appetite Statement is approved by the Board following advice from the Risk Committee. It is part of the annual planning process, in which businesses, subsidiaries and functions are required to articulate their individual risk appetite statements. These are aligned with our strategy, and provide a risk profile of each business, subsidiary or function in the context of the

individual risk categories.

Stress testing

Stress testing is an important tool for banks and regulators to assess vulnerabilities in individual banks and/or the financial banking sector under hypothetical adverse scenarios. The results of stress testing are used to assess banks' resilience to a range of adverse shocks and to assess their capital adequacy.

A number of internal macroeconomic and event-driven scenarios specific to the UK or the global economy were considered and reported to senior management during the course of the year. HSBC UK also conducts Reverse Stress Testing. This exercise requires HSBC UK to assess scenarios and circumstances that would render its business model non-viable, thereby identifying potential business vulnerabilities.

Furthermore, HSBC UK is subject to regulatory stress testing and the requirements are increasing in frequency and granularity. The assessment by the regulators is on both a quantitative and qualitative basis, the latter focusing on our portfolio quality, data provision, stress testing capability and capital planning processes.

In 2018, the business lines and subsidiaries that are now part of HSBC UK contributed to the successful completion of the HSBC Group's annual Bank of England ('BoE') concurrent stress testing exercise. The stresses applied to economic activity and financial market prices in the 2018 Annual Cyclical Scenario were the same as in the 2017 test. The scenario incorporates a severe and synchronised UK and global macro-economic and financial market stress, as well as an independent stress of misconduct costs. The PRA selected the same stress scenario as in 2017 in order to isolate, as far as possible, the impacts of IFRS 9 on banks' stressed capital position. Also the regulator considered the scenario still appropriate in the context of prevailing domestic and global economic risks.

The BoE published the results of the 2018 Concurrent Stress Test in November 2018, confirming that these tests did not reveal any capital inadequacies for the HSBC Group.

The business lines and subsidiaries that are now part of HSBC UK also contributed to the EBA EU-wide stress testing exercise in 2018, the results of which were published in November 2018. The exercise does not contain a CET1 capital ratio threshold, and is instead designed to be used as an input into the 2018 Supervisory Review and Evaluation Process ('SREP') and to allow supervisors to assess the banks' ability to meet applicable minimum and additional capital requirements under stress. The results demonstrate the HSBC Group's continuing capital strength.

Our material banking risks

The material risk types associated with our banking operations are described in the following tables.

Description of risks – banking operations

Risks	Arising from	Measurement, monitoring and management of risk
Credit risk (see page 21) The risk of financial loss if a customer or counterparty fails to meet an obligation under a contract.	Credit risk arises principally from direct lending, trade finance and leasing business, but also from certain other products such as guarantees and derivatives.	Credit risk is: <ul style="list-style-type: none"> • measured as the amount that could be lost if a customer or counterparty fails to make repayments; • monitored using various internal risk management measures and within limits approved by individuals within a framework of delegated authorities; and • managed through a robust risk control framework that outlines clear and consistent policies, principles and guidance for risk managers.

Description of risks – banking operations

Risks	Arising from	Measurement, monitoring and management of risk
Liquidity and funding risk (see page 23)		
The risk that we do not have sufficient financial resources to meet our obligations as they fall due or that we can only do so at an excessive cost. Funding Risk is the risk that funding considered to be sustainable, and therefore used to fund assets, is not sustainable over time.	Liquidity risk arises from mismatches in the timing of cash flows. Funding risk arises when illiquid asset positions cannot be funded at the expected terms and when required.	Liquidity and funding risk is: <ul style="list-style-type: none"> measured using a range of different metrics including the liquidity coverage ratio and net stable funding ratio; assessed through the internal liquidity adequacy assessment process ('ILAAP'); monitored against the group's liquidity and funding risk framework; and managed on a stand-alone basis with no reliance on any group entity (unless pre-committed) or central bank unless this represents routine established business-as-usual market practice.
Market risk (see page 23)		
The risk that movements in market factors, including but not limited to interest rates, credit spreads and foreign exchange rates will reduce our income or the value of our portfolios.	Exposure to market risk is separated into two portfolios: <ul style="list-style-type: none"> trading portfolios; and non-trading portfolios. 	Market risk is: <ul style="list-style-type: none"> measured using sensitivities, value at risk ('VaR') and stress testing, giving a detailed picture of potential gains and losses for a range of market movements and scenarios, as well as tail risks over specified time horizons; monitored using VaR sensitivities, stress testing and other measures, including the sensitivity of net interest income and the sensitivity of structural foreign exchange; and managed using risk limits approved by the risk management meeting ('RMM').
Operational risk (see page 25)		
The risk to achieving our strategy or objectives as a result of inadequate or failed internal processes, people and systems or from external events.	Operational risk arises from day-to-day operations or external events, and is relevant to every aspect of our business. Regulatory compliance risk and financial crime compliance risk are discussed below.	Operational risk is: <ul style="list-style-type: none"> measured using the risk and control assessment process, which assesses the level of risk and effectiveness of controls and is also measured for economic capital management using risk event losses and scenario analysis; monitored using key indicators and other internal control activities; and managed primarily by business and functional managers that identify and assess risks, implement controls to manage them and monitor the effectiveness of these controls utilising the operational risk management framework.
Regulatory compliance risk (see page 25)		
The risk that we fail to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice, and incur fines and penalties and suffer damage to our business as a consequence.	Regulatory compliance risk is part of operational risk, and arises from the risks associated with breaching our duty to customers and other counterparties, inappropriate market conduct and breaching other regulatory standards.	Regulatory compliance risk is: <ul style="list-style-type: none"> measured by reference to identified metrics, incident assessments, regulatory feedback and the judgement and assessment of our Regulatory Compliance teams; monitored against the first line of defence risk and control assessments, the results of the monitoring and control activities of the second line of defence functions, and the results of internal and external audits and regulatory inspections; and managed by establishing and communicating appropriate policies and procedures, training employees in them, and monitoring activity to assure their observance. Proactive risk control and/or remediation work is undertaken where required.
Financial crime compliance risk (see page 26)		
The risk that we knowingly or unknowingly help parties to commit or to further potentially illegal activity throughout HSBC UK.	Financial crime compliance risk is part of operational risk and arises from day-to-day banking operations.	Financial crime compliance risk is: <ul style="list-style-type: none"> measured by reference to identified metrics, incident assessments, regulatory feedback and the judgement and assessment of our Financial Crime Compliance teams; monitored against our financial crime compliance risk appetite statement and metrics, the results of the monitoring and control activities of the second line of defence functions, and the results of internal and external audits and regulatory inspections; and managed by establishing and communicating appropriate policies and procedures, training employees in them, and monitoring activity to ensure their observance. Proactive risk control and/or remediation work is undertaken where required.

Other material risks

Risks	Arising from	Measurement, monitoring and management of risk
Reputational risk (see page 26)		
The risk of failure to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by HSBC UK itself, our employees or those with whom we are associated, that might cause stakeholders to form a negative view of HSBC UK.	Primary reputational risks arise directly from an action or inaction by HSBC UK, its employees or associated parties that are not the consequence of another type of risk. Secondary reputational risks are those arising indirectly and are a result of a failure to control any other risks.	Reputational risk is: <ul style="list-style-type: none"> measured by reference to our reputation as indicated by our dealings with all relevant stakeholders, including media, regulators, customers and employees; monitored through a reputational risk management framework that is integrated into the group's broader risk management framework; and managed by every member of staff, and covered by a number of policies and guidelines. There is a clear structure of committees and individuals charged with mitigating reputational risk.

Other material risks

Risks	Arising from	Measurement, monitoring and management of risk
Pension risk (see page 27)		
The risk of increased costs to HSBC UK from offering post-employment benefit plans to its employees.	Pension risk arises from investments delivering an inadequate return, adverse changes in interest rates or inflation, or members living longer than expected. Pension risk also includes the operational and reputational risk of sponsoring pension plans.	Pension risk is: <ul style="list-style-type: none"> measured in terms of the schemes' ability to generate sufficient funds to meet the cost of their accrued benefits; monitored through the specific risk appetite that has been developed; and managed locally through the Pensions Oversight Forum and ultimately the RMM.

Credit risk management

(Audited)

Of the risks in which we engage, credit risk generates the largest regulatory capital requirements.

The principal objectives of our credit risk management are:

- to maintain across HSBC UK a strong culture of responsible lending and a robust risk policy and control framework;
- to both partner and challenge the Businesses in defining, implementing, and continually re-evaluating our risk appetite under actual and scenario conditions; and
- to ensure there is independent, expert scrutiny of credit risks, their costs and mitigation.

Within HSBC UK, the Credit Risk function is headed by the Chief Risk Officer who reports to the Chief Executive Officer, with a functional reporting line to the Group Chief Risk Officer.

Its responsibilities are:

- to formulate credit policy. Compliance, subject to approved dispensations, is mandatory for all operating companies which must develop local credit policies consistent with group policies that very closely reflect HSBC Group policy;
- to guide operating companies on the group's appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain higher-risk sectors;
- to undertake an independent review and objective assessment of risk. Credit risk assesses all credit facilities and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken;
- to monitor the performance and management of portfolios across the group;
- to control exposure to sovereign entities, banks and other financial institutions, as well as debt securities which are not held solely for the purpose of trading;
- to set policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to the group's capital base, and remain within internal and regulatory limits;
- to maintain and develop the risk rating framework, systems and models through appropriate governance;
- to report on retail portfolio performance, high risk portfolios, risk concentrations, large impaired accounts, impairment allowances and stress testing results and recommendations to HSBC UK's RMM, Risk Committee and Board; and
- to act on behalf of the group as the primary interface, for credit-related issues, with the BoE, the PRA, the FCA, rating agencies, analysts and counterparts in major banks and non-bank financial institutions.

Concentration of credit risk exposure

(Audited)

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or are engaged in similar activities, or operate in

the same geographical areas/industry sectors, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. A number of controls and measures are used to minimise undue concentration of exposure in the portfolios across industry, country and customer groups. These include portfolio and counterparty limits, approval and review controls, and stress testing.

Credit quality of financial instruments

(Audited)

Our credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. In the case of individually significant accounts, risk ratings are reviewed regularly and any amendments are implemented promptly. Within the retail business, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

Our risk rating system facilitates the internal ratings-based approach under the Basel framework adopted by the HSBC Group to support calculation of the minimum credit regulatory capital requirement.

Special attention is paid to problem exposures in order to accelerate remedial action. Where appropriate, operating companies use specialist units to provide customers with support to help them avoid default returning to sound trading wherever possible.

The Credit Review and Risk Identification team reviews the robustness and effectiveness of key management, monitoring and control activities.

Risk rating scales

The Customer Risk Rating ('CRR') 10-grade scale below summarises a more granular underlying 23-grade scale of obligor probability of default ('PD'). All distinct customers are rated using one of these two PD scales, depending on the degree of sophistication of the Basel II approach adopted for the exposure.

Each CRR band is associated with an external rating grade by reference to long-run default rates for that grade, represented by the average of issuer-weighted historical default rates. This mapping between internal and external ratings is an indication only and may vary over time.

The Expected Loss ('EL') 10-grade scale for retail business summarises a more granular underlying EL scale for these customer segments; this combines obligor and facility/product risk factors in a composite measure. For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications based upon the mapping of related CRR to external credit grades.

For the purpose of the following disclosure, retail loans which are past due up to 89 days and are not otherwise classified as EL 9 or EL 10, are not disclosed within the EL grade to which they relate, but are separately classified as past due but not impaired.

The five credit quality classifications defined each encompasses a range of granular internal credit rating grades assigned to wholesale and retail lending businesses and the external ratings attributed by external agencies to debt securities.

For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications based upon the mapping of related CRR to external credit ratings. The mapping is reviewed on a regular basis and the most recent review resulted in sovereign BBB+ and BBB exposures previously

mapped to Credit Quality band 'Good' being mapped to Credit Quality band 'Strong'. Sovereign BB+ and BB exposures previously mapped to Credit Quality band 'Satisfactory' were mapped to Credit Quality band 'Good'. This represents a change in disclosure mapping unrelated to changes in counterparty creditworthiness.

Credit quality classification

Quality classification	Footnotes	Debt securities and other bills	Wholesale lending		Retail lending	
		External credit rating	Internal credit rating	12-month Basel probability of default %	Internal credit rating	12-month probability-weighted PD %
Strong	1, 2	A- and above	CRR1 to CRR2	0.000–0.169	Band 1 and 2	0.000–0.500
Good		BBB+ to BBB-	CRR3	0.170–0.740	Band 3	0.501–1.500
Satisfactory		BB+ to B and unrated	CRR4 to CRR5	0.741–4.914	Band 4 and 5	1.501–20.000
Sub-standard		B- to C	CRR6 to CRR8	4.915–99.999	Band 6	20.001–99.999
Credit-impaired		Default	CRR9 to CRR10	100.000	Band 7	100.000

1 Customer risk rating ('CRR').

2 12month point-in-time ('PIT') probability weighted PD.

Quality classification definitions

- 'Strong' exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default.
- 'Good' exposures demonstrate a good capacity to meet financial commitments, with low default risk.
- 'Satisfactory' exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk.
- 'Sub-standard' exposures require varying degrees of special attention and default risk is of greater concern.
- 'Credit-impaired' exposures have been assessed as impaired.

Renegotiated loans and forbearance

A range of forbearance strategies are employed to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default, foreclosure or repossession. They include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, debt consolidations, the deferral of foreclosures and other forms of loan modifications and re-ageing.

The HSBC UK policies and practices are based on criteria which enable local management to judge whether repayment is likely to continue. These typically provide a customer with terms and conditions that are more favourable than those provided initially. Loan forbearance is only granted in situations where the customer has showed a willingness to repay their loan and is expected to be able to meet the revised obligations.

Refinance risk

Personal lending

Interest only mortgages lending incorporate bullet payments at the point of final maturity. In the UK, interest only lending is recognised as a niche product that meets a valid customer need. To reduce refinance risk, an initial on-boarding assessment of customers' affordability is made on a capital repayment basis and every customer has a credible defined repayment strategy. Additionally, the customer is contacted at least once during the mortgage term to check the status of the repayment strategy. In situations where it is identified that a borrower is expected not to be able either to repay a bullet/balloon payment, the customer is offered advice and options in order to help them repay the loan in accordance with their loan agreement. In the event that this is not possible, the customer will either default on the repayment or it is likely that the bank may need to apply forbearance to the loan. In either circumstance this gives rise to a loss event and an impairment allowance will be considered where appropriate.

Wholesale lending

Many types of wholesale lending incorporate bullet/balloon payments at the point of final maturity; often, the intention or assumption is that the borrower will take out a new loan to settle the existing debt. Where this is true the term refinance risk refers generally to the possibility that, at the point that such a repayment is due, a borrower cannot refinance by borrowing to repay existing

debt. In situations where it is identified that a borrower is expected not to be able either to repay a bullet/balloon payment or to be capable of refinancing their existing debt on commercial terms then the customer will either default on the repayment or it is likely that the bank may need to refinance the loan on terms it would not normally offer in the ordinary course of business. In either circumstance this gives rise to a loss event and the loan will be considered impaired.

Impairment assessment

(Audited)

For details of our impairment policies on loans and advances and financial investments, see Note 1.2(g) on the Financial Statements.

Write-off of loans and advances

(Audited)

For details of our policy on the write-off of loans and advances, see Note 1.2(g) on the Financial Statements.

Personal lending

Property collateral for residential mortgages is repossessed and sold on behalf of the borrower only when all normal debt recovery procedures have been unsuccessful. Any portion of the balance not covered following the realisation of security is written-off.

Unsecured personal lending products are normally written off, when there is no realistic prospect of recovery, usually when they reached 180 days past due.

In case of some products, e.g. credit cards, it is common for accounts to be written off at the end of the month in which they fall six months past due. Examples of events which may result in early write-off include bankruptcy, deceased customers, fraud and facilities with small balances.

Wholesale lending

Wholesale loans and advances are written off where normal collection procedures have been unsuccessful to the extent that there appears no realistic prospect of repayment. These procedures may include a referral of the business relationship to a debt recovery company. Debt reorganisation will be considered at all times and may involve, in exceptional circumstances and in the absence of any viable alternative, a partial write-off in exchange for a commitment to repay the remaining balance.

In the event of bankruptcy or analogous proceedings, write-off for both personal and wholesale lending may occur earlier than at the periods stated above. Collections procedures may continue after write-off.

Liquidity and funding risk management

Details of HSBC UK's Liquidity and Funding Risk Management Framework ('LFRF') can be found in the group's Pillar 3 document.

Liquidity and funding risk management framework

HSBC UK has an internal liquidity and funding risk management framework ('LFRF') which aims to allow it to withstand very severe liquidity stresses. It is designed to be adaptable to changing business models, markets and regulations. The Asset, Liability and Capital Management ('ALCM') team is responsible for the application of the LFRF. This comprises of the following elements:

- stand-alone management of liquidity and funding;
- classification by inherent liquidity risk ('ILR') categorisation;
- minimum liquidity coverage ratio ('LCR') requirement depending on ILR categorisation;
- minimum net stable funding ratio ('NSFR') requirement depending on ILR categorisation;
- depositor concentration limit;
- three-month and 12-month cumulative rolling term contractual maturity limits covering deposits from banks, deposits from non-bank financial institutions and securities issued;
- annual internal liquidity adequacy assessment;
- management and monitoring of intra-day liquidity;
- liquidity funds transfer pricing; and
- forward-looking funding assessments.

Risk governance and oversight

The elements of the LFRF are underpinned by a robust governance framework, the two major elements of which are:

- HSBC UK Asset and Liability Management Committees ('ALCOs'); and
- Annual internal liquidity adequacy assessment process ('ILAAP') used to validate risk tolerance and set risk appetite.

Second line liquidity risk assurance, provided by Risk, performs the following activities:

- reviews and challenges assumptions of current liquidity and funding risk management framework;
- reviews and challenges methods and calculation processes of all aspects of liquidity and funding risk;
- reviews results of liquidity and funding metrics against limits and proposed limit changes prior to approval at governance forums; and
- reviews risk items that require escalation.

Market risk management

Where appropriate, we apply similar risk management policies and measurement techniques to both trading and non-trading portfolios. The objective is to manage and control market risk exposures to optimise return on risk.

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

Market risk governance

(Audited)

Market risk is managed and controlled through limits approved by the RMM of the HSBC Group Management Board ('GMB') for HSBC Holdings and the global businesses. These limits are

allocated across business lines and agreed with the HSBC Group's legal entities, including HSBC UK.

The management of market risk is principally undertaken in Markets and BSM using risk limits allocated from the risk appetite, which is subject to the HSBC Group RMM ratification. The level of limits set is based on the overall risk appetite for HSBC UK being cascaded down to the individual entities and the limits required for the individual desks to be able to execute their stated business strategy. Limits are set for portfolios, products and risk types, with market liquidity being a primary factor in determining the level of limits set. The market risk limits for HSBC UK are endorsed at HSBC UK RMM.

Global Risk is responsible for setting market risk management policies and measurement techniques and is responsible for measuring market risk exposures in accordance with the policies defined by Global Risk, and monitoring and reporting these exposures against the prescribed limits on a daily basis.

HSBC UK is required to assess the market risks arising on each product in its business and to transfer them to either its local Markets unit for management, to books or to separate books managed under the supervision of ALCO.

The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to manage them professionally. In certain cases where the market risks cannot be fully transferred, we identify the impact of varying scenarios on valuations or on net interest income resulting from any residual risk positions.

Model risk is governed through Model Oversight Committees ('MOCs'). They have direct oversight and approval responsibility for all traded risk models utilised for risk measurement and management and stress testing. The MOCs prioritise the development of models, methodologies and practices used for traded risk management within the Group and ensure that they remain within risk appetite and business plans. The Markets MOC reports into the Group MOC, which oversees all model risk types at Group level. Group MOC informs the Group RMM about material issues at least on a bi-annual basis. Group RMM has delegated day-to-day governance of all traded risk models to the Markets MOC.

The control of market risk in the trading and non-trading portfolios is based on a policy restricting individual operations to trading within a list of permissible instruments authorised for HSBC UK by Global Risk, enforcing new product approval procedures, and ensuring compliance with the HSBC UK Exceptions Policy.

Market risk measures

Monitoring and limiting market risk exposures

Our objective is to manage and control market risk exposures while maintaining a market profile consistent with HSBC UK strategy and risk appetite as well as operating within the HSBC Group's risk appetite for the entity. We use a range of tools to monitor and limit market risk exposures including sensitivity analysis, value at risk ('VaR'), and stress testing.

Sensitivity analysis

Sensitivity analysis measures the impact of individual market factor movements on specific instruments or portfolios, including interest rates, foreign exchange rates and credit spreads, such as the effect of a one basis point change in yield. We use sensitivity measures to monitor the market risk positions within each risk type. Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the factors in determining the level of limits set at each risk type.

Value at risk

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. HSBC UK does not have a market risk internal model approval and therefore VaR is not used for any regulatory return but only used for internal management

information purposes. We use the Standardised Approach for its Market Risk capital calculation.

In addition, we calculate VaR for non-trading portfolios in order to have a complete picture of risk.

Stress testing

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

Stress testing is implemented at legal entity, regional and overall Group levels. Scenarios are tailored to capture the relevant events or market movements at each level. The risk appetite around potential stress losses is set and monitored against referral limits.

Market risk reverse stress tests are undertaken on the premise that there is a fixed loss. The stress testing process identifies which scenarios lead to this loss. The rationale behind the reverse stress test is to understand scenarios which are beyond normal business settings that could have contagion and systemic implications.

Stressed VaR and stress testing, together with reverse stress testing provides management with insights regarding the 'tail risk' beyond VaR for which appetite is limited.

Trading portfolios

Back-testing

Trading book VaR is not used for calculating capital requirements arising from market risk within HSBC UK therefore there is no back testing of trading book VaR.

Non-trading portfolios

Non-trading VaR of HSBC UK includes the interest rate risk of non-trading financial instruments held by the global businesses and transferred into portfolios managed by BSM or ALCM functions. In measuring, monitoring and managing risk in our non-trading portfolios, VaR is just one of the tools used. The management of interest rate risk in the banking book is described further in 'Interest rate risk in the banking book' section below, including the role of BSM.

Our control of market risk in the non-trading portfolios is based on transferring the assessed market risk of assets and liabilities created outside BSM or Markets, to the books managed by BSM, provided the market risk can be neutralised. The net exposure is typically managed by BSM through the use of fixed rate government bonds (high quality asset held in held-to-collect-and-sell (HTCS books)) and interest rate swaps. The interest rate risk arising from fixed rate government bonds held within HTCS portfolios is reflected within non-traded VaR. Interest rate swaps used by BSM are typically classified as either a fair value hedge or a cash flow hedge and included within non-traded VaR. Any market risk that cannot be neutralised in the market is managed by HSBC UK ALCM in segregated ALCO books.

Structural foreign exchange exposures

Structural foreign exchange exposures represent the group's net investments in subsidiaries, branches and associates, the functional currencies of which are currencies other than sterling. An entity's functional currency is that of the primary economic environment in which the entity operates.

The group does not have investments in subsidiaries in non-sterling currencies.

Interest rate risk in the banking book

Overview

Interest Rate Risk in the Banking Book ('IRRBB') is the risk of an adverse impact to earnings or capital due to changes in market interest rates. IRRBB is generated by our non-traded assets and liabilities. ALCM is responsible for measuring and controlling IRRBB under the supervision of the RMM who approve risk limits used in the management of interest rate risk. IRRBB is transferred to and managed by BSM, who are overseen by Risk and Product Control functions.

Key risk drivers

The IRRBB can be segregated into the following drivers:

- Managed rate risk – the risk that the pricing of products, which are dependent upon business line decisions, do not correlate to movements in market interest rates.
- Re-investment risk – risk arising due to change in rates when behavioural balances are reinvested as per the transfer pricing policy.
- Basis Risk – the risk arising from assets and liabilities that are priced referencing different market indices creating a repricing mismatch.
- Prepayment risk – the risk that the actual customer prepayment in different interest rate scenarios does not match the profile used to hedge the interest rate risk.
- Duration risk – the risk that there are changes in the maturities of assets and liabilities due to changes in interest rate, which create or exacerbate a mismatch.

Governance and structure

ALCM monitor and control non-traded interest rate risk as well as reviewing and challenging the business prior to the release of new products and proposed behavioural assumptions used for hedging activities. ALCM are also responsible for maintaining and updating the transfer pricing framework, informing ALCO of the HSBC UK group's overall banking book interest rate risk exposure and managing the balance sheet in conjunction with BSM.

The internal transfer pricing framework is constructed to ensure that structural interest rate risk, arising due to differences in the re-pricing timing of assets and liabilities, is transferred to BSM and business lines are correctly allocated income and expense based on the products they write, inclusive of activities to mitigate this risk. Contractual principal repayments, payment schedules, expected prepayments, contractual rate indices used for re-pricing and interest rate reset dates are examples of elements transferred for risk management by BSM.

The internal transfer pricing framework is governed by ALCO whose responsibility it is to define the transfer pricing curve, review and approve the transfer pricing policy, including behavioural assumptions used for products where there is either no defined maturity or customer optionality exists. ALCO is responsible for monitoring and reviewing the overall structural interest rate risk position. Interest rate behavioural policies have to be formulated in line with the HSBC Group's behavioural policies and approved at least annually by HSBC UK ALCO.

Non-traded assets and liabilities are transferred to BSM based on their re-pricing and maturity characteristics. For assets and liabilities with no defined maturity or repricing characteristics behaviouralisation is used to assess the interest rate risk profile; the maximum average duration to which a portfolio of non-maturity defined customer balances or equity can be behaviouralised is five years. The maximum percentage of any portfolio that can be behaviouralised is 90% with the residual treated as contractual, meaning overnight.

BSM manages the banking book interest rate positions transferred to it within market Risk limits. BSM will only receive non-trading assets and liabilities as long as they can economically hedge the risk they receive. Hedging is generally managed through vanilla interest rate derivatives or fixed rate government bonds. Any interest rate risk which BSM cannot economically hedge is not transferred and will remain within the business line where the risk is originated.

Measurement of interest rate risk in the banking book

The following measures are used by ALCM to monitor and control interest rate risk in the banking book including:

- Non-traded VaR;
- Net Interest Income ('NII') sensitivity; and
- Economic value of equity ('EVE').

Non-traded VaR

Non-traded VaR uses the same models as those used in the trading book but for banking book balances. It will exclude the elements of risk which are not transferred to BSM.

Net interest income sensitivity

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

A principal part of our management of non-traded interest rate risk is to monitor the sensitivity of expected NII under varying interest rate scenarios (simulation modelling), where all other economic variables are held constant. This monitoring is undertaken by ALCO.

We apply a combination of scenarios and assumptions relevant to the businesses as well as applying standard scenarios that are required throughout the HSBC Group.

Projected NII sensitivity figures represent the effect of the pro forma movements in projected yield curves based on a static balance sheet size and structure assumption, other than instances where the size of the balances or repricing is deemed interest rate sensitive (non-interest bearing current account migration and fixed rate loan early prepayment) and where non-traded VaR is assumed to contractually run off. This effect, however, does not incorporate actions which would be taken by BSM or in the business units to mitigate the effect of interest rate risk. The NII sensitivity calculations assume that interest rates of all maturities move by the same amount in the 'up-shock' scenario. Rates are not assumed to become negative in the 'down-shock' scenario unless the central bank rate is already negative and then not assumed to go further negative, which may effectively result in non-parallel shock. In addition, the net interest income sensitivity calculations take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates over which the entity has discretion in terms of the timing and extent of rate changes.

Economic value of equity

EVE represents the present value of the future banking book cash flows that could be distributed to equity providers under a managed run-off scenario, i.e. the current book value of equity plus the present value of future net interest income in this scenario. This can be used to assess the economic capital required to support IRRBB. An EVE sensitivity is the extent to which the EVE value will change due to a pre-specified movements in interest rates, where all other economic variables are held constant. EVE sensitivity is measured as a percentage of capital resources.

Defined benefit pension scheme

Market risk also arises within HSBC UK's defined benefit pension plan to the extent that the obligations of the plan are not fully matched by assets with determinable cash flows. Refer to Pension risk section on page 27 for additional information.

Operational risk management

Details of our operational risk profile in 2018 can be found on page 43, in 'Operational risk exposures in 2018'.

Overview

The objective of our operational risk management is to manage and control operational risk in a cost-effective manner within targeted levels of operational risk consistent with our risk appetite.

Key developments in 2018

During 2018, we strengthened our approach to managing operational risk, as set out in the operational risk management

framework ('ORMF'). The approach sets out our governance, appetite and provides a single view of non-financial risks that matter the most and associated controls. It incorporates a risk management system to enable active risk management. The enhancement and embedding of the Risk Appetite Framework for non-financial risk, and the consistency of the adoption of the end-to-end risk and control assessment process, have been particular areas of focus for management in 2018. Activities continue to strengthen the effectiveness of the three lines of defence model more generally.

Further information on the three lines of defence model can be found in the 'Our risk management framework' section on page 18.

Governance and structure

The ORMF defines minimum standards and processes, and the governance structure for the management of operational risk and internal control in HSBC UK. The ORMF has been codified in a high-level standards manual, supplemented with detailed policies, which describes our approach to identifying, assessing, monitoring and controlling operational risk and gives guidance on mitigating action to be taken when weaknesses are identified.

We have a dedicated Operational Risk sub-function within our Risk function. It is responsible for establishing and maintaining the ORMF, monitoring the level of operational losses and the internal control environment supported by the second line of defence functions. The Operational Risk function reviews annually the level of implementation of the ORMF within HSBC UK. The Operational Risk function provides quarterly updates on the progress in implementing the ORMF to the HSBC UK RMM.

Key risk management processes

Business managers throughout HSBC UK 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 risk management system is used to record the results of the operational risk management process within HSBC UK. Operational risk and control self-assessments, along with issues and action plans, are entered and maintained by business units. Business and functional management monitor the progress of documented action plans to address shortcomings. To help ensure that operational risk losses are consistently reported and monitored across the Business lines and functions we are required to report individual losses when the net loss is expected to exceed \$10,000, and to aggregate all other operational risk losses under \$10,000. Losses are entered into the risk management system and reported to governance on a monthly basis.

Continuity of business operations

Every department within HSBC UK undertakes business continuity management, which incorporates the development of a plan including a business impact analysis assessing risk when business disruption occurs.

HSBC UK maintains a number of dedicated work area recovery sites globally. Regular testing of these facilities is carried out with representation from each business and support function, to ensure business continuity plans remain accurate, relevant and fit for purpose. Where possible, HSBC UK has ensured that its critical business systems are not co-located with business system users, thereby reducing concentration risk.

Regulatory compliance risk management

Regulation

Financial service providers continue to operate to stringent regulatory and supervisory requirements, particularly in the areas of capital and liquidity management, conduct of business, financial crime, internal control frameworks, the use of models and the integrity of financial services delivery. Regulatory changes,

including any resulting from the UK's exit from the EU, may affect the activities of HSBC UK.

A key development during 2018 was the preparation for the ring-fencing of the qualifying UK businesses of HSBC Bank plc to become HSBC UK Bank plc. These preparations were completed ahead of the 1 January 2019 deadline.

Mitigating actions

We are fully engaged with the government and regulators in the UK to help ensure that new regulatory and supervisory requirements are considered fully by regulatory authorities and the financial sector and can be implemented in an effective manner.

We hold regular meetings with UK authorities to discuss strategic contingency plans covering a wide range of scenarios relating to the UK's exit from the EU.

Conduct of business

Financial institutions remain under considerable scrutiny regarding conduct of business, particularly in relation to fair outcomes for customers and orderly and transparent operations in financial markets. Regulators, prosecutors, the media and the public all have heightened expectations as to the behaviour and conduct of financial institutions, and any shortcomings or failure to demonstrate adequate controls are in place to mitigate such risks could result in regulatory sanctions, fines or an increase in civil litigation.

Mitigating actions

We have continued to enhance our management of conduct in areas including our governance of product arrangements, the treatment of potentially vulnerable customers and encouragement of a 'Speak Up' culture.

Financial crime risk management

Overview

HSBC UK continued to embed a sustainable financial crime risk management capability. The HSBC Group and HSBC UK are making good progress in enhancing the financial crime control framework, with the three-year programme that began in 2017 to further strengthen the management of anti-bribery and corruption risk. The Group and HSBC UK continue to take further steps to refine and strengthen defences against financial crime by applying advanced analytics and artificial intelligence.

Key developments in 2018

During 2018, HSBC UK continued to increase efforts to strengthen its ability to combat financial crime. HSBC UK integrated into day-to-day operations the majority of the financial crime risk core capabilities delivered through the Global Standards programme, which were set up in 2013 to enhance risk management policies, processes and systems. The programme infrastructure is expected to close in 2019.

The HSBC Group began several initiatives to define the next phase of financial crime risk management. The Group invested in the use of artificial intelligence and advanced analytics techniques to develop an intelligence-led financial crime risk management framework for the future. This is applicable to HSBC UK.

Working in partnership with the public and private sector is vital to managing financial crime risk. The HSBC Group and HSBC UK are strong proponents of public-private partnerships and information-sharing initiatives. During 2018, HSBC UK continued to work in partnership with the Joint Money Laundering Intelligence Taskforce, in order to bring further benefit to the bank by enhancing the understanding of financial crime risks through information sharing.

Key risk management processes

Throughout 2018, the HSBC UK Board has received regular reports from the HSBC UK Head of Financial Crime Compliance on actions being taken to address issues and vulnerabilities in relation to financial crime. The HSBC Group and HSBC UK continued to deliver against the anti-bribery and corruption transformation programme to further enhance the policies and controls around

identifying and managing the risks of bribery and corruption across the business. A Group transformation programme, applicable to HSBC UK, has also been introduced to strengthen anti-fraud capabilities, and the Group have also deployed anti-tax evasion controls. The Group and HSBC UK continue to strengthen governance and policy frameworks and improve management information on standardised financial crime controls. The Group and HSBC UK commitment to enhancing risk assessment capabilities remains, aiming to deliver more proactive risk management and improve the customer experience.

Skilled person / Independent consultant

Following expiration in December 2017 of the AML Deferred Prosecution Agreement entered into with the US Department of Justice ('DoJ'), the then Monitor has continued to work under the Direction issued by the UK Financial Conduct Authority ('FCA') in 2012 in his capacity as a Skilled Person under section 166 of the Financial Services and Markets Act. He has also continued to work in his capacity as an Independent Consultant under the 2012 Cease and Desist Order issued by the US Federal Reserve Board ('FRB'). The Skilled Person and the Independent Consultant will continue working for a period of time at the FCA's and FRB's discretion. This work is applicable to the HSBC UK.

The Skilled Person is assessing the progress of the HSBC Group towards being able to effectively manage financial risk on a business as usual basis. As part of this review, the Skilled Person has undertaken a review of HSBC UK. Although the final report has not been issued, the Skilled Person has noted improvements in HSBC UK's management of financial crime risk. The Skilled Person has also identified some areas for further enhancement that are under consideration. We recognise that there is more to do before our financial crime compliance programme is fully operationally effective.

The Independent Consultant completed his fifth annual assessment, which included HSBC UK. The Independent Consultant concluded that the HSBC Group and HSBC UK continue to make significant strides toward establishing an effective sanctions compliance programme, commending the Group on a largely successful affiliates remediation exercise. He has, however, determined that certain areas within the Group's sanctions compliance programme require further work and, as such, the Group's sanctions programme does not yet operate in a business-as-usual state. The Independent Consultant has commenced his sixth annual assessment which is due to conclude in March 2019; HSBC UK is again in scope.

Other material risks

Reputational risk management

Overview

Reputational risk is the risk of failing to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by HSBC, our employees or those with whom we are associated. Stakeholders' expectations change constantly, and so reputational risk is dynamic and varies between geographical regions, groups and individuals. We have an unwavering commitment to operating at the high standards we set for ourselves in every jurisdiction.

Key developments in 2018

In the second half of 2018, as part of a revised enterprise risk management framework, it was agreed that reputational risk would be considered as a single risk type that spans both financial and non-financial risk categories. The oversight of reputational risk as a single risk type was transitioned to the Chief Risk Officer. He is supported by the Reputational Risk Committees and a new reputational risk framework, which will be embedded during 2019. The governance structure, however, remains unchanged.

Governance and structure

Policies for the identification, assessment management and mitigation of reputational risk, we set globally and follow in HSBC

UK. Within HSBC UK, matters arising from clients, transactions and third parties that present a material reputational risk are considered by the Line Of Business Reputational Risk and Client Selection Committees. Where matters are considered to be material to HSBC Group, these will be escalated for consideration to the Group Reputational Risk Committee.

Key risk management processes

Our Reputational Risk and Client Selection team oversees the identification, management and control of significant reputational risks across the UK. It is responsible for informing on policies to guide HSBC UK reputational risk management, devising strategies to protect against reputational risk, and advising both businesses and functions to help them identify, assess and mitigate such risks, where possible. It is supported by Reputational Risk and CSEM teams in each of the businesses. Each global business has an established reputational risk management governance process. The global functions manage and escalate reputational risks within established operational risk frameworks.

Our policies set out our risk appetite and operational procedures for all areas of reputational risk, including financial crime prevention, regulatory compliance, conduct-related concerns, environmental impacts, human rights matters and employee relations.

Pension risk management

There were no material changes to our policies and practices for the management of pension risk in 2018.

Governance and structure

A global pension risk framework and accompanying global policies on the management of risks related to defined benefit and defined contribution plans are in place. Pension risk is managed by a network of local and regional pension risk forums. The HSBC Group's Europe Pension Oversight Forum, chaired by the HSBC UK Chief Risk Officer, is responsible for the governance and oversight of pension plans sponsored by HSBC UK.

Key risk management processes

In the UK, all future pension benefits are provided on a defined contribution basis. A defined benefit pension plan remains in respect of past service. Following the Banking Reform Act the defined benefit pension plan has been sectionalised to ensure no entities outside the ring-fence participate in the same section as HSBC UK.

In the defined contribution pension plan, the contributions that HSBC UK is required to make are known, while the ultimate pension benefit will vary, typically with investment returns achieved by investment choices made by the employee. While the market risk to HSBC UK of the defined contribution plan is low, the bank is still exposed to operational and reputational risk.

In the defined benefit pension plan, the level of pension benefit is known. Therefore, the level of contributions required by HSBC UK will vary due to a number of risks, including:

- investments delivering a return below that required to provide the projected plan benefits;
- the prevailing economic environment leading to corporate failures, thus triggering write-downs in asset values (both equity and debt);
- a change in either interest rates or inflation, causing an increase in the value of the plan liabilities; and
- plan members living longer than expected (known as longevity risk).

Pension risk is assessed using an economic capital model that takes into account potential variations in these factors. The impact of these variations on both pension assets and pension liabilities is assessed using a one-in-200 year stress test. Scenario analysis and other stress tests are also used to support pension risk management.

To fund the benefits associated with the defined benefit plan, HSBC UK and other sponsoring HSBC Group companies make

contributions in accordance with advice from actuaries and in consultation with the plan's trustees where relevant. Contributions are required when plan assets are considered insufficient to cover the existing pension liabilities. Contributions are typically revised once every three years.

The defined benefit plan invests contributions in a range of investments designed to limit the risk of assets failing to meet a plan's liabilities. Any changes in expected returns from the investments may also change future contribution requirements. In pursuit of these long-term objectives, an overall target allocation of the defined benefit plan assets between asset classes is established. In addition, each permitted asset class has its own benchmarks, such as stock market or property valuation indices.

The benchmarks are reviewed at least once every three to five years and more frequently if required by circumstances. The process generally involves an extensive asset and liability review.

Key developments and risk profile

Key developments in 2018

- We continued to strengthen the controls that manage our operational risks, as described on page 43 under 'Operational risk profile'.
- We have integrated the majority of our Global Standards programme financial crime risk core capabilities into our day-to-day operations during 2018, and expect to complete the transition to business and function management in the first half of 2019. We continue to take further steps to refine and strengthen our defences against financial crime by applying advanced analytics and artificial intelligence. For further details on the Global Standards programme, refer to the HSBC Holdings plc *Annual Report and Accounts 2018*.
- IFRS 9 introduced new concepts and measures such as significant increase in credit risk and lifetime expected credit losses. Existing stress testing and regulatory models, skills and expertise were adapted in order to meet IFRS 9 requirements. Data from various client, finance and risk systems has been integrated and validated. As a result of IFRS 9 adoption, management has additional insight and measures not previously utilised which, over time, may influence our risk appetite and risk management processes.

Credit risk in 2018

A summary of our current policies and practices regarding credit risk is set out on page 21.

Credit risk is the risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises principally from direct lending, trade finance and leasing business, but also from off-balance sheet products such as guarantees and credit derivatives, and from the group's holdings of debt securities.

Outside the introduction of IFRS 9, there were no material changes to our policies and practices for the management of credit risk in 2018.

Summary of credit risk

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

The transitional impact of the adoption of IFRS 9 on 1 January 2018 was immaterial.

On 1 July 2018, an IFRS 9 allowance for ECL of £1.40bn was transferred from HSBC Bank plc in respect of the assets of the transferred businesses. This allowance has increased by £0.14bn to £1.54bn at 31 December 2018.

The IFRS 9 allowance for ECL at 31 December 2018 comprises £1.46bn in respect of assets held at amortised cost and £0.08bn in respect of loan commitments and financial guarantees. There were no allowances for ECL in respect of debt instruments measured at fair value through other comprehensive income ('FVOCI').

The following table provides an overview of the group and bank's credit risk exposure. As the majority of the group's financial instruments are held by the bank, the remaining IFRS 7 credit disclosures are provided on a group only basis.

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

(Audited)

	The group ⁵		The bank	
	31 Dec 2018		31 Dec 2018	
	Gross carrying/ nominal amount	Allowance for ECL ¹	Gross carrying/ nominal amount	Allowance for ECL ¹
	£m	£m	£m	£m
Loans and advances to customers at amortised cost	176,266	(1,459)	167,130	(1,280)
– personal	110,208	(565)	103,186	(463)
– corporate and commercial	63,491	(860)	53,507	(783)
– non-bank financial institutions	2,567	(34)	10,437	(34)
Loans and advances to banks at amortised cost	1,263	–	3,883	–
Other financial assets measured at amortised costs	39,142	(3)	38,950	–
– cash and balances at central banks	33,193	–	33,187	–
– items in the course of collection from other banks	603	–	457	–
– reverse repurchase agreements – non trading	3,422	–	3,422	–
– prepayments, accrued income and other assets ²	1,924	(3)	1,884	–
Total gross carrying amount on-balance sheet	216,671	(1,462)	209,963	(1,280)
Loans and other credit related commitments	64,628	(63)	52,225	(62)
– personal	39,389	(4)	28,009	(3)
– corporate and commercial	24,884	(59)	23,915	(59)
– non-bank financial institutions	355	–	301	–
Financial guarantees	1,284	(12)	1,263	(12)
– personal	16	–	15	–
– corporate and commercial	782	(12)	762	(12)
– non-bank financial institutions	486	–	486	–
Total nominal amount off-balance sheet³	65,912	(75)	53,488	(74)
At 31 December 2018	282,583	(1,537)	263,451	(1,354)

	Fair value	Memorandum allowance for ECL ⁴	Fair value	Memorandum allowance for ECL ⁴
	£m	£m	£m	£m
Debt instruments measured at fair value through other comprehensive income ('FVOCI')	13,203	–	13,203	–

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

2 Includes only those financial instruments which are subject to the impairment requirements of IFRS 9. 'Prepayments, accrued income and other assets' as presented within the consolidated balance sheet on page 64 includes both financial and non-financial assets.

3 Represents the maximum amount at risk should the contracts be fully drawn upon and clients default.

4 For the purposes of this disclosure gross carrying value is defined as the amortised cost of a financial asset, before adjusting for any loss allowance. As such the gross carrying value of debt instruments at FVOCI as presented above will not reconcile to the balance sheet as it excludes fair value gains and losses.

5 At 31 December 2017, the group held £2m of loans and advances to banks and £13m of debt securities. No loan impairment charges were recognised in respect of these instruments.

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

- Stage 1: unimpaired and without significant increase in credit risk on which a 12-month allowance for ECL is recognised.
- Stage 2: a significant increase in credit risk has been experienced since initial recognition on which a lifetime ECL is recognised.
- Stage 3: objective evidence of impairment, and are therefore considered to be in default or otherwise credit-impaired on which a lifetime ECL is recognised.

Summary of credit risk (excluding debt instruments measured at FVOCI) by stage distribution and ECL coverage by industry sector at 31 December 2018

(Audited)

	Gross carrying/nominal amount ¹				Allowance for ECL				ECL coverage %			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 %	Stage 2 %	Stage 3 %	Total %
Loans and advances to customers at amortised cost	163,118	10,544	2,604	176,266	(247)	(597)	(615)	(1,459)	0.2	5.7	23.6	0.8
– personal	105,920	3,282	1,006	110,208	(71)	(327)	(167)	(565)	0.1	10.0	16.6	0.5
– corporate and commercial	55,084	6,890	1,517	63,491	(170)	(261)	(429)	(860)	0.3	3.8	28.3	1.4
– non-bank financial institutions	2,114	372	81	2,567	(6)	(9)	(19)	(34)	0.3	2.4	23.5	1.3
Loans and advances to banks at amortised cost	1,262	1	–	1,263	–	–	–	–	–	–	–	–
Other financial assets measured at amortised cost	39,110	23	9	39,142	(3)	–	–	(3)	–	–	–	–
Loan and other credit-related commitments	61,946	2,358	324	64,628	(32)	(13)	(18)	(63)	0.1	0.6	5.6	0.1
– personal	38,994	172	223	39,389	(4)	–	–	(4)	–	–	–	–
– corporate and commercial	22,603	2,180	101	24,884	(28)	(13)	(18)	(59)	0.1	0.6	17.8	0.2
– financial	349	6	–	355	–	–	–	–	–	–	–	–
Financial guarantee and similar contracts	1,117	96	71	1,284	(3)	(2)	(7)	(12)	0.3	2.1	9.9	0.9
– personal	15	1	–	16	–	–	–	–	–	–	–	–
– corporate and commercial	620	93	69	782	(3)	(2)	(7)	(12)	0.5	2.2	10.1	1.5
– financial	482	2	2	486	–	–	–	–	–	–	–	–
At 31 Dec 2018	266,553	13,022	3,008	282,583	(285)	(612)	(640)	(1,537)	0.1	4.7	21.3	0.5

¹ Represents the maximum amount at risk should the contracts be fully drawn upon and clients default.

Unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when they are 30 days past due ('DPD') and are transferred from stage 1 to stage 2. The following disclosure below presents the ageing of stage 2 financial assets. It distinguishes those assets that are

classified as stage 2 when they are less than 30 days past due (1-29 DPD) from those that are due to ageing and are more than 30 DPD (30 and >DPD). Past due financial instrument are those loans where customers have failed to make payments in accordance with the contractual terms of their facilities.

Stage 2 days past due analysis at 31 Dec 2018

(Audited)

	Gross carrying amount			Allowance for ECL			ECL coverage %		
	Stage 2	Of which:	Of which:	Stage 2	Of which:	Of which:	Stage 2	Of which:	Of which:
	£m	1 to 29 DPD ¹ £m	30 and > DPD ¹ £m	£m	1 to 29 DPD ¹ £m	30 and > DPD ¹ £m	%	1 to 29 DPD ¹ %	30 and > DPD ¹ %
Loans and advances to customers at amortised cost:	10,544	327	177	(597)	(53)	(47)	5.7	16.2	26.6
– personal	3,282	238	153	(327)	(37)	(38)	10.0	15.5	24.8
– corporate and commercial	6,890	89	24	(261)	(16)	(9)	3.8	18.0	37.5
– non-bank financial institutions	372	–	–	(9)	–	–	2.4	–	–
Loans and advances to banks at amortised cost	1	–	–	–	–	–	–	–	–
Other financial assets measured at amortised cost	23	–	1	–	–	–	–	–	–

¹ Days past due ('DPD'). Up to date accounts in Stage 2 are not shown in amounts presented above.

Credit exposure

Maximum exposure to credit risk

(Audited)

'Maximum exposure to credit risk' table

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

The following table provides information on balance sheet items, offsets, and loan and other credit-related commitments.

The offset on derivatives remains in line with the movements in maximum exposure amounts.

Other credit risk mitigants

While not disclosed as an offset in the following 'Maximum exposure to credit risk' table, other arrangements are in place which reduce our maximum exposure to credit risk. These include a charge over collateral on borrowers' specific assets such as residential properties and collateral held in the form of financial instruments that are not held on balance sheet. See Note 12 for further details of collateral in respect of certain loans and advances and derivatives.

Maximum exposure to credit risk

(Audited)

	31 Dec 2018		
	Maximum exposure £m	Offset £m	Net £m
The group			
Loans and advances to customers held at amortised cost	174,807	(3,220)	171,587
– personal	109,643	(88)	109,555
– corporate and commercial	62,631	(3,132)	59,499
– non-bank financial institutions	2,533	–	2,533
Loans and advances to banks at amortised cost	1,263	–	1,263
Other financial assets held at amortised cost	39,287	–	39,287
– cash and balances at central banks	33,193	–	33,193
– items in the course of collection from other banks	603	–	603
– reverse repurchase agreements – non-trading	3,422	–	3,422
– prepayments, accrued income and other assets	2,069	–	2,069
Derivatives	66	(36)	30
Total on-balance sheet exposure to credit risk	215,423	(3,256)	212,167
Total off-balance sheet	73,226	–	73,226
– financial guarantees and similar contracts	3,483	–	3,483
– loan and other credit-related commitments	69,743	–	69,743

Concentration of exposures

The diversification of our lending portfolio and our broad range of businesses and products ensured that we did not overly depend on any one business segment to generate growth in 2018.

Loans and advances to customers and banks held at amortised cost

The table on page 29 and 88 analyses loans and advances by industry sector to show any concentration of credit risk exposures.

Other financial assets held at amortised cost

Financial investments

Our holdings of government and government agency debt securities, corporate debt securities, asset-backed securities ('ABSs') and other securities were spread across a range of issuers in 2018 with 100% invested in government or government agency debt securities.

Items in the course of collection from other banks

Settlement risk arises in any situations where a payment in cash, securities or equities is made with the expectation of a corresponding receipt of cash, securities or equities. Daily settlement limits are established for counterparties to cover the aggregate of transactions with each counterparty on any single day.

The group substantially mitigates settlement risk on many transactions, particularly those involving securities and equities, by

settling through assured payment systems, or on a delivery-versus-payment basis.

Impairment of amortised cost and FVOCI financial assets

(Audited)

A summary of our current policies and practices regarding impairment under IFRS 9 is set out in Note 1.2(g) on the financial statements on page 74.

Measurement uncertainty and sensitivity analysis of ECL estimates

(Audited)

Expected credit loss impairment allowances recognised in the financial statements reflect the effect of a range of possible economic outcomes, calculated on a probability-weighted basis, based on the economic scenarios described below. The recognition and measurement of expected credit losses ('ECL') involves the use of significant judgement and estimation. It is necessary to formulate multiple forward-looking economic forecasts and incorporate them into the ECL estimates. HSBC Group uses a standard framework to form economic scenarios to reflect assumptions about future economic conditions, supplemented with the use of management judgement, which may result in using alternative or additional economic scenarios and/or management adjustments.

Methodology

We have adopted the use of three scenarios, representative of our view of forecast economic conditions, sufficient to calculate unbiased expected loss in most economic environments. They represent a 'most likely outcome' (the Central scenario), and two, less likely 'outer' scenarios, referred to as the Upside and Downside scenarios. Each outer scenario is consistent with a probability of 10%, while the Central scenario is assigned the remaining 80%, according to the decision of our senior management. This weighting scheme is deemed appropriate for the unbiased estimation of ECL in most circumstances. Key scenario assumptions are set using the average of forecasts of external economists, helping to ensure that the IFRS 9 scenarios are unbiased and maximise the use of independent information. The Central, Upside and Downside scenarios selected with reference to external forecast distributions using the above approach are termed the 'consensus economic scenarios'.

For the Central scenario, we set key assumptions such as GDP growth, inflation, unemployment and policy interest rates, using either the average of external forecasts (commonly referred to as consensus forecasts) for most economies, or market prices. An external provider's global macro model, conditioned to follow the consensus forecasts, projects the other paths required as inputs to credit models. This external provider is subject to HSBC Group's risk governance framework, with oversight by a specialist internal unit.

The Upside and Downside scenarios are designed to be cyclical, in that GDP growth, inflation and unemployment usually revert back to the Central scenario after the first three years for major economies. We determine the maximum divergence of GDP growth from the Central scenario using the 10th and the 90th percentile of the entire distribution of forecast outcomes. While key economic variables are set with reference to external distributional forecasts, we also align the overall narrative of the scenarios to the macroeconomic risks described in our 'Top and emerging risks' on page 15. This ensures that scenarios remain consistent with the more qualitative assessment of these risks. We project additional variable paths using the external provider's global macro model.

We apply the following to generate the three economic scenarios:

- Economic risk assessment: We develop a shortlist of the upside and downside economic and political risks most relevant to the HSBC Group and the IFRS 9 measurement objective.
- Scenario generation: For the Central scenario, we obtain a pre-defined set of economic paths from the average taken from the consensus survey of professional forecasters. Paths for the two outer scenarios are benchmarked to the Central scenario and reflect the economic risk assessment. We select scenarios that in management's judgement are representative of the probability weighting scheme, informed by the current economic outlook, data analysis of past recessions, and transitions in and out of recession. The key assumptions made, and the accompanying paths, represent our 'best estimate' of a scenario at a specified probability. Suitable narratives are developed for the Central scenario and the paths of the two outer scenarios.
- Variable enrichment: We expand each scenario through enrichment of variables. This includes the production of more than 400 variables that are required to calculate ECL. The external provider expands these scenarios by using as inputs the agreed scenario narratives and the variables aligned to these narratives. Scenarios, once expanded, continue to be benchmarked to latest events and information. Late breaking events could lead to revision of scenarios to reflect management judgement.

The Upside and Downside scenarios are generated at the year-end and are only updated during the year if economic conditions change significantly. The Central scenario is generated every quarter. In quarters where only the Central scenario is updated, outer scenarios for use in Wholesale are adjusted such that the relationship between the Central scenario and outer scenarios in

the quarter is consistent with that observed at the last full scenario generation. In Retail, three scenarios are run annually to establish the effect of multiple scenarios for each portfolio. This effect is then applied in each quarter with the understanding that the non-linearity of response to economic conditions should not change, unless a significant change in economic conditions occurs.

The HSBC Group recognises that the consensus economic scenario approach, using three scenarios, will be insufficient in certain economic environments. Additional analysis may be requested at management's discretion. This may result in a change in the weighting scheme assigned to the three scenarios or the inclusion of extra scenarios. We anticipate that there will be only limited instances when the standard approach will not apply. This additional step was invoked on 1 January 2018, due to the specific uncertainties facing the UK economy at that time, resulting in the recognition of additional ECL through a management adjustment for economic uncertainty (termed a 'management overlay'). During 2018, we maintained additional ECL impairment allowances for the UK. See 'Impact of UK economic uncertainty on ECL' below.

At 31 December 2018, management determined that an adjustment continues to be appropriate, under which the consensus downside for the UK has been replaced by three additional downside scenarios, described below.

Description of consensus economic scenarios

The economic assumptions presented in this section have been formed internally by the HSBC Group specifically for the purpose of calculating expected credit loss.

The consensus Central scenario

Consensus forecasts were stable over the course of 2018 and our Central scenario is one of moderate growth over the projection period 2019-2023. Global GDP growth is expected to be 2.9% on average over the period, which is marginally higher than the average growth rate over the period 2013-2017.

- Expected average rates of GDP growth over the 2019-2023 period are lower than average growth rates achieved over the 2013-2017 period for the UK. This reflects expectations that the long-term impact of current economic uncertainty will be moderately adverse.
- The average unemployment rate over the projection horizon is expected to remain at or below the averages observed in the 2013-2017 period.
- Inflation is expected to be stable despite steady GDP growth and strong labour markets and will remain close to central bank target over the forecast period.

The following table describes key macroeconomic variables and the probabilities assigned in the consensus Central scenario.

Central scenario (average 2019-2023)

	UK
GDP growth rate (%)	1.7
Inflation (%)	2.1
Unemployment (%)	4.5
Short-term interest rate (%)	1.2
10-year Treasury bond yields (%)	2.6
House price growth (%)	2.9
Equity price growth (%)	3.2
Probability (%)	50

The consensus Upside scenario

The economic forecast distribution of risks (as captured by consensus probability distributions of GDP growth) has shown a decrease for the UK over the course of 2018. Globally, real GDP growth rises in the first two years of the Upside scenario before converging to the Central scenario. Increased confidence, de-escalation of trade tensions and removal of trade barriers, expansionary fiscal policy, positive resolution of economic uncertainty in the UK, stronger oil prices as well as calming of

geopolitical tensions are the risk themes that support the 2018 year-end Upside scenario.

The following table describes key macroeconomic variables and the probabilities assigned in the consensus Upside scenario.

Upside scenario (average 2019–2023)

	UK
GDP growth rate (%)	2.2
Inflation (%)	2.3
Unemployment (%)	4.2
Short-term Interest rate (%)	1.3
10-year Treasury bond yields (%)	2.7
House price growth (%)	4.1
Equity price growth (%)	6.0
Probability (%)	10

The Downside scenarios

The consensus Downside scenario

The distribution of risks (as captured by consensus probability distributions of GDP growth) were broadly stable for the UK.

The following table describes key macroeconomic variables and the probabilities assigned in the Consensus Downside scenario.

Downside scenario (average 2019–2023)

	UK
GDP growth rate (%)	1.1
Inflation (%)	1.7
Unemployment (%)	4.8
Short Term Interest rate (%)	0.3
10Y Treasury bond Yields (%)	1.6
House price growth (%)	1.0
Equity price growth (%)	(0.2)
Probability (%)	–

Alternative Downside scenarios for the UK

A number of events occurred over the course of 2018 that led management to re-evaluate the shape of the consensus distribution for the UK.

Given the challenges facing economic forecasters in this environment, management was concerned that this distribution did not adequately represent downside risks for the UK. The high level of economic uncertainty that prevailed at the end of 2018, including the lack of progress in agreeing a clear plan for an exit from the European Union and the uncertain performance of the UK economy after an exit, was a key factor in this consideration. In management's view, the extent of this uncertainty justifies the use of the following Alternative Downside scenarios, used in place of the consensus Downside, with the assigned probabilities:

Alternative Downside scenario 1 ('AD1'): Economic uncertainty could have a large impact on the UK economy resulting in a long lasting recession with a weak recovery. This scenario reflects the consequences of such a recession with an initial risk-premium shock and weaker long-run productivity growth. This scenario has been used with a 30% weighting.

Alternative Downside scenario 2 ('AD2'): This scenario reflects the possibility that economic uncertainty could result in a deep cyclical shock triggering a steep depreciation in sterling, a sharp increase in inflation and an associated monetary policy response. This represents a tail risk and has been assigned a 5% weighting.

Alternative Downside scenario 3 ('AD3'): This scenario reflects the possibility that the adverse impact associated with economic uncertainty currently in the UK could manifest over a far longer period of time with the worst effects occurring later than in the above two scenarios. This scenario is also considered a tail risk and has been assigned a 5% weighting.

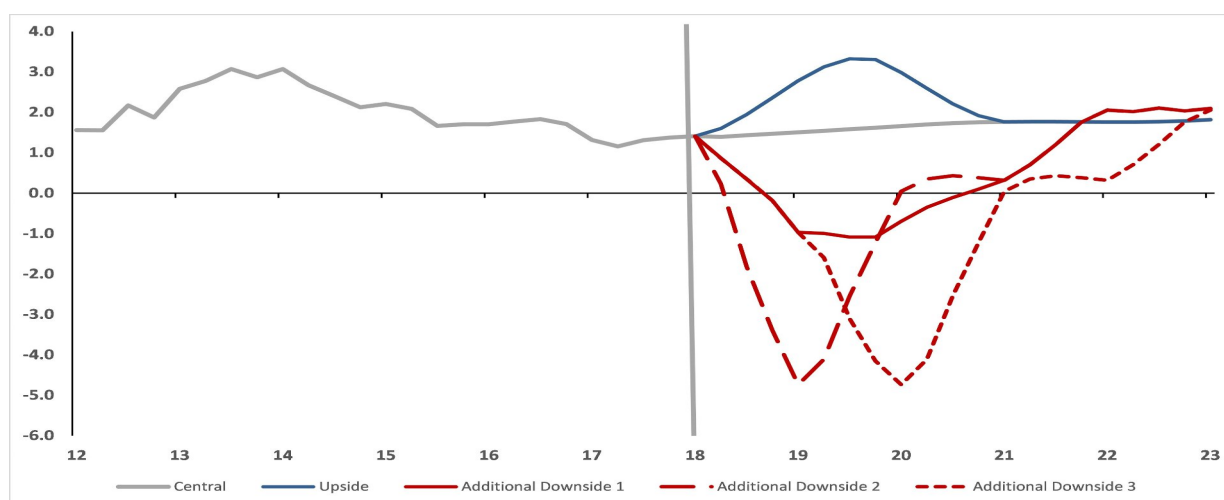
The table below describes key macro-economic variables and the probabilities for each of the Alternative Downside scenarios:

Average 2019–2023

	Alternative Downside scenario 1	Alternative Downside scenario 2	Alternative Downside scenario 3
GDP growth rate (%)	0.5	(0.1)	(0.7)
Inflation (%)	2.2	2.4	2.7
Unemployment (%)	6.5	8.0	7.7
Short-term interest rate (%)	0.4	2.5	2.5
10-year Treasury bond yields (%)	1.8	4.0	4.0
House price growth (%)	(1.5)	(3.3)	(4.8)
Equity price growth (%)	(0.9)	(2.3)	(7.5)
Probability (%)	30	5	5

The conditions that resulted in departure from the consensus economic forecasts will be reviewed regularly as economic conditions change in future to determine whether these adjustments continue to be necessary.

The graph below shows the historical and forecasted GDP growth rate for five years for the various economic scenarios.



How economic scenarios are reflected in the wholesale calculation of ECL

The calculation of ECL incorporates forward economic guidance into the estimation of the term structure of probability of default ('PD') and loss given default ('LGD'). For PDs, we consider the correlation of forward economic guidance to default rates for a particular industry in a country. For LGD calculations we consider the correlation of forward economic guidance to collateral values and realisation rates for a particular country and industry. PDs and LGDs are estimated for the entire term structure of each instrument.

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

How economic scenarios are reflected in the retail calculation of ECL

The impact of economic scenarios on PD is modelled at a portfolio level. Historic relationships between observed default rates and macro-economic variables are integrated into IFRS 9 ECL estimates by leveraging economic response models. The impact of these scenarios on PD is modelled over a period equal to the remaining maturity of underlying asset or assets. The impact on LGD is modelled for mortgage portfolios by forecasting future loan-to-value ('LTV') profiles for the remaining maturity of the asset by leveraging national level forecasts of the house price index and applying the corresponding LGD expectation.

Impact of UK economic uncertainty on ECL

While consensus forecasts for the UK remained broadly stable during 2018, management remained concerned that the consensus distribution did not adequately reflect downside risks, particularly towards the end of 2018 as the level of risk increased. At 31 December 2018, management determined that its view of the distribution of possible economic outcomes in the UK was better reflected by using three additional Downside scenarios in place of the UK consensus Downside scenario. This resulted in the recognition of additional impairment allowances of £258m compared with those implied by consensus forecasts, to reflect the increased level of economic uncertainty in the UK.

We also considered developments after the balance sheet date and concluded that they did not necessitate any adjustment to the approach or judgements taken on 31 December 2018.

Economic scenarios sensitivity analysis of ECL estimates

The ECL outcome is sensitive to judgement and estimations made with regards to the formulation and incorporation of multiple forward looking economic conditions described above. As a result, management assessed and considered the sensitivity of the ECL outcome against the forward looking economic conditions as part of the ECL governance process by recalculating the ECL under each scenario described above for selected portfolios, applying a 100% weighting to each scenario in turn. The weighting is reflected in both the determination of significant increase in credit risk as well as the measurement of the resulting ECL. For wholesale exposures, the sensitivity analysis excludes ECL and financial instruments related to defaulted obligors because the measurement of ECL is relatively more sensitive to credit factors specific to the obligor than future economic scenarios.

The economic scenarios are generated to capture management's view of a range of possible forecast economic conditions that is sufficient for the calculation of unbiased and probability-weighted ECL. Therefore, the ECL calculated for each of the scenarios represent a range of possible outcomes that have been evaluated to estimate ECL. As a result, the ECL calculated for the Upside and Downside scenarios should not be taken to represent the upper

and lower limits of possible actual ECL outcomes. There is a high degree of estimation uncertainty in numbers representing tail risk scenarios when assigned a 100% weighting, and an indicative range is provided for the UK tail risk sensitivity analysis. A wider range of possible ECL outcomes reflects uncertainty about the distribution of economic conditions and does not necessarily mean that credit risk on the associated loans is higher than for loans where the distribution of possible future economic conditions is narrower. The recalculated ECL for each of the scenarios should be read in the context of the sensitivity analysis as a whole and in conjunction with the narrative disclosures provided below.

ECL under each scenario is given in GBP terms and as a percentage of the gross carrying amount (and, for wholesale lending, the nominal amount for related-loan commitments and financial guarantees).

Wholesale analysis

IFRS 9 ECL sensitivity to future economic conditions¹

	UK
	£m
ECL coverage of financial instruments subject to significant measurement uncertainty at 31 December 2018²	
Reported ECL	491
Gross carrying/ nominal amount	129,651
Reported ECL coverage	0.38%
Coverage ratios by scenario:	
Consensus Central scenario	0.28%
Consensus Upside scenario	0.25%
Consensus Downside scenario	0.32%
Coverage ratios for alternative scenarios:	
- UK AD1	0.41%
- Tail risk scenarios (UK AD 2 - 3)	0.69% - 0.79%
ECL for Alternative scenarios (£m):	
- UK AD1	534
- Tail risk scenarios (UK AD 2 - 3)	891 - 1,019

¹ Excludes ECL and financial instruments relating to defaulted obligors because the measurement of ECL is relatively more sensitive to credit factors specific to the obligor than future economic scenarios.

² Includes off-balance sheet financial instruments that are subject to significant measurement uncertainty. Also includes low credit risk financial instruments such as Debt instruments at FVOCI which have low ECL coverage ratios under all the above scenarios.

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

The additional scenarios for UK economic uncertainty could, if they occurred, increase ECL by three to 41 basis points compared with reported ECL for all wholesale financial instruments.

Retail analysis

IFRS 9 ECL sensitivity to future economic conditions¹

	UK
ECL coverage of loans and advances to customers at 31 December 2018²	
Reported ECL (£m)	546
Gross carrying amount (£m)	106,201
Reported ECL coverage	0.51%
Coverage ratios by scenario:	
Consensus Central scenario	0.39%
Consensus Upside scenario	0.35%
Consensus Downside scenario	0.47%
Coverage ratios for alternative scenarios:	
- UK AD1	0.66%
- Tail risk scenarios (UK AD 2 - 3)	0.85% - 0.98%
ECL for Alternative scenarios (£m):	
- UK AD1	699
- Tail risk scenarios (UK AD 2 - 3)	897 - 1036

¹ ECL sensitivities exclude portfolios utilising less complex modelling approaches.

² ECL sensitivity includes only On balance sheet financial instruments to which IFRS 9 impairment requirements are applied.

For all the above sensitivity analyses, as the level of uncertainty, economic forecasts, historical economic variable correlations or credit quality changes, corresponding changes in the ECL sensitivity would occur.

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers including loan commitments and financial guarantees

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

The transfers of financial instruments represents the impact of stage transfers upon the gross carrying/nominal amount and

associated allowance for ECL. The net remeasurement of ECL arising from stage transfers represents the increase or decrease due to these transfers, for example, moving from a 12-month (stage 1) to a lifetime (stage 2) ECL measurement basis. Net remeasurement excludes the underlying CRR/PD movements of the financial instruments transferring stage. This is captured, along with other credit quality movements in the 'changes in risk parameters – credit quality' line item.

The 'new financial assets originated or purchased', 'net further lending' and 'assets derecognised (including final repayments)' represent the gross carrying/nominal amount and associated allowance ECL impact from volume movements within the Group's lending portfolio.

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers including loan commitments and financial guarantees

(Audited)

	Non credit impaired				Credit impaired		Total	
	Stage 1		Stage 2		Stage 3		Gross carrying/nominal amount	Allowance for ECL
	Gross carrying/nominal amount	Allowance for ECL	Gross carrying/nominal amount	Allowance for ECL	Gross carrying/nominal amount	Allowance for ECL		
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 Jan 2018	–	–	–	–	–	–	–	–
Transfer from HSBC Bank Plc and its subsidiaries	216,026	(288)	9,502	(453)	2,711	(663)	228,239	(1,404)
Transfers of financial instruments:	(1,336)	(36)	876	90	460	(54)	–	–
– transfers from Stage 1 to Stage 2	(4,977)	50	4,977	(50)	–	–	–	–
– transfers from Stage 2 to Stage 1	3,729	(86)	(3,729)	86	–	–	–	–
– transfers to Stage 3	(143)	6	(462)	65	605	(71)	–	–
– transfers from Stage 3	55	(6)	90	(11)	(145)	17	–	–
Net remeasurement of ECL arising from transfer of stage	–	55	–	(54)	–	(1)	–	–
Net new and further lending / (repayments)	12,160	(17)	2,653	53	53	196	14,866	232
Changes to risk parameters – credit quality	–	9	–	(250)	–	(352)	–	(593)
Changes to model used for ECL calculation	–	–	–	–	–	–	–	–
Assets written off	–	–	–	–	(233)	233	(233)	233
Others	(460)	(6)	(50)	3	9	1	(501)	(2)
At 31 Dec 2018¹	226,390	(283)	12,981	(611)	3,000	(640)	242,371	(1,534)
ECL release/(charge) for the period		47		(251)		(157)		(361)
Recoveries								52
Others								4
Total ECL release/(charge) for the period								(305)

¹ The Reconciliation excludes loans and advances to other HSBC Group companies. As at 31 December 2018, these amounted to £0.8bn (2017: £2m) and were classified as Stage 1 with no ECL.

² This disclosure does not include Other financial assets and Non-trading Reverse repurchase agreements.

The contractual amount outstanding of financial assets written off during the period, that are still subject to enforcement activities amounted to £194m.

Credit quality of financial instruments

(Audited)

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

bands exhibit a higher proportion in stage 2. The five credit quality classifications defined above each encompass a range of granular internal credit rating grades assigned to wholesale and retail lending businesses and the external ratings attributed by external agencies to debt securities, as shown in the table below. Under IAS 39 retail lending credit quality was disclosed based on expected-loss percentages. Under IFRS 9 retail lending credit quality is now disclosed based on a 12 month probability-weighted 'PD'. The credit quality classifications for wholesale lending are unchanged and are based on internal credit risk ratings.

Distribution of financial instruments by credit quality

(Audited)

	Gross carrying/notional amount						Allowance for ECL	Net
	Strong	Good	Satisfactory	Sub-standard	Credit impaired	Total		
	£m	£m	£m	£m	£m	£m	£m	£m
In-scope for IFRS 9								
Loans and advances to customers held at amortised cost	106,089	26,485	37,827	3,261	2,604	176,266	(1,459)	174,807
– personal	98,679	5,550	4,477	496	1,006	110,208	(565)	109,643
– corporate and commercial	7,009	20,301	31,998	2,666	1,517	63,491	(860)	62,631
– non-bank financial institutions	401	634	1,352	99	81	2,567	(34)	2,533
Loans and advances to banks held at amortised cost	1,254	7	2	–	–	1,263	–	1,263
Cash and balances at central banks	33,193	–	–	–	–	33,193	–	33,193
Items in the course of collection from other banks	603	–	–	–	–	603	–	603
Reverse repurchase agreements – non-trading	3,422	–	–	–	–	3,422	–	3,422
Other financial assets held at amortised cost	–	–	–	–	–	–	–	–
Other assets	1,626	99	189	1	9	1,924	(3)	1,921
– endorsements and acceptances	3	51	31	1	–	86	–	86
– accrued income and other	1,623	48	158	–	9	1,838	(3)	1,835
Debt instruments measured at fair value through other comprehensive income ¹	13,019	–	–	–	–	13,019	–	13,019
Out-of-scope for IFRS 9								
Trading assets	–	–	–	–	–	–	–	–
Derivatives	49	15	2	–	–	66	–	66
Assets held for sale	–	–	–	–	–	–	–	–
Total gross carrying amount on balance sheet	159,255	26,606	38,020	3,262	2,613	229,756	(1,462)	228,294
Percentage of total credit quality	69.4%	11.6%	16.5%	1.4%	1.1%	100.0%	–	–
Loan and other credit related commitments	42,745	11,383	9,640	536	324	64,628	(63)	64,565
Financial guarantees	499	239	460	15	71	1,284	(12)	1,272
In-scope:Irrecoverable loan commitments and financial guarantees	43,244	11,622	10,100	551	395	65,912	(75)	65,837
Loan and other credit related commitments	5,178	–	–	–	–	5,178	–	5,178
Performance and other guarantees	232	787	1,111	50	40	2,220	(9)	2,211
Out-of-scope:Revocable loan commitments and Non-financial guarantees	5,410	787	1,111	50	40	7,398	(9)	7,389
Total nominal amount off balance sheet	48,654	12,409	11,211	601	435	73,310	(84)	73,226
At 31 Dec 2018	207,909	39,015	49,231	3,863	3,048	303,066	(1,546)	301,520

¹ For the purposes of this disclosure gross carrying value is defined as the amortised cost of a financial asset, before adjusting for any loss allowance. As such the gross carrying value of debt instruments at FVOCI as presented above will not reconcile to the balance sheet as it excludes fair value gains and losses.

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

(Audited)

	Gross carrying/notional amount						Allowance for ECL	Net
	Strong	Good	Satisfactory	Sub-standard	Credit impaired	Total		
	£m	£m	£m	£m	£m	£m	£m	£m
Loans and advances to customers at amortised cost	106,089	26,485	37,827	3,261	2,604	176,266	(1,459)	174,807
– stage 1	105,924	26,060	30,547	587	–	163,118	(247)	162,871
– stage 2	165	425	7,280	2,674	–	10,544	(597)	9,947
– stage 3	–	–	–	–	2,604	2,604	(615)	1,989
Loans and advances to banks at amortised cost	1,254	7	2	–	–	1,263	–	1,263
– stage 1	1,253	7	2	–	–	1,262	–	1,262
– stage 2	1	–	–	–	–	1	–	1
– stage 3	–	–	–	–	–	–	–	–
Other financial assets measured at amortised cost	38,846	98	188	1	9	39,142	–	39,142
– stage 1	38,845	97	168	–	–	39,110	–	39,110
– stage 2	1	1	20	1	–	23	–	23
– stage 3	–	–	–	–	9	9	–	9
Loan and other credit-related commitments	42,745	11,383	9,640	536	324	64,628	(63)	64,565
– stage 1	42,667	11,036	8,099	144	–	61,946	(32)	61,914
– stage 2	78	347	1,541	392	–	2,358	(13)	2,345
– stage 3	–	–	–	–	324	324	(18)	306
Financial guarantees	499	239	460	15	71	1,284	(12)	1,272
– stage 1	499	238	378	2	–	1,117	(3)	1,114
– stage 2	–	1	82	13	–	96	(2)	94
– stage 3	–	–	–	–	71	71	(7)	64
Debt instruments at FVOCI	13,019	–	–	–	–	13,019	–	13,019
– stage 1	13,019	–	–	–	–	13,019	–	13,019
– stage 2	–	–	–	–	–	–	–	–
– stage 3	–	–	–	–	–	–	–	–
At 31 Dec 2018	202,452	38,212	48,117	3,813	3,008	295,602	(1,534)	294,068

Credit Impaired loans

(Audited)

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

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

and default are aligned as far as possible so that stage 3 represents all loans which are considered defaulted or otherwise credit-impaired.

Renegotiated loans and forbearance

The following table shows the gross carrying amounts of the group's holdings of renegotiated loans and advances to customers by industry sector and by stages. Wholesale renegotiated loans are classified as stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, observed over a minimum one-year period, and there are no other indicators of impairment. Personal renegotiated loans are deemed to remain credit-impaired until repayment or derecognition.

Renegotiated loans and advances to customers at amortised costs by stage allocation

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Gross carrying amount				
Personal	–	–	465	465
– first lien residential mortgages	–	–	348	348
– other personal lending	–	–	117	117
Wholesale	282	234	987	1,503
– corporate and commercial	282	234	980	1,496
– non-bank financial institutions	–	–	7	7
At 31 Dec 2018	282	234	1,452	1,968
Allowance for ECL				
Personal	–	–	(59)	(59)
– first lien residential mortgages	–	–	(28)	(28)
– other personal lending	–	–	(31)	(31)
Wholesale	(11)	(17)	(280)	(308)
– corporate and commercial	(11)	(17)	(279)	(307)
– non-bank financial institutions	–	–	(1)	(1)
At 31 Dec 2018	(11)	(17)	(339)	(367)

Wholesale lending

This section provides further detail on the products in wholesale loans and advances to customers and banks. Product granularity is also provided by stage.

Total wholesale lending for loans and advances to banks and customers by stage distribution

	Gross carrying amount				Allowance for ECL			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Corporate and commercial	55,084	6,890	1,517	63,491	(170)	(261)	(429)	(860)
– agriculture, forestry and fishing	2,816	717	75	3,608	(8)	(26)	(6)	(40)
– mining and quarrying	681	305	70	1,056	(3)	(2)	(4)	(9)
– manufacture	6,817	1,227	110	8,154	(21)	(33)	(36)	(90)
– electricity, gas, steam and air-conditioning supply	339	101	23	463	(1)	(7)	(7)	(15)
– water supply, sewerage, waste management and remediation	1,023	13	16	1,052	(2)	(1)	(11)	(14)
– construction	3,586	192	284	4,062	(7)	(10)	(113)	(130)
– wholesale and retail trade, repair of motor vehicles and motorcycles	7,956	1,750	211	9,917	(16)	(48)	(53)	(117)
– transportation and storage	1,454	159	18	1,631	(5)	(6)	(4)	(15)
– accommodation and food	6,232	481	87	6,800	(25)	(26)	(18)	(69)
– publishing, audiovisual and broadcasting	1,691	186	66	1,943	(11)	(5)	(39)	(55)
– real estate	10,787	619	254	11,660	(18)	(26)	(65)	(109)
– professional, scientific and technical activities	3,392	289	44	3,725	(14)	(21)	(20)	(55)
– administrative and support services	3,840	496	111	4,447	(17)	(20)	(23)	(60)
– public administration and defence, compulsory social security	17	–	–	17	–	–	–	–
– education	819	51	8	878	(6)	(5)	(3)	(14)
– health and care	1,260	175	99	1,534	(5)	(9)	(18)	(32)
– arts, entertainment and recreation	982	68	18	1,068	(4)	(6)	(3)	(13)
– other services	756	61	23	840	(7)	(10)	(6)	(23)
– activities of households	1	–	–	1	–	–	–	–
– assets backed securities	635	–	–	635	–	–	–	–
Non-bank financial institutions	2,114	372	81	2,567	(6)	(9)	(19)	(34)
Loans and advances to banks	1,262	1	–	1,263	–	–	–	–
At 31 Dec 2018	58,460	7,263	1,598	67,321	(176)	(270)	(448)	(894)

Total wholesale lending for loans and other credit-related commitments and financial guarantee and similar contracts by stage distribution

	Nominal amount				Allowance for ECL			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Corporate and commercial	23,223	2,273	170	25,666	(31)	(15)	(25)	(71)
Financial	831	8	2	841	—	—	—	—
At 31 Dec 2018	24,054	2,281	172	26,507	(31)	(15)	(25)	(71)

Commercial real estate

Commercial real estate lending includes the financing of corporate, institutional and high net worth individuals who are investing primarily in income-producing assets and, to a lesser extent, in their construction and development. The business focuses mainly on traditional core asset classes such as retail, offices, light industrial and residential building projects.

The collateral measured in the tables below consists of fixed first charges on real estate and charges over cash and marketable financial instruments. The values in the tables represent the expected market value on an open market basis; no adjustment has been made to the collateral for any expected costs of recovery. Cash is valued at its nominal value and marketable securities at their fair value. The LTV ratios presented are calculated by directly associating loans and advances with the collateral that individually and uniquely supports each facility. Where collateral assets are shared by multiple loans and advances, whether specifically or, more generally, by way of an all monies charge, the collateral value is prorated across the loans and advances protected by the collateral.

Commercial real estate lending

	2018 £m
Gross loans and advances	
Stage 1	13,572
Stage 2	630
Stage 3	525
At 31 Dec 2018	14,727
– of which: renegotiated loans	560
Allowance for ECL	(204)

Other types of collateral which are commonly taken for corporate and commercial lending such as unsupported guarantees and floating charges over the assets of a customer's business are not measured in the tables below. While such mitigants have value, often providing rights in insolvency, their assignable value is not sufficiently certain and they are therefore assigned no value for disclosure purposes.

Refinance risk in commercial real estate

Commercial real estate lending tends to require the repayment of a significant proportion of the principal at maturity. Typically, a customer will arrange repayment through the acquisition of a new loan to settle the existing debt. Refinance risk is the risk that a customer, being unable to repay the debt on maturity, fails to refinance it at commercial rates. We monitor our commercial real estate portfolio closely, assessing indicators for signs of potential issues with refinancing.

The value of commercial real estate collateral is determined by using a combination of professional and internal valuations and physical inspections. Due to the complexity of valuing collateral for commercial real estate, local valuation policies determine the frequency of review on the basis of local market conditions. Revaluations are sought with greater frequency as concerns over the performance of the collateral or the direct obligor increase.

Commercial real estate gross loans and advances maturity analysis

	2018 £m
< 1 year	7,379
1-2 years	3,383
2-5 years	3,673
> 5 years	292
At 31 Dec 2018	14,727

Commercial real estate loans and advances

The value of commercial real estate collateral is determined by using a combination of external and internal valuations and physical inspections. For CRR 1–7, local valuation policies determine the frequency of review on the basis of local market conditions because of the complexity of valuing collateral for commercial real estate. For CRR 8–10, almost all collateral would have been revalued within the last three years.

Facilities of a working capital nature are generally not secured by a first fixed charge, and are therefore disclosed as not collateralised.

Collateral and other credit enhancement held

(Audited)

Although collateral can be an important mitigant of credit risk, it is HSBC UK's practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured.

For other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of a default, the group may utilise the collateral as a source of repayment. Depending on its form, collateral can have a significant financial effect in mitigating exposure to credit risk.

Collateral on loans and advances

Collateral held is analysed separately for commercial real estate and for other corporate and commercial and financial (non-bank) lending. This reflects the greater correlation between collateral performance and principal repayment in the commercial real estate sector than applies to other lending. In each case, the analysis includes off-balance sheet commitments, primarily undrawn credit lines.

Wholesale lending: commercial real estate loans and advances including loan commitments by level of collateral (by stage)

(Audited)

	Gross carrying/ nominal amount	ECL coverage
	£m	%
Stage 1		
Not collateralised	5,591	0.2
Fully collateralised	11,890	0.1
LTV ratio:		
– less than 50%	5,285	0.1
– 51% to 75%	5,408	0.1
– 76% to 90%	800	–
– 91% to 100%	397	0.1
Partially collateralised (A):	394	0.1
– collateral value on A	214	
Total	17,875	0.1
Stage 2		
Not collateralised	250	3.4
Fully collateralised	567	2.8
LTV ratio:		
– less than 50%	285	3.8
– 51% to 75%	258	1.3
– 76% to 90%	13	3.6
– 91% to 100%	11	10.8
Partially collateralised (B):	19	10.5
– collateral value on B	16	
Total	836	3.1
Stage 3		
Not collateralised	47	84.7
Fully collateralised	339	9.1
LTV ratio:		
– less than 50%	238	9.2
– 51% to 75%	45	6.7
– 76% to 90%	27	5.1
– 91% to 100%	29	14.9
Partially collateralised (C):	204	43.0
– collateral value on C	107	
Total	590	26.8
At 31 Dec 2018	19,301	1.1

Wholesale lending: commercial real estate loans and advances including loan commitments by level of collateral

(Audited)

	Gross carrying/ nominal amount	ECL coverage
	£m	%
Rated CRR/ PD1 to 7		
Not collateralised	5,839	0.3
Fully collateralised	12,117	0.2
Partially collateralised (D):	407	0.5
– collateral value on D	225	
Total	18,363	0.2
Rated CRR/ PD 8		
Not collateralised	2	11.1
Fully collateralised	340	1.2
LTV ratio:		
– less than 50%	117	1.1
– 51% to 75%	207	0.5
– 76% to 90%	5	9.0
– 91% to 100%	11	11.3
Partially collateralised (E):	6	6.6
– collateral value on E	5	
Total	348	1.3
Rated CRR/ PD9 to 10		
Not collateralised	47	84.7
Fully collateralised	339	9.1
LTV ratio:		
– less than 50%	238	9.2
– 51% to 75%	45	6.7
– 76% to 90%	27	5.1
– 91% to 100%	29	14.9
Partially collateralised (F):	204	43.0
– collateral value on F	107	
Total	590	26.8
At 31 Dec 2018	19,301	1.1

Other corporate, commercial and financial (non-bank) loans and advances

(Audited)

Other corporate, commercial and financial (non-bank) loans are detailed below, reflecting the difference in collateral held on the portfolios. For financing activities in corporate and commercial lending that are not predominantly commercial real estate-oriented, collateral value is not strongly correlated to principal repayment performance. Collateral values are generally refreshed when an obligor's general credit performance deteriorates and we have to assess the likely performance of secondary sources of repayment should it prove necessary to rely on them.

The table includes off-balance sheet loan commitments by level of collateralisation.

Wholesale lending: other corporate, commercial and financial (non-bank) loans and advances including loan commitments by level of collateral (by stage)

(Audited)

	Gross carrying/ nominal amount £m	ECL coverage %
Stage 1		
Not collateralised	52,685	0.3
Fully collateralised	9,210	0.3
LTV ratio:		
– less than 50%	2,257	0.5
– 51% to 75%	5,383	0.2
– 76% to 90%	1,317	0.2
– 91% to 100%	253	0.3
Partially collateralised (A):	3,723	0.1
– collateral value on A	1,575	
Total	65,618	0.3
Stage 2		
Not collateralised	3,831	5.2
Fully collateralised	4,498	1.1
LTV ratio:		
– less than 50%	3,996	0.7
– 51% to 75%	390	4.3
– 76% to 90%	96	3.3
– 91% to 100%	16	5.3
Partially collateralised (B):	292	3.2
– collateral value on B	162	
Total	8,621	3.0
Stage 3		
Not collateralised	727	36.1
Fully collateralised	279	6.0
LTV ratio:		
– less than 50%	127	6.1
– 51% to 75%	110	2.4
– 76% to 90%	34	12.7
– 91% to 100%	8	23.9
Partially collateralised (C):	106	28.3
– collateral value on C	67	
Total	1,112	27.8
At 31 Dec 2018	75,351	1.0

Wholesale lending: other corporate, commercial and financial (non-bank) loans and advances including loan commitments by level of collateral rated CRR/PD 8 to 10 only

(Audited)

	Gross carrying/ nominal amount £m	ECL coverage %
Rated CRR/ PD 8		
Not collateralised	204	6.8
Fully collateralised	38	6.3
LTV ratio:		
– less than 50%	17	5.7
– 51% to 75%	18	6.3
– 76% to 90%	2	11.4
– 91% to 100%	1	7.6
Partially collateralised (A):	12	8.9
– collateral value on A	11	
Total	254	6.8
Rated CRR/ PD9 to 10		
Not collateralised	727	36.2
Fully collateralised	279	6.0
LTV ratio:		
– less than 50%	127	6.2
– 51% to 75%	110	2.4
– 76% to 90%	34	12.8
– 91% to 100%	8	24.5
Partially collateralised (B):	106	28.3
– collateral value on B	67	
Total	1,112	27.8
At 31 Dec 2018	1,366	23.9

Other credit risk exposures

In addition to collateralised lending, other credit enhancements are employed and methods used to mitigate credit risk arising from financial assets. These are described in more detail below:

- some securities issued by governments, banks and other financial institutions benefit from additional credit enhancement provided by government guarantees that cover the assets;
- debt securities issued by banks and financial institutions include ABSs and similar instruments which are supported by underlying pools of financial assets;
- the group's maximum exposure to credit risk includes financial guarantees and similar arrangements that we issue or enter into, and loan commitments that we are irrevocably committed to. Depending on the terms of the arrangement, we may have recourse to additional credit mitigation in the event that a guarantee is called upon or a loan commitment is drawn and subsequently defaults.

Personal lending

We provide a broad range of secured and unsecured personal lending products to meet customer needs. Personal lending includes advances to customers for asset purchases such as residential property where the loans are secured by the assets being acquired. We also offer loans secured on existing assets, such as first charges on residential property, and unsecured lending products such as overdrafts, credit cards and payroll loans. The following table shows the levels of personal lending products in the various portfolios.

Total personal lending for loans and advances to customers at amortised costs by stage distribution

	Gross carrying amount				Allowance for ECL			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	£m	£m	£m	£m	£m	£m	£m	£m
By portfolio								
First lien residential mortgages	92,973	930	800	94,703	(7)	(13)	(87)	(107)
– of which: interest only (including offset)	20,895	788	100	21,783	(2)	(7)	(11)	(20)
– affordability including ARMs	70	–	–	70	–	–	–	–
Other personal lending	12,947	2,352	206	15,505	(64)	(314)	(80)	(458)
– other	7,138	961	127	8,226	(36)	(133)	(49)	(218)
– credit cards	5,809	1,391	79	7,279	(28)	(181)	(31)	(240)
At 31 Dec 2018	105,920	3,282	1,006	110,208	(71)	(327)	(167)	(565)

Total personal lending for loans and other credit-related commitments and financial guarantee by stage distribution

	Nominal amount				Allowance for ECL			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	£m	£m	£m	£m	£m	£m	£m	£m
At 31 Dec 2018	39,009	173	223	39,405	(4)	–	–	(4)

Mortgage lending

We offer a wide range of mortgage products designed to meet customer needs, including capital repayment, interest-only and offset mortgages. Internal credit policies prescribe the range of acceptable residential property LTV thresholds with the maximum upper limit for new loans set between 50% and 95%, depending on the product type and loan amount.

Exposure to UK interest-only mortgage loans

The following information is presented for the bank's HSBC branded UK interest-only mortgage loans with balances of £11.3bn; this excludes offset mortgages in First Direct, Private Bank mortgages, endowment mortgages and other products.

At the end of 2018, the average LTV ratio in the portfolio was 46%, and 96% of mortgages had an LTV ratio of 75% or less.

The profile of maturing UK interest-only loans is as follows:

UK interest-only mortgage loans

	£m
Matured interest-only mortgage loans ¹	137
Interest-only mortgage loans by maturity	
– 2019	283
– 2020	313
– 2021	399
– 2022	378
– 2023–2027	2,256
– post 2027	7,489
At 31 Dec 2018	11,255

¹ Includes interest-only mortgages which have reached their contractual maturity date, but were unsettled at the end of 2018.

Other personal lending

Other personal lending consists primarily of credit cards and personal loans, both of which are generally unsecured.

Collateral and other credit enhancements held

(Audited)

The tables below show residential mortgage lending including off-balance sheet loan commitments by level of collateral. They provide a quantification of the value of fixed charges we hold over borrowers' specific assets where we have a history of enforcing, and are able to enforce, collateral in satisfying a debt in the event of the borrower failing to meet its contractual obligations, and where the collateral is cash or can be realised by sale in an established market. The LTV ratio is calculated as the gross on-balance sheet carrying amount of the loan and any off-balance sheet loan commitment at the balance sheet date divided by the value of collateral. The value of collateral is determined using professional valuations and house price indices. The collateral valuation excludes any adjustments for obtaining and selling the collateral and, in particular, loans shown as not collateralised or

partly collateralised may also benefit from other forms of credit mitigants. Valuations must be updated on a regular basis and, as a minimum, at intervals of every three years. More frequent revaluations are conducted where market conditions or portfolio performance are subject to significant change or where a loan is identified and assessed as impaired.

Personal lending: residential mortgage loans including loan commitments by level of collateral

(Audited)

	Total	
	Gross carrying/ nominal amount £m	ECL coverage %
Stage 1		
Fully collateralised	99,849	—
LTV ratio:		
– less than 50%	51,341	—
– 51% to 60%	16,127	—
– 61% to 70%	13,463	—
– 71% to 80%	11,608	—
– 81% to 90%	6,819	—
– 91% to 100%	491	—
Partially collateralised (A):	275	—
LTV ratio:		
– 101% to 110%	85	—
– 111% to 120%	35	—
– greater than 120%	155	—
– collateral value on A	209	—
Total	100,124	—
Stage 2		
Fully collateralised	928	1.3
LTV ratio:		
– less than 50%	703	0.9
– 51% to 60%	84	3.0
– 61% to 70%	82	2.2
– 71% to 80%	31	3.3
– 81% to 90%	21	3.1
– 91% to 100%	7	2.4
Partially collateralised (B):	1	7.6
LTV ratio:		
– 101% to 110%	—	—
– 111% to 120%	1	3.4
– greater than 120%	—	—
– collateral value on B	1	—
Total	929	1.4
Stage 3		
Fully collateralised	783	10.7
LTV ratio:		
– less than 50%	486	7.8
– 51% to 60%	118	11.3
– 61% to 70%	91	18.6
– 71% to 80%	54	14.9
– 81% to 90%	26	19.2
– 91% to 100%	8	35.2
Partially collateralised (C):	18	15.8
LTV ratio:		
– 101% to 110%	7	16.0
– 111% to 120%	4	25.8
– greater than 120%	7	10.0
– collateral value on C	14	—
Total	801	10.9
At 31 Dec 2018	101,854	0.1

Management of liquidity and funding risk in 2018

Liquidity coverage ratio

The Liquidity Coverage Ratio ('LCR') aims to ensure that a bank has sufficient unencumbered high-quality liquid assets ('HQLA') to meet its liquidity needs in a 30-calendar-day liquidity stress scenario. HQLA consist of cash or assets that can be converted into cash at little or no loss of value in markets.

At 31 December 2018, HSBC UK Liquidity Group was within the LCR risk tolerance level established by the Board and applicable under the LFRF.

The following table displays the individual LCR levels for HSBC UK Liquidity Group on an EC LCR Delegated Regulation basis.

HSBC UK Liquidity Group LCR

	At
	31 Dec 2018
	%
HSBC UK liquidity group ¹	143

¹ HSBC UK Liquidity Group comprises: HSBC UK Bank plc (including Dublin branch), Marks and Spencer Financial Services plc, HSBC Trust Company (UK) Limited and HSBC Private Bank (UK) Limited. It is managed as a single operating entity, in line with the application of UK liquidity regulation as agreed with the PRA.

Net stable funding ratio

The Net Stable Funding Ratio ('NSFR') requires institutions to maintain sufficient stable funding relative to required stable funding, and reflects a bank's long-term funding profile (funding with a term of more than a year). It is designed to complement the LCR.

At 31 December 2018, HSBC UK Liquidity Group was within the NSFR risk tolerance level established by the Board and applicable under the LFRF.

The table below displays the NSFR levels for the principal operating entities on a BCBS 295 basis.

HSBC UK Liquidity Group NSFR

	At
	31 Dec 2018
	%
HSBC UK liquidity group	144

Depositor concentration and term funding maturity concentration

The LCR and NSFR metrics assume a stressed outflow based on a portfolio of depositors within each deposit segment. The validity of these assumptions is undermined if the underlying depositors do not represent a large enough portfolio so that a depositor concentration exists.

In addition to this, HSBC UK Liquidity Group is exposed to term re-financing concentration risk if the current maturity profile results in future maturities being overly concentrated in any defined period.

At 31 December 2018, HSBC UK Liquidity Group was within the risk tolerance levels set for depositor concentration and term funding maturity concentration which were established by the Board and are applicable under the LFRF.

Liquid assets of HSBC UK Liquidity Group

The table below shows the unweighted liquidity value of assets categorised as liquid, which is used for the purposes of calculating the LCR metric. This reflects the stock of unencumbered liquid assets at the reporting date, using the regulatory definition of liquid assets.

HSBC UK Liquidity Group liquid assets

	Estimated liquidity value at 31 Dec 2018
	£m
HSBC UK liquidity group	
Level 1	45,318
Level 2a	1,222
Level 2b	—

Sources of funding

Our primary sources of funding are customer current accounts and customer savings deposits payable on demand or at short notice.

The following 'Funding sources and uses' table provides a consolidated view of how our balance sheet is funded, and should

be read in light of the LFRF, which requires HSBC UK Liquidity Group to manage liquidity and funding risk on a stand-alone basis.

The table analyses our consolidated balance sheet according to the assets that primarily arise from operating activities and the sources of funding primarily supporting these activities. Assets and liabilities that do not arise from operating activities are

presented as a net balancing source or deployment of funds. In 2018, the level of customer accounts exceeded the level of loans and advances to customers. The positive funding gap was predominantly deployed in liquid assets, cash and balances with central banks and financial investments, as required by the LFRF.

Funding sources and uses

	2018 £m		2018 £m
Sources		Uses	
Customer accounts	204,837	Loans and advances to customers	174,807
Deposits by banks	1,027	Loans and advances to banks	1,263
Repurchase agreements – non-trading	639	Reverse repurchase agreements – non-trading	3,422
Accruals, deferred income and other liabilities	35	Prepayments, accrued income and other assets	338
– Cash collateral, margin and settlement accounts	35	– Cash collateral, margin and settlement accounts	338
Subordinated liabilities	4,937	Financial investments	13,203
Financial liabilities designated at fair value	–	Cash and balances with Central banks	33,193
Total equity	22,333	Net deployment in other balance sheet assets and liabilities	7,582
At 31 Dec	233,808	At 31 Dec	233,808

Contractual maturity of financial liabilities

The table below shows, on an undiscounted basis, all cash flows relating to principal and future coupon payments (except for derivatives not treated as hedging derivatives). For this reason, balances in the table below do not agree directly with those in our consolidated balance sheet and the bank's balance sheet. Undiscounted cash flows payable in relation to hedging derivative liabilities are classified according to their contractual maturities.

Derivatives not treated as hedging derivatives are included in the 'On demand' time bucket and not by contractual maturity. In addition, loans and other credit-related commitments, financial guarantees and similar contracts are generally not recognised on our balance sheet. The undiscounted cash flows potentially payable under loan and other credit-related commitments, and financial guarantees are classified on the basis of the earliest date they can be called.

Cash flows payable under financial liabilities by remaining contractual maturities

The group	On demand	Due within 3 months	Due between 3 and 12 months	Due between 1 and 5 years	Due after 5 years
	£m	£m	£m	£m	£m
Deposits by banks	1,018	8	–	–	–
Customer accounts	186,411	15,762	2,250	454	12
Repurchase agreements – non-trading	–	189	453	–	–
Derivatives	44	3	26	133	279
Subordinated liabilities	–	35	105	557	6,329
Other financial liabilities	1,792	679	13	–	–
	189,265	16,676	2,847	1,144	6,620
Loan and other credit-related commitments	69,552	29	42	137	44
Financial guarantees	1,284	–	–	–	–
At 31 Dec 2018	260,101	16,705	2,889	1,281	6,664
Proportion of cash flows payable in period	91%	6%	1%	0%	2%

Cash flows payable under financial liabilities by remaining contractual maturities

The bank	On demand	Due within 3 months	Due between 3 and 12 months	Due between 1 and 5 years	Due after 5 years
	£m	£m	£m	£m	£m
Deposits by banks	1,214	2,790	217	58	–
Customer accounts	180,194	14,435	1,879	373	–
Repurchase agreements – non-trading	–	189	453	–	–
Derivatives	38	3	26	133	279
Subordinated liabilities	–	35	105	557	6,250
Other financial liabilities	2,569	411	13	–	–
	184,015	17,863	2,693	1,121	6,529
Loan and other credit-related commitments	55,505	–	–	–	–
Financial guarantees	1,263	–	–	–	–
At 31 Dec 2018	240,783	17,863	2,693	1,121	6,529
Proportion of cash flows payable in period	90%	7%	1%	0%	2%

Market risk in 2018

Market risk is the risk that movements in market factors, including but not limited to interest rates, credit spreads and foreign exchange rates will reduce the entities income or the value of its portfolios.

There were no material changes to our policies and practices for the management of market risk in 2018.

Exposure to market risk is separated into two portfolios.

Trading portfolios comprise positions arising from market-making and hedging of customer-derived positions or short dated trades executed for nostro management or liquidity management purposes.

Non-trading portfolios including BSM comprise positions that primarily arise from the interest rate management of the group's retail and commercial banking assets and liabilities and financial investments designated as held-to-collect-and-sale ('HTCS') held as part of the entities liquid asset buffer 'LAB'.

Trading portfolios

(Audited)

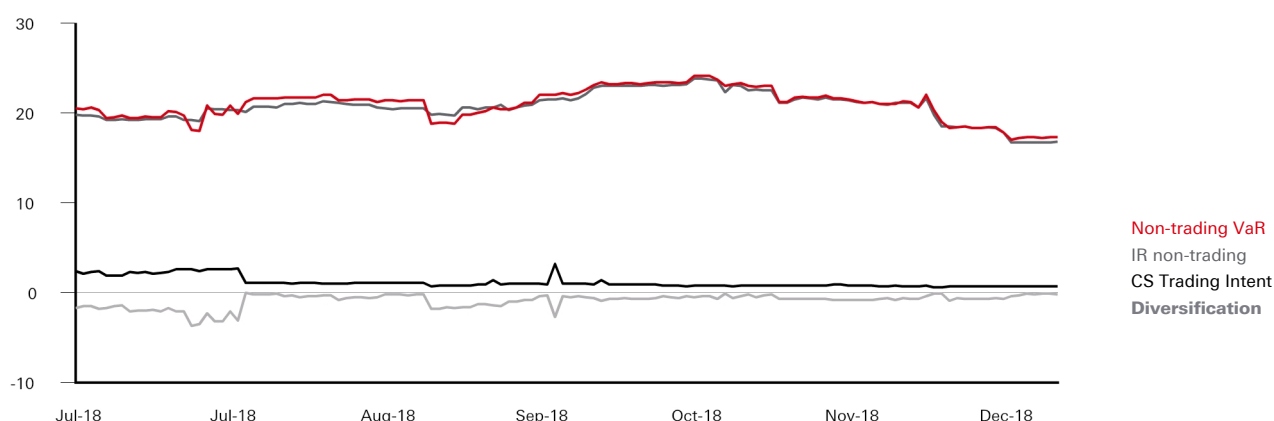
The HSBC Group's preferred method of market risk capital calculations is to use a VaR model. However due to the small size of the regulatory trading portfolio within HSBC UK, the current approach to capital calculations for market risk in the trading portfolio within the group is to use the standardised model. Trading portfolio market risk exposures within the group are not material as customer facing trades within markets are hedged on a one for one basis and the BSM trading portfolio limits are primarily used for short term cash management.

Value at Risk of the non-trading portfolios

(Audited)

Non-trading VaR of the group includes contributions from BSM and ALCO. It is primarily driven by interest rate risk of non-trading BSM positions which have the most significant market risk limits within HSBC UK. These limits and corresponding exposures are the consequence of BSM needing to meet its twin objectives of managing the structural interest rate risk transferred from the global businesses and the management of the entities LAB. The daily levels of total non-trading VaR over the last year are set out in the graph below. The primary driver of the non-trading VaR is the Interest Rate risk exposure held within BSM (£16.7m as at 31 Dec 18). The main contributor of Interest rate risk within BSM are the securities held within the LAB and their corresponding hedges.

Daily VaR (non-trading portfolios), 99% 1 day (£m)



The group's non-trading VaR for the year is shown in the table below.

Non-trading VaR, 99% 1 day

(Audited)

	2018	Credit spread	Interest Rates	Diversification ¹
	£m	£m	£m	£m
Balance at 31 Dec 2018	17.3	0.7	16.8	(0.2)
Average	20.9	1.1	20.7	(0.9)
Maximum	24.1	3.2	23.8	
Minimum	17.0	0.6	16.7	

¹ Portfolio diversification is the market risk dispersion effect of holding a portfolio containing different risk types. It represents the reduction in unsystematic market risk that occurs when combining a number of different risk types, for example, interest rate and credit risk together in one portfolio. It is measured as the difference between the sum of the VaR by individual risk type and the combined total VaR. A negative number represents the benefit of portfolio diversification. As the maximum occurs on different days for different risk types, it is not meaningful to calculate a portfolio diversification benefit for this measure.

Operational risk profile

Operational risk is the risk to achieving our 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 Group's employees. They are required to manage the operational risks of the business and operational activities for which they are responsible.

A summary of our current policies and practices regarding the management of operational risk is set out on page 25.

Operational risk exposures in 2018

In 2018 we strengthened those controls that manage our most material risks. Among other measures, we:

- enhanced our controls to help ensure that we know our customers, ask the right questions, monitor transactions and escalate concerns to detect, prevent and deter financial crime risk;
- implemented a number of initiatives to raise our standards in relation to the conduct of our business as described on page 25 of the 'Regulatory compliance risk management' section;
- increased monitoring and enhanced detective controls to manage fraud risks which arise from new technologies and new ways of banking;
- strengthened internal security controls to help prevent cyber-attacks;
- improved controls and security to protect customers when using digital channels; and
- enhanced our third-party risk management capability to help enable the consistent risk assessment of any third-party service.

Further information on the nature of these risks is provided in 'Top and emerging risks' on page 15 and in 'Risk management' from pages 18 to 26.

Operational risk losses in 2018

Operational risk losses for the period July to December 2018 were driven mainly by one large legacy and a number of other conduct-related events, and external fraud losses. For further details, see Note 27 on the Financial Statements and on conduct-related costs included in significant items on page 101.

Capital

Capital management

(Audited)

Approach and policy

Our objective in managing the group's capital is to maintain appropriate levels of capital to support our business strategy and meet regulatory and stress testing related requirements.

We manage group capital to ensure that we exceed current and expected future requirements. Throughout 2018, we complied with the Prudential Regulation Authority's ('PRA') regulatory capital adequacy requirements, including those relating to stress testing.

Capital measurement

The PRA is the supervisor of the bank and lead supervisor of the group. The PRA sets capital requirements and receives information on the capital adequacy of the bank and the group.

Our policy and practice in capital measurement and allocation at the group level is underpinned by the Capital Requirements Directive ('CRD IV') rules and any national discretions applied by the PRA.

The Basel III framework, like Basel II, is structured around three 'pillars': minimum capital requirements, supervisory review process and market discipline. Basel III also introduces a number of capital buffers, including the Capital Conservation Buffer ('CCB'), Countercyclical Capital Buffer ('CCyB'), and other systemic buffers such as the Globally/Other Systemically Important Institutions ('G-SII'/'O-SII') buffer. CRD IV legislation implemented Basel III in the EU, and in the UK, the 'PRA Rulebook' for CRR Firms transposed the various national discretions under the CRD IV legislation into UK requirements. The PRA will be obliged by the CRR to derive systemic risk buffer ('SRB') rates for ring-fenced banks ('RFBs') and expects to announce the first SRB rates in early 2019.

Regulatory capital

Our capital base is divided into three main categories, namely common equity tier 1, additional tier 1 and tier 2, depending on their characteristics.

- Common equity tier 1 ('CET 1') capital is the highest quality form of capital, comprising shareholders' equity and related non-controlling interests (subject to limits). Under CRD IV various capital deductions and regulatory adjustments are made against these items; these include deductions for goodwill and intangible assets, deferred tax assets that rely on future profitability, negative amounts resulting from the calculation of expected loss amounts under internal ratings based ('IRB') approach and surplus defined benefit pension fund assets.

- Additional tier 1 capital comprises eligible non-common equity capital instruments and any related share premium; it also includes other qualifying instruments issued by subsidiaries subject to certain limits. Holdings of additional tier 1 instruments of financial sector entities are deducted from our additional tier 1 capital.
- Tier 2 capital comprises eligible capital instruments and any related share premium and other qualifying tier 2 capital instruments issued by subsidiaries, subject to limits. Holdings of tier 2 capital instruments of financial sector entities are deducted from our tier 2 capital.

Pillar 3 disclosure requirements

Pillar 3 of the Basel regulatory framework is related to market discipline and aims to increase market transparency by requiring firms to publish, at least annually, wide-ranging information on their risks and capital, and how these are managed. Our Pillar 3 Disclosures 2018 are published on HSBC Group's website, www.hsbc.com, under 'Investors'.

Capital overview

Key capital numbers

	At 31 Dec	
	2018	2017
	<i>Footnotes</i>	
Available capital (£m)	<i>1</i>	
Common equity tier 1 capital	11,700	15
Tier 1 capital	13,896	15
Total regulatory capital	16,826	15
Risk-weighted assets (£m)		
Credit risk	81,135	–
Counterparty credit risk	66	–
Market risk	38	–
Operational risk	10,600	–
Total risk-weighted assets	91,839	–
Capital ratios (%)		
Common equity tier 1	12.7	N/A
Total tier 1	15.1	N/A
Total capital	18.3	N/A
Leverage ratio		
Tier 1 capital (£m)	13,896	N/A
Total leverage ratio exposure measure (£m)	246,659	N/A
Leverage ratio (%)	<i>2</i>	5.6

1 Capital figures are reported on a transitional basis.

2 Leverage ratio is calculated on a fully phased-in basis.

Capital

(Audited)

Own funds disclosure

Ref*		At	
		31 Dec 2018 £m	31 Dec 2017 £m
Common equity tier 1 ('CET1') capital: instruments and reserves			
1	Capital instruments and the related share premium accounts	9,015	15
	– ordinary shares	9,015	15
2	Retained earnings	10,713	–
3	Accumulated other comprehensive income (and other reserves)	(399)	–
5a	Independently reviewed interim net profits net of any foreseeable charge or dividend	562	–
6	Common equity tier 1 capital before regulatory adjustments	19,891	15
Common equity tier 1 capital: regulatory adjustments			
7	Additional value adjustments	(8)	–
8	Intangible assets (net of related deferred tax liability)	(3,808)	–
11	Fair value reserves related to gains or losses on cash flow hedges	31	–
12	Negative amounts resulting from the calculation of expected loss amounts	(25)	–
15	Defined-benefit pension fund assets	(4,381)	–
28	Total regulatory adjustments to common equity tier 1	(8,191)	–
29	Common equity tier 1 capital	11,700	15
Additional tier 1 ('AT1') capital: instruments			
30	Capital instruments and the related share premium accounts	2,196	–
31	– classified as equity under IFRSs	2,196	–
36	Additional tier 1 capital before regulatory adjustments	2,196	–
44	Additional tier 1 capital	2,196	–
45	Tier 1 capital (T1 = CET1 + AT1)	13,896	15
Tier 2 capital: instruments and provisions			
46	Capital instruments and the related share premium accounts	2,930	–
51	Tier 2 capital before regulatory adjustments	2,930	–
58	Tier 2 capital	2,930	–
59	Total capital (TC = T1 + T2)	16,826	15

* The references identify the lines prescribed in the EBA template, which are applicable and where there is a value.

Risk-Weighted Assets ('RWAs')

RWA movement by business by key driver

	Credit risk, counterparty credit risk and operational risk						
	RBWM	CMB	GB&M	GPB	Corporate Centre	Market risk	Total RWAs
	£m	£m	£m	£m	£m	£m	£m
RWAs at 1 Jan 2018	–	–	–	–	–	–	–
Transfers	20,735	66,068	187	1,851	818	41	89,700
Book size	531	2,663	(6)	32	1,512	(4)	4,728
Book quality	(58)	74	–	39	(37)	–	18
Model updates	163	(1,447)	–	–	–	–	(1,284)
– portfolios moving onto IRB approach	–	–	–	–	–	–	–
– new/updated models	163	(1,447)	–	–	–	–	(1,284)
Methodology and policy	(1)	(1,349)	(159)	2	175	–	(1,332)
– internal updates	(1)	(1,349)	(159)	2	48	–	(1,459)
– external updates – regulatory	–	–	–	–	127	–	127
Foreign exchange movement	–	–	–	–	8	1	9
Total RWA movement	21,370	66,009	22	1,924	2,476	38	91,839
RWAs at 31 Dec 2018	21,370	66,009	22	1,924	2,476	38	91,839

Leverage ratio

Our fully phased-in CRD IV leverage ratio was 5.6% at 31 December 2018.

Corporate Governance Report

The statement of corporate governance practices set out on pages 46 to 50 and information incorporated by reference constitutes the Corporate Governance Report of HSBC UK Bank plc.

The Directors serving as at 31 December 2018 are set out below.

Directors

Dame Clara Furse

Chairman and independent non-executive Director

Chairman of the Chairman's Nominations and Remuneration Committee.

Appointed to the Board: 1 April 2017

Clara is a non-executive director of Vodafone Group plc and Amadeus IT Group, S.A.. She is a member of the Panel of Senior Advisors to Chatham House and of Bocconi University's International Advisory Council. Former appointments include: external member of the Bank of England's Financial Policy Committee; lead independent director of the UK's Department for Work and Pensions; Chief Executive of the London Stock Exchange; Group Chief Executive of Credit Lyonnais Rouse; member of the Shanghai International Financial Advisory Council and non-executive director of Euroclear plc, LCH Clearnet Group Ltd., Fortis SA, Nomura Holdings and the Legal & General Group.

John David Stuart (known as Ian Stuart)

Executive Director and Chief Executive Officer

Chairman of the Executive Committee.

Appointed to the Board: 30 May 2017

Ian joined the HSBC Group in 2014. He was appointed to the Board in May 2017 and became a Group Managing Director of HSBC Holdings plc on 1 July 2018. He is a board member of UK Finance, the financial services industry association. He is also a business ambassador for Meningitis Now. He has more than 38 years' experience in the banking industry. Before joining HSBC, Ian led the Corporate Banking business at Barclays for six years and held many roles in business banking during his 22 years at NatWest.

Jonathan James Calladine (known as James Calladine)

Executive Director and Chief Risk Officer

Member of the Executive Committee.

Appointed to the Board: 2 October 2017

James joined the HSBC Group in 1983. He took up the post of UK Chief Risk Officer and was appointed to the Board in October 2017. Former HSBC Group roles include: Chief Risk Officer for the HSBC Group's Latin American operations; regional Chief Risk Officer for Continental Europe; and Senior Manager, Internal Audit in Asia Pacific.

James Coyle

Independent non-executive Director

Chairman of the Audit Committee and a member of the Risk Committee and Chairman's Nominations and Remuneration Committee.

Appointed to the Board: 1 May 2018

James is chairman of Marks & Spencer Unit Trust Management Limited and a non-executive director of Marks and Spencer Financial Services plc and Marks and Spencer Savings and Investments Limited (together the M&S Bank) and a member of the Audit & Risk Committee of the M&S Bank. James is also Chairman of HSBC Trust Company (UK) Limited and a non-executive director and member of the Audit and Risk Committee of HSBC Private Bank (UK) Limited. He is a non-executive director and chairman of the Audit and Risk Committee of Scottish Water,

a non-executive director and chairman of the Audit and Risk Committee of Honeycomb Investment Trust plc, director and chairman of the Audit and Risk Committee of World First and an independent non-executive member of Deloitte UK Oversight Board. Former appointments include: member of Committees of the Financial Reporting Council, Group Financial Controller for Lloyds Banking Group; Group Chief Accountant of Bank of Scotland; member of the Audit Committee of the British Bankers Association; non-executive director of the Scottish Building Society; and a non-executive director and chairman of the Audit Committee of Vocalink plc.

Mridul Hegde CB

Independent non-executive Director

Chairman of the Risk Committee and a member of the Audit Committee and the Chairman's Nominations and Remuneration Committee.

Appointed to the Board: 7 February 2018

Mridul is a non-executive Director of the UK Municipal Bonds Agency and is a member of its Risk and Audit Committee. Former appointments include senior roles at the Financial Reporting Council and HM Treasury, where she was Director of Financial Stability during the 2008 financial crisis and prior to that, Director of Public Spending.

Dame Denise Holt

Independent non-executive Director

Member of the Audit Committee.

Appointed to the Board: 1 May 2018

Denise is chairman of Marks and Spencer Financial Services plc and Marks and Spencer Savings and Investments Limited. She is a non-executive director of Iberdrola SA and Chairs the Council of the University of Sussex and the Cañada Blanch Centre for Contemporary Spanish Studies at the London School of Economics. Former appointments include: member of the Board of Governors at Nuffield Health; member of the board of Ofqual (examinations regulators) and of the NHS pay review body. Her career in the Foreign & Commonwealth Office included 40 years' experience of working in government, with postings in Ireland, Brazil and, as a senior Ambassador, in Mexico and Spain.

Alan Keir

Non-executive Director

Member of the Audit Committee and Risk Committee.

Appointed to the Board: 1 February 2018

Alan is a non-executive director of Sumitomo Mitsui Bank Europe and Majid Al Futtaim Holdings. Former appointments include a variety of senior executive roles within the HSBC Group. He was a Group Managing Director of HSBC Holdings plc from 2011 until his retirement from the Group in 2015. He has previously served on the boards of HSBC Bank plc, HSBC Turkey, HSBC Trinkaus and Burkhardt, HSBC Bank Middle East and HSBC France. He is also a former Board member of the British Bankers Association, the UK-UAE Business Council, the Private Sector Council for GREAT (a government campaign to promote the best of Great Britain) and the University of Bradford School of Management Advisory Board. He has also sat on the Advisory Council of TheCityUK.

Rosemary Leith

Independent non-executive Director

Member of the Risk Committee

Appointed to the Board: 1 February 2018

Rosemary is a non-executive director of YouGov plc where she chairs the Remuneration Committee and is a member of the Audit Committee. She is a non-executive director of the World Wide Web Foundation and Trustee of the National Gallery where she chairs the Digital Advisory Board. Rosemary is a member of the Advisory Councils of Glasswing Ventures, Motive Partners and the Queens University School of Business. She is a Fellow at Harvard

University's Berkman Klein Centre. Former appointments include: director of the Almeida Theatre, member of the Advisory Board of Infinite Analytics and Oxford University Wolfson College, and chair of the Council on Cyber security for the World Economic Forum, Global Agenda Council.

David Lister

Independent non-executive Director

Member of the Audit Committee and Risk Committee.

Appointed to the Board: 1 May 2018

David is chairman of HSBC Private Bank (UK) Limited. He is a non-executive director of FDM Group (Holdings) plc and Interxion Holding N.V.; and a member of the board of governors at Nuffield Health. Former appointments include: non-executive director of CIS General Insurance Limited, Weatherbys Limited and the Department for Work and Pensions; Trustee of The Tech Partnership Limited; and Group Chief Information Officer at each of National Grid, Royal Bank of Scotland, Reuters and Boots.

Philippe Leslie Van de Walle (known as Leslie Van de Walle)

Independent non-executive Director

Member of the Risk Committee and Chairman's Nominations and Remuneration Committee

Appointed to the Board: 1 February 2018

Leslie is the senior independent director and chairman of the Remuneration Committee of DCC plc and a non-executive director and deputy chairman of Crest Nicholson Holdings plc. Former appointments include: non-executive Chairman of Robert Walters plc, SIG plc and Weener Plastic Packaging Group; non-executive director of Cape plc and Aegis Group plc; non-executive director and member of the Risk Committee of Aviva plc; senior independent non-executive director and member of the Risk & Regulatory Committee and Remuneration Committee of La Seda de Barcelona; Group CEO of United Biscuits plc and Rexam plc; and Executive Vice President Global Retail and Chairman, Europe of Royal Dutch Shell plc.

David Watts

Executive Director and Chief Financial Officer

Member of the Executive Committee.

Appointed to the Board: 2 October 2017

Dave joined the HSBC Group in 1994. He took up the post of UK Chief Financial Officer and was appointed to the Board in October 2017. Former HSBC Group roles include: Chief Financial Officer for: HSBC Bank plc, Global Commercial Banking, the Middle East and North Africa, Group HSBC Technology and Operations, Global Banking, and HSBC Securities (USA) Inc; Head of Group Cost and Investment Reporting & Analysis; and Manager Treasury Services, France.

Company Secretary

Nicola Black

Nicola joined the HSBC Group in 2000 and was appointed Company Secretary in May 2017. She previously served as Company Secretary of HSBC Bank plc (2014-2017) and prior to that as Assistant Group Company Secretary, HSBC Holdings plc.

Board of Directors

The role of the Board is to provide entrepreneurial leadership of the bank within a framework of prudent and effective controls which enables risks to be assessed and managed. The Board is collectively responsible for the long-term success of the bank and delivery of sustainable value to shareholders. It reviews the strategy for the bank and approves the risk appetite statement, capital and operating plans presented by management for the achievement of the strategic objectives it has set. The roles of the

Chairman and Chief Executive Officer are separate: the Chairman leads the Board and is responsible for its effectiveness and the Chief Executive Officer leads the business and is responsible for executing the strategy.

The majority of Board members, including the Chairman, are independent.

The Board meets regularly and Directors receive information between meetings about developments in the group's business. All Directors have full and timely access to all relevant information and may take independent professional advice if necessary.

The names of Directors serving at the date of this report and brief biographical particulars for each of them are set out on pages 46 and 47.

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 have no service contracts.

Directors' emoluments

Details of the emoluments of the Directors of the bank for 2018, disclosed in accordance with the Companies Act, are shown in Note 4 'Employee compensation and benefits'.

Board committees

The Board established a number of committees during the first half of the year in preparation for the bank becoming operational from 1 July 2018, the membership of which comprises certain Directors and, where appropriate, senior executives. The Chairman of each non-executive Board committee reports to each meeting of the Board on the activities of the Committee since the previous Board meeting.

All of the members of the Chairman's Nominations and Remuneration Committee and the majority of members of the Audit and Risk Committees are independent non-executive Directors.

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

Audit Committee

The Audit Committee, established on 1 May 2018, is accountable to the Board. The Committee has non-executive responsibility for oversight of and advice to the Board on financial reporting related matters, including relevant internal controls.

The Committee meets regularly with the bank's senior financial and internal audit management and the external auditor to consider, among other matters; the group's financial reporting; the nature and scope of audit reviews; the effectiveness of the systems of internal control relating to financial reporting; and ensuring that the Internal Audit function supports the ability of the bank to be able to take decisions independently of other members of the HSBC Group by having appropriate standing within the bank and being free from constraint by management or other restrictions.

The current members are: James Coyle (Chairman); Mridul Hegde, Denise Holt, Alan Keir and David Lister.

Risk Committee

The Risk Committee, established on 1 May 2018, has been delegated responsibilities from the Board in relation to non-executive oversight of risk related matters and the enterprise risks impacting the group, risk governance and internal control systems (other than internal financial control systems).

The Committee holds regular meetings with the bank's senior financial, risk, internal audit and compliance management and the external auditor to discharge its delegated responsibilities including to consider, among other matters: current and forward-looking risk exposures; the group's risk appetite and tolerance for determining strategy; the alignment of remuneration with risk

appetite; and ensuring that the risk management function supports the ability of the bank to take decisions independently of other members of the HSBC Group by having appropriate standing within the bank and being free from constraint by management or other restrictions.

The current members are: Mridul Hegde (Chairman); James Coyle; Alan Keir; David Lister; Rosemary Leith; and Philippe Leslie Van de Walle.

Chairman's Nominations and Remuneration Committee

The Chairman's Nominations and Remuneration Committee, established on 26 June 2018, has responsibility for matters related to nomination and remuneration as delegated by the Board. It is responsible for: (i) leading the process for Board appointments and for identifying and nominating, for the approval by the Board, candidates for appointment to the Board; (ii) the endorsement of certain board and senior executive appointments for the material subsidiaries of the bank; and (iii) reviewing the implementation and appropriateness of the Group's remuneration policy and the remuneration of the bank's senior executives.

In undertaking its responsibilities, the Committee shall, among other things, plan for the orderly succession of the Board, assess the independence of non-executive Directors by reference to the criteria in the ring-fencing rules and ensure that remuneration policies, practices and procedures are in line with the business strategy, objectives, values and long-term interests of the Company.

The current members are: Dame Clara Furse (Chairman); James Coyle; Mridul Hegde; and Philippe Leslie Van de Walle.

Executive Committee

The Executive Committee 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, Ian Stuart, chairs the Committee.

Regular Risk Management Meetings of the Executive Committee, 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 group.

Regular Financial Crime Risk Management meetings of the Executive Committee, chaired by the Chief Executive Officer, are held to ensure effective enterprise wide management of financial crime risk within the group and to support the Chief Executive Officer in discharging his financial crime risk responsibilities.

Dividends

Information about dividends is provided on page 12 of the Strategic Report.

Internal control

The Board is responsible for the Risk Appetite Statement and any risk within the Risk Appetite Statement outside of risk tolerance. This is discharged through reviewing the effectiveness of risk management and internal control systems and for determining the aggregate level and types of risks the bank is willing to take to achieve its strategic objectives.

During the year the bank adopted policies to ensure compliance with the Prudential Regulation Authority's Rulebook for Ring-fenced bodies, including an over-arching Ring-fenced Bodies policy, together with additional policies covering Exceptions, Arm's Length Transactions and Distributions.

In addition, the group has implemented procedures designed to safeguard assets against unauthorised use or disposal, maintain proper accounting records and ensure the reliability and

usefulness of financial information whether used within the business or for publication.

These procedures can only provide reasonable assurance against material mis-statement, errors, losses or fraud. They are designed to provide effective internal control within the bank. The procedures have been in place since the bank became operational on 1 July 2018 and up to 18 February 2019, the date of approval of the *Annual Report and Accounts 2018*.

Key risk management and internal control procedures include the following:

- The HSBC Group's Global Standards Manual ('GSM'). The GSM outlines the core principles within which all members of the HSBC Group must operate wherever business is conducted. The GSM overlays all other policies and procedures throughout the Group. The requirements of the GSM are mandatory, apply to and must be observed by all businesses within the Group, regardless of the nature or location of their activities.
- Appointments to the most senior positions within the bank require the endorsement of the Board of Directors of HSBC Holdings plc.
- 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 Officer who has responsibility for overseeing the establishment and maintenance of systems of control appropriate to the business and authority to delegate such duties and responsibilities as he sees fit.
- Risk identification and monitoring. Systems and procedures are in place to identify, measure, monitor, control and report on the material risk types facing the group.
- 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 group to heightened risk of loss or reputational damage. The group employs a top and emerging risks framework 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. All employees are responsible for identifying and managing risk within the scope of their role as part of the three lines of defence model, which is an activity-based model to delineate management accountabilities and responsibilities for risk management and the control environment. The second line of defence sets the policy and guidelines for managing specific areas, provides advice and guidance in relation to the risk, and challenges the first line of defence (the risk owners) on effective risk management.
- Strategic plans. Strategic plans are prepared annually for each of the businesses that make up the group, within the framework of the HSBC Group's overall strategy. These business strategic plans are brought together into the five year HSBC UK Country Strategic Plan, which is refreshed every three years. Progress against the Country Strategic Plan is reported regularly to the Executive Committee, Board and the HSBC Group Management Board. The bank also approves a financial 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 control is exercised over all IT developments and operations. Common systems are employed for similar business processes wherever practicable.

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

- Audit Committee. The Audit Committee reviews financial reporting disclosures made by the bank for any material errors, misstatements or omissions. The integrity of disclosures is

underpinned by structures and processes within the group's Finance and Risk functions that support rigorous analytical review of financial reporting and the maintenance of proper accounting records.

- Financial reporting. The bank's financial reporting process for preparing the consolidated *Annual Report and Accounts 2018* is controlled using documented accounting policies and reporting formats, supported by detailed instructions and guidance on reporting requirements, issued by the HSBC Group to HSBC UK that are then cascaded to all reporting entities within the group in advance of each reporting period end. The submission of the bank's financial information is subject to certification by the responsible financial officer, and analytical review procedures at reporting entity and group levels.

Since the bank became operational on 1 July 2018, 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 Group 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.

Employees

Health and safety

As part of the HSBC Group, HSBC UK is committed to providing a healthy and safe working environment for our employees, contractors, customers and visitors on HSBC Group premises and where impacted by our operations. We aim to be compliant with all applicable health and safety legal requirements, and to ensure that best practice health and safety management standards are implemented and maintained across the the group.

Everyone in the HSBC Group has a responsibility for helping to create a healthy and safe working environment. Employees are expected to take ownership of their safety and are encouraged and empowered to report any concerns.

Chief Operating Officers have overall responsibility for ensuring that the correct policies, procedures and safeguards are put into practice. This includes making sure that everyone in the HSBC Group has access to appropriate information, instruction, training and supervision.

Putting our commitment into practice, in 2018 the group delivered a health and safety education and information training programme to every one of our employees, and a range of programmes to help us understand and effectively manage the risks we face and improve the buildings in which we operate:

We developed and implemented a health and safety continuous improvement programme, focusing on education, engineering and enforcement/reward, to improve our health and safety culture and to implement the highest standards of control for managing health and safety

We developed and implemented an improved health and safety training and awareness programme for all employees, ensuring roles and responsibilities were clear and understood; and processes for identifying and reporting hazards and incidents were clearly defined and communicated

We implemented, through our facilities management service provider, an electronic permit to work system to provide effective controls for all high risk work undertaken

We developed and implemented a national radon monitoring programme, to ensure all HSBC Group properties had been assessed and where necessary controls implemented to manage the level of risk

We developed and commenced implementation of a programme of building condition surveys at all of our properties to ensure that any improvements required to the working environment are identified and actions taken to maintain high standards.

Employee health and safety

	Footnote	2018	2017
Number of workplace fatalities		—	—
Number of RIDDOR reportable injuries	1	7	12
All injury rate per 100,000 employees		1,613	1,780

1 RIDDOR - The Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 2013

Well-being

At HSBC UK we recognise the value our people bring to the organisation. The well-being and engagement of our workforce is a key priority for us. We are embedding a culture of 'healthiest human system' and using employee feedback and ideas to help us build a workplace where employees can thrive.

We provide a range of tools, guidance and benefits to support our employees to enhance and improve their physical, mental and financial well-being. We also provide a range of volunteering opportunities for employees to connect with local communities. We are investing in the knowledge and capability of our managers to help foster teams where people feel confident and comfortable in talking about well-being matters.

Diversity and inclusion

We are committed to enabling a thriving environment where our employees are valued, respected and supported to fulfil their potential; and where leveraging the extraordinary range of ideas, backgrounds, styles and perspectives of our employees means we can effectively meet the needs of our different stakeholder groups and drive better business outcomes for all. Our employees are expected to build positive and lasting relationships across the variety of people they interact with.

We focus on enhancing the diversity profile of our workforce so that it is more reflective of the communities we operate in and the customers we serve.

To support an inclusive environment, our policy is that each of us must treat colleagues with dignity and respect. We have zero tolerance for discrimination, bullying, harassment and victimisation on any ground, including age, race, ethnic or national origin, colour, mental or physical health conditions, disability, pregnancy, gender, gender expression, gender identity, sexual orientation, marital status or other domestic circumstances, employment status, working hours or other flexible working arrangements, or religion or belief. Such behaviour is considered a personal conduct matter and managed in accordance with applicable local policies and procedures and our consequence management framework.

Diversity and inclusion carries the highest level of executive support and is governed by the UK People Committee. As part of our commitment to shared ownership of the inclusion environment, we have implemented Driving Inclusion Workshops for our most senior & influential HSBC UK Leaders, as well as introducing an Inclusive Leadership objective to the performance scorecards of all HSBC UK People Managers.

More information about our diversity and inclusion activity is available under <https://www.hsbc.com/our-approach>.

Employment of people with a disability

We believe in providing equal opportunities for all employees. The employment of people with a disability is included in this commitment. The recruitment, training, career development and promotion of employees with a disability are based on the aptitudes and abilities of the individual. Should employees become

disabled during their employment with us, efforts are made to continue their employment and, if necessary, appropriate training and reasonable equipment and facilities are provided.

Gender balance at senior leadership

We continue to focus on improving gender balance in senior leadership roles (classified as 0-3 in our global career band structure), with HSBC UK's intermediate goal on gender diversity being aligned to HSBC Group's global target of 30% of senior leadership roles held by women by 2020 (in line with our 30% Club CEO Campaign commitment). In order to achieve that, by the end of 2018 our objective was for the female share of our HSBC UK senior leadership to be at least 29.7%. We achieved 30.7% and we are continuing to focus on further improving gender balance at a senior leadership level.

Employee networks

We have 16 employee networks plus common interest groups in our HSBC Communities which provide an important space where employees can speak up about internal and commercial issues and opportunities, create connections, and learn from others. The networks focus on gender, age, ethnicity, LGBT+, faith, working parents and carers, and ability. Our HSBC Communities cover a variety of topics including flexible working, mindfulness, military/veterans, Chinese and Greek culture.

Employee development

The development of all our employees is essential to the future strength of our business and also in retaining high-calibre individuals with the values, skills and experience for current and future roles.

HSBC University, the home of learning at the HSBC Group, provides training programmes, educational resources and opportunities for connectivity, research and community engagement - with the core offering themed around leadership, risk management, strategy and performance, as well as business-specific technical training.

In 2018, HSBC University launched a number of new development offerings reflecting our strategic ambitions. These included programmes, conferences and events for managers and leaders, technology academy for our technology professionals, and new suites of training to support the digital and sustainability agendas. In the UK, we are privileged to be able to access this offering via a dedicated learning space within our new HSBC UK head office in Birmingham - providing two full floors of modern facilities specifically for colleague development.

Employee share schemes

HSBC offers employees two options to voluntarily participate in Share purchase schemes helping to align the interests of employees with the creation of shareholder value. Our Sharesave plan allows employees to save an amount of money each month over a 3 or 5 year period and these savings can be used to purchase shares at a previously agreed discounted rate. Our Share Investment Plan allows employees to purchase shares each month from their pre-tax pay and should they be held for a minimum period of time, any proceeds from the sale of the shares are released free from tax or National Insurance contributions.

Auditor

PricewaterhouseCoopers LLP ('PwC') is external auditor to the bank. PwC has expressed its willingness to continue in office and the Board recommends that PwC be re-appointed as the bank's auditor. A resolution proposing the re-appointment of PwC as the bank's auditor and giving authority to the Audit Committee to determine its remuneration will be submitted to the forthcoming AGM.

Conflicts of interest and indemnification of Directors

The bank's Articles of Association give the Board authority to approve Directors' conflicts and potential conflicts of interest. The Board has adopted a policy and procedures for the approval of Directors' conflicts or potential conflicts of interest. The Board's powers to authorise conflicts are operating effectively and the procedures are being followed. A review of situational conflicts which have been authorised, including the terms of authorisation, is undertaken by the Board annually.

The Articles of Association provide that Directors and directors of associated companies are entitled to be indemnified out of the assets of the company against claims from third parties in respect of certain liabilities arising in connection with the performance of their functions, in accordance with the provisions of the UK Companies Act 2006. Such indemnity provisions have been in place during the financial year but have not been utilised by the Directors. All Directors have the benefit of directors' and officers' liability insurance.

Statement on going concern

The Directors consider it appropriate to prepare the financial statements on the going concern basis. In making their going concern assessment, the Directors have considered a wide range of detailed information relating to present and potential conditions, including profitability, cash flows, capital requirements and capital resources.

Further information relevant to the assessment is provided in the Strategic Report and the Report of the Directors, in particular:

- A description of the group's strategic direction;
- A summary of the group's financial performance and a review of performance by business;
- The group's approach to capital management and its capital position; and
- The top and emerging risks facing the group, as appraised by the Directors, along with details of the group's approach to mitigating those risks and its approach to risk management in general.

In addition, the objectives, policies and processes for managing credit, liquidity and market risk are set out in the 'Report of the Directors: Risk'.

The Directors' Report comprising pages 15 to 51 was approved by the Board on 18 February 2019 and is signed on its behalf by

Nicola S Black

Company Secretary

HSBC UK Bank plc

Registered number 9928412

Disclosure of Information to the Auditor and Statement of Directors' Responsibilities

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the bank's auditors are unaware; and each Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

The Directors are responsible for preparing the *Annual Report and Accounts 2018*, comprising the consolidated financial statements of the group and parent company financial statements for the bank in accordance with applicable laws and regulations.

Company law requires the Directors to prepare a Strategic Report, a Report of the Directors and group and parent company financial statements for each financial year. The Directors are required to prepare the group financial statements in accordance with IFRSs as adopted by the European Union and have elected to prepare the bank's financial statements on the same basis.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and bank and of their profit or loss for that period. In preparing each of these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the European Union; and
- prepare the financial statements on a going concern basis unless it is not appropriate. Since the Directors are satisfied that the group has the resources to continue in business for the foreseeable future, the financial statements continue to be prepared on a going concern basis.

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

The Directors have responsibility for the maintenance and integrity of the Annual Report and Accounts 2018 as they appear on the bank's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Approved by the Board on 18 February 2019 and signed on its behalf by

Nicola S Black

Company Secretary

HSBC UK Bank plc

Registered number 9928412

Independent auditors' report to the member of HSBC UK Bank plc

Report on the audit of the financial statements

Opinion

In our opinion, HSBC UK Bank plc's group financial statements and parent company financial statements (the "financial statements"):

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

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

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

Basis for opinion

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

Independence

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

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

Other than those disclosed in note 5 to the financial statements, we have provided no non-audit services to the group or the parent company in the period from 1 January 2018 to 31 December 2018.

Our audit approach

Overview

- Overall group materiality: £65 million (2017: n/a), based on 5% of adjusted profit before tax.
- Overall parent company materiality: £57 million (2017: £150,000), based on 5% of adjusted profit before tax.
- HSBC UK Bank plc is a member of the HSBC Group, the ultimate parent company of which is HSBC Holdings plc. HSBC UK Bank plc operates in the UK.
- We performed an audit of the complete financial information of the HSBC UK Bank plc component.
- For one further reporting unit, specific audit procedures were performed over selected significant account balances.

The following areas were identified as key audit matters for the group and parent company. These are discussed in further detail in the Appendix:

- IT Access Management,
- Impairment of loans and advances,
- Customer Redress - Payment Protection Insurance ("PPI"),
- Impact of structural reform; and
- Recognition of income using Effective Interest Rate accounting.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We gained an understanding of the legal and regulatory framework applicable to the group and the industry in which it operates, and considered the risk of acts by the group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at a group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. This included identifying specific fraud criteria to address the risk of management override of internal controls as part of our journals testing which were relevant to HSBC UK Bank plc and its business, for example unusual account combinations. We also found recognition of income under effective interest rate accounting to be a key audit matter involving significant management estimate, and this is discussed further below.

We focused on laws and regulations that could give rise to a material misstatement in the financial statements, including, but not limited to, the Companies Act 2006, the Financial Conduct Authority's regulations, the Prudential Regulation Authority's regulations, the UK tax

legislation and equivalent local laws and regulations applicable. One identified risk related to the execution of structural reform required by the UK Financial Services (Banking Reform) Act 2013; our audit procedures are explained in the key audit matter in the Appendix. Further to this, our tests in relation to laws and regulations included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the regulators, review of correspondence with legal advisors, enquiries of management, enquiries of legal counsel and review of internal audit reports in so far as they related to the financial statements.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

Key audit matters

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

How we tailored the audit scope

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

HSBC UK Bank plc is structured into four divisions being Retail Banking and Wealth Management, Commercial Banking, Global Private Banking and Global Banking and Markets. The divisions operate across a number of operations and subsidiary entities in the United Kingdom. Within the group's main consolidation and financial reporting system, the consolidated financial statements are an aggregation of the operations and subsidiary entities ('reporting units'). Each reporting unit submits their financial information to the group in the form of a consolidation pack. One of these is significant to our audit, the HSBC UK Bank plc reporting unit, on which we performed a full scope audit.

The ring-fencing requirements of the UK Financial Services (Banking Reform) Act 2013 and associated secondary legislation and regulatory rules, require UK deposit-taking banks with more than £25bn of 'core deposits' (broadly from individuals and small to medium-sized businesses) to separate their UK retail banking activities from their other wholesale and investment banking activities by 1 January 2019. As a result, on 1 July 2018, the UK Retail Banking and Wealth Management, Global Private Banking the majority of the Commercial Banking and specific elements of Global Banking and Markets divisions were transferred into HSBC UK Bank plc from HSBC Bank plc. This transaction had a significant impact on the audit of HSBC UK Bank plc and was considered as part of the scoping and execution of our testing.

In establishing the overall approach to the group and parent company audit, we scoped using the balances included in the consolidation pack. We determined the type of work that needed to be performed over the reporting units.

As a result of our scoping, for the parent company we determined that an audit of the complete financial information of the HSBC UK Bank plc was necessary, owing to its financial significance. The group audit engagement partner was also the partner on the audit of the HSBC UK Bank plc significant reporting unit.

We then considered the significance of other reporting units in relation to primary statement account balances. In doing this we also considered the presence of any significant audit risks and other qualitative factors (including history of misstatements through fraud or error). For one reporting unit, specific audit procedures were performed over selected significant account balances. For the remainder, the risk of material misstatement was mitigated through group audit procedures including testing of entity level controls and subsidiary level analytical review procedures.

Certain group-level account balances (including goodwill) were audited by the group engagement team.

Materiality

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

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

	Group financial statements	Parent company financial statements
Overall materiality	£65 million (2017: n/a)	£57 million (2017: £150,000)
How we determined it	5% of adjusted profit before tax	5% of adjusted profit before tax
Rationale for benchmark applied	Adjusted profit before tax is the primary measure used by shareholders in assessing the performance of the group and the parent company and removes the impact of significant items that distort year-on-year comparisons. Costs relating to significant pension past service costs and customer redress programmes are large, one-off items unrelated to the underlying performance of the group and parent company and have been excluded.	

For each reporting unit in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across reporting units was between £6 million and £57 million.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £2.8 million (group audit and parent company audit) (group 2017: n/a, parent company 2017: £7,500) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

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

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

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

Reporting on other information

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

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

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

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

Strategic Report and Report of the Directors

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

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

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on page 51, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company'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 group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

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

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

Use of this report

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

Other required reporting

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the members on 7 August 2017 to audit the financial statements for the year ended 31 December 2017 and subsequent financial periods. The period of total uninterrupted engagement is 2 years, covering the years ended 31 December 2017 and 31 December 2018.

Carl Sizer (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Birmingham

18 February 2019

Appendix: Key audit matters discussed with the Audit Committee

The key audit matters are discussed below together with an explanation of how the audit was tailored to address these specific areas. All key audit matters are applicable to both the group and parent company.

IT Access Management

Nature of key audit matter	Matters discussed with the Audit Committee
<p>All banks are highly dependent on technology due to the significant number of transactions that are processed daily. The audit approach relies extensively on automated controls and therefore on the effectiveness of controls over IT systems.</p> <p>We identified and reported that controls over access to applications, operating systems and data in the financial reporting process required improvements. Access management controls are critical to ensure that changes to applications and underlying data are made in an appropriate manner. Appropriate access controls contribute to mitigating the risk of potential fraud or errors as a result of changes to applications and data.</p> <p>Management implemented several remediation activities that contributed to reducing the risk over access management in the financial reporting process. These included implementation of Group wide preventative and detective controls across critical applications and infrastructure, with the aim of reducing risks presented by excessive privileged access to IT infrastructure.</p>	<p>The audit approach relies extensively on automated controls and therefore on the effectiveness of controls over IT systems.</p> <p>We identified and reported that controls over access to applications, operating systems and data in the financial reporting process required improvements. Access management controls are critical to ensure that changes to applications and underlying data are made in an appropriate manner. Appropriate access controls contribute to mitigating the risk of potential fraud or errors as a result of changes to applications and data.</p> <p>Management has implemented remediation activities that have contributed to reducing the risk over access management in the financial reporting process. The status of the remediation was discussed at several Audit Committee meetings during the year.</p> <p>However, issues related to privileged access and business user access remained unresolved on parts of the technology infrastructure, requiring our audit approach to respond to the risks presented.</p>
Procedures performed to support our discussions and conclusions	
<p>Access rights were tested over applications, operating systems and databases relied upon for financial reporting. Specifically, the audit tested that:</p> <ul style="list-style-type: none"> • new access requests for joiners were properly reviewed and authorised; • user access rights were removed on a timely basis when an individual left or moved role; • access rights to applications, operating systems and databases were periodically monitored for appropriateness; and • highly privileged access is restricted to appropriate personnel and monitored. <p>Other areas that were independently assessed included password policies, security configurations, controls over changes to applications and databases and that business users, developers and production support did not have access to change applications, the operating system or databases in the production environment.</p> <p>As a consequence of deficiencies identified, a range of other procedures were performed:</p> <ul style="list-style-type: none"> • where inappropriate access was identified, we understood the nature of the access and obtained additional evidence on the appropriateness of the activities performed; • additional substantive testing was performed on specific year-end reconciliations (i.e. bank account and suspense account reconciliations) and confirmations with external counterparties; • testing was performed on other compensating controls, such as review controls undertaken by management; • testing was performed over toxic combination controls; and • a list of users' access permissions was obtained and manually compared to other access lists where segregation of duties was deemed to be of higher risk, for example users having access to both core banking and payments systems. 	

Impairment of loans and advances

Nature of key audit matter	Matters discussed with the Audit Committee
<p>As this is the first year of adoption of IFRS 9, there is limited experience available to back-test the charge for expected credit losses with actual results. There is also a significant increase in the number of data inputs required for the impairment calculation. The data is sourced from a number of systems that have not been used previously for the preparation of the accounting records. This increases risk around completeness and accuracy of certain data used to create assumptions and operate the models.</p> <p>The credit environment has remained relatively benign for an extended period of time, in part due to low interest rates, relative strength of the economy and low unemployment. However, there are a number of headwinds to the regional economy as well as certain country specific risks. As a result, whilst the current levels of delinquencies and defaults remains low, the risk of impairment remains significant.</p>	<p>At each Audit Committee and Risk Committee meeting there was a discussion on changes to risk factors and other inputs within the models, geopolitical risks, such as the UK's withdrawal from the EU, as well as discussions on individually significant loan impairments.</p> <p>The more judgemental interpretations of IFRS 9 made by management continued to be discussed, in particular the application of forward economic guidance, including the severity and magnitude of modelled downside scenarios; and associated considerations of post model adjustments.</p> <p>As the control environment for the calculation of ECL under IFRS 9 continued to be strengthened following initial adoption, we provided updates on the changes being made and the results of our testing procedures.</p>
Procedures performed to support our discussions and conclusions	
<p>Controls were tested over:</p> <ul style="list-style-type: none">• Model performance monitoring and validation, including periodic policy and independent model reviews, back testing of performance and approval of model changes.• Review and challenge of multiple economic scenarios by an expert panel and internal governance committee.• Inputs of critical data, into source system, and the flow and transformation of data between source systems to the impairment calculation engine were tested.• User acceptance testing over the automated calculation of ECL to ensure it is performed in line with business requirements.• Review and challenge forums to assess ECL output and approval of post model adjustments.• Review and approval of the key inputs, assumptions and discounted cash-flows that support significant individual impairments. <p>Further substantive procedures included:</p> <ul style="list-style-type: none">• Risk based testing of models, including independent re-build of certain assumptions.• Testing the multiple economic scenarios and variables using our economic experts to assess their reasonableness.• Testing of the critical data used in the year end ECL calculation.• Review of the SAS script codes for the impairment engine against business requirements and our expectations of how the calculation should operate.• Testing discounted cash flows for a sample of individually assessed loans including in specific instances, the use of experts in assessing the valuation of collateral.	
Relevant references in the Annual Report and Accounts 2018	
<p>Summary of credit risk, page 27. Measurement uncertainty and sensitivity analysis of ECL estimates, page 30.</p>	

Customer Redress – Payment Protection Insurance ('PPI')

Nature of key audit matter	Matters discussed with the Audit Committee
<p>In March 2017 the FCA issued Policy Statement 17/3 (PS17/3) concluding its PPI complaint consultation process. PS17/3 set out a number of key requirements and determinations;</p> <p>Finalisation of the time bar being 29 August 2019; and</p> <p>Details and timings on FCA-led consumer communication campaigns designed to inform consumers of the time bar.</p> <p>The provision for customer redress in respect of PPI incorporates assumptions regarding expected complaint volumes. The statements made in the policy statement impact the complaint volumes and therefore the provision set aside for customer redress.</p> <p>The assumptions made with respect to the expected volume of future customer complaints is highly judgemental.</p>	<p>We discussed with the Audit Committee the impact that the FCA-led media campaigns have had over the period and the continued monitoring of claims volumes observed to the provision held.</p> <p>With time bar drawing closer and further volatility expected, we have discussed the potential impact on compliant volumes over the remaining period.</p> <p>We discussed the results of our controls and substantive testing. We also discussed alternative scenarios and the range of sensitivity in concluding on the adequacy of the provision held.</p>
Procedures performed to support our discussions and conclusions	
<ul style="list-style-type: none"> We evaluated the design and tested the operating effectiveness of key controls over the process of capturing key data used in the PPI provision calculation model. We examined the modelling process around the PPI provision calculation. We tested the nature and history of claim volumes and redress amounts and assessed whether the assumptions underpinning the provision calculations, including future trends expected in respect of claim volumes and redress amounts, were appropriate. We tested the appropriateness of the provisioning model and underlying assumptions used, in particular how management updated their provisioning model related to complaint volumes and actual experience observed. We considered the sensitivity of the provision to possible variations in assumptions. This could result in different amounts for some provisions to those calculated, however these differences were within a reasonable range of outcomes in the context of the degree of uncertainty in future outcome. We evaluated whether the disclosures within the financial statements appropriately address the significant uncertainties that exist around determining the provisions and the sensitivity of the provisions to changes in the underlying assumptions by comparing to the output of our audit work and found these to be appropriate. 	
Relevant references in the Annual Report and Accounts 2018	
<p>Note 19: Provisions, page 94.</p>	

Impact of structural reform

Nature of key audit matter	Matters discussed with the Audit Committee
<p>On 1 July 2018, the Retail Banking and Wealth Management, Global Private Banking, the majority of the Commercial Banking and specific elements of Global Banking and Markets divisions of HSBC Bank plc were transferred to HSBC UK Bank plc. The transfer was accounted for as a group reorganisation and predecessor accounting values applied to the balances transferred.</p> <p>The separation of most financial statement line items was straightforward, however, the allocation of certain intangibles, certain provisions and specific balances in other assets and other liabilities involved a higher degree of management judgement, specifically:</p> <ul style="list-style-type: none">• the allocation of intangible assets based on an historic apportionment of central costs;• the nature of underlying transactions relating to specific balances in other assets and other liabilities;• the allocation of goodwill between the banks; and• whether the separation of certain legal provisions was appropriate and reasonable. <p>While not requiring substantial management judgement, the allocation of customer accounts was also a key driver for assignment of multiple balances to each bank and therefore also a key area of audit focus.</p>	<p>The application of predecessor accounting and the method of allocation of goodwill to the ring fenced bank was reviewed and discussed with the Audit Committee.</p> <p>We discussed the approach taken by management to identify and allocate customer accounts defined by regulation as core deposits, Relevant Financial Institutions and complex products. We also discussed the results of quality assurance procedures undertaken by management to test the appropriateness of the allocation process.</p> <p>We discussed with the Audit Committee the appropriateness of allocations involving a higher degree of judgement. We also discussed the appropriateness of customer account allocations to either HSBC Bank plc or HSBC UK Bank plc.</p> <p>We discussed the results of our controls and substantive testing, which found no material errors.</p>
Procedures performed to support our discussions and conclusions	
<p>Controls were tested over:</p> <ul style="list-style-type: none">• The quality assurance measures performed by management over customer allocations. Evidence corroborating the conclusions drawn by management was also obtained and reviewed.• Internal governance over the separation of HSBC UK Bank plc from HSBC Bank plc. <p>Further substantive procedures included:</p> <ul style="list-style-type: none">• We assessed the appropriateness of the accounting treatment applied by management.• Testing of customers allocated to each entity assessed the nature of customers and appropriateness of sort-code applied.• We recalculated the allocation of goodwill between the entities.• We obtained an understanding of management's approach to judgemental allocations in relation to vacant space provisions. We agreed the properties to the entity fixed asset register together with the associated vacant space provision. The allocation of property to the entity fixed asset register was tested.• For other assets and other liabilities not aligned to a specific customer, samples were selected and evidence reviewed to validate the nature of the underlying transactions and corroborate the allocation.• In relation to intangible assets aligned to more than one business line, the allocation percentage, based on pre-defined rates upon which all central costs are allocated, was recalculated.	

Recognition of income under Effective Interest Rate accounting

Nature of key audit matter	Matters discussed with the Audit Committee
<p>Loans and advances are recognised at amortised cost, and interest income recognised using the Effective Interest Rate (EIR) method. The majority of interest income is calculated by automated systems and requires little or no management judgement. Therefore we have focused our work in relation to revenue recognition on EIR accounting and specifically credit cards.</p> <p>EIR accounting is inherently subjective as it requires management to predict customer behaviour into the future, over the expected life of the products, on which the EIR adjustment calculation is based. Changes in the key assumptions could have a material impact on the EIR adjustments and hence the revenue recognised in any one accounting period.</p> <p>For credits cards there are significant judgments in calculating the EIR adjustment including setting assumptions relating to movements in customer balances over the expected life and the related future revenue associated with these balances in the context of the entity's historic experience. Key assumptions include retail spending levels and repayment rates.</p>	<p>Discussions with the Audit Committee have focused on the key judgements and assumptions including retail spend, repayment dates and consideration as to how the entity's historic experience is consistent with that expected in the future.</p> <p>We discussed the results of our audit work including testing of management controls, substantive testing and application of accounting standards.</p>
Procedures performed to support our discussions and conclusions	
<ul style="list-style-type: none">• We have tested the controls over data input and checked the accuracy of model calculations.• We have observed management's governance meetings for the setting, challenge and approval of key assumptions, including monitoring of actual trends compared to forecast assumptions.• We have assessed the underlying assumptions built into the EIR models, as to the appropriateness of these including the expected life of customer accounts, volume of retail spend and comparisons to historic data as an appropriate indicator of the future.• We have performed sensitivity analyses of key judgements to understand the materiality of the impact that potential realistic changes in assumptions may have, either individually or in combination, on the EIR asset. Our work has focused on the newer products where there is less experience observed to date.• We have assessed the sufficiency of the disclosures in the financial statements relating to significant estimates made in the EIR calculation, including disclosure of sensitivities.	
Relevant references in the Annual Report and Accounts 2018	
Note 1: Basis of preparation and significant accounting policies (b) Income and expense, page 72.	

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Consolidated income statement
for the year ended 31 December

	<i>Notes</i>	2018 ¹ £m	2017 ² £m
Net interest income		2,456	—
– interest income		2,805	—
– interest expense		(349)	—
Net fee income	2	648	—
– fee income		831	—
– fee expense		(183)	—
Net income from financial instruments held for trading or managed on a fair value basis	3	198	—
Gains less losses from financial investments		22	—
Other operating income		33	—
Total operating income		3,357	—
Net operating income before change in expected credit losses and other credit impairment charges		3,357	—
Change in expected credit losses and other credit impairment charges		(305)	—
Net operating income		3,052	—
Employee compensation and benefits	4	(611)	—
General and administrative expenses		(1,267)	—
Depreciation and impairment of property, plant and equipment		(46)	—
Amortisation and impairment of intangible assets		(64)	—
Total operating expenses		(1,988)	—
Operating profit	3	1,064	—
Profit before tax		1,064	—
Tax expense	6	(301)	—
Profit for the year		763	—
Attributable to:			
– ordinary shareholders of the parent company		763	—
– non-controlling interests		—	—
Profit for the year		763	—

1 Operations commenced on 1 July 2018, following the transfer of the qualifying businesses and subsidiaries from HSBC Bank plc.

2 Comparatives round to £nil when presented in millions.

Consolidated statement of comprehensive income
for the year ended 31 December

	2018 ¹	2017 ²
	£m	£m
Profit for the year	763	—
Other comprehensive income		
Items that will be reclassified subsequently to profit or loss when specific conditions are met:		
Debt instruments at fair value through other comprehensive income	10	N/A
– fair value gains	34	N/A
– fair value gains transferred to the income statement on disposal	(21)	N/A
– income taxes	(3)	N/A
Cash flow hedges	(17)	—
– fair value losses	(107)	—
– fair value losses reclassified to the income statement	84	—
– income taxes	6	—
Exchange differences	(2)	—
– other exchange differences	(2)	—
Items that will not be reclassified subsequently to profit or loss:		
Remeasurement of defined benefit asset/liability	(364)	—
– before income taxes	(485)	—
– income taxes	121	—
Other comprehensive expense for the year, net of tax	(373)	—
Total comprehensive income for the year	390	—
Attributable to:		
– ordinary shareholders of the parent company	390	—
– non-controlling interests	—	—
Total comprehensive income for the year	390	—

¹ Operations commenced on 1 July 2018, following the transfer of the qualifying businesses and subsidiaries from HSBC Bank plc.

² Comparatives round to £nil when presented in millions.

Consolidated balance sheet at 31 December

	Notes	2018 ¹ £m	2017 ² £m
Assets			
Cash and balances at central banks		33,193	—
Items in the course of collection from other banks		603	—
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	8	35	—
Derivatives	10	66	—
Loans and advances to banks		1,263	2
Loans and advances to customers		174,807	—
Reverse repurchase agreements – non-trading		3,422	—
Financial investments	11	13,203	13
Prepayments, accrued income and other assets	17	8,528	—
Interests in joint ventures	13	9	—
Goodwill and intangible assets	16	3,810	—
Total assets		238,939	15
Liabilities and equity			
Liabilities			
Deposits by banks		1,027	—
Customer accounts		204,837	—
Repurchase agreements – non-trading		639	—
Items in the course of transmission to other banks		233	—
Derivatives	10	346	—
Accruals, deferred income and other liabilities	18	2,409	—
Current tax liabilities		359	—
Provisions	19	630	—
Deferred tax liabilities	6	1,189	—
Subordinated liabilities	20	4,937	—
Total liabilities		216,606	—
Equity			
Called up share capital	23	—	—
Share premium account	23	9,015	15
Other equity instruments	23	2,196	—
Other reserves		7,657	—
Retained earnings		3,405	—
Total shareholders' equity		22,273	15
Non-controlling interests		60	—
Total equity		22,333	15
Total liabilities and equity		238,939	15

¹ Operations commenced on 1 July 2018, following the transfer of the qualifying businesses and subsidiaries from HSBC Bank plc.

² Some of the comparatives round to £nil when presented in millions.

The accompanying notes on pages 70 to 107, and the 'Report of the Directors' on pages 15 to 51 form an integral part of these financial statements.

The financial statements on pages 62 to 69 were approved by the Board of Directors on 18 February 2019 and signed on its behalf by:

John David Stuart

Director

Consolidated statement of cash flows for the year ended 31 December

	2018 £m	2017 ⁴ £m
Profit before tax	1,064	–
Adjustments for non-cash items:		
Depreciation and amortisation	110	–
Change in expected credit losses gross of recoveries and other credit impairment charges	364	–
Provisions including pensions	184	–
Elimination of exchange differences ¹	(190)	–
Changes in operating assets and liabilities		
Change in net trading securities and derivatives	(33)	–
Change in loans and advances to banks and customers	(7,346)	–
Change in reverse repurchase agreements – non-trading	(3,422)	–
Change in financial assets designated and otherwise mandatorily measured at fair value	(27)	–
Change in other assets	1,941	–
Change in deposits by banks and customer accounts	4,102	–
Change in repurchase agreements – non-trading	639	–
Change in other liabilities	(4,576)	–
Contributions paid to defined benefit plans	(80)	–
Tax paid	(74)	–
Net cash from operating activities	(7,344)	–
Purchase of financial investments	(5,369)	(13)
Proceeds from the sale and maturity of financial investments	3,292	–
Net cash flows from the purchase and sale of property, plant and equipment	(57)	–
Net investment in intangible assets	(164)	–
Net cash flow on acquisition of subsidiaries, businesses and joint venture ²	29,410	–
Net cash from investing activities	27,112	(13)
Issue of ordinary share capital and other equity instruments	9,000	15
Subordinated loan capital issued ³	2,020	–
Funds received from the shareholder of the parent company	3,000	–
Dividends paid to shareholders of the parent company and non-controlling interests	(1)	–
Net cash from financing activities	14,019	15
Net increase in cash and cash equivalents	33,787	2
Cash and cash equivalents at 1 Jan	2	–
Exchange differences in respect of cash and cash equivalents	28	–
Cash and cash equivalents at 31 Dec⁵	33,817	2
Cash and cash equivalents comprise:		
– cash and balances at central banks	33,193	–
– items in the course of collection from other banks	603	–
– loans and advances to banks of one month or less	105	2
– treasury bills, other bills and certificates of deposit less than three months	149	–
– less: items in the course of transmission to other banks	(233)	–
Cash and cash equivalents at 31 Dec⁵	33,817	2

Interest received was £2,574m (2017: £nil), interest paid was £228m (2017: £nil).

¹ Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on a line-by-line basis, as details cannot be determined without unreasonable expense.

² No cash or cash equivalent was paid in consideration of the investment in subsidiaries and joint venture as it formed part of the Part VII transfer of asset and liabilities. The aggregate amount of cash and cash equivalent in the subsidiaries and other businesses over which control was obtained was £29,410m.

³ Subordinated liabilities changes during the year are attributable to cash flows from issuance of securities (£2,020m, (2017: £nil)) as presented in the Consolidated statement of cash flows.

⁴ Comparatives round to £nil when presented in millions.

⁵ At 31 December 2018 £363m (2017: £nil) was not available for use by the group, of which all (2017: £nil) related to mandatory deposits at central banks.

Consolidated statement of changes in equity
for the year ended 31 December

	Other reserves									
	Called up share capital and share premium ¹	Other equity instruments	Retained earnings	Financial assets at FVOCI reserve	Cash flow hedging reserve	Foreign exchange reserve	Group re-organisation reserve ²	Total shareholders' equity	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 Jan 2018	15	–	–	–	–	–	–	15	–	15
Profit for the year	–	–	763	–	–	–	–	763	–	763
Other comprehensive income (net of tax)	–	–	(364)	10	(17)	(2)	–	(373)	–	(373)
– debt instruments at fair value through other comprehensive income	–	–	–	10	–	–	–	10	–	10
– cash flow hedges	–	–	–	–	(17)	–	–	(17)	–	(17)
– remeasurement of defined benefit asset/liability	–	–	(364)	–	–	–	–	(364)	–	(364)
– exchange differences	–	–	–	–	–	(2)	–	(2)	–	(2)
Total comprehensive income for the year	–	–	399	10	(17)	(2)	–	390	–	390
Capital securities issued	9,000	–	–	–	–	–	–	9,000	–	9,000
Dividends to shareholders	–	–	–	–	–	–	–	–	(1)	(1)
Capital contribution ³	–	–	3,000	–	–	–	–	3,000	–	3,000
Transfer ^{4,5}	–	2,196	–	–	–	–	–	2,196	60	2,256
Group Reorganisation Reserve	–	–	–	4	(29)	–	7,691	7,666	–	7,666
Other movements	–	–	6	–	–	–	–	6	1	7
At 31 Dec 2018	9,015	2,196	3,405	14	(46)	(2)	7,691	22,273	60	22,333
At 1 Jan 2017	–	–	–	–	–	–	–	–	–	–
Profit for the year ⁶	–	–	–	–	–	–	–	–	–	–
Other comprehensive income (net of tax) ⁶	–	–	–	–	–	–	–	–	–	–
– available-for-sale investments ⁶	–	–	–	–	–	–	–	–	–	–
Total comprehensive income for the year ⁶	–	–	–	–	–	–	–	–	–	–
Capital securities issued	15	–	–	–	–	–	–	15	–	15
At 31 Dec 2017	15	–	–	–	–	–	–	15	–	15

¹ All new capital subscribed during 2017 and 2018 was issued to HSBC UK Holdings Limited. For further details refer to note 23.

² Relates primarily to the recognition of goodwill £3,142m and the pension asset net of deferred tax £4,776m. Details of our accounting policies in respect of the transfer of the ring-fenced businesses to HSBC UK Bank plc are set out in Note 1.

³ HSBC UK Holdings Limited injected £3,000m of CET1 capital.

⁴ Other equity instruments amounting to £2,196m consists of additional Tier 1 capital.

⁵ Non-controlling interests ('NCI') of £60m transferred to HSBC UK relates to Marks and Spencer Financial Services plc.

⁶ Comparatives round to £nil when presented in millions.

HSBC UK Bank plc balance sheet at 31 December

	Notes	2018 ¹ £m	2017 ² £m
Assets			
Cash and balances at central banks		33,187	—
Items in the course of collection from other banks		457	—
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	8	35	—
Derivatives	10	61	—
Loans and advances to banks		3,883	2
Loans and advances to customers		165,850	—
Reverse repurchase agreements – non-trading		3,422	—
Financial investments	11	13,203	13
Investments in subsidiaries	14	1,907	—
Prepayments, accrued income and other assets	17	8,523	—
Interests in joint ventures	13	5	—
Goodwill and intangible assets	16	718	—
Total assets		231,251	15
Liabilities and equity			
Liabilities			
Deposits by banks		4,265	—
Customer accounts		196,858	—
Repurchase agreements – non-trading		639	—
Items in the course of transmission to other banks		225	—
Derivatives	10	341	—
Accruals, deferred income and other liabilities	18	2,274	—
Current tax liabilities		286	—
Provisions	19	515	—
Deferred tax liabilities	6	1,224	—
Subordinated liabilities	20	4,858	—
Total liabilities		211,485	—
Equity			
Called up share capital	23	—	—
Share premium account	23	9,015	15
Other equity instruments	23	2,196	—
Other reserves		5,214	—
Retained earnings		3,341	—
Total equity		19,766	15
Total liabilities and equity		231,251	15

¹ Operations commenced on 1 July 2018, following the transfer of the qualifying businesses from HSBC Bank plc.

² Some of the comparatives round to £nil when presented in rounded millions.

Profit after tax for the year was £701m (2017: £nil)

The accompanying notes on pages 70 to 107, and the audited sections of the 'Report of the Directors' on pages 15 to 51 form an integral part of these financial statements.

The financial statements on pages 62 to 69 were approved by the Board of Directors on 18 February 2019 and signed on its behalf by:

John David Stuart

Director

HSBC UK Bank plc statement of cash flows
for the year ended 31 December

	2018 £m	2017 ⁴ £m
Profit before tax	968	–
Adjustments for non-cash items:		
Depreciation and amortisation	94	–
Change in expected credit losses gross of recoveries and other credit impairment charges	313	–
Provisions including pensions	124	–
Share-based payment expense	(1)	–
Elimination of exchange differences ¹	(190)	–
Changes in operating assets and liabilities		
Change in net trading securities and derivatives	6	–
Change in loans and advances to banks and customers	(9,560)	–
Change in reverse repurchase agreements – non-trading	(3,422)	–
Change in financial assets designated and otherwise mandatorily measured at fair value	(27)	–
Change in other assets	1,801	–
Change in deposits by banks and customer accounts	5,457	–
Change in repurchase agreements – non-trading	639	–
Change in other liabilities	(3,392)	–
Contributions paid to defined benefit plans	(80)	–
Net cash from operating activities	(7,270)	–
Purchase of financial investments	(5,369)	(13)
Proceeds from the sale and maturity of financial investments	3,290	–
Net cash flows from the purchase and sale of property, plant and equipment	(48)	–
Net investment in intangible assets	(154)	–
Net cash outflow on cost of investment in subsidiaries	(48)	–
Net cash flow on acquisition of subsidiaries, businesses and joint venture ²	29,222	–
Net cash from investing activities	26,893	(13)
Issue of ordinary share capital and other equity instruments	9,000	15
Subordinated loan capital issued ³	2,020	–
Funds received from the shareholder of the parent company	3,000	–
Net cash from financing activities	14,020	15
Net increase in cash and cash equivalents	33,643	2
Cash and cash equivalents at 1 Jan	2	–
Exchange differences in respect of cash and cash equivalents	28	–
Cash and cash equivalents at 31 Dec⁵	33,673	2
Cash and cash equivalents comprise:		
– cash and balances at central banks	33,187	–
– items in the course of collection from other banks	457	–
– loans and advances to banks of one month or less	105	2
– treasury bills, other bills and certificates of deposit less than three months	149	–
– less: items in the course of transmission to other banks	(225)	–
Cash and cash equivalents at 31 Dec⁵	33,673	2

Interest received was £2,454m (2017: £nil), interest paid was £212m (2017: £nil).

- 1 Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on line-by-line basis, as details cannot be determined without unreasonable expense.
- 2 No cash or cash equivalent was paid in consideration of the investment in subsidiaries and joint venture as it formed part of the Part VII transfer of asset and liabilities. The aggregate amount of cash and cash equivalent in the businesses over which control was obtained was £29,222m.
- 3 Subordinated liabilities changes during the year are attributable to cash flows from issuance of securities (£2,020m, (2017: £nil)) as presented in the Consolidated statement of cash flows.
- 4 Comparatives round to £nil when presented in rounded millions.
- 5 At 31 December 2018, £350m (2017: £nil) was not available for use by the bank, of which all (2017: £nil) related to mandatory deposits at central banks.

HSBC UK Bank plc statement of changes in equity
for the year ended 31 December

	Called up share capital and share premium ¹	Other equity instruments	Retained earnings	Other reserves				Total shareholders' equity
				Financial assets at FVOCI reserve	Cash flow hedging reserve	Foreign exchange reserve	Group re-organisation reserve ²	
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 Jan 2018	15	–	–	–	–	–	–	15
Profit for the year	–	–	701	–	–	–	–	701
Other comprehensive income (net of tax)	–	–	(364)	10	(17)	(2)	–	(373)
– debt instruments at fair value through other comprehensive income	–	–	–	10	–	–	–	10
– cash flow hedges	–	–	–	–	(17)	–	–	(17)
– remeasurement of defined benefit asset/liability	–	–	(364)	–	–	–	–	(364)
– exchange differences	–	–	–	–	–	(2)	–	(2)
Total comprehensive income for the year	–	–	337	10	(17)	(2)	–	328
Capital securities issued ¹	9,000	–	–	–	–	–	–	9,000
Dividends to shareholders	–	–	–	–	–	–	–	–
Capital contribution ³	–	–	3,000	–	–	–	–	3,000
Transfer ⁴	–	2,196	–	–	–	–	–	2,196
Group Reorganisation Reserve	–	–	–	4	(29)	–	5,248	5,223
Other movements	–	–	4	–	–	–	–	4
At 31 Dec 2018	9,015	2,196	3,341	14	(46)	(2)	5,248	19,766
At 1 Jan 2017 ⁵	–	–	–	–	–	–	–	–
Profit for the year ⁵	–	–	–	–	–	–	–	–
Other comprehensive income (net of tax)	–	–	–	–	–	–	–	–
– available-for-sale investments ⁵	–	–	–	–	–	–	–	–
Total comprehensive income for the year ⁵	–	–	–	–	–	–	–	–
Capital securities issued	15	–	–	–	–	–	–	15
At 31 Dec 2017	15	–	–	–	–	–	–	15

1 All new capital subscribed during 2017 and 2018 was issued to HSBC UK Holdings Limited. For further details refer to note 23.

2 Relates primarily to the recognition of the pension asset net of deferred tax £4,776m. Details of our accounting policies in respect of the transfer of the ring-fenced businesses to HSBC UK Bank plc are set out in Note 1.

3 HSBC UK Holdings Limited injected £3,000m of CET1 capital.

4 Other equity instruments amounting to £2,196m consists of additional Tier 1 capital.

5 Comparatives round to £nil when presented in millions.

1 Basis of preparation and significant accounting policies

1.1 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The consolidated financial statements of HSBC UK and the separate financial statements of the bank have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB'), including interpretations issued by the IFRS Interpretations Committee, and as endorsed by the European Union ('EU'). At 31 December 2018, there were no unendorsed standards effective for the year ended 31 December 2018 affecting these consolidated and separate financial statements, and the group's application of IFRSs results in no differences between IFRSs as issued by the IASB and IFRSs as endorsed by the EU.

Standards adopted during the year ended 31 December 2018

The group has adopted the requirements of IFRS 9 'Financial Instruments', including the adoption of 'Prepayment Features with Negative Compensation (Amendments to IFRS 9)', which is effective for annual periods beginning on or after 1 January 2019 with early adoption permitted. IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting, which the group has exercised. Since at the time of adoption of IFRS 9, the bank's debt securities consisted only of short dated UK Treasury Gilts guaranteed by the UK Government, IFRS 9 had no significant effect on their presentation or measurement.

In addition, the group has adopted the requirements of IFRS 15 'Revenue from contracts with customers' and a number of interpretations and amendments to standards, which have had an insignificant effect on the consolidated financial statements of the group and the separate financial statements of the bank.

(b) Transfer of the ring-fenced businesses to HSBC UK Bank plc

To meet HSBC Holdings plc's UK ring-fencing obligations in accordance with the UK Banking Reform Act, on 1 July 2018, HSBC Bank plc's UK Retail Banking and Wealth Management, Commercial Banking and Private Banking (the 'ring-fenced businesses') were legally separated into a ring-fenced bank, HSBC UK Bank plc. This legal separation resulted in the demerger of the ring-fenced businesses in accordance with the application made to the High Court. The transfer of the various assets and liabilities making up the ring-fenced bank followed a variety of legal mechanisms (the most significant mechanism being a transfer under Part VII of the Financial Services and Markets Act 2000).

In the absence of explicit IFRS guidance for the demerger of businesses under common control, HSBC Group's internal accounting policy on group restructuring has been determined with reference to the existing framework of accounting standards and requirements on similar and related matters. The policy is consistent with HSBC Group's past practice and is in line with the market approach. HSBC group restructuring accounting most faithfully represents the substance of the facts and circumstances of the series of transactions that comprise UK ring fencing because those transactions are not designed to deliver economic benefits from changes in business activities, but represent a re-arrangement of the organisation of business activities across legal entities under the common control of HSBC Holdings plc in its capacity as the ultimate shareholder in order to be compliant with the relevant regulations.

The main principle of the HSBC group restructuring accounting policy is to treat the new structure as if it has always been in place. Therefore, the group uses the carrying amounts in HSBC Bank plc's consolidated accounts at the date of transfer to determine the value of the assets and liabilities transferred resulting in predecessor carrying values being attributed to the ring-fenced businesses. As a result, there is no new initial recognition point for the assets and liabilities (together with the related equity and OCI reserves) transferred and the demerged businesses are accounted for as if they have always been held by the group. Hedge accounting continues to be applied to the transferred designated hedge relationships as if they have originally been designated by the group. Since a significant percentage of the businesses that supported goodwill in HSBC Bank plc were transferred to HSBC UK, a significant proportion of the goodwill was also transferred with these businesses.

The group presents the results of the ring-fenced businesses from the date of legal separation on a prospective basis; comparative information reflecting the activities of those businesses prior to the date of legal separation is not presented. The demerger results in the creation of an equity reserve called "Group Reorganisation Reserve" which is used to recognise the contribution of equity reserves associated with the ring fenced businesses, which are notionally transferred from HSBC Bank plc.

(c) Future accounting developments

Minor amendments to IFRSs

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

Major new IFRSs

The IASB has published IFRS 16 'Leases' and IFRS 17 'Insurance Contracts'. IFRS 16 has been endorsed for use in the EU. IFRS 17 has not yet been endorsed but is not expected to have a significant impact on the consolidated financial statements of the group and the separate financial statements of the bank.

IFRS 16 'Leases'

IFRS 16 'Leases' has an effective date for annual periods beginning on or after 1 January 2019. IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under IAS 17 'Leases'. Lessees will recognise a right of use (ROU) asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease, and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as under IAS 17. At 1 January 2019, the group expects to adopt the standard using a modified retrospective approach where the cumulative effect of initially applying it is recognised as an adjustment to the opening balance of retained earnings and comparatives are not restated. The implementation is expected to increase assets by approximately £0.4bn and increase financial liabilities by the same amount with no effect on net assets or retained earnings.

(d) Foreign currencies

The functional currency of the bank is sterling, which is also the presentational currency of the consolidated financial statements of the group.

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

(e) Presentation of information

Certain disclosures required by IFRSs have been included in the audited sections of this *Annual Report and Accounts 2018* as follows:

- disclosures concerning the nature and extent of risks relating to financial instruments are included in the 'Report of the Directors: Risk' on pages 15 to 43.
- capital disclosures are included in the 'Report of the Directors: Capital' on pages 44 to 45.

In publishing the parent company financial statements together with the group financial statements, the bank has taken advantage of the exemption in Section 408(3) of the Companies Act 2006 not to present its individual income statement and related notes.

(f) Critical accounting estimates and judgements

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

(g) Segmental analysis

HSBC UK's chief operating decision-maker is the group Chief Executive, supported by the group Executive Committee, and operating segments are reported in a manner consistent with the internal reporting provided to the group Chief Executive and the group Executive Committee.

Measurement of segmental assets, liabilities, income and expenses is in accordance with the bank's accounting policies. Segmental income and expenses include transfers between segments and these transfers are conducted at arm's length. Shared costs are included in segments on the basis of the actual recharges made.

The types of products and services from which each reportable segment derives its revenue are discussed in the 'Strategic Report - Products and services'.

(h) Going concern

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the group and bank have the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows and capital resources.

1.2 Summary of significant accounting policies

(a) Consolidation and related policies

Investments in subsidiaries

Where an entity is governed by voting rights, the group consolidates when it holds, directly or indirectly, the necessary voting rights to pass resolutions by the governing body. In all other cases, the assessment of control is more complex and requires judgement of other factors, including having exposure to variability of returns, power to direct relevant activities and whether power is held as agent or principal.

Business combinations are accounted for using the acquisition method. The amount of non-controlling interest is measured either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. The election is made for each business combination.

The bank's investments in subsidiaries are stated at cost less impairment losses.

Goodwill

Goodwill is allocated to cash-generating units ('CGUs') for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. The group's CGUs are based on the business lines described in the Strategic Report. Impairment testing is performed once a year, or whenever there is an indication of impairment, by comparing the recoverable amount of a CGU with its carrying amount.

Goodwill is included in a disposal group if the disposal group is a CGU to which goodwill has been allocated or it is an operation within such a CGU. The amount of goodwill included in a disposal group is measured on the basis of the relative values of the operation disposed of and the portion of the CGU retained.

Interests in associates and joint arrangements

Joint arrangements are investments in which the group, together with one or more parties, has joint control. Depending on the group's rights and obligations, the joint arrangement is classified as either a joint operation or a joint venture. The group classifies investments in entities over which it has significant influence, and that are neither subsidiaries nor joint arrangements, as associates.

The group recognises its share of the assets, liabilities and results in a joint operation. Investments in associates and interests in joint ventures are recognised using the equity method. The attributable share of the results and reserves of joint ventures and associates are included in the consolidated financial statements of the group based on either financial statements made up to 31 December or pro-rated amounts adjusted for any material transactions or events occurring between the date the financial statements are available and 31 December.

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Investments in associates and joint ventures are assessed at each reporting date and tested for impairment when there is an indication that the investment may be impaired. Goodwill on acquisition of interests in joint ventures and associates is not tested separately for impairment, but is assessed as part of the carrying amount of the investment.

(b) Income and expense

Operating income

Interest income and expense

Interest income and expense for all financial instruments, excluding those classified as held for trading or designated at fair value, are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method. However, as an exception to this, interest on debt securities issued by the group that are designated under the fair value option and derivatives managed in conjunction with those debt securities is included in interest expense.

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

Critical accounting estimates and judgements

The effective interest rate applied to interest income recognised on credit card lending includes significant estimates and judgements related to their behavioural life. This life is estimated based on internal models and is reviewed regularly to reflect actual experience. The application of the effective interest rate method to credit card lending has resulted in the recognition of £138m within loans and advances to customers as at 31 December 2018.

The estimated life is reviewed annually and management has assessed 7 years as continuing to be the most appropriate life.

A key metric is the stick rate, being the proportion of acquired balances which remain on book after the end of promotional period. Where actual experience differs from forecasts, an adjustment to the carrying value of the asset is required to be recognised in the financial statements.

Management has assessed the sensitivity of balance and interest assumptions by considering the impact of changes as follows:

- a decrease in the closing balance stick rate assumption of 5% would decrease the asset value by £3.8m;
- Similarly, a decrease in the assumed interest yield of 5% would decrease the asset value by £14.6m. (The interest yield assumption is the amount of interest receivable over the life of the account).

Non-interest income and expense

The group generates fee income from services provided at a fixed price over time, such as account service and card fees, or when it delivers a specific transaction at a point in time, such as broking services and import/export services. With the exception of certain performance fees, all other fees are generated at a fixed price. Fund management and performance fees can be variable depending on the size of the customer portfolio and the group's performance as fund manager. Variable fees are recognised when all uncertainties are resolved. Fee income is generally earned from short-term contracts with payment terms that do not include a significant financing component.

The group acts as principal in the majority of contracts with customers, with the exception of broking services. For most brokerage trades, the group acts as agent in the transaction and recognises broking income net of fees payable to other parties in the arrangement.

The group recognises fees earned on transaction-based arrangements at a point in time when we have fully provided the service to the customer. Where the contract requires services to be provided over time, income is recognised on a systematic basis over the life of the agreement.

Where the group offers a package of services that contains multiple non-distinct performance obligations, such as those included in account service packages, the promised services are treated as a single performance obligation. If a package of services contains distinct performance obligations, such as those including both account and insurance services, the corresponding transaction price is allocated to each performance obligation based on the estimated stand-alone selling prices.

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.

The group buys and sells currencies to customers, as principal, with the purpose of short term profit taking and presents the results of this activity, including the related gains and losses from changes in foreign exchange rates, as trading.

Net income/(expense) from financial instruments measured at fair value through profit or loss includes the following:

- 'Net income from financial instruments held for trading or managed on a fair value basis': This comprises net trading income, which includes all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with the related interest income, expense and dividends. It also includes all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets and liabilities measured at fair value through profit or loss.
- 'Changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss': This includes interest on instruments that fail the solely payments of principal and interest ('SPPI') test, see (d).

(c) Valuation of financial instruments

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

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 IFRS offsetting criteria. Financial instruments are classified into one of three fair value hierarchy levels, described in Note 8, 'Fair values of financial instruments carried at fair value'.

(d) Financial instruments measured at amortised cost

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

Non-trading reverse repurchase, repurchase and similar agreements

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

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

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

(f) Derivatives

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

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

Hedge accounting

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

Fair value hedge

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

Cash flow hedge

The effective portion of gains and losses on hedging instruments is recognised in other comprehensive income; the ineffective portion of the change in fair value of derivative hedging instruments that are part of a cash flow hedge relationship is recognised immediately in the income statement within 'Net income from financial instruments held for trading or managed on a fair value basis'. The accumulated gains and losses recognised in other comprehensive income are reclassified to the income statement in the same periods in which the hedged item affects profit or loss. When a hedge relationship is discontinued, or partially discontinued, any cumulative gain or loss recognised in other comprehensive income remains in equity until the forecast transaction is recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss previously recognised in other comprehensive income is immediately reclassified to the income statement.

Critical accounting estimates and judgements

As a result of the request received by the Financial Stability Board from the G20, a fundamental review and reform of the major interest rate benchmarks is underway across the world's largest financial markets. The process of replacing existing benchmark interbank offered rates ('Ibors') with alternative risk free rates ('RFRs') is at different stages, and is progressing at different speeds, across several major jurisdictions. There is therefore uncertainty as to the timing and the methods of transition for many financial products affected by these changes, and whether some existing benchmarks will continue to be supported in some way.

As a result of these developments, significant accounting judgement is involved in determining whether certain hedge accounting relationships that hedge the variability of cash flows and interest rate risk due to changes in Ibors continue to qualify for hedge accounting as at 31 December 2018.

Management's judgement is that those existing hedge accounting relationships continue to be supported at the 2018 year-end. Even though there are plans to replace those rates with economically similar rates based on new RFRs over the next few years, there is widespread continued reliance on Ibors in market pricing structures for long term products with maturities over the hedged horizon that extend beyond the timescales for replacing Ibors. In addition there is a current absence of term structures based on the new RFRs. This judgement will be kept under review in future as markets based on the new RFRs develop, taking into consideration any specific accounting guidance that may be developed to deal with these unusual circumstances. The IASB has commenced the due process for providing clarification on how the guidance for hedge accounting in IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 9: 'Financial Instruments' should be applied in these circumstances, which were not contemplated when the standards were published.

(g) Impairment of amortised cost and FVOCI financial assets

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

Credit impaired (stage 3)

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

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

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

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

Write-off

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

Renegotiation

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

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

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

Loan modifications that are not credit impaired

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

Significant increase in credit risk (stage 2)

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

For wholesale portfolios, the quantitative comparison assesses default risk using a lifetime probability of default which encompasses a wide range of information including the obligor's customer risk rating ('CRR'), macroeconomic condition forecasts and credit transition probabilities. For origination CRRs up to 3.3, significant increase in credit risk is measured by comparing the average PD for the

remaining term estimated at origination with the equivalent estimation at the reporting date. The quantitative measure of significance varies depending on the credit quality at origination as follows:

Origination CRR	Significance trigger - PD to increase by
0.1-1.2	15bps
2.1-3.3	30 bps

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

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

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

Further information about the 23-grade scale used for CRR can be found on page 21 - Risk rating scales.

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

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

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

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

Purchased or originated credit impaired

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

Movement between stages

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

Measurement of ECL

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

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

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

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

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

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

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

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

Period over which ECL is measured

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

Forward-looking economic inputs

The group will in general apply three forward-looking global economic scenarios determined with reference to external forecast distributions representative of our view of forecast economic conditions, the consensus economic scenario approach. This approach is considered sufficient to calculate unbiased expected loss in most economic environments. They represent a 'most likely outcome' (the Central scenario) and two, less likely, outer scenarios on either side of the Central, referred to as the Upside and Downside scenarios. The Central scenario is the basis for the annual operating planning process and, with regulatory modifications, will also be used in enterprise-wide stress tests. The Upside and Downside scenarios are constructed following a standard process supported by a scenario narrative reflecting the group's current top and emerging risks and by consulting external and internal subject matter experts. The relationship between the outer scenarios and Central scenario will generally be fixed with the Central scenario being assigned a weighting of 80% and the Upside and Downside scenarios 10% each, with the difference between the Central and outer scenarios in terms of economic severity being informed by the spread of external forecast distributions among professional industry forecasts. The outer scenarios are economically plausible, internally consistent states of the world and will not necessarily be as severe as scenarios used in stress testing. The period of forecasts is 5 years for the central scenario. Upside and Downside scenarios use distributional forecasts for the first two years after which they converge to the central forecasts. The central forecast and spread between the Central and outer scenarios is grounded on the expected gross domestic product of the UK. This includes consideration of domestic economic factors as well as global economic events, the economic performance of other countries and the impact these can have on the gross domestic product of the UK. HSBC Group runs a global process which ensures that both domestic and international economic factors are considered in creating scenarios for the UK.

The economic factors include, but are not limited to, gross domestic product, unemployment, interest rates, inflation and commercial property prices, reflecting both domestic and international economic factors as appropriate.

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

The group recognises that the consensus economic scenario approach using three scenarios will be insufficient in certain economic environments. Additional analysis may be requested at management's discretion, including the production of extra scenarios. If conditions warrant, this could result in alternative scenarios and probability weightings being applied in arriving at the ECL.

Critical accounting estimates and judgements

In determining ECL, management is required to exercise judgement in defining what is considered to be a significant increase in credit risk and in making assumptions and estimates to incorporate relevant information about past events, current conditions and forecasts of economic conditions. Judgement has been applied in determining the lifetime and point of initial recognition of revolving facilities. The PD, LGD and EAD models which support these determinations are reviewed regularly in light of differences between loss estimates and actual loss experience, but given that IFRS 9 requirements have only just been applied, there has been little time available to make these comparisons. Therefore, the underlying models and their calibration, including how they react to forward-looking economic conditions, remain subject to review and refinement. This is particularly relevant for lifetime PDs, which have not been previously used in regulatory modelling and for the incorporation of 'Upside scenarios' which have not generally been subject to experience gained through stress testing.

The exercise of judgement in making estimations requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions. Many of the factors have a high degree of interdependency and there is no single factor to which loan impairment allowances as a whole are sensitive. The sections marked as audited in pages 30 to 34 'Measurement uncertainty and sensitivity analysis of ECL estimates' set out the assumptions underlying the Central scenario and information about how scenarios are developed in relation to the group's top and emerging risks and its judgements, informed by consensus forecasts of professional industry forecasters. The sensitivity of ECL to different economic scenarios is illustrated by recalculating the ECL for selected portfolios as if 100% weighting had been assigned to each scenario.

(h) Employee compensation and benefits

Share-based payments

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

The vesting period for these schemes may commence before the legal grant date if the employees have started to render services in respect of the award before the legal grant date, where there is a shared understanding of the terms and conditions of the arrangement. Expenses are recognised when the employee starts to render service to which the award relates.

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

Post-employment benefit plans

The group operates a pension plan which provides defined benefit and defined contribution pensions.

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

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

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

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

(i) Tax

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

Current tax is the tax expected to be payable on the taxable profit for the year and on any adjustment to tax payable in respect of previous years. The group provides for potential current tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet, and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax is calculated using the tax rates expected to apply in the periods as the assets will be realised or the liabilities settled.

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

(j) Provisions, contingent liabilities and guarantees

Provisions

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

Notes on the Financial Statements

Critical accounting estimates and judgements

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

Contingent liabilities, contractual commitments and guarantees

Contingent liabilities

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

Financial guarantee contracts

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

(k) Accounting policies applied to financial instruments prior to 1 January 2018

Financial instruments measured at fair value

Available-for-sale financial assets

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

Impairment of available-for-sale financial assets

Available-for-sale financial assets are assessed at each balance sheet date for objective evidence of impairment. Impairment losses are recognised in the income statement.

Available-for-sale debt securities

In assessing objective evidence of impairment at the reporting date, the company 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. A subsequent decline in the fair value of the instrument is recognised in the income statement when there is objective evidence of impairment as a result of decreases in the estimated future cash flows. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, or the instrument is no longer impaired, the impairment loss is reversed through the income statement.

2 Net fee income

Net fee income by global business

	2018						2017
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Corporate Centre	Total	Total
	£m	£m	£m	£m	£m	£m	£m
Account services	240	123	(1)	–	–	362	–
Funds under management	27	1	–	18	–	46	–
Cards	88	11	–	–	–	99	–
Credit facilities	1	71	–	–	–	72	–
Broking income	4	1	–	–	–	5	–
Unit trusts	7	–	–	–	–	7	–
Imports/exports	–	21	–	–	–	21	–
Remittances	4	(3)	–	–	–	1	–
Insurance agency commission	27	–	–	–	–	27	–
Other	123	164	(97)	1	–	191	–
Fee income	521	389	(98)	19	–	831	–
Less: fee expense	(180)	(11)	–	(7)	15	(183)	–
Net Fee income	341	378	(98)	12	15	648	–

3 Operating profit

Operating profit is stated after the following items:

	2018 £m	2017 £m
Income		
Interest recognised on credit impaired financial assets	25	—
Interest recognised on financial assets measured at amortised cost ¹	2,722	N/A
Interest recognised on financial assets measured at FVOCI ¹	81	N/A
Fees earned on financial assets that are not at fair value through profit and loss (other than amounts included in determining the effective interest rate)	636	—
Fees earned on trust and other fiduciary activities	50	—
Net income from financial instruments held for trading or managed on a fair value basis	198	—
Trading activities	200	—
Other trading income – hedge ineffectiveness	(3)	—
– on cash flow hedges	(1)	—
– on fair value hedges	(2)	—
Fair value movement on non-qualifying hedges	1	—
Expense		
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated or otherwise mandatorily measured at fair value	(349)	—
Fees payable on financial liabilities that are not at fair value through profit or loss (other than amounts included in determining the effective interest rate)	(117)	—
Fees payable relating to trust and other fiduciary activities	(2)	—
Payments under lease and sublease agreements	(75)	—
– minimum lease payments	(75)	—
Change in expected credit loss charges and other credit impairment charges	(305)	N/A
– loans and advances to banks and customers	(298)	N/A
– loans commitments and guarantees	(7)	N/A

¹ Interest revenue calculated using the effective interest method comprises interest recognised on financial assets measured at either amortised cost or fair value through other comprehensive income.

4 Employee compensation and benefits

	2018 £m	2017 £m
Wages and salaries	400	—
Social security costs	44	—
Post-employment benefits	167	—
Year ended 31 Dec	611	—

Notes on the Financial Statements

Average number of persons employed by the group during the year¹

	2018	2017
Retail Banking and Wealth Management	8,739	—
Commercial Banking	2,424	—
Global Banking and Markets	26	—
Global Private Banking	137	—
Corporate Centre	151	—
Year ended 31 Dec	11,477	—

¹ Numbers exclude staff seconded to HSBC Bank plc until 30 June 2018.

In October 2017, 21,571 employees were transferred from HSBC Bank plc to the group, and were seconded back to HSBC Bank plc until 30 June 2018.

Share-based payments

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

	2018 £m	2017 £m
Restricted share awards	—	—
Savings-related and other share award option plans	7	—
Year ended 31 Dec	7	—

HSBC Group share awards

Award	Policy
Deferred share awards (including annual incentive awards, LTI awards delivered in shares) and GPSP	<ul style="list-style-type: none"> 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, five or seven years. Vested shares may be subject to a retention requirement post-vesting. GPSP awards are retained until cessation of employment. Awards granted from 2010 onwards are subject to a malus provision prior to vesting. Awards granted to Market Risk Takers from 2015 onwards are subject to clawback post vesting.
International Employee Share Purchase Plan ('ShareMatch')	<ul style="list-style-type: none"> The plan was first introduced in Hong Kong in 2013 and now includes employees based in 27 jurisdictions. Shares are purchased in the market each quarter up to a maximum value of £750, or the equivalent in local currency. 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.

Movement on HSBC share awards

	2018 Number (000s)	2017 Number (000s)
Restricted share awards outstanding at 1 Jan	—	—
Transfer from HSBC Bank plc and other Group subsidiaries	1,126	—
Additions during the year	20	—
Released in the year	(143)	—
Forfeited in the year	(4)	—
Restricted share awards outstanding at 31 Dec	999	—
Weighted average fair value of awards granted (£)	1.33	—

HSBC Group share option plans

Plans	Policy
Savings-related share option plans ('Sharesave')	<ul style="list-style-type: none"> From 2014, eligible employees can save up to £500 per month with the option to use the savings to acquire shares. Exercisable within six months following either the third or fifth anniversary of the commencement of a three-year or five-year contract, respectively. The exercise price is set at a 20% (2017: 20%) discount to the market value immediately preceding the date of invitation.

Calculation of fair values

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

Movement on HSBC Group share option plans

	Savings-related share option plans	
	Number (000s)	WAEP ¹ £
Outstanding at 1 Jan 2018		
Transfer from HSBC Bank plc and other Group subsidiaries	27,064	4.51
Granted during the year	8,803	5.45
Exercised during the year	(10,294)	4.15
Expired during the year	(879)	5.37
Forfeited during the year	(231)	4.70
Outstanding at 31 Dec 2018	24,463	4.97
Of which exercisable	1,218	4.10
Weighted average remaining contractual life (years)	2.59	

¹ Weighted average exercise price.

Post-employment benefit plans

We operate a pension plan for our employees called the HSBC Bank (UK) Pension Scheme ('the plan'), which has both defined benefit and defined contribution sections. To meet the requirements of the Banking Reform Act, from 1 July 2018, the main employer of the plan changed from HSBC Bank plc to HSBC UK Bank plc, with additional support from HSBC Holdings plc. At that time, the non-ring fenced entities including HSBC Bank plc exited the section of the plan for ring-fenced entities (the "HSBC UK section") and joined a newly created section for the future defined benefit and defined contribution pension benefits of their employees. These changes have not materially affected the funding position of the plan.

The Pension Risk section on page 27 contains details about the policies and practices associated with the plan.

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

The investment strategy of the plan is to hold the majority of assets in bonds, with the remainder in a diverse range of investments. It also includes some interest rate swaps to reduce interest rate risk and inflation swaps to reduce inflation risk.

The latest funding valuation of the plan at 31 December 2016 was carried out by Colin G Singer, at Willis Towers Watson Limited, who is a Fellow of the UK Institute and Faculty of Actuaries, using the projected unit credit method. At that date, the market value of the plan's assets was £28.8bn and this exceeded the value placed on its liabilities on an ongoing basis by £1.4bn, giving a funding level of 105%. These figures relate only to the HSBC UK section of the plan and include defined contribution assets amounting to £2.0bn. The main differences between the assumptions used for assessing the liabilities for this funding valuation and those used for IAS 19 are more prudent assumptions for discount rate, inflation rate and life expectancy assumptions.

Although the plan was in surplus at the valuation date, further contributions will be made to the plan to support a lower-risk investment strategy over the longer term. The remaining contributions are £64m in 2019, and £160m in each of 2020 and 2021.

The actuary also assessed the value of the liabilities the HSBC UK section of the plan were to be stopped and an insurance company asked to secure all future pension payments. This is generally larger than the amount needed on the ongoing basis described above because an insurance company would use more prudent assumptions and include an explicit allowance for the future administrative expenses of the plan. Under this approach, the amount of assets needed was estimated to be £37bn at 31 December 2016.

The Trust Deed gives the ability for HSBC to take a refund of surplus assets after the plan has been run down such that no further beneficiaries remain. On this basis, any net surplus in the HSBC UK section of the plan is recognised in group's financial statements.

Guaranteed Minimum Pension ('GMP') Equalisation

On 26 October 2018, the High Court of Justice of England and Wales issued a judgment in a claim between Lloyds Banking Group Pension Trustees Limited as claimant and Lloyds Bank plc and others as defendants regarding the rights of men and women to equal treatment in relation to their benefits from certain pension schemes.

The judgment concluded that the claimant is under a duty to amend the schemes to equalise benefits for men and women in relation to GMP benefits. The judgment also provided comments on the method to be adopted to equalise benefits, on the period during which a member can claim in respect of previously underpaid benefits, and on what should be done in relation to benefits that have been transferred into, and out of, the relevant schemes.

We have estimated the financial effect of equalising benefits in respect of GMPs, and any potential conversion of GMPs into non-GMP benefits, to be an approximate 0.9% increase in the plan's liabilities, or £187m on the IAS 19 basis as at 31 December 2018. This has been recognised as a past service cost in the income statement. The estimate was performed based on Method C2, which compares the accumulated benefits, with interest, payable to a member on their 'own sex' and an 'opposite sex' basis and each year pays the amount necessary to ensure the higher of the two accumulated amounts has been paid.

Income statement charge

	2018	2017
	£m	£m
Defined benefit pension plans ¹	122	—
Defined contribution pension plans	44	—
Pension plans	166	—
Year ended 31 Dec	166	—

¹ Includes a £187m past service cost in respect of GMP equalisation.

Notes on the Financial Statements

Cumulative actuarial losses recognised in other comprehensive income

	2018 £m	2017 £m
At 1 Jan	–	–
Actuarial losses recognised in other comprehensive income for the year	(485)	–
At 31 Dec	(485)	–

Net assets/(liabilities) recognised on the balance sheet in respect of defined benefit plans

	Fair value of plan assets £m	Present value of defined benefit obligations £m	Effect of limit on plan surpluses £m	Total £m
Defined benefit pension plans	26,687	(20,846)	–	5,841
At 31 Dec 2018	26,687	(20,846)	–	5,841
Total employee benefit liabilities (within 'Accruals, deferred income and other liabilities')				–
Total employee benefit assets (within 'Prepayments, accrued income and other assets')				5,841

For 2017, the group had no defined benefit pension plans.

Defined benefit pension plans

Net asset/(liability) under defined benefit pension plans

	Fair value of plan assets £m	Present value of defined benefit obligations £m	Effect of the asset ceiling £m	Net defined benefit assets/ (liabilities) £m
At 1 Jan 2018	–	–	–	–
Transfer in from HSBC Bank plc on 1 July 2018	26,948	(20,580)	–	6,368
Current service cost	–	(2)	–	(2)
Past service cost and gains/(losses) from settlements	–	(187)	–	(187)
Service cost	–	(189)	–	(189)
Net interest income/(cost) on the net defined benefit asset/(liability)	358	(279)	–	79
Remeasurement effects recognised in other comprehensive income	(279)	(206)	–	(485)
– return on plan assets (excluding interest income)	(279)	–	–	(279)
– actuarial gains/(losses)	–	(186)	–	(186)
– other changes	–	(20)	–	(20)
Contributions by the group	80	–	–	80
– normal	80	–	–	80
– special	–	–	–	–
Contributions by employees	–	–	–	–
Benefits paid	(405)	405	–	–
Administrative costs and taxes paid by plan	(15)	3	–	(12)
At 31 Dec 2018	26,687	(20,846)	–	5,841
Present value of defined benefit obligation relating to:				
– actives		(3,856)		
– deferreds		(6,418)		
– pensioners		(10,572)		

HSBC UK expects to make £64m of contributions to defined benefit pension plans during 2019. Benefits expected to be paid from the HSBC UK Pension Scheme to retirees over each of the next five years, and in aggregate for the five years thereafter, are as follows:

Benefits expected to be paid from plan

	2019 £m	2020 £m	2021 £m	2022 £m	2023 £m	2024–2028 £m
The plan ¹	875	902	930	959	989	5,423

¹ The duration of the defined benefit obligation is 17.0 years under the disclosure assumptions adopted.

Fair value of plan assets by asset classes

	31 Dec 2018		
	Value	Quoted market price in active market	No quoted market price in active market
	£m	£m	£m
The plan			
Fair value of plan assets	26,687	23,710	2,977
– equities	2,468	2,101	367
– bonds	20,763	20,763	–
– derivatives	1,618	–	1,618
– other	1,838	846	992

Post-employment defined benefit plan actuarial financial assumptions

The group determines the discount rates to be applied to its obligations in consultation with the plans' local actuaries, on the basis of current average yields of high quality (AA-rated or equivalent) debt instruments with maturities consistent with those of the defined benefit obligations.

Key actuarial assumptions for the plan

	Discount rate	Inflation rate	Rate of increase for pensions	Rate of pay increase
	%	%	%	%
UK				
At 31 Dec 2018	2.80	3.40	3.10	3.65

Mortality tables and average life expectancy at age 65 for the plan

	Mortality table	Life expectancy at age 65 for a male member currently:		Life expectancy at age 65 for a female member currently:	
		Aged 65	Aged 45	Aged 65	Aged 45
UK					
At 31 Dec 2018	SAPS S2¹	21.6	22.9	24.1	25.6

¹ Self-administered pension scheme ('SAPS') S2 table (males: 'All Pensioners' version; females: 'Normal Pensions' version) with a multiplier of 0.98 for both male and female pensioners. Improvements are projected in accordance with the Continuous Mortality Investigation ('CMI') core projection model 2016 with a long-term rate of improvement of 1.25% per annum. Separate tables assuming lighter mortality have been applied to higher paid pensioners.

The effect of changes in key assumptions on the plan

	Impact on HSBC Bank (UK) Pension Scheme Obligation			
	Financial impact of increase		Financial impact of decrease	
	2018	2017	2018	2017
	£m	£m	£m	£m
Discount rate – increase/decrease of 0.25%	(844)	–	900	–
Inflation rate – increase/decrease of 0.25%	569	–	(562)	–
Pension payments and deferred pensions – increase/decrease of 0.25%	926	–	(870)	–
Pay – increase/decrease of 0.25%	22	–	(23)	–

Directors' emoluments

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

	2018	2017
	£000	£000
Fees paid to non-executive Directors ¹	1,262	338
Salaries and other emoluments ^{2,3}	1,366	–
Annual incentives ^{3,4}	495	–
Long-term incentives ^{3,5}	295	–
Year ended 31 Dec	3,418	338

¹ The 2017 fees paid to non-executive Directors have been borne by a fellow HSBC Group undertaking and are therefore not charged in arriving at the profit before taxation.

² Salaries and other emoluments include Fixed Pay Allowances.

³ For 2017, no remuneration is disclosed for Directors who are employed by other companies within the HSBC Group and their services to the bank are incidental to their other responsibilities within the HSBC Group. During the first six months of 2018 the banks' Executive Directors provided services to other companies within the HSBC Group and their services to the bank were incidental. Therefore the Executive Directors remuneration disclosed represents the period from 1 July to 31 December 2018.

⁴ Discretionary annual incentives for executive Directors are based on a combination of individual and corporate performance and are determined by the Remuneration Committee of the bank's ultimate parent company, HSBC Holdings plc. Incentive awards made to executive Directors are delivered in the form of cash and HSBC Holdings plc shares. The total amount shown is comprised of £247,275 (2017: Nil) in cash and £247,275 (2017: Nil) in Restricted Shares, which is the upfront portion of the annual incentive granted in respect of performance year 2018.

⁵ The amount shown is comprised of £120,000 (2017: Nil) in deferred cash and £175,358 (2017: Nil) in deferred Restricted Shares. These amounts relate to the portion of the awards that will vest following the substantial completion of the vesting condition attached to these awards in 2018. The total vesting period of deferred cash and share awards is no less than three years, with 33% of the award vesting on each of the first and second anniversaries of the date of the award and the balance vesting on the third anniversary of the date of the award. The deferred share awards are subject to a six-month retention period upon vesting. Details of the Plans are contained within the Directors' Remuneration Report of HSBC Holdings plc.

Notes on the Financial Statements

One Director exercised share options over HSBC Holdings plc ordinary shares during the year (2017: 0).

Awards were made to 3 Directors under long-term incentive plans in respect of qualifying services rendered in 2018 (2017: no Director). During 2018, 3 Directors received shares in respect of awards under long-term incentive plans that vested during the year (2017: no Director).

No retirement benefits accrued to Directors during the year in respect of their qualifying services (2017: no Directors). Three Directors received cash in lieu of pension contributions during the year in respect of their qualifying services. Cash received in lieu of pension is included in the salary and other emoluments disclosure in the table above.

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

	2018	2017
	£000	£000
Fees paid to non-executive directors	—	338
Salaries and other emoluments ³	776	—
Annual incentives ^{1,3}	274	—
Long-term incentives ^{2,3}	176	—
Year ended 31 Dec	1,226	338

1 Awards made to the highest paid Director are delivered in the form of cash and HSBC Holdings plc shares. The amount shown is comprised of £136,805 (2017: £nil) in cash and £136,805 (2017: £nil) in Restricted Shares.

2 The amount shown is comprised of £66,575 (2017: £nil) in deferred cash and £109,145 (2017: £nil) in deferred Restricted Shares. These amounts relate to a portion of the awards that will vest following the substantial completion of the vesting condition attached to these awards in 2018. The total vesting period of deferred cash and share awards is no less than three years, with 33% of the award vesting on each of the first and second anniversaries of the date of the award and the balance vesting on the third anniversary of the date of the award. The share awards are subject to a six-month retention period upon vesting.

3 During the first six months of 2018 the banks' Executive Directors provided services to other companies within the HSBC Group and their services to the bank were incidental. Therefore the Executive Directors remuneration disclosed represents the period from 1 July to 31 December 2018.

The highest paid Director received shares in respect of qualifying services under a long-term incentive scheme.

Pension contributions of £nil were made by the bank in respect of services by the highest paid Director during the year (2017: £nil).

5 Auditors' remuneration

	2018	2017
	£m	£m
Audit fees payable to PwC ⁴	4.3	0.1
Other audit fees payable	0.7	—
Year ended 31 Dec	5.0	0.1

Fees payable by the group to PwC

	2018	2017
	£m	£m
Audit fees for HSBC UK Bank plc's statutory audit ¹ : current year	3.6	—
Fees for other services provided to the group	1.4	—
– audit of the group's subsidiaries ²	0.7	—
– audit-related assurance services ³	0.7	—
Year ended 31 Dec	5.0	—

1 Fees payable to PwC for the statutory audit of the consolidated financial statements of the group and the separate financial statements of HSBC UK Bank plc. They exclude amounts payable for the statutory audit of the bank's subsidiaries which have been included in 'Fees for other services provided to the group'.

2 Including fees payable to PwC for the statutory audit of the bank's subsidiaries.

3 Including services for assurance and other services that relate to statutory and regulatory filings, including comfort letters and interim reviews.

4 2017 fees for HSBC UK Bank plc statutory audit of £20,000 and other audit related services of £40,000 were paid by other HSBC Group companies.

No fees were payable to PwC as principal auditor for the following types of services: internal audit services and services related to litigation, recruitment and remuneration.

Fees payable for non-audit services for HSBC UK Bank plc are not disclosed separately because such fees are disclosed on a consolidated basis for the group.

6 Tax

Tax expense

	2018 £m	2017 ¹ £m
Current tax	321	—
– for this year	323	—
– adjustments in respect of prior years	(2)	—
Deferred tax	(20)	—
– origination and reversal of temporary differences	(21)	—
– effect of changes in tax rates	2	—
– adjustments in respect of prior years	(1)	—
Year ended 31 Dec	301	—

¹ For 2017 comparatives round to £nil when presented in millions.

The tax rate applying to HSBC UK Bank plc and its banking subsidiaries was 27%, comprising 19% UK corporation tax plus 8% surcharge on UK banking profits. The tax rate applicable for non-banking entities is 19% (2017: 19.25%). The 19% rate of corporation tax in the UK will be reduced to 17% by 1 April 2020. The Dublin branch provided for taxation at the appropriate rate in Ireland.

Tax reconciliation

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

	2018		2017 ¹	
	£m	%	£m	%
Profit before tax	1,064		—	
Tax expense				
Taxation at UK corporation tax of 19.00% (2017: 19.25%)	202	19.00	—	19.25
Other items increasing tax charge in 2018:				
– UK banking surcharge	80	7.6	—	—
– permanent disallowables	20	1.8	—	—
– change in tax rates	2	0.1	—	—
Items reducing tax charge in 2018:				
– adjustments in respect of prior period liabilities	(3)	(0.2)	—	—
Year ended 31 Dec	301	28.3	—	19.3

¹ For 2017 comparatives round to £nil when presented in millions.

The effective tax rate for the year was 28.3% (2017: 19.25%), reflecting the UK rate of corporation tax for banking entities of 27% and the impact of non-deductible expenses.

Accounting for taxes involves some estimation because the tax law is uncertain and its application requires a degree of judgement, which authorities may dispute. Liabilities are recognised based on best estimates of the probable outcome, taking into account external advice where appropriate. We do not expect significant liabilities to arise in excess of the amounts provided. The group only recognises current and deferred tax assets where recovery is probable.

Movement of deferred tax assets and liabilities

	Loan impairment provisions	Cash flow hedges	FVOCI reserves	Defined benefit pension	Expense provisions	Other ¹	Total
	£m	£m	£m	£m	£m	£m	£m
The group							
At 1 Jan 2018	—	—	—	—	—	—	—
Transfer from HSBC Bank plc and its subsidiaries ³	156	10	(1)	(1,592)	—	93	(1,334)
Income statement	(9)	—	—	11	6	13	21
Other comprehensive income	—	6	(3)	121	—	—	124
At 31 Dec 2018	147	16	(4)	(1,460)	6	106	(1,189)
Assets ²	147	16	—	—	6	106	275
Liabilities ²	—	—	(4)	(1,460)	—	—	(1,464)

For 2017 comparatives round to £nil when presented in millions.

¹ Other deferred tax assets and liabilities relate primarily to fixed assets.

² After netting off balances within countries, the balances as disclosed in the accounts are as follows: deferred tax assets £nil (2017: £nil); and deferred tax liabilities £1,189m (2017: £nil).

³ Forms part of the transfer of qualifying components of the UK business in accordance with the ring-fencing rules.

Notes on the Financial Statements

Movement of deferred tax assets and liabilities

	Loan impairment provisions £m	Cash flow hedges £m	FVOCI reserves £m	Defined benefit pension £m	Expense provisions £m	Other ¹ £m	Total £m
The bank							
At 1 Jan 2018	–	–	–	–	–	–	–
Transfer from HSBC Bank plc ³	145	10	(1)	(1,592)	–	70	(1,368)
Income statement	(8)	–	–	11	6	11	20
Other comprehensive income	–	6	(3)	121	–	–	124
Equity	–	–	–	–	–	–	–
Foreign exchange and other adjustments	–	–	–	–	–	–	–
At 31 Dec 2018	137	16	(4)	(1,460)	6	81	(1,224)
Assets ²	137	16	–	–	6	81	240
Liabilities ²	–	–	(4)	(1,460)	–	–	(1,464)

For 2017 comparatives round to £nil when presented in millions.

¹ Other deferred tax assets and liabilities relate to fixed assets.

² After netting off balances within countries, the balances as disclosed in the accounts are as follows: deferred tax assets £nil (2017: £nil); and deferred tax liabilities £1,224m (2017: £nil).

³ Forms part of the transfer of qualifying components of the UK business in accordance with the ring-fencing rules.

7 Dividends

No interim dividend was paid or declared on the ordinary share capital during the year and up to the date when the financial statements were authorised for issue.

8 Fair values of financial instruments carried at fair value

Control framework

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

Where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is used.

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

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

Fair value hierarchy

Fair values of financial assets and liabilities 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 can be accessed at the measurement date.
- Level 2 – valuation technique using observable inputs: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
- Level 3 – valuation technique with significant unobservable inputs: financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

Financial instruments carried at fair value and bases of valuation

	2018				2017			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
The group								
Recurring fair value measurements at 31 Dec								
Assets								
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	34	1	–	35	N/A	N/A	N/A	N/A
Derivatives	2	64	–	66	–	–	–	–
Financial investments	12,613	590	–	13,203	13	–	–	13
Liabilities								
Derivatives	1	345	–	346	–	–	–	–

Financial instruments carried at fair value and bases of valuation

	2018				2017			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
The bank								
Recurring fair value measurements at 31 Dec								
Assets								
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	34	1	–	35	N/A	N/A	N/A	N/A
Derivatives	2	59	–	61	–	–	–	–
Financial investments	12,613	590	–	13,203	13	–	–	13
Liabilities								
Derivatives	1	340	–	341	–	–	–	–

Transfers between levels of the fair value hierarchy are deemed to occur at the end of each semi-annual reporting period. Transfers into and out of levels of the fair value hierarchy are primarily attributable to observability of valuation inputs and price transparency. There were no transfers between Level 1 and Level 2 during 2018.

Fair value adjustments

Fair value adjustments are adopted when the group determines that there are additional factors considered by market participants that are not incorporated within the valuation model. Fair value adjustments are typically adopted to reflect bid-offer costs required to close positions or to reflect the valuation impact on derivative contracts in relation to the default probability of the contract.

Fair value valuation bases

Financial instruments measured at fair value using a valuation technique with significant unobservable inputs – Level 3

The group and bank

The bank had no financial instruments measured at fair value using a valuation technique with significant unobservable inputs.

The group had £1.4m of Level 3 private equity investments which were transferred from HSBC Bank plc on 1 July 2018. These were disposed of on 10 October 2018.

9 Fair values of financial instruments not carried at fair value

Fair values of financial instruments not carried at fair value and bases of valuation

	Carrying amount £m	Fair value			Total £m
		Quoted market price Level 1 £m	Observable inputs Level 2 £m	Significant unobservable inputs Level 3 £m	
The group					
At 31 Dec 2018					
Assets					
Loans and advances to banks	1,263	–	1,263	–	1,263
Loans and advances to customers	174,807	–	631	176,229	176,860
Reverse repurchase agreements – non-trading	3,422	–	3,422	–	3,422
Liabilities					
Deposits by banks	1,027	–	1,027	–	1,027
Customer accounts	204,837	–	204,818	–	204,818
Repurchase agreements – non-trading	639	–	639	–	639
Subordinated liabilities	4,937	–	5,040	–	5,040
At 31 Dec 2017					
Assets					
Loans and advances to banks	2	–	2	–	2
Loans and advances to customers	–	–	–	–	–
Reverse repurchase agreements – non-trading	–	–	–	–	–
Liabilities					
Deposits by banks	–	–	–	–	–
Customer accounts	–	–	–	–	–
Repurchase agreements – non-trading	–	–	–	–	–
Subordinated liabilities	–	–	–	–	–

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Fair values of financial instruments not carried at fair value and bases of valuation

	Carrying amount £m	Fair value			Total £m
		Quoted market price Level 1 £m	Observable inputs Level 2 £m	Significant unobservable inputs Level 3 £m	
The bank					
At 31 Dec 2018					
Assets					
Loans and advances to banks	3,883	–	3,883	–	3,883
Loans and advances to customers	165,850	–	631	167,468	168,099
Reverse repurchase agreements – non-trading	3,422	–	3,422	–	3,422
Liabilities					
Deposits by banks	4,265	–	4,265	–	4,265
Customer accounts	196,858	–	196,858	–	196,858
Repurchase agreements – non-trading	639	–	639	–	639
Subordinated liabilities	4,858	–	4,961	–	4,961
At 31 Dec 2017					
Assets					
Loans and advances to banks	2	–	2	–	2
Loans and advances to customers	–	–	–	–	–
Reverse repurchase agreements – non-trading	–	–	–	–	–
Liabilities					
Deposits by banks	–	–	–	–	–
Customer accounts	–	–	–	–	–
Repurchase agreements – non-trading	–	–	–	–	–
Subordinated liabilities	–	–	–	–	–

Other financial instruments not carried at fair value are typically short-term in nature and reprice to current market rates frequently. Accordingly, their carrying amount is a reasonable approximation of fair value. They include cash and balances at central banks and items in the course of collection from and transmission to other banks, all of which are measured at amortised cost.

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

	Carrying amount			Fair value		
	Not Impaired £m	Impaired £m	Total £m	Not Impaired £m	Impaired £m	Total £m
Loans and advances to customers						
– personal	108,804	839	109,643	110,051	813	110,864
– corporate and commercial	61,543	1,088	62,631	62,343	1,126	63,469
– non-bank financial institutions	2,471	62	2,533	2,464	62	2,526
At 31 Dec 2018	172,818	1,989	174,807	174,858	2,001	176,859

Loans and advances to customers are classified as not credit impaired or credit impaired in accordance with the criteria described on page 22.

Valuation

Fair value is an estimate of 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. It does not reflect the economic benefits and costs that the group expects to flow from an instrument's cash flow over its expected future life. Our valuation methodologies and assumptions in determining fair values for which no observable market prices are available may differ from those of other companies.

Loans and advances to banks and customers

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

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

Financial investments

The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that incorporate the prices and future earnings streams of equivalent quoted securities.

Deposits by banks and customer accounts

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

Subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments.

Repurchase and reverse repurchase agreements – non-trading

Fair values approximate carrying amounts as balances are generally short dated.

10 Derivatives

Notional contract amounts and fair values of derivatives by product contract type held

	Notional contract amount		Fair value – Assets			Fair value – Liabilities		
	Trading £m	Hedging £m	Trading £m	Hedging £m	Total £m	Trading £m	Hedging £m	Total £m
The group								
Foreign exchange	5,740	2,222	42	5	47	44	79	123
Interest rate	15,587	12,522	142	79	221	133	292	425
Gross total fair values	21,327	14,744	184	84	268	177	371	548
Offset (Note 22)					(202)			(202)
At 31 Dec 2018	21,327	14,744	184	84	66	177	371	346

For 2017, the group had no derivatives.

	Notional contract amount		Fair value – Assets			Fair value – Liabilities		
	Trading £m	Hedging £m	Trading £m	Hedging £m	Total £m	Trading £m	Hedging £m	Total £m
The bank								
Foreign exchange	5,189	2,222	37	5	42	38	79	117
Interest rate	15,567	12,522	142	79	221	133	293	426
Gross total fair values	20,756	14,744	179	84	263	171	372	543
Offset (Note 22)					(202)			(202)
At 31 Dec 2018	20,756	14,744	179	84	61	171	372	341

For 2017, the bank had no derivatives.

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

Use of derivatives

We undertake derivative activity for two primary purposes: to create risk management solutions for clients and to manage and hedge our own risks.

Trading derivatives

Most of the group's derivative transactions relate to sales and trading activities. Sales activities include marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities principally includes risk management. Risk management activity is undertaken to manage the risks arising from client transactions, with the principal purpose of retaining client margin. Other derivatives classified as held for trading include non-qualifying hedging derivatives.

Hedge accounting derivatives

The group applies hedge accounting to manage interest rate risk and foreign exchange risk. The Report of the Directors Risk presents more details on how these risks arise and how they are managed by the group.

Fair value hedges

The group enters into fixed-for-floating-interest-rate swaps to manage the exposure to changes in fair value due to movements in market interest rates on certain fixed rate financial instruments which are not measured at fair value through profit or loss.

Hedging instrument by hedged risk

	Hedging Instrument					
	Notional amount ¹	Carrying amount			Balance sheet presentation	Change in fair value ²
		Assets	Liabilities			
	£m	£m	£m		£m	
Hedged risk						
Interest rate ³	8,762	63	278	Derivatives	(38)	
At 31 Dec 2018	8,762	63	278		(38)	

¹ The notional contract amounts of derivatives designated in qualifying hedge accounting relationships indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

² Used in effectiveness testing; comprising the full fair value change of the hedging instrument not excluding any component.

³ The hedged risk "interest rate" includes inflation risk.

Notes on the Financial Statements

Hedged item by hedged risk

Hedged risk	Hedged item					Ineffectiveness		
	Carrying amount		Accumulated fair value hedge adjustments included in carrying amount ²			Change in fair value ¹	Recognised in profit and loss	Profit and loss presentation
	Assets	Liabilities	Assets	Liabilities	Balance sheet presentation			
	£m	£m	£m	£m	£m	£m	£m	
					Financial assets designated and otherwise mandatorily measured at fair value through other comprehensive income		(2)	Net income from financial instruments held for trading or managed on a fair value basis
Interest rate ⁴	7,161	–	166	–	Deposits by banks ³	57		
	–	2,033	–	21		(21)		
At 31 Dec 2018	7,161	2,033	166	21		36	(2)	

¹ Used in effectiveness assessment; comprising amount attributable to the designated hedged risk that can be a risk component.

² The accumulated amount of fair value adjustments remaining in the statement of financial position for hedged items that have ceased to be adjusted for hedging gains and losses were liabilities of £1.3m for FVOCI.

³ The notional amount of non-dynamic fair value hedges is equal to GBP2,000m, of which the weighted-average maturity date is March 2027 and the weighted average swap rate is 1.45%. These hedges are all internal to HSBC Group and composed by internal funding between HSBC Holdings and HSBC UK.

⁴ The hedged risk "interest rate" includes inflation risk.

The hedged item is either the benchmark interest rate risk portion within the fixed rate of the hedged item or the full fixed rate and it is hedged for changes in fair value due to changes in the benchmark interest rate risk.

Sources of hedge ineffectiveness may arise from basis risk including but not limited to the discount rates used for calculating the fair value of derivatives, hedges using instruments with a non-zero fair value and notional and timing differences between the hedged items and hedging instruments.

For 2017, the group had no qualifying hedge accounting relationships.

The disclosures for the group are materially the same as the disclosures for the bank.

Cash flow hedges

The group's cash flow hedging instruments consist principally of interest rate swaps and cross-currency swaps that are used to manage the variability in future interest cash flows of non-trading financial assets and liabilities, arising due to changes in market interest rates and foreign-currency basis.

The group applies macro cash flow hedging for interest-rate risk exposures on portfolios of replenishing current and forecasted issuances of non-trading assets and liabilities that bear interest at variable rates, including rolling such instruments. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio of financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate cash flows representing both principal balances and interest cash flows across all portfolios are used to determine the effectiveness and ineffectiveness. Macro cash flow hedges are considered to be dynamic hedges.

The group also hedges the variability in future cash-flows on foreign-denominated financial assets and liabilities arising due to changes in foreign exchange market rates with cross-currency swaps, these are considered dynamic hedges.

Hedging instrument by hedged risk

Hedged risk	Notional amount ¹	Hedging Instrument			Change in fair value ²	Hedged Item	Change in fair value ³	Ineffectiveness	
		Carrying amount		Balance sheet presentation				Recognised in profit and loss	Profit and loss presentation
		Assets	Liabilities						
	£m	£m	£m		£m	£m	£m		
Foreign currency	2,222	5	79	Derivatives	(110)	(110)	–		
Interest rate	3,760	16	14	Derivatives	2	3	(1)		
At 31 Dec 2018	5,982	21	93		(108)	(107)	(1)	Net income from financial instruments held for trading or managed on a fair value basis	

¹ The notional contract amounts of derivatives designated in qualifying hedge accounting relationships indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

² Used in effectiveness testing; comprising the full fair value change of the hedging instrument not excluding any component.

³ Used in effectiveness assessment; comprising amount attributable to the designated hedged risk that can be a risk component.

Sources of hedge ineffectiveness may arise from basis risk, including but not limited to timing differences between the hedged items and hedging instruments and hedges using instruments with a non-zero fair value.

During the year to 31 December 2018, a loss of £1m (2017: £nil) was recognised due to hedge ineffectiveness.

For 2017, the group had no qualifying hedge accounting relationships.

The disclosures of the group is materially the same as the disclosures of the bank.

Reconciliation of equity and analysis of other comprehensive income by risk type

	Interest rate £m	Foreign Currency £m
Cash flow hedging reserve at 1 Jan 2018	–	–
Fair value gains/(losses)	3	(110)
Fair value (gains)/losses reclassified from the cash flow hedge reserve to the income statement in respect of:		
– hedged items that have affected profit or loss	(7)	91
Income taxes	6	–
Transfer in from HSBC Bank plc	(26)	(3)
Cash flow hedging reserve at 31 Dec 2018	(24)	(22)

11 Financial investments

Carrying amount of financial investments

	The group		The bank	
	2018 £m	2017 £m	2018 £m	2017 £m
Financial investments measured at fair value through other comprehensive income	13,203	N/A	13,203	N/A
– treasury and other eligible bills	1,286	N/A	1,286	N/A
– debt securities	11,917	N/A	11,917	N/A
Available for sale securities at fair value	N/A	13	N/A	13
– debt securities	N/A	13	N/A	13
At 31 Dec¹	13,203	13	13,203	13

¹ Categories of financial instruments are disclosed under IFRS 9 at 31 December 2018. These are not directly comparable with 31 December 2017, where the instruments were categorised in accordance with IAS 39.

12 Assets pledged, collateral received and assets transferred

Assets pledged

Financial assets pledged as collateral

	The group		The bank	
	2018 £m	2017 £m	2018 £m	2017 £m
Debt securities	4,324	–	4,324	–
Other	95	–	95	–
Assets pledged at 31 Dec	4,419	–	4,419	–

The amount of assets pledged to secure liabilities may be greater than the book value of assets utilised as collateral. For example, where assets are placed with a custodian or a settlement agent that has a floating charge over all the assets placed to secure any liabilities under settlement accounts.

These transactions are conducted under terms that are usual and customary to collateralised transactions including, where relevant, standard securities lending and borrowing, repurchase agreements and derivative margining. The group places both cash and non-cash collateral in relation to derivative transactions.

Financial assets pledged as collateral that the counterparty has the right to sell or repledge

	The group		The bank	
	2018 £m	2017 £m	2018 £m	2017 £m
Financial investments	2,299	–	2,299	–
At 31 Dec	2,299	–	2,299	–

Collateral received

The fair value of assets accepted as collateral, relating primarily to standard securities lending, reverse repurchase agreements and derivative margining, that the group is permitted to sell or repledge in the absence of default was £3,422m (2017: £nil) (the bank: 2018 £3,422m; 2017: £nil). The group is obliged to return equivalent securities. These transactions are conducted under terms that are usual and customary to standard securities lending, reverse repurchase agreements and derivative margining.

Assets transferred

The assets pledged include transfers to third parties that do not qualify for derecognition, notably secured borrowings such as debt securities held by counterparties as collateral under repurchase agreements and securities lent under securities lending agreements. For secured borrowings, the transferred asset collateral continues to be recognised in full and a related liability, reflecting the group's obligation to repurchase the assets for a fixed price at a future date is also recognised on the balance sheet. Where securities are swapped, the transferred asset continues to be recognised in full. There is no associated liability as the non-cash collateral received is not recognised on the balance sheet. The group is unable to use, sell or pledge the transferred assets for the duration of these transactions, and remains exposed to interest rate risk and credit risk on these pledged assets. The counterparty's recourse is not limited to the transferred assets.

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Transferred financial assets not qualifying for full derecognition and associated financial liabilities

	Carrying amount of:	
	Transferred assets	Associated liabilities
	£m	£m
The group		
At 31 Dec 2018		
Repurchase agreements	727	639
Securities lending agreements	1,572	—

For 2017, the group had no such transfers.

The bank		
At 31 Dec 2018		
	£m	£m
Repurchase agreements	727	639
Securities lending agreements	1,572	—

For 2017, the bank had no such transfers.

13 Interests in joint ventures

Interests in joint ventures

Vaultex UK Limited is a joint venture of the bank and the group. Vaultex UK Limited is incorporated in England and its principal activity is that of cash management services. At 31 December 2018, the group had a 50% interest in the £10m issued equity capital (2017: no interest). On 1 July 2018, HSBC Bank plc transferred its shareholding in Vaultex through the court approved ring-fencing transfer scheme as provided for in Part VII of the FSMA.

For further detail see Note 30.

14 Investments in subsidiaries

Principal subsidiaries of HSBC UK Bank plc

	Country of incorporation or registration	HSBC UK Bank plc's interest in equity capital %	Share class
HSBC Equipment Finance (UK) Limited	England and Wales	100.00	Ordinary £1
HSBC Invoice Finance (UK) Limited	England and Wales	100.00	Ordinary £1
HSBC Private Bank (UK) Limited	England and Wales	100.00	Ordinary £10
HSBC Trust Company (UK) Limited	England and Wales	100.00	Ordinary £5
Marks and Spencer Financial Services plc	England and Wales	100.00	Ordinary £1

All the above prepare their financial statements up to 31 December.

Details of all group subsidiaries, as required under Section 409 of the Companies Act 2006, are set out in Note 30. The principal country of operation is the same as the country of incorporation.

Transfer of the ring-fenced bank entities

On 1 July 2018, HSBC Bank plc transferred its shareholding in a number of entities, including those listed above and set out in Note 30 to HSBC UK Bank plc. These transfers were made through the court approved ring-fencing transfer scheme as provided for in Part VII of the FSMA. As a result of the transfer, the total assets including goodwill of the group increased by £234bn and the total liabilities increased by £212bn. The results of these entities from the date of transfer are included in the group results.

Impairment testing of investments in subsidiaries

At each reporting period end, HSBC UK Bank plc reviews investments in subsidiaries for indicators of impairment. An impairment is recognised when the carrying amount exceeds the recoverable amount for that investment.

The recoverable amount is the higher of the investment's fair value less costs of disposal and its value in use. The value in use is calculated by discounting management's cash flow projections for the investment.

- The cash flow projections for each investment are based on the latest approved plans and a long-term growth rate is used to extrapolate the cash flows in perpetuity.
- The growth rate reflects GDP and inflation and is based on the long-term average growth rates for the UK.
- The rate used to discount the cash flows is based on the cost of capital assigned to each investment, which is derived using a capital asset pricing model ('CAPM'). CAPM depends on a number of inputs reflecting financial and economic variables, including the risk-free rate and a premium to reflect the inherent risk of the business being evaluated. These variables are based on the market's assessment of the economic variables and management's judgement. The discount rates for each investment are refined to reflect the UK rate of inflation. In addition, for the purposes of testing investments for impairment, management supplements this process by comparing the discount rates derived using the internally generated CAPM, with cost of capital rates produced by external sources for businesses operating in similar markets.

No impairment was recognised as a result of the impairment test performed in 2018, and the bank had no investment in subsidiaries in 2017.

15 Structured entities

The group has no consolidated structured entities.

Unconsolidated structured entities

The term 'unconsolidated structured entities' refers to all structured entities not controlled by the group. The group enters into transactions with unconsolidated structured entities in the normal course of business to facilitate customer transactions and for specific investment opportunities.

The group's interest in unconsolidated structured entities consist of unit holdings in four funds managed by a third party within the wider HSBC Group. The groups unit holdings are held in order to facilitate customer transactions and are recognised as Other Assets with a carrying value and maximum exposure to loss as at 31 December 2018 of £0.2m. The total assets of the funds as at 31 December 2018 was £1.2bn. The group has no liabilities or commitments in respect of the funds.

In 2017 the group had no interests in unconsolidated structured entities.

16 Goodwill and intangible assets

	The group		The bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
Goodwill	3,285	–	223	–
Other intangible assets ^{1, 2}	525	–	495	–
At 31 Dec	3,810	–	718	–

¹ For 2018, the amortisation and impairment of intangible assets totalled for the group £64m(2017: £nil).

² Included within the group's other intangible assets is internally generated software with a net carrying value of £518m (2017: £nil).

For the group, an amount of £3,285m (2017: £nil) was transferred from HSBC Bank plc and its subsidiaries in respect of the businesses and subsidiaries transferred as part of the ring-fence implementation. There was no change to the amount during 2018, and no accumulated impairment losses recognised.

For the bank, an amount of £223m (2017: £nil) was transferred from HSBC Bank plc in respect of the businesses transferred as part of the ring-fence implementation. There was no change to the amount during 2018, and no accumulated impairment losses recognised.

Impairment testing

The group's impairment test in respect of goodwill allocated to each CGU is performed as at 1 July each year, with a review for indicators of impairment at 30 June and 31 December. At 31 December 2018, this review did not identify any indicators of impairment. As a result, no impairment tests have been performed as at 31 December 2018. For all CGUs, the annual test performed as at 1 July remains the latest impairment test and the disclosures given are as at 1 July. The testing at 1 July resulted in no impairment of goodwill.

Basis of the recoverable amount

The recoverable amount of all CGUs to which goodwill has been allocated was equal to its VIU at each respective testing date for 2018.

For each CGU, the VIU is calculated by discounting management's cash flow projections for the CGU.

Key assumptions in VIU calculation

Cash-generating unit	Annual Impairment Test 2018		
	Goodwill at: 1 Jul 2018	Discount rate	Nominal growth rate beyond initial cash flow projections
	£m	%	%
RBWM	1,686	7.9	3.8
CMB	1,239	9.7	3.8
GPB	360	9.4	3.8
Total	3,285		

Management's judgement in estimating the cash flows of a CGU

The cash flow projections for each CGU are based on the latest plans presented to the Board. For the goodwill impairment test conducted at 1 July 2018, management's cash flow projections until the end of 2022 were used.

Discount rate

The rate used to discount the cash flows is based on the cost of capital assigned to each CGU, which is derived using a CAPM. CAPM depends on a number of inputs reflecting financial and economic variables, including the risk-free rate and a premium to reflect the inherent risk of the business being evaluated. These variables are based on the market's assessment of the economic variables and management's judgement. The discount rates for each CGU are refined to reflect the rates of inflation for the countries within which the CGU operates. In addition, for the purposes of testing goodwill for impairment, management supplements this process by comparing the discount rates derived using the internally generated CAPM, with cost of capital rates produced by external sources for businesses operating in similar markets. In all periods, internal rates were adjusted to reflect the uncertainty of the cash flows used in the test.

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Nominal long-term growth rate

The long-term growth rate is used to extrapolate the cash flows in perpetuity. The growth rate reflects GDP and inflation for the countries within which the CGU operates or derives revenue from. The rates are based on 20-year forecast growth rates, as they represent an objective estimate of likely future trends.

Sensitivities of key assumptions in calculating VIU

At 1 July 2018, there were no CGUs deemed sensitive to reasonably possible changes in the key assumptions supporting the recoverable amount. In making an estimate of reasonably possible changes to assumptions, management considers the available evidence in respect of each input to the model. These include the external range of observable discount rates, historical performance against forecast and risks attaching to the key assumptions underlying cash flow projections.

17 Prepayments, accrued income and other assets

	The group		The bank	
	2018 £m	2017 £m	2018 £m	2017 £m
Prepayments and accrued income	650	—	636	—
Settlement accounts	56	—	268	—
Cash collateral and margin receivables	279	—	279	—
Endorsements and acceptances	86	—	86	—
Employee benefit assets (Note 4)	5,841	—	5,841	—
Other accounts	1,008	—	921	—
Property, plant and equipment	608	—	492	—
At 31 Dec	8,528	—	8,523	—

Prepayments, accrued income and other assets include £2,016m (2017: £nil) of financial assets, the majority of which are measured at amortised cost.

18 Accruals, deferred income and other liabilities

	The group		The bank	
	2018 £m	2017 £m	2018 £m	2017 £m
Accruals and deferred income	498	—	438	—
Settlement accounts	31	—	548	—
Cash collateral and margin payable	4	—	4	—
Endorsements and acceptances	86	—	86	—
Other liabilities	1,790	—	1,198	—
At 31 Dec	2,409	—	2,274	—

For the group, accruals, deferred income and other liabilities include £2,208m (2017: £nil), and for the bank £2,200m (2017: £nil) of financial liabilities, the majority of which are measured at amortised cost.

19 Provisions

The group	Restructuring costs	Legal proceedings and regulatory matters	Customer remediation	Other provisions	Total
	£m	£m	£m	£m	£m
Provisions (excluding contractual commitments)					
At 1 Jan 2018	—	—	—	—	—
Transfer from HSBC Bank plc and its subsidiaries	2	2	742	5	751
Additions	—	—	78	3	81
Amounts utilised	—	—	(283)	—	(283)
Unused amounts reversed	(2)	(1)	(13)	(2)	(18)
Unwinding of discounts	—	—	—	(1)	(1)
Other movements	—	(1)	16	—	15
At 31 Dec 2018	—	—	540	5	545
Contractual commitments¹					
At 1 Jan 2018	—	—	—	—	—
Transfer from HSBC Bank plc and its subsidiaries	—	—	—	—	72
Net change in expected credit loss provision	—	—	—	—	13
At 31 Dec 2018	—	—	—	—	85
Total Provisions					
At 31 Dec 2018	—	—	540	5	630

¹ Contractual commitments include the provision for contingent liabilities measured under IFRS 9 Financial Instruments in respect of financial guarantees and the expected credit loss provision on off-balance sheet guarantees and commitments.

The bank	Restructuring costs £m	Legal proceedings and regulatory matters £m	Customer remediation £m	Other provisions £m	Total £m
Provisions (excluding contractual commitments)					
At 1 Jan 2018	–	–	–	–	–
Transfer from HSBC Bank plc	2	–	615	5	622
Additions	–	–	18	2	20
Amounts utilised	–	–	(209)	–	(209)
Unused amounts reversed	(2)	–	(13)	(2)	(17)
Unwinding of discounts	–	–	–	(1)	(1)
Other movements	–	–	16	–	16
At 31 Dec 2018	–	–	427	4	431
Contractual commitments¹					
At 1 Jan 2018	–	–	–	–	–
Transfer from HSBC Bank plc	–	–	–	–	71
Net change in expected credit loss provision	–	–	–	–	13
At 31 Dec 2018	–	–	–	–	84
Total Provisions					
At 31 Dec 2018	–	–	–	–	515

¹ This line includes the provision for contingent liabilities measured under IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' in respect of financial guarantees and the expected credit loss provision on off-balance sheet guarantees and commitments.

Payment Protection Insurance

At 31 December 2018, £435m (2017: Nil) of the customer remediation provision relates to the estimated liability for redress in respect of the possible mis-selling of payment protection insurance ('PPI') policies in previous years. A PPI provision of £629m was transferred from HSBC Bank plc to HSBC UK Bank plc on 1 July 2018, of which £253m had been utilised as at 31 December 2018.

An increase in provisions of £59m was recognised during H2 2018, primarily reflecting an adjustment to expected future complaint volumes as a result of increased levels of observed complaints and of information requests during the year.

The estimated liability for redress is calculated on the basis of the total premiums paid by the customer plus simple interest of 8% per annum (or the rate inherent in the related loan product where higher). The basis for calculating the redress liability is the same for single premium and regular premium policies. Future estimated redress levels are based on the historically observed redress per policy.

A total of 5.4 million PPI policies have been sold since 2000, generating estimated revenues of £2.6bn at 2018. The gross written premiums on these policies was approximately £3.4bn. At 31 December 2018, the estimated total complaints expected to be received were 2.3 million, representing 42% of total policies sold. It is estimated that contact will be made with regard to 2.6 million policies, representing 49% of total policies sold. This estimate includes inbound complaints as well as the group's proactive contact exercise on certain policies ('outbound contact').

The following table details the cumulative number of complaints received at 31 December 2018 and the number of claims expected in the future:

Cumulative PPI complaints received to 31 December 2018 and future claims expected

	Cumulative actual to 31 Dec 2018	Future expected
Inbound complaints ('000s of policies) ¹	1,777	183
Outbound contact ('000s of policies)	685	–
Response rate to outbound contact	44%	n/a
Average uphold rate per claim ²	77%	83%
Average redress per claim (£)	2,046	2,347
Complaints to Financial Ombudsman Service ('FOS') ('000s of policies)	166	9
Average uphold rate per FOS claim	38%	32%

¹ Excludes invalid claims where complainant has not held a PPI policy and FOS complaints.

² Claims include inbound and responses to outbound contact, but exclude FOS complaints.

A 100,000 increase/decrease in the total inbound complaints would increase/decrease the redress provision by approximately £195m.

Legal proceedings and regulatory matters

Further details of legal proceedings and regulatory matters are set out in Note 27. Legal proceedings include civil court, arbitration or tribunal proceedings brought against HSBC companies (whether by way of claim or counterclaim), or civil disputes that may, if not settled, result in court, arbitration or tribunal proceedings. Regulatory matters refer to investigations, reviews and other actions carried out by, or in response to the actions of, regulatory or law enforcement agencies in connection with alleged wrongdoing.

20 Subordinated liabilities

Subordinated liabilities

	The group		The bank	
	2018 £m	2017 £m	2018 £m	2017 £m
At amortised cost	4,937	—	4,858	—
– subordinated liabilities ¹	4,937	—	4,858	—
At 31 Dec	4,937	—	4,858	—

¹ Includes £2bn of eligible debt issued to meet our Minimum requirement for own funds and Eligible Liabilities ('MREL') applicable from 1 January 2019.

Subordinated liabilities rank behind senior obligations and generally count towards the capital base of the group. Capital securities may be called and redeemed by the group subject to consent/ prior permission from the PRA.

The balance sheet amounts disclosed below are presented on an IFRS basis and do not reflect the amount that the instruments contribute to regulatory capital principally due to regulatory amortisation and regulatory eligibility limits.

Subordinated liabilities of the group

	First call date	Maturity date	Carrying amount	
			2018 £m	2017 £m
Capital instruments				
Tier 2 instruments				
£550m HSBC UK Bank plc Subordinated Floating Loan 2028 ^{1,6}	Jul 2023	Jul 2028	550	—
£1,000m HSBC UK Bank plc Subordinated Floating Loan 2030 ^{2,6}	Jul 2025	Jul 2030	1,000	—
£650m HSBC UK Bank plc Subordinated Floating Loan 2033 ^{3,6}	Sep 2028	Sep 2033	650	—
Other Tier 2 instruments each less than £100m ^{4,6}			79	—
\$840m HSBC UK Bank plc Subordinated Floating Loan 2028 ^{5,6}	Jul 2023	Jul 2028	658	—
Other instruments				
Subordinated loan instruments not eligible for inclusion in regulatory capital				
£1,000m HSBC UK Bank plc 3.2485% MREL eligible Subordinated Loan 2026	Nov 2025	Nov 2026	1,000	—
£1,000m HSBC UK Bank plc 3.4602% MREL eligible Subordinated Loan 2029	Aug 2028	Aug 2029	1,000	—
At 31 Dec			4,937	—

¹ The distribution rate is three month sterling Libor plus 1.51%.

² The distribution rate is three month sterling Libor plus 1.78%.

³ The distribution rate is three month sterling Libor plus 2.03%.

⁴ Two subordinated notes issued by Marks and Spencer Financial Services plc, £54m maturing 2026 and £25m maturing 2027.

⁵ The distribution rate is three month USD Libor plus 1.51%.

⁶ Transferred from HSBC Bank plc and its subsidiaries on 1 July 2018.

21 Maturity analysis of assets, liabilities and off-balance sheet commitments

The table on page 97 provides an analysis of consolidated total assets, liabilities and off-balance sheet commitments by residual contractual maturity at the balance sheet date. These balances are included in the maturity analysis as follows:

- Trading derivatives are included in the 'Due not more than 1 month' time bucket, because trading balances are typically held for short periods of time.
- Financial assets and liabilities with no contractual maturity (such as equity securities) are included in the 'Due over 5 years' time bucket. Undated or perpetual instruments are classified based on the contractual notice period which the counterparty of the instrument is entitled to give. Where there is no contractual notice period, undated or perpetual contracts are included in the 'Due over 5 years' time bucket.
- Non-financial assets and liabilities with no contractual maturity are included in the 'Due over 5 years' time bucket.
- Loan and other credit-related commitments are classified on the basis of the earliest date they can be drawn down.

Maturity analysis of assets, liabilities and off-balance sheet commitments

	Due not more than 1 month	Due over 1 month but not more than 3 months	Due over 3 months but not more than 6 months	Due over 6 months but not more than 9 months	Due over 9 months but not more than 1 year	Due over 1 year but not more than 2 years	Due over 2 years but not more than 5 years	Due over 5 years	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
The group									
Financial assets									
Cash and balances at central banks	33,193	–	–	–	–	–	–	–	33,193
Items in the course of collection from other banks	603	–	–	–	–	–	–	–	603
Financial assets designated or otherwise mandatorily measured at fair value	29	–	–	–	–	–	–	6	35
Derivatives	50	–	9	–	–	6	–	1	66
Loans and advances to banks	908	–	351	–	–	–	–	4	1,263
Loans and advances to customers	14,085	9,321	7,562	5,918	5,676	18,257	33,511	80,477	174,807
– personal	2,415	1,546	2,164	2,143	2,040	7,363	17,843	74,129	109,643
– corporate and commercial	10,917	7,566	5,173	3,622	3,396	10,627	15,163	6,167	62,631
– financial	753	209	225	153	240	267	505	181	2,533
Reverse repurchase agreements – non-trading	1,989	1,433	–	–	–	–	–	–	3,422
Financial investments	375	444	1,024	518	568	393	6,366	3,515	13,203
Accrued income and other financial assets	1,805	182	26	2	1	–	–	–	2,016
Total financial assets at 31 Dec 2018	53,037	11,380	8,972	6,438	6,245	18,656	39,877	84,003	228,608
Non-financial assets	–	–	–	–	–	–	–	10,331	10,331
Total assets at 31 Dec 2018	53,037	11,380	8,972	6,438	6,245	18,656	39,877	94,334	238,939
Off-balance sheet commitments received									
Loan and other credit-related	–	–	–	–	–	–	–	–	–
Financial liabilities									
Deposits by banks	1,018	9	–	–	–	–	–	–	1,027
Customer accounts ¹	200,036	2,103	1,023	692	528	312	134	9	204,837
– personal	128,872	873	816	657	477	297	122	7	132,121
– corporate and commercial	66,700	1,054	188	34	50	15	12	2	68,055
– financial	4,464	176	19	1	1	–	–	–	4,661
Repurchase agreements – non-trading	189	–	450	–	–	–	–	–	639
Items in the course of transmission to other banks	233	–	–	–	–	–	–	–	233
Derivatives	44	3	–	26	–	134	–	139	346
Accruals and other financial liabilities	1,671	399	14	–	–	–	–	94	2,178
Subordinated liabilities	–	–	–	–	–	–	–	4,937	4,937
Total financial liabilities at 31 Dec 2018	203,191	2,514	1,487	718	528	446	134	5,179	214,197
Non-financial liabilities	–	–	–	–	–	–	–	2,409	2,409
Total liabilities at 31 Dec 2018	203,191	2,514	1,487	718	528	446	134	7,588	216,606
Off-balance sheet commitments given									
Loan and other credit-related	69,570	13	–	42	–	78	59	44	69,806
– personal	39,389	–	–	–	–	–	–	–	39,389
– corporate and commercial	29,895	13	–	42	–	78	59	44	30,131
– financial	286	–	–	–	–	–	–	–	286

1. 'Customers accounts' includes £110,226m (2017: £nil) insured by guarantee schemes

At 31 December 2017, the group had Financial investments of £13m with a fixed maturity date of 22 July 2018, and Loans and advances to banks of £2m due within one month.

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Maturity analysis of assets, liabilities and off-balance sheet commitments

	Due not more than 1 month	Due over 1 month but not more than 3 months	Due over 3 months but not more than 6 months	Due over 6 months but not more than 9 months	Due over 9 months but not more than 1 year	Due over 1 year but not more than 2 years	Due over 2 years but not more than 5 years	Due over 5 years	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
The bank									
Financial assets									
Cash and balances at central banks	33,187	–	–	–	–	–	–	–	33,187
Items in the course of collection from other banks	457	–	–	–	–	–	–	–	457
Trading assets	–	–	–	–	–	–	–	–	–
Financial assets designated or otherwise mandatorily measured at fair value	29	–	–	–	–	–	–	6	35
Derivatives	45	–	9	–	–	6	–	1	61
Loans and advances to banks	1,041	445	1,012	118	121	418	697	31	3,883
Loans and advances to customers	14,006	6,634	9,228	5,485	5,259	17,200	29,427	78,611	165,850
– personal	1,652	1,149	1,739	1,722	1,714	6,274	15,636	72,839	102,725
– corporate and commercial	10,338	3,397	4,353	3,433	3,144	10,021	12,498	5,538	52,722
– financial	2,016	2,088	3,136	330	401	905	1,293	234	10,403
Reverse repurchase agreements – non-trading	1,989	1,433	–	–	–	–	–	–	3,422
Financial investments	375	444	1,024	518	568	393	6,367	3,514	13,203
Accrued income and other financial assets	2,025	76	26	2	1	–	–	–	2,130
Total financial assets at 31 Dec 2018	53,154	9,032	11,299	6,123	5,949	18,017	36,491	82,163	222,228
Non-financial assets	–	–	–	–	–	–	–	9,023	9,023
Total assets at 31 Dec 2018	53,154	9,032	11,299	6,123	5,949	18,017	36,491	91,186	231,251
Financial liabilities									
Deposits by banks	3,956	39	115	50	50	25	30	–	4,265
Customer accounts ¹	193,037	1,579	810	555	509	264	104	–	196,858
– personal	123,626	480	643	529	465	257	100	–	126,100
– corporate and commercial	65,326	923	148	25	43	7	4	–	66,476
– financial	4,085	176	19	1	1	–	–	–	4,282
Repurchase agreements – non-trading	189	–	450	–	–	–	–	–	639
Items in the course of transmission to other banks	225	–	–	–	–	–	–	–	225
Derivatives	38	3	–	26	–	134	–	140	341
Accruals and other financial liabilities	2,015	139	16	–	–	–	–	–	2,170
Subordinated liabilities	–	–	–	–	–	–	–	4,858	4,858
Total financial liabilities at 31 Dec 2018	199,460	1,760	1,391	631	559	423	134	4,998	209,356
Non-financial liabilities	–	–	–	–	–	–	–	2,129	2,129
Total liabilities at 31 Dec 2018	199,460	1,760	1,391	631	559	423	134	7,127	211,485
Off-balance sheet commitments given									
Loan and other credit-related commitments	55,505	–	–	–	–	–	–	–	55,505
– personal	28,009	–	–	–	–	–	–	–	28,009
– corporate and commercial	27,264	–	–	–	–	–	–	–	27,264
– financial	232	–	–	–	–	–	–	–	232

1. 'Customers accounts' includes £107,993m (2017: £nil) insured by guarantee schemes

At 31 December 2017, the bank had Financial investments of £13m with a fixed maturity date of 22 July 2018, and Loans and advances to banks of £2m due within one month.

22 Offsetting of financial assets and financial liabilities

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

- the counterparty has an offsetting exposure with the group 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 not otherwise satisfied; and
- in the case of derivatives and reverse repurchase/repurchase, stock borrowing/lending and similar agreements, cash and non-cash collateral has been received/pledged.

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

	Amounts subject to enforceable netting arrangements									
	Amounts not set off in the balance sheet								Amounts not subject to enforceable netting arrangements ⁴	Total
	Gross amounts	Amounts offset	Net amounts in the balance sheet	Financial instruments	Non-cash collateral	Cash collateral	Net amount			
£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	
Financial assets										
Derivatives ¹ (Note 10)	263	(202)	61	(22)	(25)	(4)	10	5	66	
Reverse repos, stock borrowing and similar agreements classified as:										
– non-trading assets	3,422	–	3,422	–	(3,422)	–	–	–	3,422	
Loans and advances to customers ²	7,768	(2,021)	5,747	(4,177)	–	–	1,570	–	5,747	
At 31 Dec 2018	11,453	(2,223)	9,230	(4,199)	(3,447)	(4)	1,580	5	9,235	
Financial liabilities										
Derivatives ¹ (Note 10)	543	(202)	341	(22)	–	(95)	224	5	346	
Repos, stock lending and similar agreements classified as:										
– non-trading liabilities	639	–	639	–	(639)	–	–	–	639	
Customer accounts ³	7,311	(2,021)	5,290	(4,177)	–	–	1,113	1	5,291	
At 31 Dec 2018	8,493	(2,223)	6,270	(4,199)	(639)	(95)	1,337	6	6,276	

¹ At 31 December 2018, the amount of cash margin paid that had been offset against the gross derivatives liabilities was £141m (2017: Nil).

² At 31 December 2018, the total amount of 'Loans and advances to customers' recognised on the balance sheet was £174,807m (2017: £nil) of which £5,747m (2017: £nil) was subject to offsetting.

³ At 31 December 2018, the total amount of 'Customer accounts' recognised on the balance sheet was £204,837m (2017: £nil) of which £5,290m (2017: £nil) was subject to offsetting.

⁴ These exposures continue to be secured by financial collateral, but we may not have sought or been able to obtain a legal opinion evidencing enforceability of the right of offset.

For 2017, the group had no amounts subject to enforceable netting arrangements.

23 Called up share capital and other equity instruments

Called up share capital and share premium

HSBC UK Bank plc ordinary shares of £1.00 each, issued and fully paid

	2018		2017	
	Number	£m	Number	£m
At 1 Jan and 31 Dec	50,002	–	50,001	–

HSBC UK Bank plc share premium

	2018	2017
	£m	£m
At 31 Dec	9,015	15

Total called up share capital and share premium

	2018	2017
	£m	£m
At 31 Dec	9,015	15

On 1 July 2018, the bank issued one ordinary share of £1 in exchange for a consideration of £9,000m. On 30 May 2017, the bank issued one ordinary share of £1 in exchange for a consideration of £15m.

Other equity instruments

HSBC UK Bank plc additional tier 1 instruments

	2018	2017
	£m	£m
£1,096m Undated Subordinated Additional Tier 1 instrument issued 2014 (Callable December 2019 onwards)	1,096	–
£1,100m Undated Subordinated Additional Tier 1 instrument issued 2014 (Callable December 2024 onwards)	1,100	–
At 31 Dec	2,196	–

The bank has issued capital instruments that are included in the group's capital base as fully CRD IV compliant additional tier 1 capital.

Interest on these instruments will be due and payable only at the sole discretion of the bank, and the bank has sole and absolute discretion at all times and for any reason to cancel (in whole or in part) any interest payment that would otherwise be payable on any date. There are limitations on the payment of principal, interest or other amounts if such payments are prohibited under UK banking regulations, or other requirements, if the bank has insufficient distributable items or if the bank fails to satisfy the solvency condition as defined in the instruments terms.

The instruments are undated and are repayable, at the option of the bank, in whole at the initial call date, or on any Interest Payment Date after the initial call date. In addition, the instruments are repayable at the option of the bank in whole for certain regulatory or tax reasons. Any repayments require the prior consent of the Prudential Regulation Authority. These instruments rank *pari passu* with the

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bank's most senior class or classes of issued preference shares and therefore ahead of ordinary shares. These instruments will be written down in whole, together with any accrued but unpaid interest if either the group's solo or consolidated Common Equity Tier 1 Capital Ratio falls below 7.00%.

24 Contingent liabilities, contractual commitments and guarantees

	The group		The bank	
	2018 £m	2017 £m	2018 £m	2017 £m
Guarantees and other contingent liabilities:				
– Financial guarantees contracts	1,284	–	1,263	–
– Performance and other guarantees	2,220	–	2,220	–
At 31 Dec	3,504	–	3,483	–
Commitments:				
– Documentary credits and short-term trade-related transactions	83	–	83	–
– Forward asset purchases and forward deposits placed	248	–	–	–
– Standby facilities, credit lines and other commitments to lend	69,475	–	55,422	–
At 31 Dec	69,806	–	55,505	–

¹ 'Financial guarantees' to which the impairment requirements of IFRS 9 are applied have been presented separately from other guarantees to align with credit risk disclosures.

The above table discloses the nominal principal amounts, which represents the maximum amounts at risk should the contracts be fully drawn upon and clients default. As a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not indicative of future liquidity requirements.

The expected credit loss provision relating to guarantees and commitments under IFRS 9 is disclosed in Note 19.

Contingent liabilities arising from legal proceedings, regulatory and other matters against group companies are disclosed in Note 27

Financial Services Compensation Scheme

The Financial Services Compensation Scheme ('FSCS') has provided compensation to consumers following the collapse of a number of deposit takers. The compensation paid out to consumers was funded through loans from HM Treasury which have now been repaid (2017: £4.7bn). HSBC UK could be liable to pay a proportion of any future amounts that the FSCS borrows from HM Treasury. The ultimate FSCS levy to the industry as a result of a collapse cannot currently be estimated reliably, as it is dependent on various uncertain factors, including the potential recoveries of assets by the FSCS and changes in the level of protected deposits and the population of FSCS members at the time.

Guarantees

	The group				The bank			
	At 31 Dec 2018		At 31 Dec 2017		At 31 Dec 2018		At 31 Dec 2017	
	In favour of third parties £m	By the group in favour of other Group entities £m	In favour of third parties £m	By the group in favour of other Group entities £m	In favour of third parties £m	By the bank in favour of other Group entities £m	In favour of third parties £m	By the bank in favour of other Group entities £m
Financial guarantees ¹	1,284	–	–	–	1,263	–	–	–
Performance and other guarantees	2,220	–	–	–	2,220	–	–	–

¹ Financial guarantees contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due, in accordance with the original or modified terms of a debt instrument. The amounts in the above table are nominal principal amounts.

The group provides guarantees and similar undertakings on behalf of third-party customers. These guarantees are generally provided in the normal course of the group's banking businesses.

25 Lease commitments

Operating lease commitments

At 31 December 2018, future minimum lease payments under non-cancellable operating leases for land, buildings and equipment were £310m (2017: £nil).

Finance lease receivables

The group leases a variety of assets to third parties under finance leases, including transport assets, property and general plant and machinery. At the end of lease terms, assets may be sold to third parties or leased for further terms. Rentals are calculated to recover the cost of assets less their residual value, and earn finance income.

	2018			2017		
	Total future minimum payments	Unearned finance income	Present Value	Total future minimum payments	Unearned finance income	Present Value
	£m	£m	£m	£m	£m	£m
Lease receivables						
- No later than one year	588	(35)	553	-	-	-
- Later than one year and no later than 5 years	2,716	(155)	2,561	-	-	-
- Later than 5 years	707	(52)	655	-	-	-
At 31 Dec	4,011	(242)	3,769	-	-	-

26 Segmental Analysis

Significant revenue items by business segment - (gains)/losses

	RBWM £m	CMB £m	GB&M £m	GPB £m	Corporate Centre £m	Total £m
31 Dec 2018						
Reported revenue	1,766	1,383	72	78	58	3,357
Significant revenue items	-	(5)	-	-	-	(5)
- customer redress programmes	-	(5)	-	-	-	(5)
Adjusted revenue	1,766	1,378	72	78	58	3,352

The 2017 profit before tax was not presented on a segmental basis as banking activities had not commenced.

Significant cost items by business segment - (recoveries)/charges

	RBWM £m	CMB £m	GB&M £m	GPB £m	Corporate Centre £m	Total £m
31 Dec 2018						
Reported operating expenses	(1,186)	(518)	(69)	(54)	(161)	(1,988)
Significant cost items	61	(12)	-	-	191	240
- costs of structural reform	1	2	-	-	11	14
- customer redress programmes	60	(14)	-	-	-	46
- guaranteed minimum pension benefits equalisation	-	-	-	-	187	187
- other	-	-	-	-	(7)	(7)
Adjusted operating expenses	(1,125)	(530)	(69)	(54)	30	(1,748)

The 2017 profit before tax was not presented on a segmental basis as banking activities had not commenced.

Net impact on profit before tax by business segment

	RBWM £m	CMB £m	GB&M £m	GPB £m	Corporate Centre £m	Total £m
31 Dec 2018						
Reported profit/(loss) before tax	416	720	3	28	(103)	1,064
Net impact on reported profit and loss	61	(17)	-	-	191	235
- significant revenue items	-	(5)	-	-	-	(5)
- significant cost items	61	(12)	-	-	191	240
Adjusted profit before tax	477	703	3	28	88	1,299

The 2017 profit before tax was not presented on a segmental basis as banking activities had not commenced.

Notes on the Financial Statements

Adjusted profit for the year

	RBWM	CMB	GB&M	GPB	Corporate Centre	Total
	£m	£m	£m	£m	£m	£m
31 Dec 2018						
Net interest income	1,391	979	(3)	57	28	2,452
Net fee income	341	378	(98)	14	14	649
Net operating income before change in expected credit losses and other credit impairment charges	22	7	173	1	(5)	198
Other income	12	14	–	6	21	53
Net operating income before change in expected credit losses and other credit impairment charges	1,766	1,378	72	78	58	3,352
– external	1,747	1,365	74	78	88	3,352
– inter-segment	19	13	(2)	–	(30)	–
Change in expected credit losses and other credit impairment charges	(164)	(145)	–	4	–	(305)
Net operating income	1,602	1,233	72	82	58	3,047
Total operating expenses	(1,125)	(530)	(69)	(54)	30	(1,748)
– employee compensation and benefits	(304)	(167)	(5)	(21)	72	(425)
– general and administrative expenses	(816)	(354)	(64)	(33)	54	(1,213)
– depreciation and impairment of property, plant and equipment	–	(9)	–	–	(37)	(46)
– amortisation and impairment of intangible assets	(5)	–	–	–	(59)	(64)
Operating profit	477	703	3	28	88	1,299
Adjusted profit before tax	477	703	3	28	88	1,299
	%	%	%	%	%	%
Cost efficiency ratio	63.7	38.5	95.8	69.2	(51.7)	52.1

The 2017 profit before tax was not presented on a segmental basis as banking activities had not commenced.

Balance sheet information by global business as at 31 Dec 2018

	RBWM	CMB	GB&M	GPB	Corporate Centre	Total
	£m	£m	£m	£m	£m	£m
Loans and advances to customers	106,609	63,302	–	4,269	627	174,807
Customer accounts	128,409	71,411	–	5,338	(321)	204,837

The 2017 balance sheet was not presented on a segmental basis as banking activities had not commenced.

27 Legal proceedings and regulatory matters

HSBC UK Bank plc and its affiliates ('the group') are party to legal proceedings and regulatory matters in a number of jurisdictions arising out of its normal business operations. Apart from the matters described below, the group considers that none of these matters are material. The recognition of provisions is determined in accordance with the accounting policies set out in Note 1 of the Annual Report and Accounts 2018. While the outcome of legal proceedings and regulatory matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of these matters at 31 December 2018 (see Note 19). Where an individual provision is material, the fact that a provision has been made is stated and quantified, except to the extent doing so would be seriously prejudicial. Any provision recognised does not constitute an admission of wrongdoing or legal liability. It is not practicable to provide an aggregate estimate of potential liability for our legal proceedings and regulatory matters as a class of contingent liabilities.

Anti-money laundering and sanctions-related matters

In December 2012, among other agreements, HSBC Holdings plc ('HSBC Holdings') agreed to an undertaking with the UK Financial Conduct Authority ('FCA') and consented to a cease-and-desist order with the FRB, both of which contained certain forward-looking AML and sanctions-related obligations. HSBC also agreed to retain an independent compliance monitor (who is, for FCA purposes, a 'Skilled Person' under section 166 of the Financial Services and Markets Act and, for FRB purposes, an 'Independent Consultant') to produce periodic assessments of the Group's AML and sanctions compliance programme (the 'Skilled Person/Independent Consultant'). In December 2012, HSBC Holdings also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions. The Skilled Person/Independent Consultant will continue to conduct country reviews and provide periodic reports for a period of time at the FCA's and FRB's discretion. The role of the Skilled Person/Independent Consultant is discussed on page 26.

Through his country-level reviews, the Skilled Person/Independent Consultant has identified potential AML and sanctions compliance issues that the HSBC Group is reviewing further with the FRB and/or FCA. The FCA is also conducting an investigation into HSBC Bank plc's compliance with UK money laundering regulations and financial crime systems and controls requirements. HSBC UK is also cooperating with this investigation.

Based on the facts currently known, it is not practicable at this time for HSBC UK to predict the resolution of these matters, including the timing or any possible impact on HSBC UK, which could be significant.

Foreign exchange related investigation

In January 2018, HSBC Holdings entered into a three-year deferred prosecution agreement with the Criminal Division of the DoJ (the 'FX DPA'), regarding fraudulent conduct in connection with two particular transactions in 2010 and 2011. This concluded the DoJ's investigation into HSBC Group's historical foreign exchange activities. Under the terms of the FX DPA, the HSBC Group has a number of

ongoing obligations, including implementing enhancements to its internal controls and procedures in its Global Markets business, which will be the subject of annual reports to the DoJ.

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

Based on the facts currently known, it is not practicable at this time for HSBC UK to predict the resolution of these matters, including the timing or any possible impact on HSBC UK, which could be significant.

Film finance litigation

In July and November 2015, respectively, two actions were brought by individuals against HSBC Private Bank (UK) Limited ('PBGB') in the High Court of England and Wales seeking damages on various alleged grounds, including breach to the claimants, in connection with their participation in certain Ingenious film finance schemes. These actions are ongoing.

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

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

Based on the facts currently known, it is not practicable at this time for HSBC UK to predict the resolution of these matters, including the timing or any possible aggregate impact on HSBC UK, which could be significant.

Mossack Fonseca & Co.

A number of HSBC companies have received requests for information from various tax administration or regulatory authorities relating to Mossack Fonseca & Co. The HSBC companies are cooperating with the relevant authorities.

Based on the facts currently known, it is not practicable at this time for HSBC UK to predict the resolution of these matters, including the timing or any possible impact on HSBC UK, which could be significant.

28 Related party transactions

The immediate parent company of the group is HSBC UK Holdings Limited and the ultimate parent company is HSBC Holdings plc. Both are incorporated in England.

Copies of these financial statements may be obtained from the following address:

HSBC Holdings plc
8 Canada Square
London E14 5HQ

The group's related parties include the parent, fellow subsidiaries, joint ventures, post-employment benefit plans for HSBC employees, Key Management Personnel ('KMP') of the bank and its ultimate parent company, HSBC Holdings plc, close family members of KMP and entities which are controlled, jointly controlled or significantly influenced by KMP or their close family members.

Particulars of transactions between the group and its related parties are tabulated below in accordance with IAS 24 'Related party disclosures'. The disclosure of the year-end balance and the highest amounts outstanding during the year are considered to be the most meaningful information to represent the amount of the transactions and outstanding balances during the year.

Key Management Personnel

The KMP of the bank are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the bank and the group, and include the Directors of the bank, and directors and certain Group Managing Directors of HSBC Holdings plc. The emoluments of those KMP who are not directors of the bank are paid by other Group companies who make no recharge to the bank. It is not possible to make a reasonable apportionment of their emoluments in respect of the bank. Accordingly, no emoluments in respect of these KMP are included in the following disclosure.

The table below represents the compensation for Directors of the bank in exchange for services rendered to the bank for the period they served during the year.

Compensation of Key Management Personnel

	2018 £000	2017 £000
Short-term employee benefits	2,875	—
Post-employment benefits	—	—
Other long-term employee benefits	120	—
Share-based payments	423	—
Year ended 31 Dec¹	3,418	—

¹ During the first six months of 2018 the banks' Executive Directors provided services to other companies within the HSBC Group and their services to the bank were incidental. Therefore the Executive Directors remuneration disclosed represents the period from 1 July to 31 December 2018.

Notes on the Financial Statements

Transactions and balances during the year with Key Management Personnel¹

	2018		2017	
	Balance at 31 Dec ²	Highest amounts outstanding during year ³	Balance at 31 Dec	Highest amounts outstanding during year
	£m	£m	£m	£m
Advances and credits	11	12	—	—
Guarantees	—	—	—	—
Deposits	27	50	—	—

¹ Includes close family members and entities which are controlled or jointly controlled by KMP or their close family members.

² Exchange rates applied for non-GBP amounts is as at 31 December 2018.

³ Exchange rates applied for non-GBP amounts is the average for the year.

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

In addition to the requirements of IAS 24, particulars of advances (loans and quasi-loans), credits and guarantees entered into by the bank and its subsidiaries with Directors of the bank are required to be disclosed pursuant to section 413 of the Companies Act 2006. Under the Companies Act, there is no requirement to disclose transactions with other KMP.

Transactions with Directors: advances, credits and guarantees (Companies Act 2006)

	2018	2017
	Balance at 31 Dec	Balance at 31 Dec
	£000	£000
Loans	5,361	—
Guarantees	—	—

Other related parties

Transactions and balances during the year with KMP of the bank's ultimate parent company^{1,2}

	2018		2017	
	Balance at 31 Dec ³	Highest amounts outstanding during year ⁴	Balance at 31 Dec	Highest amounts outstanding during year
	£m	£m	£m	£m
Advances and credits	12	12	—	—
Guarantees	—	—	—	—
Deposits	—	—	—	—

¹ Excludes those who are also KMP of the bank

² Includes close family members and entities which are controlled or jointly controlled by the KMP or their close family members.

³ Exchange rates applied for non-GBP amounts is as at 31 December 2018.

⁴ Exchange rates applied for non-GBP amounts is the average for the year.

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

Transactions and balances during the year with the joint venture

	2018		2017	
	Balance at 31 Dec	Highest balance during the year	Balance at 31 Dec	Highest balance during the year
	£m	£m	£m	£m
Unsubordinated amounts due from the joint venture	90	100	—	—
Amounts due to joint ventures	17	17	—	—
Guarantees and commitments	400	480	—	—

The group provides certain banking and financial services to its joint venture, including loans, overdrafts, interest and non-interest-bearing deposits and current accounts. Details of the interest in the joint venture are given in Note 13.

The group's transactions and balances during the year with HSBC Holdings plc and subsidiaries of HSBC Holdings plc

	2018				2017			
	Due to/from HSBC Holdings plc		Due to/from subsidiaries of HSBC Holdings plc		Due to/from HSBC Holdings plc		Due to/from subsidiaries of HSBC Holdings plc	
	31 Dec £m	Highest balance £m	31 Dec £m	Highest balance £m	31 Dec £m	Highest balance £m	31 Dec £m	Highest balance £m
Assets								
Derivatives	-	-	27	38	-	-	-	-
Loans and advances to banks	-	-	802	920	-	-	2	15
Loans and advances to customers	-	-	-	177	-	-	-	-
Other assets	8	8	416	1,842	-	-	-	-
Total related party assets at 31 Dec	8	8	1,245	2,977	-	-	2	15
Liabilities								
Deposits by banks	-	-	220	846	-	-	-	-
Customer accounts	-	784	1	61	-	-	-	-
Derivatives	-	-	211	224	-	-	-	-
Subordinated liabilities	79	79	4,858	4,859	-	-	-	-
Total related party liabilities at 31 Dec	79	863	5,290	5,990	-	-	-	-

	Due to/from HSBC Holdings plc		Due to/from subsidiaries of HSBC Holdings plc	
	2018 £m	2017 £m	2018 £m	2017 £m
	Income statement			
Interest income	-	-	(3)	-
Interest expense	4	-	59	-
Fee income	-	-	14	-
Fee expense	-	-	25	-
Other operating income	4	-	15	-
General and administrative expenses	74	-	894	-

The above outstanding balances arose in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

All costs relating to the set-up of HSBC UK Bank plc up to the date of legal separation were incurred by HSBC Bank plc. These included directors' emoluments and auditors' remuneration.

The bank's transactions and balances during the year with HSBC UK Bank plc subsidiaries, HSBC Holdings plc and subsidiaries of HSBC Holdings plc

	2018						2017					
	Due to/from subsidiaries of HSBC UK Bank plc subsidiaries		Due to/from HSBC Holdings plc		Due to/from subsidiaries of HSBC Holdings plc		Due to/from subsidiaries of HSBC UK Bank plc subsidiaries		Due to/from HSBC Holdings plc		Due to/from subsidiaries of HSBC Holdings plc	
	31 Dec £m	Highest balance £m	31 Dec £m	Highest balance £m	31 Dec £m	Highest balance £m	31 Dec £m	Highest balance £m	31 Dec £m	Highest balance £m	31 Dec £m	Highest balance £m
Assets												
Derivatives	-	-	-	-	24	37	-	-	-	-	-	-
Loans and advances to banks	2,729	2,729	-	-	706	913	-	-	-	-	2	15
Loans and advances to customers	8,005	8,005	-	-	-	-	-	-	-	-	-	-
Other assets	2,134	2,134	6	7	412	1,873	-	-	-	-	-	-
Total related party assets at 31 Dec	12,868	12,868	6	7	1,142	2,823	-	-	-	-	2	15
Liabilities												
Deposits by banks	3,238	3,385	-	-	220	846	-	-	-	-	-	-
Customer accounts	357	357	-	784	1	1	-	-	-	-	-	-
Derivatives	-	-	-	-	209	217	-	-	-	-	-	-
Subordinated liabilities	-	-	-	-	4,858	4,859	-	-	-	-	-	-
Total related party liabilities at 31 Dec	3,595	3,742	-	784	5,288	5,923	-	-	-	-	-	-

The above outstanding balances arose in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

Post-employment benefit plans

The group's pension funds had placed deposits of £104m (2017: £nil) with its banking subsidiaries.

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

29 Events after the balance sheet date

These accounts were approved by the Board of Directors on 18 February 2019 and authorised for issue.

HSBC UK considered the events related to the process of UK withdrawal from the European Union that occurred between the 31 December 2018 and the date when the financial statements were authorised for issue, and concluded that no adjustments to the financial statements were required.

30 HSBC UK Bank plc's subsidiaries and joint ventures

In accordance with section 409 of the Companies Act 2006 a list of HSBC UK Bank plc subsidiaries and joint ventures, the registered office address and the effective percentage of equity owned at 31 December 2018 is disclosed below.

Unless otherwise stated, the share capital comprises ordinary or common shares which are held by HSBC UK Bank plc subsidiaries. The ownership percentage is provided for each undertaking. The undertakings below are consolidated by HSBC UK Bank plc unless otherwise indicated.

Subsidiaries

The undertakings below are consolidated by HSBC UK Bank plc.

Subsidiaries	% of share class held by immediate parent company (or by HSBC UK Bank plc where this varies)	Footnotes
Assetfinance December (F) Limited	100.00	2
Assetfinance June (D) Limited	100.00	2
Assetfinance March (D) Limited	100.00	2
Assetfinance September (G) Limited	100.00	2
B&Q Financial Services Limited	100.00	1, 3
Canada Square Nominees (UK) Limited	100.00	1, 2
HSBC Branch Nominee (UK) Limited	100.00	1, 2
HSBC Client Share Offer Nominee (UK) Limited	100.00	1, 2
HSBC Equipment Finance (UK) Limited	100.00	1, 2
HSBC Executor & Trustee Company (UK) Limited	100.00	2
HSBC Finance Limited	100.00	1, 2
HSBC Invoice Finance (UK) Limited	100.00	1, 4
HSBC Private Bank (UK) Limited	100.00	1, 2
HSBC Stockbrokers Nominee (UK) Limited	100.00	1, 2
HSBC Trust Company (UK) Limited	100.00	1, 2
HSBC UK Client Nominee Limited	100.00	1, 2
HSBC Wealth Client Nominee Limited	100.00	1, 2
John Lewis Financial Services Limited	100.00	1, 2
Kings Meadow Nominees Limited	100.00	5
Marks and Spencer Financial Services plc	100.00	1, 5
Marks and Spencer Savings and Investments Limited	100.00	1, 5
Marks and Spencer Unit Trust Management Limited	100.00	1, 5
Midland Bank (Branch Nominees) Limited	100.00	1, 2
Midland Nominees Limited	100.00	2
St Cross Trustees Limited	100.00	2
Turnsonic (Nominees) Limited	100.00	2

Joint Ventures

The undertakings below are Joint Ventures and equity accounted.

Joint Ventures	% of share class held by immediate parent company (or by HSBC UK Bank plc where this varies)	Footnotes
Vaultex UK Limited	50.00	2, 6

Footnotes

¹ Directly held by HSBC UK Bank plc

Registered Offices

² 8 Canada Square, London, United Kingdom, E14 5HQ

³ Camden House West, The Parade, Birmingham, United Kingdom, B1 3PY

⁴ 21 Farncombe Road, Worthing, United Kingdom, BN11 2BW

⁵ Kings Meadow Chester Business Park, Chester, United Kingdom, CH99 9FB

⁶ All Saints Triangle, Caledonian Road, London, N1 9UT

HSBC UK Bank plc

1 Centenary Square
Birmingham B1 1HQ
United Kingdom
Telephone: 03456 040 626
www.hsbc.co.uk

**(B) THE ISSUER'S AUDITED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31
DECEMBER 2017**

HSBC UK Bank plc (formerly HSBC UK RFB Limited)

Annual Report and Accounts 2017



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Presentation of information

This document comprises the *Annual Report and Accounts 2017* for HSBC UK Bank plc ('the Company'). 'We', 'us' and 'our' refer to HSBC UK Bank plc. It contains the Strategic Report, the Report of the Directors, the Statement of Directors' Responsibilities and Financial Statements, together with the Independent Auditors' Report, as required by the UK Companies Act 2006. References to 'HSBC', 'HSBC Group' or 'the Group' within this document mean HSBC Holdings plc together with its subsidiaries.

HSBC UK Bank plc's obligations under the Capital Requirements Country-by-Country Reporting Regulations 2013 will be met by HSBC Holdings plc which publishes annually the information required on a consolidated basis. HSBC Holdings plc will publish this information in respect of the year ended 31 December 2017 by 31 December 2018 on HSBC's website: www.hsbc.com.

All narrative disclosures, tables and graphs within the Strategic Report and Report of the Directors are unaudited unless otherwise stated.

Our reporting currency is £ sterling.

The Company was incorporated on 23 December 2015. Prior period comparatives cover the period from incorporation to 31 December 2016.

Principal activities

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

To meet these requirements, HSBC's ring-fenced bank ('RFB'), named HSBC UK Bank plc, was set up on 23 December 2015, to hold the qualifying components of HSBC Bank plc's UK Retail Banking and Wealth Management ('RBWM'), Commercial Banking ('CMB') and Global Private Banking ('GPB') businesses. The UK Global Banking and Markets ('GB&M') business and current overseas subsidiaries and branches will remain in HSBC Bank plc, which will become HSBC's NRFB.

Principal place of business

The Company is incorporated and domiciled in England and Wales. Its registered office is 8, Canada Square London E14 5HQ. The Company is a wholly owned subsidiary of HSBC UK Holdings Limited. The ultimate holding company is HSBC Holdings plc.

Business review

HSBC UK Bank plc is expected to become HSBC's ring-fenced bank and to commence trading on 1 July 2018. In preparation for this, the following activities took place in 2017:

- In January 2017, HSBC UK Holdings Limited was incorporated and in March 2017 HSBC UK Bank plc was transferred from HSBC Holdings plc to this new intermediate holding company;
- In May 2017, the Company issued one ordinary share of £1 in exchange for a consideration of £14.95m, and on 26 July 2017 it invested £12.9m of the cash received in UK treasury gilts;
- In July 2017, the Company was granted a restricted banking licence from its regulators prior to the satisfaction of the Prudential Regulation Authority ('PRA') and Financial Conduct Authority ('FCA') Threshold Conditions, and HSBC is currently working on an agreed mobilisation plan to receive an unrestricted licence in 2018; and
- In August 2017, the Company re-registered from a private to a public company and its name changed from HSBC UK RFB Limited to HSBC UK RFB plc on 8 August 2017 and again to HSBC UK Bank plc, on 21 August 2017.

Financial performance

The Company is expected to start operating as HSBC's UK ring-fenced bank on 1 July 2018.

The results and position of the Company for the year ended 31 December 2017 are set out on pages 11 to 19.

The Company made a pre-tax profit of £16,000 (2016: £nil) representing interest earned on UK treasury gilts purchased during the year.

The Company's total shareholders' equity including reserves amounted to £15.01m (2016: £50,000), following the issue of one new £1 ordinary share, issued at a premium of £14.95m. This was used to purchase £12.9m of UK treasury gilts and the balance deposited with HSBC Bank plc.

Risk overview

The Company's exposure to market risk is set out on page 4 of the Report of the Directors.

On behalf of the Board

John David Stuart

Director

HSBC UK Bank plc

Registered number 09928412

21 February 2018

Risk management

The Company has limited market risk exposure in respect of its investment in short dated UK treasury gilts. These gilts were purchased in order to comply with the PRA single counterparty exposure rules. They offer a fixed rate of interest and are AA rated, therefore the market risk associated with these securities is minimal. Ongoing risk monitoring procedures are not considered necessary at this stage, but will be established in advance of the initiation of banking operations in July 2018. For further details on the gilts held, please refer to note 5 on the financial statements.

The number of principal risks is expected to increase significantly in July 2018 as the Company commences banking activities. The Risk Management Framework that will be adopted is expected to be aligned to that of the HSBC Group.

Capital

Capital management

(Audited)

Approach and policy

On 30 May 2017, the Company issued one ordinary share of £1 in exchange for a consideration of £14.95m, to comply with the regulatory capital requirements that apply following the granting of a banking licence. The Company applied to the PRA for a banking licence which was granted (with restrictions) on 10 July 2017. On 26 July 2017, the Company invested £12.9m of the cash received in UK gilts. This capital position still stands as at the end of the reporting period.

Capital measurement

The PRA, as the supervisor of the Company sets capital requirements and receives information on the capital adequacy of HSBC UK Bank plc. The Company complied with the PRA's capital adequacy requirements throughout 2017.

The Basel III framework is structured around three 'pillars': minimum capital requirements, supervisory review process and market discipline. Basel III also introduces a number of capital buffers, including the Capital Conservation Buffer ('CCB'), Countercyclical Capital Buffer ('CCyB'), and other systemic buffers such as the Globally/Other Systemically Important Institutions ('G-SII'/'O-SII') buffer. CRD IV legislation implemented Basel III in the EU, and in the UK, the 'PRA Rulebook' for CRR Firms transposed the various national discretions under the CRD IV legislation into UK requirements.

Regulatory capital

The capital base of an organisation is divided into three main categories, namely common equity tier 1, additional tier 1 and tier 2, depending on their characteristics. At present the Company only holds common equity tier 1, which is the highest quality form of capital, comprising shareholders' equity. We aim to maintain a strong capital base to support the risks inherent in our business and meet capital requirements at all times.

Corporate Governance Report

The Directors who served during the period and up to the date of approval of the financial statements were as follows:

Directors

Name	Appointed	Resigned
Richard John Hennity	23 December 2015	19 September 2017
Stephen James Wotton	23 March 2016	19 September 2017
Dame Clara Hedwig Frances Furse	1 April 2017	
John David Stuart	30 May 2017	
Jonathan James Calladine	2 October 2017	
David Michael Watts	2 October 2017	
Alan Keir	1 February 2018	
Rosemary Leith	1 February 2018	
Leslie Van de Walle	1 February 2018	
Mridul Hegde	7 February 2018	

Fees to non-executive directors are detailed in Note 2 of the financial statements. No remuneration is disclosed for directors whose services are deemed to be provided to the Company as part of their services to HSBC Bank plc.

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

Dividends

The Directors do not recommend the payment of a dividend in respect of the year ended 31 December 2017 (2016: £nil).

Future changes in business activity

The Company is expected to become HSBC's ring-fenced bank on 1 July 2018. We plan to execute simultaneously the following three transfers on 1 July 2018 under an agreement between HSBC Holdings plc, HSBC Bank plc, HSBC UK Bank plc and HSBC UK Holdings Limited:

- HSBC Bank plc's UK RBWM and the qualifying components of CMB businesses and related items will be transferred to HSBC UK Bank plc through a court-approved ring-fencing transfer scheme process ('RFTS') as defined in Part VII, section 106 of the Financial Services and Markets Act 2000 (as amended) ('FSMA'). In addition to these transfers, certain items will be transferred via alternative arrangements;
- HSBC Bank plc qualifying subsidiaries, notably Marks and Spencer Financial Services Limited, HSBC Private Bank (UK) Limited and a number of asset finance entities, will be transferred to HSBC UK Bank plc as part of the RFTS; and
- HSBC Bank plc will transfer excess reserves to HSBC UK Bank plc through a capital contribution.

Significant events since the end of the financial year

In January 2018, the ring-fencing transfer scheme (RFTS) court process was initiated with the submission of an application to the High Court, followed by the first hearing to consider and approve the communications programme.

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

Statement on going concern

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the Company has the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions.

Disclosure of Information to the Auditor

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each Director has taken all the steps that she/he ought to have taken as a Director to make herself/himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

On behalf of the Board

John David Stuart

Director

HSBC UK Bank plc

Registered number 09928412

21 February 2018

Statement of Directors' Responsibilities in Respect of the Annual Report and Accounts 2017 and the Financial Statements

The Directors are responsible for preparing, in accordance with applicable law and regulations, a Strategic Report, a Directors' Report and financial statements for each financial year.

The Directors are required to prepare the financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union ('EU'). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is not appropriate. Since the Directors are satisfied that the Group has the resources to continue in business for the foreseeable future, the financial statements continue to be prepared on a going concern basis.

The Directors have responsibility for ensuring that sufficient accounting records are kept that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 2006. The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The Directors have responsibility for the maintenance and integrity of the *Annual Report and Accounts 2017* as they appear on HSBC's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors, the names of whom are set out in the 'Report of Directors: Governance' section on page 4 of the *Annual Report and Accounts 2017*, confirm that, to the best of their knowledge:

- The financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company; and
- the management report represented by the Strategic Report and the Report of the Directors includes a fair review of the development and performance of the Company, together with a description of the principal risks it faces.

On behalf of the Board

John David Stuart

Director

HSBC UK Bank plc

Registered number 09928412

21 February 2018

Independent auditors' report to the members of HSBC UK Bank plc

Report on the audit of the financial statements

Opinion

In our opinion, HSBC UK Bank plc's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2017 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report & Accounts (the "Annual Report"), which comprise: the balance sheet as at 31 December 2017; the income statement, the statement of comprehensive income, the statement of cash flows, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Board of Directors.

Basis for opinion

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

Independence

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

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

Other than those disclosed in note 3 to the financial statements, we have provided no non-audit services to the company in the period from 1 January 2017 to 31 December 2017.

Our audit approach

Overview

- Overall materiality: £149,990, based on 1% of Total assets.
- As the entity was not trading in the year, there have been no matters requiring significant auditor's attention. We have no key audit matters to report.

The scope of our audit

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

We gained an understanding of the legal and regulatory framework applicable to the company and the industry in which it operates, and considered the risk of acts by the company which were contrary to applicable laws and regulations, including fraud. We designed audit procedures to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

We focused on laws and regulations that could give rise to a material misstatement in the financial statements, including the Companies Act 2006, the Financial Conduct Authority's regulations, the Prudential Regulation Authority's regulations, and the UK tax legislation. Our tests included review of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the regulators, enquiries of management.

There are inherent limitations in the audit procedures described above and the further removed non-compliance is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We determined that there were no key audit matters applicable to the company to communicate in our report.

Independent auditors' report to the members of HSBC UK Bank plc (formerly HSBC UK RFB Limited)

How we tailored the audit scope

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

Materiality

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

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

Overall materiality	£149,990
How we determined it	1% of Total assets.
Rationale for benchmark applied	Total assets is used as a benchmark as the entity has not yet commenced trading and therefore profitability is not a relevant measure. Total assets represents the most appropriate benchmark given the nature of the entity.

We agreed with the Board of Directors that we would report to them misstatements identified during our audit above £7,500 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

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

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

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

Reporting on other information

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

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

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

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

Strategic Report and Report of the Directors

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Report of the Directors for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

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

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

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

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

Auditors' responsibilities for the audit of the financial statements

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

Independent auditors' report to the members of HSBC UK Bank plc (formerly HSBC UK RFB Limited)

aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

Use of this report

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

Other required reporting

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment

We were appointed by the directors on 7 August 2017 to audit the financial statements for the year ended 31 December 2017 and subsequent financial periods. This is therefore our first year of uninterrupted engagement.

Other matter

The financial statements for the period ended 31 December 2016, forming the corresponding figures of the financial statements for the year ended 31 December 2017, are unaudited.

Carl Sizer

(Senior Statutory Auditor)

for and on behalf of **PricewaterhouseCoopers LLP**

Chartered Accountants and Statutory Auditors

Birmingham

21 February 2018

Financial Statements

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HSBC UK Bank plc (formerly HSBC UK RFB Limited) income statement
for the year/period ended 31 December

	<i>Notes</i>	2017 £000	2016 £000
Net interest income		16	–
– interest income		16	–
– interest expense		–	–
Total operating income		16	–
Total operating expenses		–	–
Operating profit		16	–
Profit before tax		16	–
Tax expense	4	(3)	–
Profit for the year/period		13	–

HSBC UK Bank plc (formerly HSBC UK RFB Limited) statement of comprehensive income
for the year/period ended 31 December

	2017	2016
	£000	£000
Profit for the year/period	13	–
Items that will be reclassified subsequently to profit or loss when specific conditions are met:		
Available-for-sale investments	(2)	–
– fair value losses	(3)	–
– income taxes	1	–
Other comprehensive income for the year/period, net of tax	(2)	–
Total comprehensive income for the year/period	11	–

HSBC UK Bank plc (formerly HSBC UK RFB Limited) balance sheet
at 31 December

	<i>Notes</i>	2017	2016
		£000	£000
Assets			
Cash and balances with HSBC Group undertakings		2,128	50
Financial investments	5	12,885	–
Deferred tax assets	4	1	–
Total assets at 31 Dec		15,014	50
Liabilities and equity			
Liabilities			
Current tax liabilities	4	3	–
Total liabilities at 31 Dec		3	–
Equity			
Total shareholders' equity		15,011	50
– called up share capital	6	50	50
– share premium account		14,950	–
– other reserves		(2)	–
– retained earnings		13	–
Total equity at 31 Dec		15,011	50
Total liabilities and equity at 31 Dec		15,014	50

The accompanying notes on pages 16 to 19 and the audited section of the 'Report of the Directors' on page 4 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 21 February 2018 and signed on its behalf by:

John David Stuart
 Director

HSBC UK Bank plc (formerly HSBC UK RFB Limited) statement of cash flows for the year/period ended 31 December

	2017	2016
	£000	£000
Profit before tax	16	–
Adjustments for non-cash items:		
Accrued interest income	(16)	–
Net cash from operating activities	–	–
Purchase of financial investments	(12,872)	–
Net cash from investing activities	(12,872)	–
Issue of ordinary share capital	14,950	50
Net cash from financing activities	14,950	50
Net increase in cash and cash equivalents	2,078	–
Cash and cash equivalents at the beginning of the period	50	–
Cash and cash equivalents at 31 Dec	2,128	50
Cash and cash equivalents comprise of:		
Cash and balances with HSBC Group undertakings	2,128	50

HSBC UK Bank plc (formerly HSBC UK RFB Limited) statement of changes in equity
for the year/period ended 31 December

	Called up share capital £000	Share premium £000	Retained earnings £000	Available-for-sale fair value reserve £000	Total shareholders' equity £000
At 1 Jan 2017	50	–	–	–	50
Profit for the year	–	–	13	–	13
Other comprehensive income (net of tax)	–	–	–	(2)	(2)
– available-for-sale investments	–	–	–	(2)	(2)
Total comprehensive income for the year	–	–	13	(2)	11
Share capital issued ¹	–	14,950	–	–	14,950
At 31 Dec 2017	50	14,950	13	(2)	15,011
At 23 Dec 2015	–	–	–	–	–
Profit for the period	–	–	–	–	–
Other comprehensive income (net of tax)	–	–	–	–	–
– available-for-sale investments	–	–	–	–	–
Total comprehensive income for the period	–	–	–	–	–
Share capital issued	50	–	–	–	50
At 31 Dec 2016	50	–	–	–	50

¹ All new capital subscribed during the year was issued to HSBC UK Holdings Limited. See Note 6 for further details.

1 Basis of preparation and significant accounting policies

1.1 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The financial statements of HSBC UK Bank plc have been prepared in accordance with IFRSs as issued by the IASB, including interpretations issued by the IFRS Interpretations Committee, and as endorsed by the European Union ('EU').

Standards adopted during the year ended 31 December 2017

There were no new standards applied in 2017, and new interpretations and amendments to standards had an insignificant effect on the financial statements.

(b) Future accounting developments

Minor amendments to IFRSs

The IASB has published a number of minor amendments to IFRSs which are effective from 1 January 2018 and 2019, some of which have been endorsed for use in the EU. The Company expects they will have an insignificant effect, when adopted, on the financial statements of HSBC UK Bank plc.

Major new IFRSs

The IASB has published IFRS 9 'Financial Instruments', IFRS 15 'Revenue from Contracts with Customers', IFRS 16 'Leases' and IFRS 17 'Insurance contracts'. IFRS 9, IFRS 15 and IFRS 16 have been endorsed for use in the EU and IFRS 17 has not yet been endorsed. The Company has no revenue other than from financial instruments and has no lease obligations or insurance contracts. Therefore only IFRS 9 is expected to be applicable. Since all of the Company's debt securities are short dated UK Treasury Gilts guaranteed by the UK Government, IFRS 9 is not expected to have a significant effect on their presentation or measurement.

(c) Foreign currencies

The functional currency of the entity is sterling, which is also the presentational currency of the financial statements. HSBC UK Bank plc did not enter into any transactions in foreign currencies during the period.

(d) Critical accounting estimates and judgements

The Company did not make any critical accounting estimates and judgements during the period.

(e) Segmental analysis

The Company does not disclose a segmental analysis, as it did not have any separate operating segments during the period.

(f) Going concern

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the Company has the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows and capital resources.

(g) Presentation of information

Certain disclosures required by IFRSs have been included in the audited sections of this Annual Report and Accounts as follows:

- capital disclosures are included in the 'Report of the Directors: Capital' on page 4.

1.2 Summary of significant accounting policies

(a) Income and expense

Operating income

Interest income and expense

Interest income and expense for all financial instruments are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method.

(b) Valuation of financial instruments

All financial instruments are initially recognised at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received).

(c) Financial instruments measured at fair value

Available-for-sale financial assets

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

Impairment of available-for-sale financial assets

Available-for-sale financial assets are assessed at each balance sheet date for objective evidence of impairment. Impairment losses are recognised in the income statement.

Notes on the Financial Statements

Available-for-sale debt securities

In assessing objective evidence of impairment at the reporting date, the Company 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. A subsequent decline in the fair value of the instrument is recognised in the income statement when there is objective evidence of impairment as a result of decreases in the estimated future cash flows. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, or the instrument is no longer impaired, the impairment loss is reversed through the income statement.

(d) Tax

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

Current tax is the tax expected to be payable on the taxable profit for the year and on any adjustment to tax payable in respect of previous years. The group provides for potential current tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet, and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax is calculated using the tax rates expected to apply in the periods as the assets will be realised or the liabilities settled.

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

2 Employee compensation and benefits

In October 2017, 21,571 employees were transferred from HSBC Bank plc to the Company. Their remuneration and numbers have not been included in the Company's financial statements as the employees were seconded back to HSBC Bank plc until 30 June 2018.

The Company had no other employees and hence no staff costs for the year ending 31 December 2017 (2016: £nil).

Directors' emoluments

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

	2017	2016
	£000	£000
Fees paid to non-executive directors	338	—

Fees paid to non-executive directors have been borne by a fellow group undertaking and are therefore not charged in arriving at profit before taxation (2016: £nil).

No remuneration is disclosed for directors who are employed by other companies within the HSBC Group and their services to the Company are incidental to their other responsibilities within the HSBC Group.

The highest paid director received a fee of £337,500.

3 Auditors' remuneration

	2017	2016
	£000	£000
Audit fees payable to PwC by other HSBC Group companies ¹	60	—

¹ Include fees payable for HSBC UK Bank plc statutory audit of £20,000 and other audit related services of £40,000.

4 Tax

Tax expense

	2017 £000	2016 £000
Current tax	(3)	–
– for this year	(3)	–
Total tax expense for the year/period ended 31 December	(3)	–

The UK tax rate applying to HSBC UK Bank plc was 19% and will be gradually reduced to 17% by 1 April 2020. The Company did not commence banking operations during the year and therefore the 8% supplementary surcharge on UK banking profits did not apply.

Tax reconciliation

The tax charged to the income statement is taxed at the UK corporation tax rate as follows:

	2017		2016	
	£000	%	£000	%
Profit before tax	16		–	
Tax expense				
UK corporation tax at 19%	(3)	19	–	–
Total tax charged to the income statement	(3)	19	–	–

The effective tax rate for the year was 19%.

Accounting for taxes involves some estimation because the tax law is uncertain and the application requires a degree of judgement, which authorities may dispute. Liabilities are recognised based on best estimates of the probable outcome, taking into account external advice where appropriate. We do not expect significant liabilities to arise in excess of the amounts provided.

Movement of deferred tax assets and liabilities

	Available-for-sale investments		Total	
	£000		£000	
At 1 Jan 2017	–		–	
Other comprehensive income	1		1	
At 31 Dec 2017	1		1	
– assets	1		1	

5 Financial investments

Carrying amount of financial investments

	2017 £000	2016 £000
Available for sale securities at fair value		
– debt securities	12,885	–
At 31 Dec	12,885	–

All of the Company's debt securities are short dated UK Treasury Gilts guaranteed by the UK Government. The gilts have a fixed maturity date of 22 July 2018. The debt securities are traded in an active market and externally quoted prices are readily available. They are classified as Level 1 in the fair value hierarchy.

6 Called up share capital

Issued and fully paid

HSBC UK Bank plc £1.00 ordinary shares

	2017		2016	
	Number	£000	Number	£000
At 31 Dec	50,001	50	50,000	50

On 30 May 2017, the Company issued one ordinary share of £1 in exchange for a consideration of £14.95m.

7 Related party transactions

The immediate parent of the Company is HSBC UK Holdings Limited. The parent undertaking of the smallest group that presents consolidated financial statements including the Company is HSBC Holdings plc, which is also the ultimate holding company and the parent company of the largest group that presents consolidated financial statements.

The financial statements of HSBC Holdings plc are available from 8 Canada Square, London, E14 5HQ. Both HSBC UK Holdings Limited and HSBC Holdings plc are incorporated and registered in England and Wales.

Transactions and balances during the year with subsidiaries of HSBC Holdings plc

	2017		2016	
	Due to/from subsidiaries of HSBC Holdings plc		Due to/from subsidiaries of HSBC Holdings plc	
	31 Dec £000	Highest balance £000	31 Dec £000	Highest balance £000
Assets				
Cash and balances with HSBC Group undertakings	2,128	15,000	50	50
Total related party assets at 31 Dec	2,128	15,000	50	50

The amounts owed by HSBC Group undertakings relate to cash deposited with HSBC Bank plc.

All costs relating to the set-up of HSBC UK Bank plc up to the date of legal separation will be incurred by HSBC Bank plc. These include director emoluments and auditors' remuneration.

8 Events after the balance sheet date

In January 2018, the ring-fencing transfer scheme (RFTS) court process was initiated with the submission of an application to the High Court, followed by the first hearing to consider and approve the communications programme.

There have been no other significant events after the balance sheet date.

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