HSBC Bank Oman S.A.O.G

Annual Report and Accounts 2017

HSBC

Welcome to HSBC Bank Oman's
Annual Report For 2017

His Majesty Sultan Qaboos bin Said

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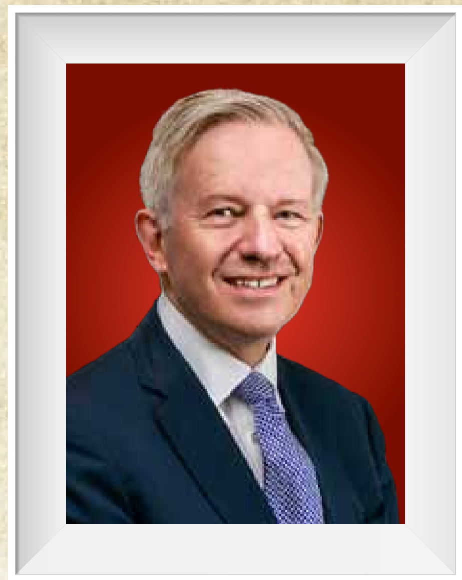
Board of Directors



Sir Sherard Cowper-Coles
Chairman

Waleed Omar Al Zawawi
Deputy Chairman and Director

Dr. Juma Ali Juma Al Juma
Senior Independent Director

Sheikh Aimen Ahmed Sultan Al Hosni
Director

Abdulfattah Sharaf
Director

Robert Adrian Underwood
Director

Robin Dougles Jones
Director


HSBC

Management Team

First Row
(Left To Right)

- **Ahmed El Damaty**
  General Manager and Chief Financial Officer
- **Daniel Felton**
  General Manager and Head of Commercial Banking
- **Andrew P Long**
  Chief Executive Officer
- **Sulaiman Al Lamki**
  General Manager and Chief Risk Officer
- **Saud Al Shidhani**
  General Manager and Chief Operating Officer

Second Row
(Left To Right)

- **Ali Al Abri**
  General Manager and Head of Human Resources
- **Abdul Qader Al Sumali**
  General Manager and Head of Retail Banking and Wealth Management

Third Row
(Left To Right)

- **Amir Bourani**
  Head of Global Banking
- **Baha Uddin**
  General Manager Financial Crime Compliance
- **Pierre El Ahmar**
  General Manger and Treasurer, Global Markets

Fourth Row
(Left To Right)

- **Biju Thottingal**
  General Manager, Legal
- **Khalid Al Mahari**
  Assistant General Manager and Head of Regulatory Compliance

Fifth Row
(Left To Right)

- **Sameh Al Wahaibi**
  Assistant General Manager and Head of Communications
- **Ifzal Nawaz**
  Assistant General Manager and Head of Internal Audit

Board of Directors' Report for the year ended 31 December 2017

Dear Shareholders,

On behalf of the Board of Directors, I am pleased to present your Bank's full year financial results for 2017. We made good progress in 2017, and our businesses performed well in challenging conditions. Our strong capital and prudent risk appetite enabled us to capture market share in strategic product areas.

Our success was evident through the global awards which we won in 2017, including the "Euromoney Best Bank in Oman" Award and "Safest Bank in Oman in 2017" from Global Finance Magazine.

Performance Summary

I am delighted to share with you the results achieved by the Bank during 2017. Our performance shows a 13.0% increase in net profit for the year ended 31 December 2017 to RO19.1 M compared with RO16.9 M for the year ended 31 December 2016. Profit grew owing to an increase in net operating income, lower loan impairment charges and improved tax expenses.
Net operating income before loan impairment charges increased by 0.1% to RO75.3 M compared with RO75.2 M for last year.

Net interest income remains flat at RO54.3 M compared with last year as margins continue to be squeezed in our consumer lending portfolio. Net fee income fell by 4.9% to RO11.7 M for the year ended 31 December 2017 owing to lower credit structuring fees from corporate customers and to lower cards and wealth revenue from retail customers.

Net trading income increased by 17.9% to RO9.2 M owing mainly to balance sheet portfolio optimisation.
Other operating and dividend income fell to RO0.1 M compared with RO0.8 M for the year ended 31 December 2016 owing primarily to the non-repeat of the gain on sale of legacy investments of RO0.5 M and lower dividend income compared with 2016 following such sales.

A net charge of RO5.5 M has been reported for loan impairment charges compared with a net charge of RO5.6 M for the same period in 2016. This was due mainly to a release from the general provision of RO0.3 M owing to the overall reduction in wholesale loans. This was partly offset by specific provision charges of RO2.1 M in the Wholesale and RO3.7 M in the Retail portfolio.

Operating expenses were marginally down at RO48.4 M owing to our continuing focus on managing our cost base – the fourth consecutive year in which we have cut our cost base.

Loans and advances, net of provisions and reserved interest, fell by 1.7% to RO1,394.9 M owing mainly to the aforementioned reduction in wholesale loans, itself owing almost entirely to the repayment of a single short term loan in January 2017.

Customer deposits increased by 3.5% to RO1,932.1 M compared with RO1,866.7 M as at 31 December 2016.

HBON's capital adequacy ratio stood at 16.9% for the year ended 31 December 2017 compared with 18.7% as at 31 December 2016, with the change largely due to the impact of regulatory changes in relation to the treatment of investments in certain overseas government securities.

The Board of Directors proposes a total cash dividend of RO11.4 M, with a dividend pay-out ratio of 59.6%. This represents a 14% increase in our payment compared with last year.

Delivering the best customer experience

In 2017 we embarked on a branch optimisation project with the aim of better aligning our branch network to Oman's population distribution and our clients' changing branch usage habits. This initiative was based on a deep understanding of our customers' channel preferences and their evolving use of digital channels such as Mobile Banking, Internet, ATMs and CDMs in preference to branch counter utilization. Because

Board of Directors' Report for the year ended 31 December 2017

our clients increasingly prefer to access their branch through digital channels, we are investing a growing proportion of our distribution budget here rather than in our branches.

We continued to enhance our digital banking penetration as we launched a new mobile clearing system allowing customers to make instant money transfers to certain local banks within the country using the beneficiary's mobile number.

During the year several campaigns were introduced for our retail customers. This included our Mandoos Savings scheme encouraging our customers to save for the future. This was followed by another campaign promoting our Advance proposition encouraging customers to open accounts and transfer their salaries to HSBC. One benefit of this is to give them opprtunities to win cash prizes during the campaign period. We also ran an acquisition campaign during the last quarter focusing on Advance and Premier "New to Bank" customers.

In Wholesale Banking, demonstrating our ability to combine our global connectivity and strength with our local expertise, HSBC acted as an Underwriter, Bookrunner and Mandated Lead Arranger on Oman Telecommunications Company's (Omantel) USD2.25 billion syndicated facility. The Facility funded Omantel's acquisition of a controlling 22% stake in Kuwait's Mobile Telecommunications Company ("Zain").

During the year we also acted as joint coordinator and initial mandate lead arranger of Oman Oil Company Exploration and Production's (OOCEP) debut financing to secure USD1 billion from the international debt market.

These transactions demonstrate HSBC's ability to execute and deliver structured and secured trade and receivable finance transactions across the MENA region and beyond. They also reinforce HSBC's position as a core relationship bank, positioning us favorably in Oman for future corporate event and strategic business opportunities.

We continued to support to small and medium enterprises in Oman through the several customer events designed to provide the ambitious small business with the insight they need to prosper in the local and international markets. Such events also give an insight on how HSBC can help businesses achieve greater efficiency through our advanced technology.

As part of our efforts to help develop and diversify the Omani economy, during the year we signed a partnership framework with the Public Authority of Investment Promotion and Export Development (Ithraa) aiming to support foreign direct investment in Oman and to strengthen Ithraa's work in promoting Oman's offer as an attractive place to live, work and invest.

In October we were also delighted to receive the Euromoney Award for the 'Best Cash Management Bank in Oman' for the 7th consecutive year, again showing the strength of our Global Liquidity and Cash Management services. This followed the award earlier in this year by Euromoney, for the first time, as the Best Bank in Oman.

Investing in our people and community

We remain committed to supporting the national people agenda and are proud to have achieved an Omanisation rate of over 93% as at 31 December 2017, noticeably ahead of the 90% target set by the Central Bank of Oman (CBO). The Omanisation rate in the Middle and Senior Management reached 91% (above the CBO's target of 90%) and 75% respectively. We continued to invest in staff training programmes focusing on improving the customer experience, fighting financial crime and improving risk management. This included launching a "Risk Certification Programme" as part of our plan to embed the FCC (Fighting Financial Crime) culture in the Bank. Throughout the year staff have also gone through several classroom based and online training programmes that can help them achieve their career goals.

Under the Corporate Sustainability (CS) agenda, we have partnered with a number of non-governmental organizations including the Environment Society of Oman and the Omani Association for the Disabled aiming to fulfil our commitment towards society. Throughout the year we gave more focus to raising staff awareness of the importance of volunteering and to fostering a volunteering culture in the Bank. As a result, we managed to triple the number of volunteering hours at the Bank in 2017 to 2,157 hours.

In partnership with the British Council, we launched the "Taqaddam" programme, to support the development of life skills in college students. Staff have also volunteered in several charitable activities during the holy month of Ramadan that aimed to reach out to the needy families around the Sultanate.

Board of Directors’ Report for the year ended 31 December 2017

Conclusion

In 2018, the environment for banking remains challenging, but we are confident that HSBC Bank Oman is well positioned, with a strong and liquid capital base and a prudent risk appetite, to face the challenges that lie ahead. We will continue to focus on our strategic objectives and on delivering the high quality experience our customers expect from us.

On behalf of the Board of Directors, I would like to thank all of our customers, staff and management for their commitment and dedication. Special thanks also go to the Central Bank of Oman and the Capital Market Authority for their continued support and guidance.

Finally, I wish to express our deepest appreciation to His Majesty Sultan Qaboos Bin Said for the peace, stability and growth that his wise leadership continues to bring to Oman and its people. We offer our full support as His Majesty continues to lead the Sultanate to further prosperity and development.

Sir Sherard Cowper-Coles
Chairman

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REPORT OF FACTUAL FINDINGS

TO THE SHAREHOLDERS OF HSBC BANK OMAN SAOG

1. We have performed the procedures agreed with you pursuant to the Capital Market Authority (CMA) circular number E/4/2015, dated 22 July 2015, with respect to the Board of Directors' corporate governance report of HSBC Bank Oman SAOG (the Bank) as at and for the year ended 31 December 2017 and application of the corporate governance practices in accordance with amendments to CMA Code of Corporate Governance issued under circular number E/10/2016 dated 1 December 2016 (collectively the 'Code').

2. Our engagement was undertaken in accordance with the International Standard on Related Services 4400 applicable to agreed-upon procedures engagements. The procedures were performed solely to assist you in complying with the requirements of the Code issued by the CMA.

3. We have performed the following procedures:

    a) We have checked that the corporate governance report issued by the Board of Directors includes as a minimum, all items suggested by CMA to be covered by the report as detailed in the Annexure 3 of the Code by comparing the report with such suggested content in the Annexure 3; and

    b) We obtained the detailed list of areas of non-compliance identified by the Bank's Board of Directors with the Code, included in the report together with the reasons for such non-compliance and agreed these to the discussions in the Board minutes or/and a checklist prepared by the Board of Directors to identify any non-compliance.

4. As a result of performing the above procedures, we have no exceptions to report.

5. Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance on the accompanying corporate governance report.

6. Had we performed additional procedures or had we performed an audit or a review in accordance with International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

7. Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose. This report relates only to the Board of Directors' corporate governance report included in its annual report for the year ended 31 December 2017 and does not extend to any financial statements of the Bank taken as a whole.

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PricewaterhouseCoopers LLC
C.R. No 1230865

4 March 2018
Muscat, Sultanate of Oman

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Corporate Governance Report
For the Annual Report 2017

'To be where the growth is, connecting customers to opportunities; to enable businesses to thrive and the economy of the Sultanate of Oman to prosper; to help people fulfill their hopes and dreams and realise their ambitions.'

HBON mission and vision (purpose) statement

1. Values

1.1 The Board of HSBC Bank Oman S.A.O.G. ('HBON'/'the Bank') is committed to the highest standards of corporate governance to create long-term value for its stakeholders to achieve HBON's strategic goals, and to position HBON as Oman's leading bank.

1.2 HBON's value proposition is:

- To be dependable and do the right thing;
- To be open to different ideas and cultures; and
- To be connected to customers, communities, regulators and each other.

1.3 HBON's values are based on sound business principles including:

- Financial Strength - maintain capital strength and liquidity;
- Risk-Management - be enterprising and commercial, understand and be accountable for the impact of our actions, take prudent decisions;
- Speed - be fast and responsive, make principles-led decisions;
- Performance focused - drive market competitive levels of performance, act with urgency and intensity, prioritise, and simplify;
- Efficiency - focus on cost discipline and process efficiency;
- Quality - pursue excellence;
- Customer focus - provide outstanding customer experience;
- Integrated - align HBON with the standards of the rest of the HSBC Group to ensure a seamless, integrated service for all stakeholders; and
- Sustainability - take a long-term outlook; understand the impact of actions on stakeholders, brand and reputation.

2. Governance philosophy

2.1 HBON's governance philosophy is based on the following principles:

- An effective and accountable Board of Directors;
- A clear strategic direction for business development;
- Prudent accounting principles and information;
- Sound decision-making mechanisms;
- Strategy-linked performance evaluation; and
- Human resource development.

2.2 HBON's governance philosophy is embodied in the way HBON works and in how good corporate governance is applied to ensure that HBON:

- Has robust structures and procedures;
- Takes account of the needs and interests of all stakeholders; and
- Takes decisions in a balanced and transparent manner.

2.3 HBON seeks to apply best practice in corporate governance through clear values based on sound business principles, a governance philosophy embodied in the way HBON works and through complying with the letter and spirit of:

- The law;
- The Capital Market Authority ('CMA') Oman Code of Corporate Governance for Public Listed Companies, as amended from time to time, ('Code');
- The regulations for Corporate Governance of Banking and Financial Institutions issued by the Central Bank of Oman ('CBO'); and
- The HSBC Group global standards, including the HSBC Corporate Governance Code.

2.4 The Board has implemented a Corporate Governance Framework ('Framework') which meets all local Oman regulations, embodies international best practice and encompasses HSBC Group global standards. The Framework is reviewed annually, and updated periodically as required. The Framework sets out the matters reserved to the shareholders, to the Board and to the executive management team ('Management').

3. Board of Directors - nominations & duties

3.1 The current Board consists of seven members and all members are non-executive and independent.

3.2 The term of the current Board started on 30 March 2015 for a period of three years. The next Board election will be on 29 March 2018.

3.3 Any vacancy arising owing to the resignation of any Director may be filled temporarily by the Board, subject to election at the next Annual General Meeting ('AGM'). Anyone wishing to be nominated for the position of Director must:

- Meet all legal requirements, including those set out in the Commercial Companies Law and the Articles; and
- Submit an application form (in the pro-forma template issued by the Capital Market Authority) at least two days before the General Meeting at which the election of Directors will take place.

3.4 The Board shall recommend suitable names to the shareholders for election as Directors in the context of the perceived needs of the Board. This does not affect the freedom of shareholders to vote for any candidate(s).

3.5 The HBON Legal Advisor shall review eligibility and correctness of the applications and compliance with laws and regulations. As required by Ministerial Decision No. E/53/2008, HBON shall file the elected Directors' forms together with the Minutes of the AGM with the CMA within the period specified by the law.

3.6 The duties and function of the Board are defined in the Framework and are governed by all relevant laws, regulations and the Articles, to include the Banking Law, the CBO regulations, the Commercial Companies Law, and Principles 2 and 3 of the Code.

3.7 The Chairman of the Board and the CEO are separate and their roles clearly defined.

4. Board of Directors - characteristics and core competency

4.1 HBON is committed to ensuring that each of the seven Directors on the Board possesses the following characteristics:

- High ethical standards and integrity in their personal and professional dealings;
- High intelligence and wisdom, which is applied to make sound decisions;
- Capacity to read and understand financial statements;
- Potential to contribute towards the effective stewardship of HBON;
- The ability to perform to a high standard during periods of short and long term pressure;
- Capacity to approach others assertively, responsibly and cooperatively and
- Capacity to activate and consult employees of HBON to reach high standards of management.

4.2 The Board as a whole strives to achieve the following core competencies, with each candidate contributing in at least one domain:

- Skills to motivate high performing talent;
- Strategic insight and ability to direct by encouraging innovation and continuously challenging the organisation to sharpen its vision;
- Expertise in financial and corporate finance;
- The ability to understand management trends in general and to understand the banking industry locally and globally;
- To acquire and maintain appropriate and relevant industry specific knowledge; and
- To acquire and maintain business expertise in international markets.

4.3 The following table sets out the qualifications and biographies of the Board members.

Corporate Governance Report (continued)
For the Annual Report 2017

Name & Category	Biography
Directors in office	
Sir Sherard Cowper-Coles KCMG LVO *Chairman & Non-executive director* *Qualification(s):* *Hertford College, Oxford (Degree in Classics, Scholar, Honorary Fellow)*	Sherard has nearly 40 years' experience of working in the region and internationally. He spent over 30 years in the British Diplomatic Service and was Ambassador to Saudi Arabia from 2003 to 2007. He joined HSBC Holdings in 2013 as Senior Adviser to the Group Chairman and Group Chief Executive, and was appointed Group Head of Government Affairs in 2015. Sherard is also a Director of HSBC Bank Egypt SAE. In addition, he is a member of the Board of the Egyptian British Business Council, the Saudi British Joint Business Council, and Asia House and the Chairman of the Omani-British Business Council.
Brig. (Retd.) Waleed Omar Al Zawawi *Deputy Chairman & independent non-executive director* *Qualification(s):* *Masters from Kings College – London (United Kingdom) – 2007* *Graduated from The Royal College of Defence Studies (UK) – 2006* *Graduated from Camberly (United Kingdom) – 1992* *Graduated from Sandhurst (United Kingdom) – 1982*	Director on the Board of various companies in Oman (since 1984), and abroad including on the Board of Oman International Bank SAOG since 1996 to end May 2012. Currently, Deputy Chairman of HSBC Bank Oman SAOG with effect from 31 May 2012. Served in the Oman Armed Forces for 30 years.
Dr. Juma Ali Juma Al Juma *Independent senior non-executive director* *Qualification(s):* *PhD in Political Science*	Dr. Juma worked with the Royal Office from 1982 to 1996; and thereafter worked as the General Secretary of the Tender Council from 1996 to 2001; as the Minister of Manpower from 2001 to 2008; as the Chairman of Oman Airports Maintenance Company SAOC from 2010 to 2015. Dr. Juma is the Chairman of Al Maha Petroleum Products Marketing Company SAOG from 2016.
Aimen Ahmed Sultan Al Hosni *Independent, non-executive director* *Qualification(s):* *Masters in Public Administration* *Bachelor in Political Science*	Aimen bin Ahmed Al Hosni serves as the Chief Executive Officer of Oman Airports Management Company since May 2015. Oman Airports is responsible for managing and developing all civil airports in the Sultanate of Oman within the context of the country's vision of establishing a safe, modern and customer centric aviation sector in Oman. Airports in Oman have become important to Oman's society, contributing to national prosperity and well-being. Oman Airports currently operates 4 airports: Muscat, Salalah, Duqm and Sohar. Aimen joined Oman Airports in 2012 as the General Manager of Muscat International Airport. He successfully managed the flawless launch of Phase 1 of new Muscat International Airport by opening the second Runway and the new Air Traffic Control Tower. He also managed successfully the smooth opening of the new state-of-the-art Salalah Airport in November 2015. Continuing to do more of the same will not be enough, therefore Aimen's focus is the transformation of Oman Airports to a dynamic world-class airport operator, while getting ready for the opening of the new Muscat International Airport.

Corporate Governance Report (continued)
For the Annual Report 2017

Name & Category	Biography
Directors in office	
	Over the last twenty years and prior to joining Oman Airports, Aimen led multinational organizations. In addition to his current role at Oman Airports, he also holds various executive positions as a Board Member at ACI World and ACI Asia Pacific, Oman National Investment and Engineering, Muscat Insurance Company , Omantel Telecommunication and HSBC Oman.
Abdulfattah Sharaf *Independent, non-executive director* *Qualification(s):* *Graduate of the University of Denver, USA*	Abdulfattah Sharaf is a Group General Manager and the Chief Executive Officer, United Arab Emirates. He is also Head of International, which covers Bahrain, Kuwait and Algeria. Abdulfattah is a Board Member of HSBC Bank Middle East Limited (HBME) and HSBC Bank Oman S.A.O.G. (HBON). Prior to his appointment as the CEO UAE, he was the CEO Personal Financial Services, Middle East and North Africa, and responsible for all of HSBC's Retail Banking business in the MENA region. He was also a Board member of HSBC Saudi Arabia Limited (IBSA). Before joining HSBC Bank Middle East Limited, Abdulfattah was the Chief Executive Officer of NBD Securities, a subsidiary of Emirates NBD. Abdulfattah is currently a member of the Higher Board of the Dubai International Financial Centre (DIFC) and a Board member of the Emirates Telecommunications Corporation (Etisalat) and Noor Dubai Foundation. He is also a member of the Mastercard MEA Advisory Board, a member of the Advisory Board Council of the American University of Sharjah's School of Business and Management, and a Board Member of the Emirates Golf Federation.
Rob Underwood *Independent, non-executive director* *Qualification(s):* *BSc Economics and Politics, Bath University, Bath, UK* *Associate of Chartered Institute of Bankers, London, UK*	From 1987 to 2000: Various roles in HSBC Group in London, Hong Kong and Saudi Arabia covering Credit Risk, Credit Training, Corporate Lending and Specialised Industries and Shipping Lending. From November 2000 to February 2004: was Senior Manager, Group HR. From February 2004 to September 2007 was CEO of HSBC Chile. From September 2007 to February 2010 was Head of Wholesale Risk for HSBC Latin America based in Mexico. From February 2010 to June 2014 was Regional Head of Wholesale and Market Risk, HSBC Middle East, and from June 2014 to date is Chief Risk Officer, HSBC Middle East and North Africa based in Dubai.
Robin D. Jones *Independent, non-executive director* *Qualification(s):* *Fellow member of the Chartered Association of Certified Accountants*	Robin has been the Chief Operating Officer of SABB since 1 July 2017. Before joining SABB, Robin joined HSBC Bank Middle East Limited ('HBME') in October 2013 as the Deputy CEO MENA and Head of Strategy & Planning MENA, from HSBC Bank plc, London, where he was Chief Risk and Administration Officer from July 2011 to September 2013, reporting to HSBC Group Chief Operating Officer. In this capacity Robin ensured HSBC pro-actively manages Risk and Quality across all HOST functions. In addition, Robin was responsible for operational support to ensure key governance processes operate effectively. Robin also oversaw cross HOST programmes, such as, OE, Recovery and Resolution, Global Transaction Team and Data Strategy. Prior to his role in the London, Robin was seconded to Saudi British Bank as Executive Director and Chief Operating Officer.

Corporate Governance Report (continued)
For the Annual Report 2017

Name & Category	Biography
Directors in office	
	In addition to his current responsibilities as Deputy CEO of the HBME, Robin is proactively engaged with the Country CEO's and COO's to drive business performance in accordance with HSBC's global standards and values. Robin joined HSBC in 1994 and has worked in South Africa, Canada, Australia, the USA, and the UK, including roles in Global Banking & Markets as Global Head of Re-Engineering and Chief Operating Officer from October 2006 to March 2009.
Relinquished the office (on 29 January 2017)	
David Gordon Eldon *Chairman & independent non-executive director* *Qualification(s):* Honorary Doctor of Business Administration from University of Hong Kong Justice of the Peace Fellow of the Chartered Institute of Bankers (FCIB)	Entered banking in 1964, undertaking a wide variety of banking and executive management roles in UK, Middle East and Asia. Became a General Manager of HSBC Group in 1990, an Executive Director of the Hongkong and Shanghai Banking Corporation Limited in 1994, its Chief Executive Officer in 1996 and its Chairman in 1999. In 1996 became Chairman of Hang Seng Bank, and a director of HSBC Holdings plc on 1 January 1999. He retired in 2005. Since 2011, Director and Non- Executive Chairman of HSBC Bank Middle East Limited, and since 2016 Adviser to the CEO of HSBC's Global Commercial Bank. Chairman of Octopus Holdings Ltd. in Hong Kong, Vice Chairman of Singapore Listed Noble Group Limited, a member of the Government of Dubai's International Financial Centre Higher Board and until December 2012 consultant to the Office of the President of South Korea. Past Chairman of the Hong Kong General Chamber of Commerce, and the Seoul International Business Advisory Committee. Adviser to Singapore-based Southern Capital Group, and Hong Kong-based New Lily International Group. He holds a number of Government and Community Appointments in Hong Kong. DHL/SCMP Hong Kong Business Person of the Year 2003: 2004 awarded the Gold Bauhinia Star (GBS) by the Government of Hong Kong SAR, 2005 made a Commander of the British Empire (CBE) for his contribution to banking and awarded Honorary Citizenship of Seoul in recognition of his work for the city. In 2005 awarded the Asian Banker Lifetime Achievement Award, and in 2011 conferred an Honorary Doctorate by the Hong Kong Academy for Performing Arts.

Corporate Governance Report (continued)
For the Annual Report 2017

4.4 The composition of the Board and its skill base are kept under continual review and a Board Evaluation is conducted on an annual basis. Board induction and training is provided on a regular basis, and includes training on relevant legal, regulatory and financial affairs.

5. Information given to the Board

5.1 The Framework sets out the matters reserved to the Board, and to the shareholders.

5.2 All Board members receive comprehensive and timely information to enable them to perform their duties.

5.3 All annual and interim financial statements, price sensitive public reports and the reports to the regulators prepared by the Board contain a balanced and understandable assessment.

5.4 The Board is aware of its responsibilities for preparing the accounts.

5.5 The Board ensures effective internal control in all areas of HBON's operations, including financial, operations-related, compliance and risk management.

5.6 The Board has adopted a transparent policy in the matter of relationship with the external auditors, particularly in relation to any award of non-audit related work. The overriding principle is that the external auditors are (and are seen to be) independent in exercising their duties.

5.7 HBON follows internal policies to ensure fair disclosure of all public information released in relation to HBON, and in particular, to ensure that any such information is timely, honest, correct, straightforward, not misleading, and complete.

6. Board & Committee Meetings

6.1 As at December 2017, the Board of Directors had three standing committees, the Audit Committee, the Risk Committee and the Nomination & Remuneration Committee ('NRC') and had delegated day to day business matters and conduct to the HBON Management through the Executive Committee ('EXCO').

6.2 The Board has appointed a legally qualified Company Secretary to carry out the duties set out in the Fifth Principle of the Code, and in addition, to advise on best international governance practice, and local governance requirements.

6.3 The Board and the three Board Committees met on the following dates in 2017, and a comprehensive agenda and Board pack (covering the matters set out in Annexure 3 of the Code) were tabled for information and (where applicable) approval.

2017 Dates	Board & Committee
29 January	Board, Audit, Risk, NRC
5 March	Board, Audit
30 March	Board
26 April	Board, Audit, Risk, NRC
26 July	Board, Audit, Risk
29 October	Board, Audit, Risk, NRC

6.4 The Board met six times, the Audit Committee met five times, the Risk Committee met four times, and the NRC met three times in 2017. The AGM was held on 30 March 2017. The composition, name of members, Chairperson, and attendance record of the Board and Committees and directorships are given in the table below:

Corporate Governance Report (continued)
For the Annual Report 2017

Name	Board & Committee membership	Attendance at Board and Committee meetings				Attendance at the Shareholders Meeting	Director of any other SAOG Company
		Board#	Audit	Risk	NRC	AGM	
Sir Sherard Cowper-Coles	Board Chairman	5	N/A	N/A	N/A	Yes	No
Brig. (Retd.) Waleed Omar Al Zawawi	Board Deputy Chairman, and Audit	6	5	N/A	N/A	Yes	No
Dr. Juma Ali Juma Al Juma	Board	5	N/A	N/A	N/A	No	Yes
Aimen Ahmed Sultan Al Hosni	Board, Risk, NRC	5	N/A	4	3	Yes	Yes
Abdulfattah Sharaf	Board, Risk, NRC and Audit NRC Chairman effective 3 March 2016.	5	3	4	3	No	No
Rob Underwood	Board, Audit, Risk, and NRC. Risk Committee Chairman effective from 21 July 2014.	6	1	4	3	Yes	No
Robin D. Jones	Board and Audit. Audit Committee Chairman effective from 30 March 2015.	6	5	3	N/A	Yes	No
David Gordon Eldon	Board Chairman	1	N/A	N/A	N/A	No	No

The full Board met for a Bank-wide Strategy session on 30 October 2017. The meeting was not considered a formal Board meeting. Sitting fees were paid for attendance and have been recorded in a separate column. 'Strategy session fees in RO' is set out in paragraph 7.1.4 below.

7. Remuneration

7.1 Board of Directors

7.1.1 The Directors are entitled to receive Board and Committee sitting fees in the following amounts, namely:

- RO 500 as a sitting fee payable for every Board meeting attended; and
- RO 500 as a sitting fee for every Committee meeting attended;

subject always to (i) an individual director cap of RO 10,000 per annum and (ii) a maximum annual fees/expenses cap in aggregate (for the Board as a whole) of RO 200,000.

7.1.2 As all members of the Board are non-executive directors, no fixed remuneration or performance linked incentives are applicable. All directors are reimbursed expenses for attending the Board and committee meetings.

7.1.3 During 2017, Sir Sherard Cowper-Coles, Rob Underwood, Abdulfattah Sharaf, and Robin D. Jones each waived their entitlement to be paid the whole or any part of their Board/ Committee sitting fees.

7.1.4 The total Board/Committee sitting fees and expenses paid during 2017 amounted to RO28,630 in accordance with the following table:

Name of the Director	Sitting fees RO	Strategy Session fees RO	Total Sitting fees RO
Sir Sherard Cowper-Coles	-	-	-
Brig. (Retd.) Waleed Omar Al Zawawi	5,500	500	6,000
Dr. Juma Ali Juma Al Juma	2,500	-	2,500
Aimen Ahmed Sultan Al Hosni	6,000	500	6,500
Abdulfattah Sharaf	-	-	-
Rob Underwood	-	-	-
Robin D. Jones	-	-	-
David Gordon Eldon	500	-	500
Total sitting fees	**14,500**	**1,000**	**15,500**
Total hotel, travel and other board expenses	13,130	-	13,130
GRAND TOTAL	**27,630**	**1,000**	**28,630**

7.2 **Staff & Senior Management**

7.2.1 **Reward Framework** – The Bank's Reward Policy provides a Reward Framework which includes the following key elements:

- An assessment of performance with a reference to clear and relevant objectives set within a performance scorecard framework;
- A focus on the total compensation (fixed plus variable pay) with variable pay (namely bonus payments and the value of long-term incentives) differentiated by performance;
- The use of discretion to assess the extent to which performance has been achieved rather than applying a formulaic approach which, by its nature, cannot cover all scenarios and may encourage inappropriate risk taking or mis-selling;
- A significant proportion of variable pay to be deferred into HSBC Holdings Restricted Shares, as well as deferred cash in certain instances, to tie recipients to the future performance, further align the relationship between Risk and Reward, meet the local regulatory requirements and aid employee retention.

7.2.2 **Fixed Pay Policy -** Fixed Pay is designed to attract and retain employees through market competitive pay for the role, skills and experience of the individual and as required for the business. This may include elements, such as salary, other cash allowances and benefits provided in accordance with the local market practices. These payments are fixed and do not vary with performance. Fixed pay is also not subject to malus and clawback provisions that are applicable to variable pay awards. Fixed pay elements are reviewed as a part of the annual pay review cycle or when there is a change in the role and organisational responsibilities of the individual. Incremental Fixed Pay spend for HBON as a result of the pay review is OMR 463,740 reflecting a 2.95% increase over the December 2017 Fixed Pay bill, and within the parameters of the Fixed Pay Framework, HBON's Annual Operating Plan (AOP) and Statutory requirements.

The Fixed Pay Framework aims to provide clear and consistent guidance in respect of the HSBC approach to Fixed Pay, and to make decisions taking into account the following considerations:; (a) Fixed Pay increases to be differentiated based on performance – with any increases targeted towards Top and Strong performers, (b) Considered as part of an appropriate mix of Fixed and Variable Pay as part of an employee's overall Total Compensation, (c) Mandatory Increase of 3% on basic salary of Omani and GCC national employees only, (d) Wage inflation of circa 1.4%,, localised attrition as well as Market pressures

Introduction of Country Fixed Pay Adjustment (CFPA) for PY2017 employees in grades 4 to 8 across all global businesses, global functions, HOST & CEO office not covered by the mandatory increase requirement are awarded a minimum fixed pay increase of 1.4% to support the inflationary cost increases.

7.2.3 **Variable Pay Policy** - Variable Pay awards are designed to drive and reward performance based on annual financial and non-financial measures consistent with the Bank's medium to long-term strategy, shareholder interests and adherence to HSBC values. The Variable Pay awards are to be granted in accordance with the Sound Compensation Principles and Standards, including deferral and retention requirements. This includes any guaranteed Variable Pay that an employee may be entitled to. All Variable Pay awards granted to the employee for a performance year in which he/she was identified as a Material Risk Taker ('MRT') is subject to malus and clawback. All deferred Variable Pay is conditional upon the employee remaining employed with HSBC until the vesting date, save in circumstances where "good leaver" treatment applies.

7.2.4 **The 2017 Pay Review Funding** - Fixed and Variable Pay review funding was established during 4Q17 for each Business, Function and for HBON overall. The 2017 Fixed Pay funding followed the Bank's Fixed Pay Policy, with due consideration to HBON's Annual Operating Plan ('AOP'), affordability, Regulatory/legal requirements, external economic and market characteristics along with the need to retain talent. The Variable Pay funding was based on overall business performance, market characteristics, risk and compliance issues, values adjustment and individual performance. Individual reward assessment was based on the existing four point performance rating scale as well as the behaviour rating. The impact of breaches, non-completion of certain Mandatory Training and other transgressions, as well as recognition/ positive adjustment, was applied in line with the HBON Consequence Management Framework. Funding values have been ascertained for each Business and Function as a part of the standard governance process. The annual pay review has been facilitated across the Bank against the backdrop of overall performance, individual employee performance, behaviour, adherence to HSBC values, the external economic and market environment, affordability, pay trends, employee expectations and the global and local legal, regulatory and social responsibility environment.

7.2.5 **The 2017 Variable Pay Spend** - The Variable Pay Spend for 2017 is RO 3.425 million representing an increase of 5.3% over the 2016 spend and a headcount reduction from PY2016 to PY2017 of - 4.6%. Aggregate Variable Pay spend reflects a payout ratio of 16% of Profit before Tax (PBT) and 4.5% of overall HBON revenue (against 19 % and 4.4 % respectively in 2016).

7.2.6 **Total Compensation of Material Risk Takers ('MRTs')** - The HBON Executive Committee and senior management members, all of whom are MRTs, as well as others classified as per the CBO definition (38 executives in total) were subject to the same recommendations, review and challenge process as the broader HBON employee population. The Pay Review for HBON was reviewed as a part of the Bank's governance process on annual reward reviews. The total remuneration paid in aggregate during 2017 to the MRTs including salary, cash and non-cash benefits, bonuses, stock options, gratuity and pensions amounted to RO 3.59 million. The total remuneration paid in aggregate during 2017 to the top 5 officers amounted to RO 1.25 million.

7.2.7 **Compensation Deferment Policy** - In accordance with the CBO's Deferral Rules, Variable Pay awards equal to or in excess of RO35,000/- are subject to a deferral of 45% and was combined with the Bank's existing matrix based approach deferral which applies to Variable Pay values in excess of RO28,800/-. As a result of the application of this Policy, circa RO 354,271 or (31%) of the senior management and all MRTs Variable Pay will be in the form of restricted stock and/or deferred cash/stock,

7.2.8 The executive management has been appointed under formal contracts of employment. Employment contracts are for a period of two years for expatriates and are regulated by local labour laws for Omanis. The notice period is 3 months.

8. Board Committee and Management Committees

8.1 The Board has implemented three Board committees as required under the local laws, namely the Audit Committee, the Risk Committee and the NRC. The Board also has oversight for the HBON management committees, which include an Asset & Liability Management Committee ('ALCO'), a Risk Management Meeting ('RMM'), and an EXCO.

8.2 All three Board Committees, namely - the Audit Committee, the Risk Committee, and the NRC – comprise three members.

8.3 Each of these Board and Management committees is governed by formal Terms of Reference which set out their membership, scope, responsibilities and accountability.

8.4 The Board has approved and delegated authority to executives within HBON. The executive management is accountable to the Board through the Chief Executive Officer ('CEO'). Clear delegations of authority and matters reserved to the Board are set out in the Framework.

8.5 The Board ensures that the decisions and policies which it approves under the 'reserved matters' set out in the Framework are implemented by Management. The CEO attends the Board meetings, and is accountable for ensuring that the Board decisions and policies are implemented effectively, and on time.

8.6 The Board keeps the systems of internal control of HBON under continual review.

8.7 The Board keeps the training and development of Management, together with skills required and succession planning, under continual review.

9. Audit Committee

9.1 The Board has set up the Audit Committee in compliance with the Tenth Principle of the Code. Private sessions are held regularly between the Audit Committee on the one part (separately) with the Chief Financial Officer, Head of Internal Audit, External Auditors, Head of Compliance, and the statutory Legal Advisor.

9.2 The Terms of Reference of the Audit Committee set out the responsibility and authority of the Committee and are approved by the Board and reviewed annually.

9.3 The primary objective of the Audit Committee is to be accountable to the Board and to provide non-executive responsibility for oversight of, and advice to the Board on, matters relating to financial reporting; together also with all other matters set out in Annexure 3 of the Code.

10. Risk Committee

10.1 The Terms of Reference of the Risk Committee set out the responsibility and authority of the Committee and are approved by the Board and reviewed annually.

10.2 The primary objective of the Risk Committee is to be accountable to the Board and to provide non-executive responsibility for oversight of, and advice to the Board on, high level risk related matters, and risk governance. In addition, the Risk Committee provides credit decisions in accordance with the limits of credit sanction authority delegated by the Board or the Chairman of the Board from time to time.

11. NRC

11.1 The Board has set up the NRC in compliance with the Eleventh Principle of the Code. The Terms of Reference of the NRC set out the responsibility and authority of the Committee and are approved by the Board and reviewed annually.

11.2 The primary objective of the NRC is to be accountable to the Board and to review the over-arching principles, parameters and governance framework of the CMA's Code and HBON's remuneration policy and the remuneration of (i) Senior Executives (HBON CEO, HBON General Managers and the HBON Company Secretary), (ii) Regulated Employees (Regulated employees are employees who perform a significant influence function), (iii) material risk takers, (iv) employees whose activities have or could have a material impact on the HBON's risk profile, and (v) any other employee as determined by the Committee from time to time in accordance with the requirements of HBON's regulators including implementation of the 9 Principles and 19 Standards of the Financial Stability Board as applicable and evidencing response to the papers on "Range of Methodologies for Risk and Performance Alignment of Remuneration" and "Pillar 3 Disclosure Requirements for Remuneration by the Basel Committee on Banking Supervision (BCBS) as may be applicable".

12. Means of Communication with Shareholders and Investors

12.1 HBON had 3,392 shareholders as at 31 December 2017.

12.2 HBON is ready, where practicable, to enter into dialogue with institutional investors, based on a mutual understanding of objectives.

12.3 The main source of information for the shareholders is the Annual Report which includes, amongst other things, the Board of Directors' statement, Management Discussion & Analysis report and the audited financial statements.

12.4 HBON financial information is uploaded onto the Muscat Securities Market ('MSM') in accordance with the local regulatory requirements. It is also uploaded onto the HBON website (www.hsbc.co.om).

12.5 In addition, the Interim Condensed Financial Report is posted on HBON's website (www.hsbc.co.om) and published in the local press. The Annual financial statements are posted on HBON's website at www.hsbc.co.om and MSM and published in the local press. The Annual Report (including the Annual financial statements) are also sent to the shareholders and filed with the CMA and MSM.

12.6 The website displays official news announcements and public presentations made to institutional investors and analysts.

13. Market Price and distribution of holdings

13.1 The following table sets out the HBON market price data during 2017:

Market price data - high and low

(Based on the daily closing prices on the MSM)

Month	RO High	RO Low	Average Index (MSM-Financial)
January 2017	0.131	0.121	7,877.35
February 2017	0.131	0.124	8,142.12
March 2017	0.132	0.125	8,039.65
April 2017	0.136	0.127	8,034.82
May 2017	0.136	0.126	8,004.29
June 2017	0.132	0.123	7,942.34
July 2017	0.125	0.120	7,601.29
August 2017	0.120	0.111	7,437.46
September 2017	0.120	0.110	7,445.12
October 2017	0.120	0.111	7,305.85
November 2017	0.126	0.120	7,374.72
December 2017	0.128	0.120	7,416.63

13.2 The following table sets out the distribution of HBON share ownership during 2017:

% Shareholding	No of shareholders
Less than 5%	3,391
Between 5 – 10%	0
More than 10%	1
Total	3,392

13.3 HBON has no GDRs (Global Depository Receipt), ADRs (American Deposit Receipts), warrants or convertible instruments in issue.

14. Details of non-compliance by HBON

14.1 During the last 3 years total fines of RO 67,770 (RO 33,770 for Year 2015; RO 19,000 for Year 2016; and RO 15,000 for Year 2017) were imposed on the Bank for regulatory penalties as detailed hereunder:

Corporate Governance Report (continued)
For the Annual Report 2017

Year	Entity	Regulator	Brief Description	Amount of penalties RO
2015	HBON - Oman	CBO	The Bank had not put in place a separate Policy on Small & Medium Enterprises ('SME') lending and had not appointed Assistant General Manager or above to head the SME unit.	2,500
		CBO	There was no clean break between the loan approval and the risk classification authority as the Chief Risk Officer responsible for the risk classification also had lending powers. Besides, a few customers of the Bank had not been classified as per the CBO guidelines.	2,500
		CBO	The customers were not separated into risk categories on the basis of their risk profile except for a few high risk businesses, customers from high risk countries and Politically Exposed Persons (PEPs).	10,000
		CBO	The Bank has not conducted periodic reviews of security and operational aspects of the electronic banking activities to ensure adequacy of security and access controls.	2,500
		CBO	Data Quality Issue. The Bank Credit and Statistical Bureau ('BCSB') was not updated. A total fine of RO 9,600 was imposed on three occasions (RO 600; RO 8,200; and RO 800).	9,600
		Telecom Regulatory Authority ('TRA')	HBON had procured walkie-talkie radio units from a TRA approved vendor. But the TRA inspection team concluded that the radio units had not been authorised by the TRA.	6,670
Total Fines 2015				**33,770**
2016	HBON - Oman	CBO	The Bank had signed several new Intra Group Service Agreements with Group entities and had failed to obtain prior approval from the CBO for the changes to the outsourcing arrangements that had been hitherto approved by the CBO.	10,000
		CBO	The Bank had violated the CBO instructions with regard to Omanisation of Personnel in the Banking Sector.	4,000
		CBO	The Bank had not complied with the provisions of the CBO Circular on combating frauds where, the Bank had not reported frauds to the CBO and the ROP within three days of knowledge/occurrence.	4,000
		CBO	Data Quality Issue. The Bank Credit and Statistical Bureau ('BCSB') was not updated. A total fine of RO 1,000 was imposed on two occasions (RO 200; and RO 800).	1,000
Total Fines 2016				**19,000**
2017	HBON - Oman	CBO	Data Quality Issue. The BCSB was not updated.	3,000
		CBO	The Bank was not in compliance with the CBO Regulations on Outsourcing.	4,000
		CBO	The Bank had not complied with the condition stipulated by the CBO, while granting the approval for product.	4,000
		CBO	The Bank was not compliant with the Regulatory requirements on security of Electronic Banking systems.	4,000
Total Fines 2017				**15,000**

The Chairman has responded to the CBO and a Board approved action plan is in place to rectify the issues.

15. Disclosure

15.1 Management is bound by a conflict of interest policy and also a share dealing policy.

15.2 Details of Directors' interests are maintained in order to identify any contracts or other interests held by any of the HBON Directors.

15.3 Effective 22 July 2016, all new Related Party Transactions ('RPTs'), (i) where RPTs are within the ordinary course of business, are being submitted to the Audit Committee for review and to the Board for approval and (ii) where RPTs are not within the ordinary course of business, are being submitted to the Board for review and recommendation and to the Shareholders for approval, prior to execution. The definition of 'Related Parties' has been defined in the Code. The details of Related Party Transactions carried in the ordinary course of business during 2017 have been (i) disclosed in the Notes to the Financial Statements as at 31 December 2017 (included in the Annual Report) and (ii) included in the notice to AGM.

15.4 HBON complies with all other international standards relating to the disclosure of related party transactions.

15.5 HBON has implemented and follows a formal works and procurement policy.

16. Professional profile of the statutory auditor

16.1 PricewaterhouseCoopers ('PwC') were the statutory auditors of HBON in 2017.

16.2 The Shareholders of the Bank appointed PwC as the Bank's auditors for the year 2017.

16.3 PwC is a global network of firms operating in 158 countries with more than 236,000 people who are committed to delivering quality in assurance, tax and advisory services. PwC also provides corporate training and professional financial qualifications through PwC's Academy.

Established in the Middle East for over 40 years, PwC Middle East has firms in Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Oman, the Palestinian territories, Qatar, Saudi Arabia and the United Arab Emirates, with more than 4,200 people. (www.pwc.com/me).

PwC has been established in Oman for over 40 years and the Firm comprises 4 partners, including one Omani national, and over 130 professionals and support staff. Our experts in assurance, tax and advisory professionals are able to combine internationally acquired specialist consulting and technical skills with relevant local experience.

PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.

17. Audit Fees

17.1 PwC charged fees of RO90,000 for audit services and RO16,550 for non-audit services, totaling RO106,550, towards their engagement as the external auditor of the Bank for the year 2017.

18. Acknowledgment by the Board of Directors:

18.1 The Board confirms that to the best of its knowledge and belief:

- The financial statements have been prepared in accordance with the applicable standards and rules;
- The efficiency and adequacy of the internal control systems of HBON have been reviewed and are in compliance with internal rules and regulations; and
- There are no material things that affect the continuation of HBON and its ability to continue its operations during the next financial year.

For and on behalf of the Board of Directors

Sir Sherard Cowper-Coles
Chairman


The legendary journey continues…
For us, sustainability means building our business for the long term, which enables us to help businesses thrive and contribute to the growth and resilience of communities. Over the last 4 years, we have funded research on the sustainable growing and harvesting of the frankincense trees in Dhofar.
70 YEARS IN OMAN
HSBC
Together we thrive
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Management Discussion and Analysis

HSBC Bank Oman at a glance

HSBC Bank Oman (HBON/The Bank) is a proud local bank, having been established in Oman in 1948. The Bank has over 200,000 active clients and a broad based footprint across the length and breadth of the Sultanate of Oman. HBON is part of the HSBC Group, one of the largest banking and financial services organisations in the world, which serves customers worldwide from over 3,900 offices in 67 countries and territories in Europe, Asia, North and Latin America, and the Middle East and North Africa. HSBC brings global access to our local stakeholders – customers, shareholders and staff

Our Values:

Open, Connected, Dependable

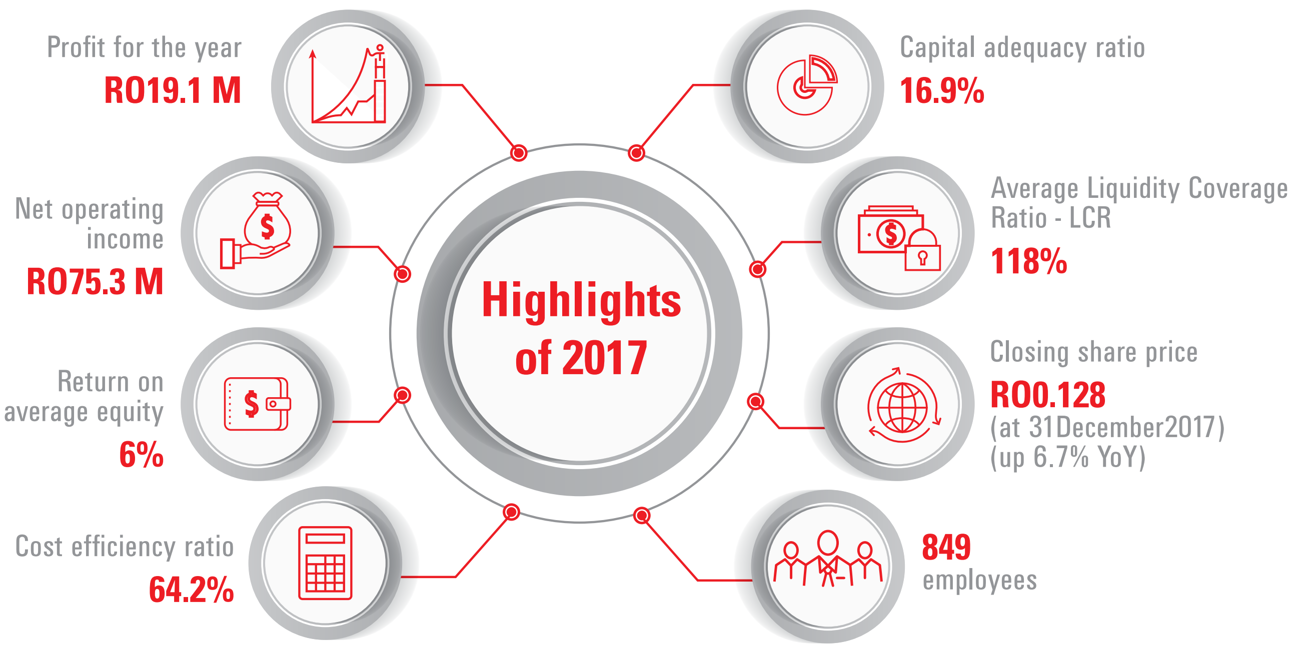
Our Purpose

Our purpose is to support the growth and diversification of Oman, contribute to the development of the community, support financial institutions and help people fulfil their hopes and realize their ambitions.

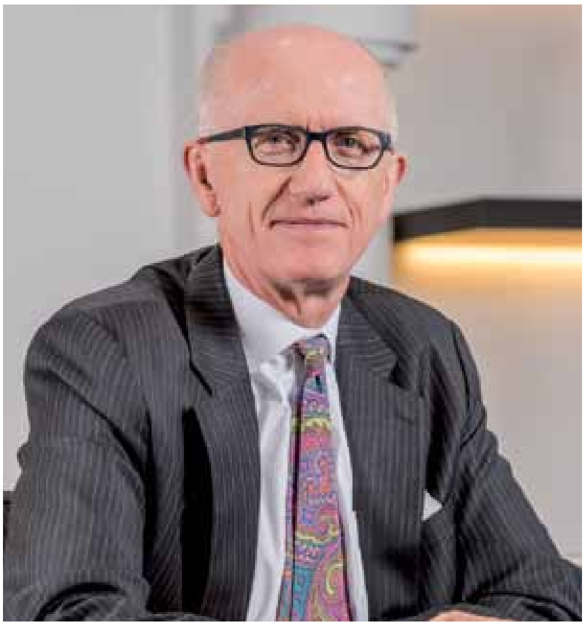
Our Vision

Our vision is to become the leading bank in Oman. We will achieve this by focusing on the needs of our customers and the communities in which we operate, thereby delivering long-term sustainable value to all of our stakeholders.

Highlights of 2017



Management Discussion and Analysis (continued)



Oman's Banking Environment

The banking sector in Oman continued to witness reasonable growth in both credit and deposits. Credit to the private sector increased by 6.5% to RO 21 B as at the end of December 2017. Of the total credit to the private sector, the household sector (mainly under personal loans) stood at 46.1% closely followed by the non-financial corporate sector at 45.7%, while financial corporations and other sectors obtained 4.9% and 3.3% respectively.

Total deposits registered a growth of 5.6% to RO 21.6 B as at the end of December 2017. Private sector deposits of the banking system registered a growth of 5.2% to RO 14 B as at the end of December 2017.

Financial Performance Analysis

Profit for the year: HBON recorded a 13.0% increase in net profit to RO19.1 M for the year ended 31 December 2017 compared with RO16.9 M for the year ended 31 December 2016. Profit grew owing to an increase in net operating income, lower loan impairment charges and improved tax expenses. For the fourth consecutive year, HBON reduced its total cost base.

HBON's performance in 2017 demonstrated the fundamental strength of our business. Our strong capital and prudent risk appetite helped us to achieve positive growth in a difficult market environment. The financial results are further analysed as follows:

Net Interest Income (NII): NII remains flat at RO54.3M compared with last year as margins continued to be squeezed in our consumer lending portfolio, partially offset by rising yields from the investment of surplus liquidity in government securities.

Net fee, trading and other operating income: Net fee, trading and other operating income was RO21.0m compared to RO20.9 M in 2016. The reasons for the underlying movements were:

Net fee income fell by 4.9% to RO11.7 M for the year ended 31 December 2017 due to lower credit structuring fees from corporate customers and lower cards and wealth revenue from retail customers.

Net trading income increased by 17.9% to RO9.2 M owing mainly to balance sheet portfolio optimisation.

Other operating and dividend income fell to RO0.1 M compared with RO0.8 M for the year ended 31 December 2016 owing primarily to the non-repeat of the gain on sale of legacy investments of RO0.5 M and lower dividend income compared with 2016 following such sales.

Loan impairment charges net of recoveries: A net charge of RO5.5 M has been reported for loan impairment charges compared to a net charge of RO5.6 M for the same period in 2016. This was due mainly to a release from the general provision of RO0.3 M following the overall reduction in wholesale loans. This was partly offset by specific provision charges of RO2.1 M in Wholesale and RO3.7 M in the Retail portfolio. Non-performing loans as a percentage of total loans reduced marginally from 4.6% in 2016 to 3.8% in 2017.

Operating expenses: Total operating expenses were marginally down at RO48.4 M as a result of our continuing focus on managing our cost base - the fourth consecutive year in which we have cut our cost base.

The Cost Efficiency Ratio (CER) improved slightly to 64.2% compared to 64.3% for the same period in 2016.

Total assets: HBON's total assets increased from RO2,253.9 M to RO2,333.8 M. The major upturn in assets comprised of RO202.0 M in Financial Investments. This was partly offset by a reduction in Cash and balances with the Central Bank of RO61.1 M, amounts Due from banks of RO39.9 M and Loans and advances to customers of RO23.5 M.

Loans and advances: Customer lending fell by 1.7% to RO1,394.9 M owing mainly to the aforementioned reduction in wholesale loans, itself owing almost entirely to the repayment of a single short term wholesale loan in January 2017 which fall was largely offset by growth across the rest of the lending portfolio.

Customer deposits: Customer deposits increased by 3.5% to RO1,932.1 M compared with RO1,866.7 M as at 31 December 2016

HBON's Advances to Deposits (ADR) ratio stood at 72.0% as compared to 76.0% in 2016. The ADR reflects the liquidity of the Bank as HBON continues to position itself among its peers as having the most liquid balance sheet.

Capital Adequacy Ratio: HBON's Capital Adequacy Ratio (CAR) stood at 16.9% for the year ended 31 December 2017 compared with 18.7% as at 31 December 2016, with the change largely due to the impact of regulatory changes in relation to the treatment of investments in certain overseas government securities. Without such regulatory changes, HBON's CAR would have strengthened further.

Our approach to managing capital is designed to ensure that we exceed current regulatory requirements and we are well placed to meet those which are expected in the future.

HBON's growth aspirations and conservative approach to managing its balance sheet require a strong and liquid capital base. Our financial performance in 2017 has kept HBON well capitalised to support these aspirations. We seek to position ourselves to deliver sustainable shareholder returns over the coming years. Accordingly, HBON's dividend payout has been set in line with capital and growth targets to support these returns.

Retail Banking and Wealth Management

In Retail Banking and Wealth Management (RBWM), we continued our focus on the premium customer segments in line with our strategy. We started the year with an acquisition campaign targeting Advance customers along with a campaign to launch our Mandoos programme for the year. This was followed by card campaigns to promote usage of our credit and debit cards during the summer spend season. We also ran a "Member get Member" campaign where we rewarded our existing Advance customers who referred new customers. To sustain acquisition momentum towards the end of the year, we ran a campaign again focusing on Advance "New to Bank" customers.

Keeping up with the rapidly evolving digital technologies, we have introduced several enhancements to our digital platforms and have rolled out projects which enhance the customer experience whilst utilizing the improved infrastructure provided by the Regulator. These efforts have resulted in an increase in our new to bank customers' digital engagement to 41% in Q4 2017 compared to 34% in same period last year. During the last quarter we also introduced the "e-wallet" functionality to support the Mobile Clearing System which was launched earlier in the year. We continued optimizing our ATM fleet by closing / relocating ATMs based on usage and potential.

We have continued to listen to our customers and build a deeper understanding of their channel usage preferences. Therefore, and based on the significant reduction in transaction volumes across our counters over the last two years, as customers have switched to using digital/alternative channels, we initiated a branch rationalization project at the beginning of the year. We successfully merged 22 branches bringing down the number of our branches to 48 branches. This initiative demonstrates the strength of our digital banking proposition and our ability to serve our customers through alternative channels.

We also opened one Customer Service Unit (CSU) in Salalah, increasing the number of CSUs to 3 in addition to the 48 branches. We have also completed the refurbishment of 34 branches to meet the our and Regulatory standards. We will be completing the refurbishment of the remaining 14 branches by the end of Q1 2018.

We continued to focus on improving the quality of our customer experience by fostering a customer centric culture in the Bank. During the year we launched a tailor made "Absher in action" training programme in partnership with Oman Sail, with the aim of transforming our employees' performance in key areas such as customer service, teamwork, decision making and problem solving. As a result of these efforts, we have seen a progress in the Premier customer recommendation index from 86% in 2016 to 88% in 2017.

RBWM will continue to focus on delivering an exceptional customer experience at all times and through all customer touch-points – our branch network, Call Centres and digital banking channels.

Commercial Banking

In Commercial Banking we continued to leverage our regional and global connections in support of our local expertise to the benefit of our clients in Oman. We have worked on enhancing our product suite for customers and have introduced new developments in our digital offering. This has included the launch of our Virtual card, which is an extension of our existing market-leading Corporate credit card offering. This proposition, which is the first of its kind in Oman, allows customers to set spending limits and define their own reconciliation controls specific to their purchasing needs.

As part of our support to the small and medium enterprises (SMEs) and to other Corporate clients in Oman, we conducted an event that focused on the evolution of technology for payments across companies' treasury functions. The objective of these regular events is to help businesses achieve greater efficiency by adopting the most advanced technology and to ensure that our clients make the most of the international growth opportunities at hand.

During the year we also hosted the 20th HSBC Economist roadshow in Oman, where our customers had the opportunity to hear from HSBC Group's in-house Economists and senior Foreign Exchange strategists as they discussed the outlook for the region and gave their insight on the GCC and on Oman's economies in light of the current operating environment locally, regionally and globally.

The strength of our liquidity and cash management proposition was recognised, for the 7th consecutive year, by winning the Euromoney "Best Cash Management Bank in Oman Award". The Euromoney's Annual Cash Management Survey provides cash managers, treasurers and financial officers with the opportunity to comment on the standard of the international cash management services they receive and rate the financial institutions they bank with. Being recognised by our clients demonstrates our clear ability to support their business requirements locally and internationally.

Global Banking & Markets

In Global Banking we provide financial services and products to the Government of Oman, to Financial Institutions and to subsidiaries of Multinationals banking in Oman. Our comprehensive range of products and solutions, across capital financing, advisory and transaction banking services, can be customised to meet our clients' specific objectives.

In 2017 we have successfully executed a number of strategic deals that demonstrated HSBC Bank Oman's position as a strategic partner in the Government's plan to develop and diversify the Omani Economy. The below examples highlight some of the creative and diversified liquidity sources HSBC is able to advise on.

In March 2017 we acted as a Joint Global Coordinator, Joint Lead Manager and Bookrunner on the Ministry of Finance's largest ever USD 144A/RegS bond in the international capital market with a total size of USD 5 B across the 5, 10 and 30 year tranches. This deal marks the first ever 30 year offering from the Sultanate, the largest CEMEEA transaction and the second largest transaction of the Emerging Market in 2017.

In May 2017, the Ministry of Finance successfully priced its debut international 7-year USD 2 B 144A/RegS Sukuk issuance. This deal also marks the first ever 7 year offering from the Government. HSBC acted as a Joint Lead Manager and Bookrunner on this transaction.

Another achievement for HBON in 2017 was our appointment as a coordinator and initial mandate lead arranger for Oman Oil Company Exploration and Production's (OOCEP) debut debt financing. This transaction was structured as a pre-export finance facility extended to OOCEP, and secured against future sales of crude oil exports.

We also acted as an underwriter and mandated lead arranger on Oman Telecommunication Company's (Omantel) USD 2.25 B syndicated facility. Comprising a USD1.45 B bridge facility and a term loan, the Facility funded Omantel's acquisition of a controlling 22% stake in Kuwait's Mobile Telecommunications Company ("Zain").

Finally HBON also acted as Joint Global Coordinator, Sole Left Lead on the EUR tranche, Bookrunner, Mandated Lead Arranger and Rating Advisor on the German chemical company OXEA's EUR900 million Senior Secured Dual Tranche Term Loan B issuance for the refinancing of existing debt.

Human Resources

In 2017 we continued our commitment towards the national recruitment agenda, as we have achieved an Omanization rate of 93% as at 31 December 2017, which is ahead of the 90% target set by the Central Bank of Oman.

We continued to invest in a number of human resources and skills development strategies to help our employees realize their potential through different development programs that are conducted locally as well as regionally in HSBC's regional Head Office in Dubai.

In 2017 our focus to continue to drive the FCC Culture continued as we launched a "Risk Certification Programme" early in the year, with employees in roles which involved managing risk commencing ICA International Diplomas on "Governance, Risk and Compliance", "Financial Crime Prevention" and "Anti Money Laundering". We introduced an FCC "At our Best" on-line recognition tool for all employees in the Bank which allows employees and managers to recognize colleagues who display exceptional commitment in fighting financial crime.

Operational Risk

During 2017 we implemented a new operational risk management framework ('ORMF') and system of record. The new ORMF provides an end-to-end view of non-financial risks, enhancing staff focus on the risks that matter the most and their associated controls. It provides a platform to drive forward looking risk awareness and assist management focus. It also helps the Bank to understand the level of risk it is willing to accept. We also maintained activity to continually strengthen our risk culture. In particular, we focused on the use of the three lines of defence model, which sets our roles and responsibilities for managing operational risk on a daily basis.

('ORMF') defines the minimum standards and processes, as well as the governance structure for the management of operational risk and internal control in HBON's businesses and functions. The ORMF has been codified in a high-level Standards manual, supplemented with detailed policies, which describe our approach to identifying, assessing, monitoring and controlling operational risk and which give guidance on mitigating actions to be taken when weaknesses are identified.

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

Operational risk and control self-assessments are input and maintained on the system by business units. Business and functional management together with business risk and control managers monitor the progress of documented action plans to address shortcomings. Losses are entered into the Bank's operational risk database and reported to the monthly Risk Management Meeting.

The Bank uses an activity-based three lines of defence model to delineate management accountabilities and responsibilities for risk management and the control environment. This creates a robust control environment to manage risks. The model underpins the approach to risk management by clarifying responsibility, encouraging collaboration, and enabling efficient coordination of risk and control activities.

The three lines of defence are summarised below:

- The First Line of Defence owns the risks and is responsible for identifying, recording, reporting and managing them, and ensuring that the right controls and assessments are in place to mitigate them. Most of HBON's staff are in the First Line of Defence, including Risk Owners, Control Owners and Business Risk & Control Managers.
- The Second Line of Defence sets the policy and guidelines for managing operational risk and provides advice and guidance on effective risk management. The Second Line are risk management specialists comprising Risk Stewards and the Operational Risk Function.
- The Third Line of Defence is our Internal Audit function who independently ensure that HBON is managing operational risk effectively.

Business Continuity Planning (BCP)

HBON has adopted industry leading best practices, building on the HSBC Group's global strategy and experiences over the last 150 years. HBON has establis-hed a set of operating principles which govern how risks of a significant business disruption are mitigated to protect the Bank's customers, employees and stakeholders.

The Bank has a robust and well defined Business Continuity program which comprises policies and procedures with clearly defined roles, responsibilities and ownership for Crisis Management, Emergency Response, Business Recovery and IT Disaster Recovery Planning. The Bank's BCP committee, represented by the senior executive management of the Bank, oversees the annual Business Continuity Management strategies and progress.

Regular drills, exercise and tests are conducted to cover all aspects of the BCP. Plans are reviewed and maintained bi-annually to incorporate any changes to environment, people, process and technology.

In addition, technical arrangements for Disaster Recovery are also in place to ensure that the critical systems disruption are completely avoided or minimized in case of a disaster. Annual tests are done in coordination with the Central Bank of Oman for all critical banking applications. The recovery times of these tests are logged and monitored in order to ensure that the recovery of systems is within the pre-agreed timeframes with the business. The Bank's Business Continuity function continuously works towards strengthening the business continuity preparedness of the Bank. The Bank›s Business Continuity program is developed to manage the impact of significant disruptions and will endeavor to resume business and operations to an acceptable level within a reasonable time in the event of a disaster. While the Maximum Disruption Time (MDT) have been defined and documented in the plans, various external factors beyond our control could affect the actual recovery time.

The Bank's Business Continuity plan is in line with the guidelines issued by regulatory bodies and is subject to regular internal, external and regulatory reviews.

Corporate Sustainability

Corporate sustainability (CS) is an integral part of the way we do business. In 2017, we continued our commitment to contribute to the country's prosperity in an economically, environmentally and socially responsible manner.

During 2017, we conducted several voluntary activities in line with our efforts on fostering a volunteering culture at the Bank and raising awareness among our employees on the importance of volunteering. As a result we managed to almost triple our volunteering hours in 2017 to 2,157 hours, which is an achievement that reflects the increased awareness and interest among staff to play a role in the Bank's CS agenda.

During the holy month of Ramadhan we organized a charity fair for over 1,500 laborers, where they could select from a variety of goods and commodities free of charge. We also had several engagement activities with the Orphanage Center, and distributed food vouchers to a number of needy families around the Sultanate.

The "Taqaddam Programme", which was developed in partnership with the British Council and the Caledonian College of Engineering, was one of the highlights of the year. This is an HSBC regional program that is designed in a unique way to reflect the changing demand in the working world and aims to provide the college students with the skills, confidence and lifelong learning they need to succeed in the 21st century. We are proud to note that two teams of students from Oman competed and won at a regional level in Taqaddam's "Make it Virtual" regional competition held in Dubai.

Our CS activities also included a Sea Bed cleaning campaign that was conducted in coordination with the Ministry of Environment and Climate Affairs aiming to help preserve the marine life and provide safer breeding grounds for fish and crustaceans in the coral reefs of Oman's Damaniyat Island Nature Reserve. 22 scuba diving volunteers from HSBC Oman and HSBC UAE participated in this campaign and helped to save sea creatures that had become trapped in the abandoned fishing nets.

Looking Ahead

Oman's government has announced an expansionary budget for 2018 giving the economy the needed boost towards sustainable growth. According to Oman's 2018 budget statement, GDP growth is projected to be positive at a rate of at least 3% in 2018. This is driven by the oil price partial recovery and the continuing efforts to diversify the economy.

The Government has planned to fund the projected 2018 deficit as in 2017 through international and domestic borrowing and through use of state reserves. HBON has played a strategic role in facilitating these debt issuance programmes in 2017 and in the January 2018 sovereign debt issuance and continues to support the government's overall plan to develop and diversify the economy.

Management Discussion and Analysis (continued)

For HSBC Bank Oman, 2018 marks a very important and special milestone insofar as we will complete 70 years of operations in Oman. Since the inception of our first branch in Muscat in 1948, as a branch of the British Bank of the Middle East (Bank Britani), HSBC has celebrated many milestones together with the country, and remains a key part of Oman's banking history. As we enter a new era of our journey in Oman, we look ahead with confidence and renew our commitment to all our customers and stakeholders, and assure them of an exceptional banking experience at all times.

Andrew P Long
Chief Executive Officer

Report of factual findings to the Board of Directors of HSBC Bank Oman SAOG in respect of Basel II - Pillar III and Basel III Disclosures

We have performed the procedures agreed with you and as prescribed in the Central Bank of Oman (CBO) Circular No. BM 1027 dated 4 December 2007 with respect to the Basel II - Pillar III Disclosures and Basel III related Disclosures (the disclosures) of HSBC Bank Oman SAOG (the bank) set out on pages 34 to 52 as at and for the year ended 31 December 2017. The disclosures were prepared by the management in accordance with the CBO's Circular No. BM 1009 dated 13 September 2006, Circular No. BM 1027 dated 4 December 2007 and Circular No. BM 1114 dated 17 November 2013. Our engagement was undertaken in accordance with the International Standard on Related Services applicable to agreed-upon-procedures engagements. The procedures, as set out in Circular No. BM 1027 dated 4 December 2007, were performed solely to assist you in evaluating the bank's compliance with the disclosure requirements set out in CBO's Circular No. BM 1009 dated 13 September 2006 and BM 1114 dated 17 November 2013.

We report our findings as follows:

Based on performance of the procedures detailed above, we found the disclosures free from any material misrepresentation.

Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance on the disclosures.

Had we performed additional procedures or had we performed an audit or review of the disclosures in accordance with International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose or to be distributed to any other parties other than CBO. This report relates only to the bank's disclosures and does not extend to any financial statements of the bank taken as a whole or to any other reports of the bank.

Our obligations in respect of this report are entirely separate from, and our responsibility and liability is in no way changed by, any other role we may have (or may have had) as auditors of the bank or otherwise. Nothing in this report, nor anything said or done in the course of or in connection with the services, will extend any duty of care we may have in our capacity as auditors of any financial statements of the bank.

PricewaterhouseCoopers

4 March 2018
Muscat, Sultanate of Oman

PricewaterhouseCoopers LLC, Hatat House A, Suites 204-211, Wadi Adai, P. O. Box 3075, Ruwi, PC 112, Muscat, Sultanate of Oman, T: +968 2 455 9110, F: +968 2 456 4408, www.pwc.com/me

HSBC Bank Oman S.A.O.G. ('the Bank' or 'HBON') is an Omani joint stock company, which was incorporated on 1 January 1979, operating as a commercial bank through a network of branches in the Sultanate of Oman. The registered address of the Bank is P.O. Box 1727, CPO Seeb, Postal Code 111, Sultanate of Oman. The Bank has its shares listed on Muscat Securities Market.

HSBC Middle East Holdings BV ('HMEH') holds 51% of the shares in HBON. The ultimate parent company of HBON is HSBC Holdings plc.

Disclosure Policy

The Bank has developed a formal policy on the disclosure requirements forming part of Basel II and Basel III Norms which is approved by the Board of Directors in line with the requirements of the Central Bank of Oman ('CBO') regulations.

Scope of Application

The information provided in this statement is for the Bank's operations in Oman. The Bank has no subsidiaries.

Capital Structure

Objectives & Strategy:

CBO sets and monitors regulatory requirements. The Bank's objectives when managing capital are to:

- Safeguard the Bank's ability to continue as a growing entity and increase the returns for its ultimate shareholders;
- Comply with regulatory capital requirements set by the CBO;
- Maintain Capital Adequacy Ratios above the minimum specified by the CBO and Basel II Accord guidelines and Basel III framework;
- Manage the investments in short term money market placements in CBO instruments or above investment grade financial institutions.

Qualitative Disclosures:

- The Bank uses Standardized Approach for estimating the Capital Charge for credit risk.
- The Bank uses Basic Indicator Approach for estimating the Capital Charge for Operational Risk.
- In implementing current capital requirements, the Bank calculates Risk Assets Ratio in accordance with the Capital Adequacy guidelines established by the CBO prescribing the ratio of total capital to total Risk Weighted Assets (RWA).

Quantitative disclosure

Capital Structure:

Common Equity Tier 1 (CET1) Capital is comprised of common shares issued by the bank, legal reserves and retained earnings. The book values of goodwill, intangible assets, cumulative unrealised losses on available for sale investments/loans are deducted in arriving at CET1 capital. Currently, the Bank does not have any goodwill on its book.

Additional Tier 1 Capital (AT1)

Additional Tier 1 Capital consisting of the following:

- Perpetual capital instruments issued by the bank which should be subordinated to depositors, general creditors and subordinated debt/sukuk of the bank and meets the further criteria as specified under the Basel III framework;
- Share premium resulting from the issue of Additional Tier I instruments;
- Qualifying Additional Tier 1 capital instruments issued by consolidated subsidiaries of the bank held by third parties, on minority interest and which are not included in Common Equity Tier 1; and
- Less regulatory adjustments applied in the calculation of Additional Tier 1 Capital.

Tier II capital comprises of general loan loss provisions and cumulative fair value gains on available for sale equity instruments. The fair value gains are recognized after a haircut of 55% on the difference between the historical cost book value and market value and are applied in order to cushion against market volatility and tax charges.

In line with CBO guidelines, non-strategic investments made in banks/financial entities up to either 5% of the capital of the investee bank/financial entity or 5% of the net worth of the investing bank, whichever is lower, has been risk weighted at 100%.

The Composition of the Capital structure is as follows:

	RO in 000
Paid up share capital	200,031
Legal reserve	39,879
Retained earnings*	74,110
Regulatory adjustments to CET1	(8,099)
CET1 capital	**305,921**
Additional Tier 1 capital	-
Total Tier 1 capital	**305,921**
Fair value reserve for available-for-sale equity securities	18
Provision for loan impairment – general	18,289
Tier 2 capital	**18,307**
Total regulatory capital	**324,228**

*Net of proposed dividend

The additional disclosures as per Basel III framework are as follows.

Basel III common disclosures during the transition phase

Basel III common disclosures during transition phase of regulatory adjustment (i.e. from December 31, 2013 to December 31, 2017) is designed to meet the Basel III requirement for banks to disclose the components of capital which will benefit from the transitional arrangements. (refer Annexure I)

Regulatory adjustments of all deductions and prudential filters would be phased in and deducted from CET1/AT1/T2 so as to be completely implemented by December 31, 2017. The gradual phase in is given in the following table:-

Year ending	Deduction using the corresponding deduction approach
2013	20%
2014	40%
2015	60%
2016	80%
2017	100%

Any shortfall in mandated deductions shall be deducted from the next higher tier of capital if the relevant tier of capital is insufficient for the deduction. The remainder amount not deducted from CET1/AT1/T2 during the transitional arrangement will be subject to the regulatory adjustments as provided in CBO circular BM 1009.

Disclosure for 3 step approach reconciliation

Under Basel III frameworks, banks should disclose a full reconciliation of all regulatory capital elements back to the statement of financial position in the audited financial statements. The reconciliation process laid down is aimed at addressing the issues of disconnect between the numbers disclosed for the calculation of regulatory capital and the numbers used in the published financial statements. The 3 step approach indicated below ensures that the reconciliation between these numbers is undertaken in a consistent manner (refer Annexure II).

- Step 1: The reported statement of financial position under the regulatory scope of consolidation.
- Step 2: Expand the lines of the statement of financial position under the regulatory scope of consolidation to display all of the components that are used in the composition of capital disclosure (refer Annexure I).
- Step 3: Map each of the components that are disclosed in Step 2 to the composition of capital disclosure set out in Annexure I.

Disclosure for main feature of regulatory capital instruments

The disclosure of main feature of regulatory capital instruments provides a main features report that summarises all of the regulatory capital instruments of the bank. This is a minimum level of summary disclosure that required to report in respect of each regulatory capital instrument issued by the bank, including common shares.

A description of the main feature of regulatory capital instruments issued by the Bank is set out in Annexure III.

Compensation policy

In line with the CBO guidelines on sound compensation practices, the Bank has outlined the relevant compensation policies as part of the pillar III disclosures requirement;

Qualitative Disclosures

The Bank has a Board constituted Nomination & Remuneration Committee ('NRC') whose primary objectives are

- to review the over-arching principles, parameters and governance framework of the CMA's Code
- to review the Bank's remuneration policy and the remuneration of (i) senior executives (HBON CEO, HBON General Managers and the HBON company secretary), (ii) regulated employees (regulated employees are employees who perform a significant influence function), (iii) material risk takers, (iv) employees whose activities have or could have a material impact on the HBON's risk profile, and (v) any other employee as determined by the Committee from time to time in accordance with the requirements of HBON's regulators.

Remuneration policy

The scope of Bank's remuneration policy extends to all employees of the Bank. The Banks remuneration policy includes the rewards framework, fixed pay policy and variable pay policy. The details of such policies are discussed in the Banks Corporate Governance Report.

Material Risk Takers ('MRT')

The Bank has identified the members as material risk takers as their activities are considered to have a potentially material impact on the Bank's risk profile.

Quantitative Disclosures

The below table provide the details of compensation to the key management personnel;

Board of Directors' Report
Corporate Governance Report
Management Discussion & Analysis
Basel II-Pillar III and Basel III Framework
Financial Statements

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)

For the year ended 31 December 2017

	2017 RO'000	2016 RO'000
Wages, salaries and other short term benefits	**1,376**	1,328
Post-employment benefits	**87**	96
	1,463	1,424

Capital Adequacy:

The Bank's policy is to maintain a strong capital base so as to maintain investor, depositor and market confidence and to sustain future business developments.

The Bank is fully committed in implementing the Basel III Norms as adopted by the CBO and currently follows the Standardised approach for credit and market risk and the Basic Indicator Approach for operational risk.

The Bank has currently set the internal minimum target Capital Adequacy Ratio (CAR) at 16% for 2018 and 2019.

The capital to support current and future activities is discussed in the Bank's Asset Liability Committee ("ALCO") and documented.

In line with CBO, Capital Adequacy regulations and HSBC Group practices we monitor the Capital Adequacy on a monthly basis. Further, a full Basel II Return in line with CBO format is submitted each quarter as per standard requirements.

Credit Risk

The Bank has implemented the Standardized Approach across its Banking Book.

Operational Risk

The Bank uses the Basic Indicator Approach for the allocation of operational risk capital. The Bank allocates capital for operational risk based on the average annual gross income for the past three years.

Market Risk

The Bank is using Value at Risk ('VaR') methodology in calculating market risk on exposures on the balance sheet. VaR methodology is set out in detail under note 30.5 of the financial statements.

The details of capital, risk weighted assets and capital adequacy ratio as at 31 December 2017 are as follows:

RO '000

Details	Gross balance (Book value)	Net balances (Book value)*	Risk weighted assets
On-balance sheet items	2,328,158	2,303,815	1,529,861
Off-balance sheet items	303,427	300,924	206,477
Derivatives	1,989	1,989	1,989
Total	**2,633,574**	**2,606,728**	**1,738,327**
Market risk			25,521
Operational risk			152,247
Total			**1,916,095**
CET 1 capital			305,921
Additional Tier 1 capital			-
Total Tier 1 capital			**305,921**
Tier 2 capital			**18,307**
Total regulatory capital			**324,228**
Capital requirement for credit risk			230,328
Capital requirement for market risk			3,382
Capital requirement for operational risk			20,173
Total required capital			**253,883**
CET1 / Tier 1 Capital ratio			**15.97%**
Total capital ratio			**16.92%**

*Net of eligible collaterals.

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)

For the year ended 31 December 2017

Risk Exposure and Assessment

All of the Bank's activities involve, to varying degrees, the analysis, evaluation, acceptance and management of risks or combinations of risks. The most important categories of risk that the Bank is exposed to are credit risk (including cross-border country risk), market risk, operational risks in various forms, liquidity risk, reputational risk, legal risk and sustainability (environmental and social) risks. Market risk includes foreign exchange, interest rate and equity price risks. The management of these various risk categories is discussed below.

The risk profiles of the Bank change constantly under the influence of a wide range of factors. The risk management framework established by the Bank fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interdependencies.

The Bank's Risk Management framework is set out in note 30 of the financial statements.

Credit Risk

Credit Risk is the risk of financial loss to the Bank if a customer or counterparty fails to meet an obligation under a contract. It arises principally from direct lending, trade finance and from off-balance sheet products such as guarantees and from the holding of debt and other securities. Credit risk generates the largest regulatory capital requirement of the risks we incur.

The Bank has standards, policies and procedures dedicated to controlling and monitoring risk from all such activities. These are similar to those applied to all HSBC Group offices in various regions.

The Bank has standalone credit policies that are aligned to HSBC group. This includes application of credit risk rating system for corporate counterparties for which the Bank uses a 23 point credit risk rating system called Credit Risk Rating ('CRR'). Each CRR is mapped to a Probability of Default (PD), which is also reviewed and updated periodically. Since such accounts are individually significant, risk ratings are reviewed regularly and amendments made as and when appropriate. Within the Bank's retail business, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

A comparison of the Bank's Credit Risk Ratings compared to those with CBO classification categories is as follows:

HBON CRR	CBO Classification
1.1 – 6.2	Standard
7.1 – 8.3	Special Mention
9.0	Substandard / Doubtful / Loss
10.0	Loss

The management of credit risk, credit approval process, credit quality of loans and advances, impaired loans, credit administration is set out in note 30.3 of the financial statements.

The Bank's credit risk limits to counterparties in the financial and government sectors are in line with the delegation of authorities by the Bank's Board. The main purpose is to optimize the use of credit availability and avoid excessive risk concentration. Cross-border risk is subject to limits which are delegated by the Bank's Board and is aligned to the HSBC Group credit process.

The Bank has an established risk management process encompassing credit approvals, the control of exposures, credit policy direction to business units and the monitoring and reporting of exposures both on an individual and a portfolio basis which includes the management of adverse trends. The Bank is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality. Regular reviews are undertaken to assess and evaluate levels of risk concentration, including those to individual industry sectors and products, or to individual geographic areas.

Special attention is paid to the management of problem loans. A specialist unit exists to provide intensive management and control to maximize recoveries of doubtful debts.

Risk reporting

In addition to the quantitative disclosures and other reporting/returns submitted to our regulators in Oman, the Bank provides various reports to HSBC regional office in Dubai and HSBC group head office in London. These reports include large exposures to banks, sovereigns, corporates and exposures to the property sector. In addition, exposure to the key sectors is monitored through the monthly HBON Risk Management Meeting.

Policies for hedging and/or mitigating risk

The Bank follows the policies and processes for mitigating risks as per the instructions given under the HSBC Group Business Functional Instruction Manual (FIM).

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)

For the year ended 31 December 2017

Past Dues

The basic definition of past due is when a loan instalment is not paid by the due date.

Impairment

A financial asset is impaired and an impairment loss is incurred if, and only if, there is objective evidence of impairment as a result of an event after initial recognition of the asset, and this event has an effect on future cash flows that can be estimated reliably. Impairment allowances are calculated by way of assessment either:

- at individual account level (using discounted cash flow techniques as appropriate); or
- on a collective basis for assets with similar credit risk characteristics.

Description of approaches followed for specific and general provisions and statistical methods used

It is the Bank's policy to make an allowance for impaired loans promptly when required and on a consistent basis with established HSBC group guidelines and regulatory requirements.

The rating process for credit facilities is designed to highlight exposures requiring greater management attention based on a higher probability of default and potential loss. Management is required to particularly focus on facilities to those borrowers and portfolio segments classified as below satisfactory. Amendments to risk grades, where necessary, are undertaken promptly. Management regularly evaluates the adequacy of the established allowances for impaired loans by conducting a detailed review of the loan portfolio, comparing performance and delinquency statistics with historical trends and assessing the impact of current economic conditions.

Two types of impairment allowances are in place: individually assessed and collectively assessed. The Bank's policy requires a review of the level of impairment allowances on individual facilities that are above materiality thresholds at least half-yearly, and more regularly, where individual circumstances require. The policy requires that this will normally include a review of collateral held (including re-confirmation of its enforceability) and an assessment of actual and anticipated receipts.

Portfolio allowances for retail customers are generally reassessed monthly and charges for new allowances, or releases of existing allowances, are calculated for each separately identified portfolio.

Non-performing loans

For individually assessed accounts, loans are required to be designated as non-performing as soon as there is objective evidence that an impairment loss has been incurred. Objective evidence of impairment includes observable data such as when contractual payments of principal or interest are 90 days overdue. Portfolios of homogenous loans are designated as non-performing if facilities are 90 days or more overdue. The Bank has adopted the Flow Rate Model by which an impairment allowance for retail portfolio is booked for all past due loans commencing day 1 of delinquency. However, in the financial statements provisions are recorded in line with CBO requirements.

The details for total gross credit risk exposures, plus average gross exposure over the period broken down by major types of credit exposure are listed as under:

RO'000

Type of Credit Exposure	Average gross exposure		Total gross exposure	
	31 December 2017	31 December 2016	**31 December 2017**	31 December 2016
Overdraft	**63,391**	71,793	**59,926**	63,745
Personal loans*	**496,510**	489,558	**484,652**	480,665
Loans against trust receipts	**266,925**	185,135	**303,905**	258,076
Other loans	**552,724**	691,406	**595,072**	688,558
Bills purchased / discounted	**23,711**	15,375	**21,278**	9,693
Total	**1,403,261**	1,453,267	**1,464,833**	1,500,737

*Personal loans are excluding the personal overdrafts of RO3,907 K (31 Dec 2016: RO3,916 K) which has been included under overdrafts.

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)
For the year ended 31 December 2017

Geographical distribution

Geographic distribution of exposures, broken down in significant areas by major types of credit exposure

RO'000

Type of Credit Exposure	Oman	Other GCC countries	OECD Countries	Other	Total
Overdraft	59,926	-	-	-	**59,926**
Personal loans*	484,273	-	122	257	**484,652**
Loans against trust receipts	197,665	-	106,240	-	**303,905**
Other loans	583,491	-	11,581	-	**595,072**
Bills purchased / discounted	18,315	2,963	-	-	**21,278**
Total	**1,343,670**	**2,963**	**117,943**	**257**	**1,464,833**

*Personal loans are excluding the personal overdrafts of RO3,907 K which has been included under overdrafts.

Industry or counterparty type distribution of exposures, broken down by major types of credit exposure:

Economic Sector	Overdraft	Loans	Bills purchased / discounted	Total	Off-balance sheet exposure
Import trade	40,239	182,919	10,684	233,842	38,759
Wholesale & retail trade	1,168	68,889	80	70,137	12,797
Mining & quarrying*	28	18,455	-	18,483	1,390
Construction	5,251	41,275	48	46,574	79,820
Manufacturing	3,007	221,679	10,466	235,152	14,644
Electricity, gas and water	143	40,190	-	40,333	5,283
Transport and communication	436	4,537	-	4,973	3,257
Financial institutions	-	-	-	-	53,134
Services*	2,756	156,206	-	158,962	67,345
Personal loans*	3,907	484,273	-	488,180	-
Agriculture and allied activities	1,483	782	-	2,265	1
Government	2	-	-	2	30,286
Non-resident lending*	-	118,200	-	118,200	124,665
All others	1,506	46,224	-	47,730	14,221
Total	**59,926**	**1,383,629**	**21,278**	**1,464,833**	**445,602**

*Mining & quarrying sector does not include loans of RO106,240 K, which has been included under the head non-resident lending.
*Services sector does not include loans of RO11,581 K, which has been included under the head non-resident lending.
*The personal loans does not includes non-resident housing loans of RO379 K, which has been included under the head non-resident lending.

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)
For the year ended 31 December 2017

Residual contractual maturity of the loan portfolio, broken down by major types of credit exposure:

RO'000

Time Band	Overdraft	Loans	Bills purchased / discounted	Total	Off-balance sheet exposure
Upto1 month	18,204	327,599	18,031	363,834	49,471
1-3 months	-	51,379	1,575	52,954	62,680
3-6 months	-	114,053	1,628	115,681	39,339
6-9 months	-	6,787	-	6,787	35,560
9-12 months	-	4,999	-	4,999	34,502
1-3 years	-	108,090	-	108,090	101,519
3-5 years	-	757,134	-	757,134	21,047
Over Over 5 years	41,722	13,588	44	55,354	101,484
Total	**59,926**	**1,383,629**	**21,278**	**1,464,833**	**445,602**

Risk exposure by major industry

RO'000

Economic Sector	Gross Loans	Of which, NPLs	General provisions held	Specific provisions held	Reserve interest	Provisions made during the year**	Advances written off during the year
Import trade	233,842	39,495	1,942	10,072	25,993	223	662
Wholesale & retail trade	70,137	377	694	88	196	41	402
Mining & quarrying*	18,483	-	185	-	-	-	1
Construction	46,574	3,172	431	1,509	1,420	732	14,428
Manufacturing	235,152	1,623	2,333	741	807	311	382
Electricity, gas and water	40,333	-	403	-	-	-	1,015
Transport and communication	4,973	1,253	37	200	1,000	-	2,670
Services*	158,962	3,006	1,558	2,929	1,714	1,330	222
Personal loans*	488,180	4,070	9,063	2,090	873	7,343	7,175
Agriculture and allied activities	2,265	2,264	-	619	1,397	184	-
Government	2	-	-	-	-	-	-
Non-resident lending*	118,200	-	1,186	-	-	-	200
All others	47,730	9	457	-	9	-	272
Total	**1,464,833**	**55,269**	**18,289**	**18,248**	**33,409**	**10,164**	**27,429**

*Mining & quarrying sector does not include loans of RO106,240 K, which has been included under the head non-resident lending.
*Services sector does not include loans of RO11,581 K, which has been included under the head non-resident lending.
*The personal loans does not includes non-resident housing loans of RO379 K, which has been included under the head non-resident lending.
**Provision made during the year contains specific provision made during the year.

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)

For the year ended 31 December 2017

Amount of impaired loans broken down by significant geographic areas including specific and general allowances related to each geographical area.

RO'000

Country	Gross loans	Of which, NPLs	General provision held	Specific provision held	Reserve interest	Provisions made during the year*	Advances written off during the year
Oman	1,343,670	55,269	17,103	18,248	33,409	10,164	27,229
Other GCC countries	2,963	-	-	-	-	-	34
OECD countries	117,943	-	1,181	-	-	-	166
Others	257	-	5	-	-	-	-
Total	**1,464,833**	**55,269**	**18,289**	**18,248**	**33,409**	**10,164**	**27,429**

*Provisions made during the year contain specific provision made during the year.

Movements of Gross Loans:

RO'000

Details	Performing loans		Non-performing loans			
	Standard	S.M	Sub-standard	Doubtful	Loss	Total
Opening balance	**1,384,903**	**46,707**	**2,918**	**298**	**65,911**	**1,500,737**
Migration / changes (+/-)	(90,183)	73,429	6,604	(87)	10,237	-
New loans	2,791,513	19,840	-	-	-	**2,811,353**
Recovery of loans	(2,722,608)	(94,037)	(994)	(31)	(2,158)	**(2,819,828)**
Loans written off	-	-	(5,220)	-	(22,209)	**(27,429)**
Closing balance	**1,363,625**	**45,939**	**3,308**	**180**	**51,781**	**1,464,833**
Provisions held	**19,133**	**2,175**	**551**	**35**	**14,643**	**36,537**
Reserve Interest	**550**	**83**	**174**	**6**	**32,596**	**33,409**

Credit Risk disclosures relating to the Standardised Approach

The Bank uses the ratings from Eligible Credit Assessment Institutions ('ECAI') recognised by CBO like Fitch and Standard & Poor's for the assessment of credit risk under the Basel II Standardized Approach. Each of the rating agencies is used for the purpose of assessing Sovereign, Bank and Corporate credit assessments. The process of transferring the public issue rating in to comparable assets in the banking book is not widely applied in Oman as most corporate clients are unrated. However the exposure to banks through money market placements, balances with other banks and counter guarantees are governed, by the ratings applied by the rating agencies.

The total Banking Book risk weighted assets amounted to RO1,738 M as at 31 December 2017 after the application of credit risk mitigants.

The analysis of exposure with banks and sovereign by ECAI ratings is set out in note 30.3 of the financial statements.

Credit Risk Mitigation: Disclosures for Standardised Approach

The Bank endeavours to obtain collateral for all corporate credits unless the business case warrants clean lending. Collaterals stipulated are usually mortgages, charges over business, stock and debtors, financial instruments and cash. Security is however recognized only as a fall back option and repayment of facilities is primarily predicated on cash flow from the borrower's business. However, collateral may be an important mitigant of risk.

In the Retail loan segment, facilities granted are predominately salary linked loans for personal purposes. Prudent norms as well as regulatory guidelines are applied to ensure that the borrower is not overstretched to repay his dues. For housing loans and auto loans, besides the salary assignments, the underlying asset is mortgaged.

Where reliance is placed on real estate as collateral, professional valuations by a Bank approved valuer are required. Revaluations are obtained every two years. If equities are taken as collateral, only shares quoted on the MSM can be accepted and the value of shares will be based on the average value over the 15 days preceding the drawdown. For both mortgage and financial instruments values should have margin cover applied as defined in the Banks Lending Guidelines.

The Bank uses the Basel II Simple Approach for Credit Risk Mitigation - Collateral. HBON's policies, procedures and processes including collateral valuation and management are governed by HSBC Group guidelines.

The total value of eligible financial collateral, for example deposits under lien and other bank guarantees, for the credit risk portfolio is RO26.8m. The Bank does make use of netting whether on or off balance sheet.

Information about (market or credit) risk concentrations within the mitigation taken

Credit risk concentrations are monitored through monthly ALCO and Risk Management Meetings.

Market risks in the trading book

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads will affect the Bank's income or the value of its holding of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

The management of market risk is set out in note 30.5 of the financial statements.

One of the principal tools used by the Bank to monitor and limit market risk exposure is VAR. VAR is a technique that estimates the potential losses that could occur 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 (for the Bank, 99 per cent). The Bank calculates VAR daily. The VAR model used by the Bank is based on historical simulation. The historical simulation model derives plausible future scenarios from historical market rates times series, taking account of inter-relationships between different markets and rates, for example between interest rates and foreign exchange rates. Potential movements in market prices are calculated with reference to market data from the last two years.

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

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

The Bank recognizes these limitations by augmenting its VAR limits with other position and sensitivity limit structures.

Market risk in trading portfolios is monitored and controlled at both portfolio and position levels using a complementary set of techniques, such as VAR and present value of a basis point, together with stress and sensitivity testing and concentration limits.

Other controls include restricting individual operations to trading within a list of pre-approved permissible instruments, and enforcing rigorous new product approval procedures

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)

For the year ended 31 December 2017

The VAR for Global markets was as follows:

	2017	Average	Maximum	Minimum	2016	Average	Maximum	Minimum
	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
Total VAR	103	83	122	60	73	67	94	35
Trading VAR	33	25	44	8	22	9	23	1

The principal objective of market risk management of non-trading portfolios is to optimize net interest income. Market risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost as a result of interest rate changes. Analysis of this risk is complicated by having to make behavioral assumptions regarding the economic duration of liabilities which are contractually repayable on demand, for example, current accounts. In order to manage this risk optimally, market risk in non-trading portfolios is transferred to Global Markets or to separate books managed under the auspices of ALCO. ALCO regularly reviews that these portfolios are managed within pre-approved interest rate risk limits.

Interest Rate Risk:

Interest rate risk is the sensitivity of the Bank's financial condition to movements in interest rates. Mismatches or gaps in the amount of assets, liabilities and off-balance sheet instruments can generate interest rate risk, the impact of which is a function of the interest rate changes and the maturity profile of the assets and liabilities. Positions are monitored regularly and hedging strategies are used to manage the interest rate risk. The management of mismatches and gap position is set out in note 23 of financial statements. The impact of an incremental / decreased 100 basis points parallel shift on net interest income ('NII') for the next 12 months is given as follows:

	2017	2016
	RO'000	RO'000
1% UP - Increase in NII by	7,812	5,104
1% DOWN - Decrease in NII by	(11,260)	(8,987)
Ramp up scenario		
25bp increase per quarter	4,030	3,501
25bp decrease per quarter	(4,941)	(4,581)

The capital requirements for market risk are as follows:

	RO'000
Interest rate risk	-
Equity position risk	-
Commodities position risk	-
Foreign exchange risk	2,042
Total	**2,042**

Liquidity and funding Risk:

Liquidity risk is the risk that the Bank does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.

Funding risk (a form of liquidity risk) arises when the liquidity needed to fund illiquid asset positions cannot be obtained on the expected terms and when required.

Liquidity and funding risk management framework

The objective of the Bank's liquidity and funding risk framework ('LFRF') management is to allow it to withstand severe liquidity stresses. It is designed to be adaptable to changing business models and regulations.

The LFRF is delivered using the following key aspects:

- minimum LCR requirement depending on inherit liquidity risk ('ILR') categorization;
- minimum NSFR requirement depending on ILR categorization;
- depositor concentration limit;
- three-month and 12-month cumulative rolling term contractual maturity limits covering deposits from bank, deposits from non-bank financial institutions and securities issued; and
- minimum LCR requirement by currency.

Liquidity and funding for the year ended 2017

The liquidity position of the Bank remained strong as of 31 December 2017. Our liquidity coverage ratio was 223% (2016: 364%).

The Bank also calculates the LCR as per the CBO requirement and same has been disclosed separately in note 31 of these financial statements.

Management of liquidity and funding risk

Liquidity coverage ratio

The LCR metric is designed to promote the short-term resilience of a bank's liquidity profile. It aims to ensure that a bank has sufficient unencumbered high-quality liquid assets ('HQLA') to meet its liquidity needs

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)

For the year ended 31 December 2017

in a 30-calendar-day liquidity stress scenario. HQLAs consist of cash or assets that can be converted into cash at little or no loss of value in markets.

Net stable funding ratio

The 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.

Sources of funding

The current accounts, savings deposits and term deposits are the Bank's primary source of funding. The Bank places considerable importance on the stability of these deposits.

The level of customer accounts continued to exceed the level of loans and advances to customers. The positive funding gap was predominantly deployed into liquid assets, cash and balances with central banks and financial investments, as required by the LFRF. Loans and other advances to banks continued to exceed deposits by banks.

Operational Risk:

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. Operational risk is relevant to every aspect of the Bank's business and covers a wide spectrum of issues. Losses arising through fraud, unauthorised activities, errors, omission, inefficiency, systems failure or from external events all fall within the operational risk definition.

A formal governance structure provides oversight over the management of operational risk. The Risk Management Meeting convenes monthly to discuss operational risk issues and the effectiveness of internal controls. The capital requirement of RO20.2m is based on the average gross income for the three year period ending 31 December 2017.

The management of operational risk is set out in note 30.7 of the financial statements.

Basic Indicator Approach calculation

RO in 000's

Year	Business line	Total gross income	Total gross (after negative GI adjustment)	Alpha	Capital charge
2015	Total business	78,374	78,374	15.00%	**11,756**
2016	Total business	82,369	82,369	15.00%	**12,355**
2017	Total business	82,852	82,852	15.00%	**12,428**
Number of years with positive total gross income					**3**
Basic Indicator approach capital charge @ 12.50					**12,180**
Total Risk Weighted Assets - Operational Risk					**152,247**

I approve and authorize for issue these Basel II Pillar 3 and Basel III disclosures.

Andrew Long
Chief Executive Officer

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)

For the year ended 31 December 2017

Annexure I

	Basel III common disclosure during the transition of regulatory adjustments (i.e. from 1 January 2013 to 1 January 2018) (RO '000)		AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT
	Common Equity Tier 1 capital: instruments and reserves		
1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	200,031	
2	Retained earnings	74,110	
3	Accumulated other comprehensive income (and other reserves)	39,879	
4	*Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies)*	-	
	Public sector capital injections grandfathered until 1 January 2018	-	
5	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)	-	
6	**Common Equity Tier 1 capital before regulatory adjustments**	**314,020**	**-**
	Common Equity Tier 1 capital: regulatory adjustments		
7	Prudential valuation adjustments	(3,310)	-
8	Goodwill (net of related tax liability)	-	-
9	Other intangibles other than mortgage-servicing rights (net of related tax liability)	(3,239)	-
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	(1,550)	-
11	Cash-flow hedge reserve	-	-
12	Shortfall of provisions to expected losses	-	-
13	Securitisation gain on sale (as set out in paragraph 14.9 of CP-1)	-	-
14	Gains and losses due to changes in own credit risk on fair valued liabilities.	-	-
15	Defined-benefit pension fund net assets	-	-
16	Investments in own shares (if not already netted off paid-in capital on reported balance sheet)	-	-
17	Reciprocal cross-holdings in common equity	-	-
18	Investments in the capital of banking, financial, insurance and takaful entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)	-	-
19	Significant investments in the common stock of	-	-
20	Mortgage Servicing rights (amount above 10% threshold)	-	-
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)	-	-
22	Amount exceeding the 15% threshold	-	-

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)

For the year ended 31 December 2017

23	of which: significant investments in the common stock of financials	-	-
24	of which: mortgage servicing rights	-	-
25	of which: deferred tax assets arising from temporary differences	-	-
26	National specific regulatory adjustments	-	-
	REGULATORY ADJUSTMENTS APPLIED TO COMMON EQUITY TIER 1 IN RESPECT OF AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT	-	-
27	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions	-	-
28	**Total regulatory adjustments to Common equity Tier 1**	**(8,099)**	
29	**Common Equity Tier 1 capital (CET1)**	**305,921**	
Additional Tier 1 capital: instruments			
30	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus	-	
31	of which: classified as equity under applicable accounting standards	-	
32	of which: classified as liabilities under applicable accounting standards	-	
33	*Directly issued capital instruments subject to phase out from Additional Tier 1*	-	
34	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)	-	
35	*of which: instruments issued by subsidiaries subject to phase out*	-	
36	**Additional Tier 1 capital before regulatory adjustments**	-	
Additional Tier 1 capital: regulatory adjustments			
37	Investments in own Additional Tier 1 instruments	-	-
38	Reciprocal cross-holdings in Additional Tier 1 instruments	-	-
39	Investments in the capital of banking, financial, insurance and takaful entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)	-	-
40	Significant investments in the capital of banking, financial, insurance and takaful entities that are outside the scope of regulatory consolidation (net of eligible short positions)	-	-
41	National specific regulatory adjustments	-	-
	REGULATORY ADJUSTMENTS APPLIED TO ADDITIONAL TIER 1 IN RESPECT OF AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT	-	-
	OF WHICH*:* Prudential valuation adjustments	-	-
	OF WHICH : Other intangibles other than mortgage-servicing rights (net of related tax liability)	-	-
	OF WHICH*:* Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	-	-
42	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions	-	

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)

For the year ended 31 December 2017

43	**Total regulatory adjustments to Additional Tier 1 capital**	-	
44	**Additional Tier 1 capital (AT1)**	-	
45	**Tier 1 capital (T1 = CET1 + AT1)**	**305,921**	
	Tier 2 capital: instruments and provisions		
46	Directly issued qualifying Tier 2 instruments plus related stock surplus	-	
47	*Directly issued capital instruments subject to phase out from Tier 2*	-	
48	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)	-	
49	*of which: instruments issued by subsidiaries subject to phase out*	-	
50	Provisions *(General loan loss provision and Cumulative fair value gain on AFS investments)*	18,307	
51	**Tier 2 capital before regulatory adjustments**	**18,307**	
	Tier 2 capital: regulatory adjustments	-	
52	Investments in own Tier 2 instruments	-	
53	Reciprocal cross-holdings in Tier 2 instruments	-	
54	Investments in the capital of banking, financial, insurance and takaful entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above the 10% threshold)	-	
55	Significant investments in the capital banking, financial, insurance and takaful entities that are outside the scope of regulatory consolidation (net of eligible short positions)	-	
56	National specific regulatory adjustments		
	REGULATORY ADJUSTMENTS APPLIED TO TIER 2 IN RESPECT OF AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT.		
	OF WHICH: [INSERT NAME OF ADJUSTMENT]		
	OF WHICH: [INSERT NAME OF ADJUSTMENT]		
	OF WHICH: [INSERT NAME OF ADJUSTMENT]		
57	**Total regulatory adjustments to Tier 2 capital**		
58	**Tier 2 capital (T2)**	**18,307**	
59	**Total capital (TC = T1 + T2)**	**324,228**	
	RISK WEIGHTED ASSETS IN RESPECT OFAMOUNTS SUBJECT TO PRE-BASEL III TREATMENT		
	OF WHICH: [INSERT NAME OFADJUSTMENT]		
	OF WHICH…..		
60	**Total risk weighted assets (60a+60b+60c)**	**1,916,095**	
60a	*Of which: Credit risk weighted assets*	1,738,327	
60b	*Of which: Market risk weighted assets*	25,521	
60c	*Of which: Operational risk weighted assets*	152,247	

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)

For the year ended 31 December 2017

Capital Ratios			
61	**Common Equity Tier 1 (as a percentage of risk weighted assets)**	**15.97%**	
62	**Tier 1 (as a percentage of risk weighted assets)**	**15.97%**	
63	**Total capital (as a percentage of risk weighted assets)**	**16.92%**	
64	Institution specific buffer requirement (minimum CET1 requirement plus capital conservation buffer plus countercyclical buffer requirements plus G-SIB/D-SIB buffer requirement expressed as a percentage of risk weighted assets)	-	
65	*of which: capital conservation buffer requirement*	-	
66	*of which: bank specific countercyclical buffer requirement*	-	
67	*of which: D-SIB/G-SIB buffer requirement*	-	
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets	-	
National minima (if different from Basel III)			
69	National Common Equity Tier 1 minimum ratio (if different from Basel 3 minimum)	-	
70	National Tier 1 minimum ratio (if different from Basel 3 minimum)	-	
71	National total capital minimum ratio (if different from Basel 3 minimum)	-	
	Amounts below the thresholds for deduction (before risk weighting)		
72	Non-significant investments in the capital of other financials	-	
73	Significant investments in the common stock of financials	-	
74	Mortgage servicing rights (net of related tax liability)	-	
75	Deferred tax assets arising from temporary differences (net of related tax liability)	-	
Applicable caps on the inclusion of provisions in Tier 2			
76	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	-	
77	Cap on inclusion of provisions in Tier 2 under standardised approach	-	
78	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap)	-	
79	Cap for inclusion of provisions in Tier 2 under internal ratings-based approach	-	
	Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2018 and 1 Jan 2022)		
80	*Current cap on CET1* instruments *subject to phase out arrangements*	-	
81	*Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)*	-	
82	*Current cap on AT1 instruments subject to phase out arrangements*	-	
83	*Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)*	-	
84	*Current cap on T2 instruments subject to phase out arrangements*	-	
85	*Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)*	-	

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)
For the year ended 31 December 2017

Annexure II

Step 1

The scope of regulatory consolidation and accounting consolidation is identical accordingly the step 1 of the reconciliation is not required.

Step 2

	Balance sheet as in published financial statements	Under regulatory scope of consolidation	Reference
	As at 31.12.2017	As at 31.12.2017	
Assets			
Cash and balances with CBO	223,806	223,806	
Balance with banks and money at call and short notice	40,363	40,363	
Investments :			
Of which Held to Maturity	-	-	
Out of investments in Held to Maturity:	-	-	
Investments in subsidiaries	-	-	
Investments in Associates and Joint Ventures	-	-	
Available for Sale of which:	614,921	614,921	
Investments in Subsidiaries	-	-	
Investments in Associates and Joint Ventures	-	-	
Held for Trading	-	-	
Loans and advances of which :	1,464,833	1,464,833	
Loans and advances to domestic banks	-	-	
Loans and advances to non-resident banks	-	-	
Loans and advances to domestic customers	-	1,337,015	
Loans and advances to non-resident customers for domestic operations	-	-	
Loans and advances to non-resident customers for operations abroad	-	118,200	
Loans and advances to SMEs	-	9,618	
Financing from Islamic banking window	-	-	
Provision against Loans and advances of which:	**(69,946)**	**(69,946)**	
Provision for Loan impairment - Specific	(18,248)	(18,248)	
Provision for Loan impairment – general	(18,289)	(18,289)	
Reserve Interest	(33,409)	(33,409)	
Fixed assets	26,238	26,238	
Other assets of which:	33,582	33,582	
Goodwill and intangible assets Out of which:			
Goodwill			a
Other intangibles (excluding MSRs)	3,239	3,239	b

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Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)
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	Balance sheet as in published financial statements	Under regulatory scope of consolidation	Reference
	As at 31.12.2017	As at 31.12.2017	
Deferred tax assets	1,550	1,550	
Goodwill on consolidation	-	-	
Debit balance in Profit & Loss account	-	-	
Total Assets	**2,333,797**	**2,333,797**	
Capital & Liabilities			
Paid-up Capital Of which:			
Amount eligible for CET1	200,031	200,031	**h**
Amount eligible for AT1	-	-	**i**
Reserves & Surplus	123,225	123,225	
Total Capital	**323,256**	**323,256**	
Deposits Of which:			
Deposits from banks	34,358	34,358	
Customer deposits	1,932,050	1,932,050	
Deposits of Islamic Banking window	-	-	
Other deposits(please specify)	-	-	
Borrowings Of which:	1,600	1,600	
From CBO	-	-	
From banks	1,600	1,600	
From other institutions & agencies	-	-	
Borrowings in the form of bonds, Debentures and sukuks	-	-	
Others (Please specify)	-	-	
Other liabilities & provisions Of which:	42,533	42,533	
DTLs related to goodwill	-	-	**c**
DTLs related to intangible assets	-	-	**d**
TOTAL	**2,333,797**	**2,333,797**	

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)

For the year ended 31 December 2017

Step 3

Common Equity Tier 1 capital: instruments and reserves			
		Component of regulatory capital reported by bank	**Source based on reference numbers/letters of the balance sheet under the regulatory scope of consolidation from step 2**
1	Directly issued qualifying common share (and equivalent for non- joint stock companies) capital plus related stock surplus	200,031	**h**
2	Retained earnings	74,110	
3	Accumulated other comprehensive income (and other reserves)	39,879	
4	Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies)	-	
5	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)	-	
6	**Common Equity Tier 1 capital before regulatory adjustments**	**314,020**	
7	Prudential valuation adjustments	(3,310)	
8	Goodwill (net of related tax liability)	-	**(a-c)**
9	Other intangibles other than mortgage-servicing rights (net of related tax liability)	(3,239)	
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	(1,550)	
11	Regulatory adjustments applied to Common Equity Tier 1 and Tier 2 to cover deductions	-	
	Common Equity Tier 1 capital (CET1)	**305,921**	

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)
For the year ended 31 December 2017

Annexure III

1	**Issuer**	
2	Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement)	NA
3	Governing law(s) of the instrument Regulatory treatment	-
4	Transitional Basel III rules	-
5	Post-transitional Basel III rules	-
6	Eligible at solo/group/group & solo	-
7	Instrument type (types to be specified by each jurisdiction)	Common Equity Shares
8	Amount recognised in regulatory capital (Currency in million, as of most recent reporting date)	RO200.031 million
9	Par value of instrument	RO0.100 each
10	Accounting classification	Common Equity Shares
11	Original date of issuance	Various
12	Perpetual or dated	NA
13	Original maturity date	NA
14	Issuer call subject to prior supervisory approval	NA
15	Optional call date, contingent call dates and redemption amount	NA
16	Subsequent call dates, if applicable	NA
	Coupons / dividends	
17	Fixed or floating dividend/coupon	NA
18	Coupon rate and any related index	NA
19	Existence of a dividend stopper	NA
20	Fully discretionary, partially discretionary or mandatory	NA
21	Existence of step up or other incentive to redeem	NA
22	Noncumulative or cumulative	NA
23	Convertible or non-convertible	Non Convertible
24	If convertible, conversion trigger (s)	NA
25	If convertible, fully or partially	NA
26	If convertible, conversion rate	NA
27	If convertible, mandatory or optional conversion	NA
28	If convertible, specify instrument type convertible into	NA
29	If convertible, specify issuer of instrument it converts into	NA
30	Write-down feature	NA
31	If write-down, write-down trigger(s)	NA
32	If write-down, full or partial	NA
33	If write-down, permanent or temporary	NA
34	If temporary write-down, description of write-up mechanism	NA
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	NA
36	Non-compliant transitioned features	NA
37	If yes, specify non-compliant features	NA

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Independent auditor's report to the shareholders of HSBC Bank Oman SAOG

Report on the audit of the financial statements

Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of HSBC Bank Oman SAOG (the "Bank") as at 31 December 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

What we have audited

The Bank's financial statements comprise:

- the statement of comprehensive income for the year ended 31 December 2017;
- the statement of financial position as at 31 December 2017;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *auditor's 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 are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements that are relevant to our audit of the financial statements in the Sultanate of Oman. We have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Our audit approach

Overview

Key audit matters	• Impairment of loans and advances to customers • IT access management • Impact assessment of IFRS 9 and related disclosures

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we considered 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. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the financial statements as a whole, taking into account the structure of the Bank, the accounting processes and controls, and the industry in which the Bank operates.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters 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.

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Key audit matter	How our audit addressed the key audit matter
Impairment of loans and advances to customers Our audit was focused on impairment due to the materiality of the balance and the subjective nature of the impairment calculations. Impairment allowances represent management's best estimate of the losses incurred within the loan portfolios at the statement of financial position date. These are calculated on a collective basis for portfolios of loans of a similar nature and on an individual basis for non-performing corporate loans. The calculation of both collective and individual impairment allowances is inherently judgmental for any Bank. For non-performing commercial loans, management exercises judgement to determine when an impairment event has occurred and then estimates the expected future cash flows related to that loan to calculate specific impairment provisions. Collective impairment provisions for performing commercial loans and the entire retail loans are calculated using historical default rates prevalent in the banking industry in Oman. The fluctuation in the price of oil in the recent past had resulted in reduction in market liquidity and government spending, higher levels of redundancies in the market and reductions in salary benefits, primarily in the Oil & Gas (exploration, production and supply), Engineering, Procurement and Construction and Manufacturing sectors. In light of these macro-economic factors, the Bank continuously assesses the adequacy of its impairment provisions on regular basis and considers any requirement for incremental provision attributable to such factors. Please refer to notes 2.9 and 11 of the financial statements for the accounting policy and other details relating to impairment of loans and advances.	The relevant policies and methodologies used by the Bank, including how they comply with IAS 39, were discussed by us with the management and the audit committee. In light of the deterioration in the price of oil, specific discussion on the overall credit exposures of the Bank was held between us and the management as well as the audit committee. The following procedures were performed to support our discussions and conclusions: • The key controls management has established to support their specific impairment provision calculations that we considered to be relevant for our audit were tested. This included controls over review of the credit watch list, controls over internal credit rating / grading, credit file review processes, approval of external collateral valuation vendors and review controls over the approval of significant individual impairments. • For specific impairment provisions, we also tested (sample selected on the basis of materiality and specific risk characteristics) the application of the Bank's provisioning methodology and policies. These included re-performance of the calculations of discounted cash flow models and verifying the model inputs from the underlying supports (for example the valuation of collateral). • The appropriateness of management's judgement with respect to the methodology used to calculate industry historical default rates was evaluated by us. This evaluation included assessment of the reasonableness of portfolio segmentation, basis of selection of comparable local peer banks and judgmental overlays.

Key audit matter	How our audit addressed the key audit matter
IT access management All banks are highly dependent on technology due to the significant number of transactions that are processed daily. The audit approach relies extensively on automated controls and therefore procedures are designed to test access and control over IT systems. Access rights are important as they ensure that changes to applications and data are authorised and made in an appropriate manner. Ensuring staff have only appropriate access, and that the access is monitored, are key controls to mitigate the potential for fraud or error as a result of a change to an application or underlying data. In previous years, it was identified and reported that controls over access to applications, operating segments and data in the financial reporting process required improvement. Access management controls are critical to ensure that changes to applications and underlying data are made in an appropriate manner. Appropriate access controls contribute to mitigating the risk of potential fraud or errors as a result of changes to applications and data. Management implemented several remediation activities that contributed to reducing the risk over access management in the financial reporting process. These included implementation of group wide preventative and detective controls across critical applications and related infrastructure. Due to the pervasive nature of access management issues, however, we continued to assess the risk of a material misstatement arising from access to technology as significant for the audit.	The status on remediation of access controls was discussed at the audit committee at the group level during the year. Controls were enhanced and implemented over FY17 to respond to our audit findings and to reduce the risks over privileged access to IT infrastructure such as databases and operating systems. However, given the scale and complexity of the remediation, there are still actions to be taken to ensure that controls are fully embedded and operate effectively. Access rights were tested over applications, operating systems and databases relied upon for financial reporting. Specifically, the audit tested that: • new access requests for joiners were properly reviewed and authorised; • user access rights were removed on a timely basis when an individual left or moved role; • access rights to applications, operating systems and database were periodically monitored for appropriateness; and • highly privileged access is restricted to appropriate personnel. Other areas that were independently assessed by the audit team 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. As a consequence of the deficiencies, the following procedures were performed: • where inappropriate access was identified, we understood the nature of the access and, where possible, obtained additional evidence on the appropriateness of the activities performed; • additional substantive testing was performed on specific year-end balances and confirmations were sent to external counterparties; • testing was performed on other compensating controls such as business process reviews; and • 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.

Key audit matter	How our audit addressed the key audit matter
Impact assessment of IFRS 9 and the related disclosures The Bank will adopt IFRS 9 on 1 January 2018 and has computed its impact in line with Central Bank of Oman guidelines. IFRS 9 will replace IAS 39 *'Financial Instruments: Recognition and Measurement'* and introduces new requirements for: • the classification and measurement of financial assets and financial liabilities; • recognising loan loss provisions on the basis of expected credit losses instead of incurred credit losses; and • simplifies hedge accounting by aligning hedge accounting more closely with an entity's risk management methodology. The Bank will apply the new standard retrospectively from 1 January 2018, with the practical expedients permitted under the standard. The Bank considers implementation of IFRS 9 as a significant project and accordingly, multidisciplinary teams were formed at the regional and group level to identify and assess the impact of IFRS 9 on the Bank's financial instruments. IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which financial assets are managed and the underlying cash flow characteristics. IFRS 9 contains three principal classification categories for financial assets: • measured at Amortised Cost (AC); • Fair Value through Other Comprehensive Income (FVOCI); and • Fair Value through Profit or Loss (FVPL). In addition, IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' (ECL) model. The new impairment model will apply to financial assets measured at amortised cost or FVOCI, except for investments in equity instruments. A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as: • determining criteria for significant increase in credit risk (SICR); • choosing appropriate models and assumptions for the measurement of ECL; • establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and • establishing portfolios of similar financial assets for the purposes of measuring ECL.	We have obtained the disclosure and policy notes prepared by the Bank along with the work performed by the Bank's group teams pertaining to the following: • classification of financial instruments • ECL methodology and models PwC global and regional teams were engaged to perform audit procedures on application of IFRS 9. We have leveraged from the work performed by our global and regional teams to form our assessment on the appropriateness of the methodology and disclosure. The work performed included the following: • review of business models driving classification and measurement of financial instruments; • review of mapping financial assets to business models; • performing the 'Solely Payment of Principal and Interest' (SPPI) test on specific number of samples of the asset portfolio of the Bank; • documenting the resultant new classification of financial assets tested by us; • review of IFRS 9 compliant classification and measurement policy notes; • review of the ECL and Probability of Default (PD)/Loss Given Default (LGD)/Exposure At Default (EAD) methodology documents; • performing phased testing on a sample basis of the PD/LGD/EAD models, reviewing key assumptions and key areas where significant judgment is exercised; • recalculation of expected credit loss numbers at specified dates during 2017 to gain assurance over the ECL provisions calculated by the Bank; and • review of the financial statement disclosure to assess that it is compliant with other work performed as above.

Key audit matter	How our audit addressed the key audit matter
The Bank has performed an impact assessment on the basis of IFRS 9 in accordance with the requirements of IAS 8 and had disclosed the results of the new classification and measurement approach together with impairment calculation as per ECL model on financial instruments. This overall assessment is based on the significant judgments mentioned in note 2.1 (e) of the financial statements. The audit team focused on this area due to the complexity, subjectivity and judgments involved in calculation of ECL and its impact assessment on the financial statements of the Bank as at 31 December 2017 with the audit team spending a considerable amount of time in reviewing the impact assessment performed by the management.	

Other information

The directors are responsible for the other information. The other information which we obtained prior to the date of the auditor's report comprises of:

- Board of Directors' report;
- Corporate Governance Report;
- Management Discussion and Analysis; and
- Statutory Disclosure under Basel II – Pillar III and Basel III Framework.

Other information does not include the financial statements and our auditor's report thereon. The complete annual report which is not yet received is expected to be made available to us after the date of the auditor's report.

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

In connection with our audit of the financial statements, our responsibility is to read the other information identified above 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, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

When we read the complete annual report which is not yet received, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of management and those charged with governance for the financial statements

The directors are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards and their preparation with the relevant requirements of Capital Market Authority (the "CMA") of the Sultanate of Oman and the Commercial Companies Law of 1974, as amended, and for such internal control as the directors 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 Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

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Auditor's 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 auditor's 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 will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on other legal and regulatory requirements

Further, we report that the financial statements have been prepared and comply, in all material respects, with the relevant requirements of the CMA of the Sultanate of Oman and Commercial Companies Law of 1974, as amended.

PricewaterhouseCoopers

Kashif Kalam
4 March 2018
Muscat, Sultanate of Oman

برايس وترهاوس كوبرز
C.R. No 1230865
PricewaterhouseCoopers LLC

Statement of comprehensive income
for the year ended 31 December

2016 US$'000	2017 US$'000		Notes	2017 RO'000	2016 RO'000
160,696	**164,616**	Interest income	3(a)	**63,377**	61,868
(19,745)	**(23,699)**	Interest expense	3(b)	**(9,124)**	(7,602)
140,951	**140,917**	**Net interest income**		**54,253**	54,266
38,808	**37,403**	Fee income		**14,400**	14,941
(6,829)	**(7,070)**	Fee expense		**(2,722)**	(2,629)
31,979	**30,333**	**Net fee income**		**11,678**	12,312
20,195	**23,956**	Net trading income		**9,223**	7,775
574	**288**	Dividend income		**111**	221
1,629	**86**	Other operating income	4	**33**	627
195,328	**195,580**	**Net operating income before loan impairment charges and other credit risk provisions**		**75,298**	75,201
(14,662)	**(14,366)**	Loan impairment charges and other credit risk provisions - net of recoveries	5	**(5,531)**	(5,645)
180,666	**181,214**	**Net operating income**		**69,767**	69,556
(119,691)	**(119,662)**	Operating expenses	6	**(46,070)**	(46,081)
(5,935)	**(5,935)**	Amortisation of intangible assets	7	**(2,285)**	(2,285)
(125,626)	**125,597**	**Total operating expenses**		**(48,355)**	(48,366)
55,040	**55,617**	**Profit before tax**		**21,412**	21,190
(11,145)	**(5,964)**	Tax expense	8	**(2,296)**	(4,291)
43,895	**49,653**	**Profit for the year**		**19,116**	16,899
		Other comprehensive income/(loss)			
		Items that will be reclassified subsequently to profit or loss when specific conditions are met			
		Available-for-sale investments			
(10,748)	**1,543**	- Fair value gain / (loss)	12	**594**	(4,138)
(639)	**(94)**	- Fair value gain reclassified to profit or loss on disposal		**(36)**	(246)
145	**-**	- Amount reclassified to profit or loss in respect of impairment		**-**	56
1,341	**13**	- Income tax	8	**5**	516
(9,901)	**1,462**			**563**	(3,812)
		Items that will not be reclassified subsequently to profit or loss			
(351)	**(340)**	Remeasurement of defined benefit liability	18(a)	**(131)**	(135)
(10,252)	**1,122**	**Other comprehensive income / (loss) for the year - net of tax**		**432**	(3,947)
33,643	**50,775**	**Total comprehensive income for the year**		**19,548**	12,952
US$0.022	**US$0.025**	**Earnings per share – basic and diluted**	9(a)	**RO0.010**	RO0.008

The accompanying notes on pages 63 to 104 form an integral part of these financial statements.

Statement of financial position
as at 31 December

2016 US$'000	2017 US$'000		Notes	2017 RO'000	2016 RO'000
		Assets			
740,122	**581,314**	Cash and balances with central bank	**10(a)**	**223,806**	284,947
208,369	**104,839**	Due from banks	**10(b)**	**40,363**	80,222
3,684,195	**3,623,083**	Loans and advances to customers - net	**11**	**1,394,887**	1,418,415
1,072,647	**1,597,197**	Financial investments	**12**	**614,921**	412,969
60,516	**74,787**	Other assets	**13**	**28,793**	23,299
14,348	**8,413**	Intangible assets	**14**	**3,239**	5,524
68,842	**68,151**	Property and equipment	**15**	**26,238**	26,504
5,229	**4,026**	Deferred tax assets	**8**	**1,550**	2,013
5,854,268	**6,061,810**	**Total assets**		**2,333,797**	2,253,893
		Liabilities and equity			
		Liabilities			
97,210	**93,397**	Due to banks	**16**	**35,958**	37,426
4,848,455	**5,018,312**	Deposits from customers	**17**	**1,932,050**	1,866,655
77,977	**98,462**	Other liabilities	**18**	**37,908**	30,021
15,795	**12,013**	Current tax liabilities	**8**	**4,625**	6,081
5,039,437	**5,222,184**	**Total liabilities**		**2,010,541**	1,940,183
		Equity			
519,561	**519,561**	Share capital	**19**	**200,031**	200,031
98,616	**103,582**	Legal reserve	**20(a)**	**39,879**	37,967
(7,088)	**(5,626)**	Available-for-sale fair value reserve	**20(b)**	**(2,166)**	(2,729)
203,742	**222,109**	Retained earnings		**85,512**	78,441
814,831	**839,626**	**Net equity**		**323,256**	313,710
5,854,268	**6,061,810**	**Total equity and liabilities**		**2,333,797**	2,253,893
US$0.407	**US$0.420**	**Net assets per share**	**9(b)**	**RO0.162**	RO0.157
		Off-balance sheet items:			
		Contingent liabilities and other commitments			
137,600	**164,805**	- Documentary credits		**63,450**	52,976
925,774	**992,603**	- Guarantees and performance bonds		**382,152**	356,423
2,347,166	**2,179,049**	- Others		**838,934**	903,659
3,410,540	**3,336,457**		**21(a)**	**1,284,536**	1,313,058

The accompanying notes on pages 63 to 104 form an integral part of these financial statements.

The financial statements were authorised for issue on 04 March, 2018 in accordance with a resolution of the Board of Directors.

Sir Sherard Cowper-Coles
Chairman

Andrew Long
Chief Executive Officer

Statement of changes in equity
for the year ended 31 December 2017

	Share capital RO'000	Legal reserve RO'000	Available-for-sale fair value reserve RO'000	Retained earnings RO'000	Total RO'000
At 1 January 2016	200,031	36,277	1,083	71,125	308,516
Total comprehensive income for the year					
Profit for the year	-	-	-	16,899	16,899
Other comprehensive loss for the year					
Net movement in fair value of available-for-sale investments (net of tax)	-	-	(3,812)	-	(3,812)
Remeasurement of defined benefit liability	-	-	-	(135)	(135)
Total other comprehensive loss for the year	-	-	(3,812)	(135)	(3,947)
Total comprehensive (loss) / income for the year	-	-	(3,812)	16,764	12,952
Transfer to legal reserve	-	1,690	-	(1,690)	-
Transaction with shareholders, recorded directly in equity					
Dividend paid for 2015	-	-	-	(7,758)	(7,758)
At 31 December 2016	200,031	37,967	(2,729)	78,441	313,710
Total comprehensive income for the year					
Profit for the year	**-**	**-**	**-**	**19,116**	**19,116**
Other comprehensive income / (loss) for the year					
Net movement in fair value of available-for-sale investments (net of tax)	**-**	**-**	**563**	**-**	**563**
Remeasurement of defined benefit liability	**-**	**-**	**-**	**(131)**	**(131)**
Total other comprehensive income / (loss) for the year	**-**	**-**	**563**	**(131)**	**432**
Total comprehensive income for the year	**-**	**-**	**563**	**18,985**	**19,548**
Transfer to legal reserve	**-**	**1,912**	**-**	**(1,912)**	**-**
Transaction with shareholders, recorded directly in equity					
Dividend paid for 2016	**-**	**-**	**-**	**(10,002)**	**(10,002)**
At 31 December 2017	**200,031**	**39,879**	**(2,166)**	**85,512**	**323,256**
At 31 December 2017 (USD 000's)	**519,561**	**103,582**	**(5,626)**	**222,109**	**839,626**
At 31 December 2016 (USD 000's)	519,561	98,616	(7,088)	203,742	814,831

The accompanying notes on pages 63 to 104 form an integral part of these financial statements.

Statement of cash flows
for the year ended 31 December

2016 US$'000	**2017 US$'000**		Notes	**2017 RO'000**	2016 RO'000
		Cash flows from operating activities			
55,040	**55,617**	Profit before tax		**21,412**	21,190
		Adjustments for:			
14,662	**14,366**	– Loan impairment charges and other credit risk provisions – net of recoveries	5	**5,531**	5,645
4,429	**4,208**	– Depreciation and impairment of property and equipment	15	**1,620**	1,705
-	**249**	– Loss on disposal of property and equipment		**96**	-
5,935	**5,935**	– Amortisation of intangible assets	7	**2,285**	2,285
(1,325)	**(34)**	– Net gain on sale of financial investments	4	**(13)**	(510)
(4,946)	**(8,595)**	– Amortisation and impairment of financial investment	12	**(3,309)**	(1,904)
449	**488**	– Employer's current service cost with interest	18(a)	**188**	173
213	**145**	– Finance lease charge		**56**	82
473	**(1,187)**	– Effect of currency translation	12	**(457)**	182
		– change in operating assets			
(579,875)	**46,745**	change in loans and advances to customers-net		**17,997**	(223,252)
48,547	**(14,267)**	change in other assets		**(5,493)**	18,690
		– change in operating liabilities			
167,058	**169,857**	change in deposits from customers		**65,395**	64,317
(51,351)	**20,449**	change in other liabilities		**7,873**	(19,770)
(2,390)	**(8,530)**	– Tax paid	8	**(3,284)**	(920)
(491)	**(190)**	– Retirement benefits paid	18(a)	**(73)**	(189)
(343,572)	**285,256**	**Net cash generated from / (used in) operating activities**		**109,824**	(132,276)
		Cash flows from investing activities			
(4,006,483)	**(8,031,654)**	Purchase of financial investments	12	**(3,092,187)**	(1,542,496)
4,572,340	**7,518,366**	Proceeds from maturity of financial investments	12	**2,894,571**	1,760,351
(3,356)	**(3,805)**	Purchase of property and equipment	15	**(1,465)**	(1,292)
-	**39**	Proceeds from sale of property and equipment		**15**	-
562,501	**(517,055)**	**Net cash (used in) / generated from investing activities**		**(199,066)**	216,563
		Cash flows from financing activities			
(20,151)	**(25,979)**	Dividends paid		**(10,002)**	(7,758)
(1,511)	**(748)**	Finance leases paid		**(288)**	(582)
(21,662)	**(26,727)**	**Net cash used in financing activities**		**(10,290)**	(8,340)
197,267	**(258,525)**	**Net change in cash and cash equivalents**		**(99,532)**	75,947
654,014	**851,281**	Cash and cash equivalents at the beginning of the year		**327,743**	251,796
851,281	**592,756**	**Cash and cash equivalents at the end of the year**	25	**228,211**	327,743

The accompanying notes on pages 63 to 104 form an integral part of these financial statements.

Notes to the Financial Statements
As of 31 December 2017

1 Legal status and principal activities

HSBC Bank Oman S.A.O.G. ('the Bank' or 'HBON') is an Omani joint stock company, which was incorporated on 1 January 1979, operating as a commercial bank through a network of branches in the Sultanate of Oman. The registered address of the Bank is P.O. Box 1727, CPO Seeb, Postal Code 111, Sultanate of Oman. The Bank has its shares listed on Muscat Securities Market.

HSBC Middle East Holdings BV ('HMEH') holds 51% of the shares in HBON. The ultimate parent company of HBON is HSBC Holdings plc.

2 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented.

2.1 Basis of preparation

(a) Statement of compliance

The financial statements of the Bank at 31 December 2017 have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB'), the disclosure requirements and the applicable regulations of the Capital Market Authority ("CMA"), and Central Bank of Oman ("CBO") and Commercial Companies Law of 1974, as amended.

IFRSs comprise accounting standards issued by the IASB as well as interpretations issued by the IFRS Interpretations Committee ('IFRIC').

The Bank presents its assets and liabilities broadly in order of their liquidity in statement of financial position as this presentation is more appropriate to the Banks's operations.

The financial statements have been prepared on the historical cost basis except for available-for-sale financial investments and derivative financial instruments which are measured at fair value.

(b) Functional and presentation currency

The financial statements are presented in Rials Omani ("RO"), which is the functional currency of the primary economic environment in which the Bank operates. The United States Dollar amounts disclosed in the financial statements have been translated from Rial Omani at the exchange rate of RO0.385 to each US Dollar, and are shown for the convenience of the readers only.

(c) Use of estimates and assumptions

The preparation of the financial statements in conformation with IFRS requires the use of estimates and assumptions about future conditions. The use of available information and the application of judgement are inherent in the formation of estimates; actual results in the future may differ from estimates upon which financial information is prepared. Management believes that the Bank's critical accounting policies where judgement is necessarily applied are those which relate to impairment of loans and advances, the valuation of financial instruments and the impairment of available-for-sale financial assets.

(d) Standards applicable during the year

There are no standards, interpretations or amendments to existing standards that are effective for the first time for the financial year beginning on 1 January 2017 which have a material impact on the financial statements of the Bank.

(e) Future accounting developments

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning on or after 1 January 2018. The impact assessment of the relevant standards is set out below:

IFRS 9 'Financial Instruments'

In July 2014, the IASB issued IFRS 9 'Financial Instruments', which is the comprehensive standard to replace IAS 39 'Financial Instruments: Recognition and Measurement', and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

Classification and measurement

The classification and measurement of financial assets will depend on how these are managed (the entity's business model) and their contractual cash flow characteristics.

2 Summary of significant accounting policies *(continued)*

2.1 Basis of preparation *(continued)*

(e) Future accounting developments (continued)

These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income ('FVOCI') or fair value through profit or loss ('FVPL'). The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of financial assets measured at amortised cost or fair value compared with IAS 39.

For financial liabilities designated to be measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in other comprehensive income. However, based on an assessment of financial assets and financial liabilities performed to date and expectations around changes to balance sheet composition, the Bank expects that the overall impact of any change will not be significant.

Impairment

The impairment requirements apply to financial assets measured at amortised cost and FVOCI (comprise primarily debt securities) and lease receivables and certain loan commitments and financial guarantee contracts. At initial recognition, an impairment allowance (or provision in the case of commitments and guarantees) is required for expected credit losses ('ECL') resulting from default events that are possible within the next 12 months ('12-month ECL'). In the event of a significant increase in credit risk, an allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in 'stage 3'.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under IAS 39 and the resulting impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

Hedge accounting

The general hedge accounting requirement's aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks, but do not explicitly address macro hedge accounting strategies, which are particularly important for banks. As a result, IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting, which the Bank has exercised, although it will implement the revised hedge accounting disclosures required by the related amendments to IFRS 7 'Financial Instruments: Disclosures'.

Transition

The requirements of IFRS 9 'Financial Instruments' will be adopted from 1 January 2018. The classification and measurement and impairment requirements will be applied retrospectively by adjusting the opening statement of financial position at the date of initial application, with no requirement to restate comparative periods. Adoption is expected to reduce net equity by 1.3% and total assets by 0.04% at 1 January 2018. As a consequence, CET 1 capital is expected to reduce by 1.8%.

IFRS 15 'Revenue from Contracts with Customers'

Notes to the Financial Statements (continued)

As of 31 December 2017

2 Summary of significant accounting policies *(continued)*

2.1 Basis of preparation *(continued)*

(e) Future accounting developments (continued)

In May 2014, the IASB issued IFRS 15 'Revenue from Contracts with Customers'. The original effective date of IFRS 15 has been delayed by one year and the standard is now effective for annual periods beginning on or after 1 January 2018 with early application permitted. IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for performance obligations as they are satisfied. The standard should be applied retrospectively, with certain practical expedients available. The Bank has assessed the impact of IFRS 15 and expects that the standard will have no significant effect, when applied, on the financial statements of the Bank.

IFRS 16 'Leases'

In January 2016, the IASB issued IFRS 16 'Leases' with an effective date of 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' asset and a corresponding financial liability on the statement of financial position. 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 in IAS 17. The Bank is currently assessing the impact of this standard and has not quantified the potential impact as at the date of approval of these financial statements.

2.2 Foreign currency transactions and balances

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated at the foreign exchange rate ruling at the reporting date. Foreign exchange differences arising on translation are recognised in the statement of comprehensive income.

2.3 Financial instruments

All financial instruments are recognised initially at fair value at trade date. In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (that is, the fair value of the consideration given or received). In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Bank recognises a trading gain or loss on inception of the financial instrument, being the difference between the transaction price and the fair value. When unobservable market data has a significant impact on the valuation of financial instruments, the entire initial difference in fair value indicated by the valuation model from the transaction price is not recognised immediately in the statement of comprehensive income. Instead, it is recognised over the life of the transaction on an appropriate basis, or when the inputs become observable, or the transaction matures or is closed out, or when the Bank enters into an offsetting transaction. Financial instruments include cash and balances with central bank, due from banks, loans and advances to customers, financial investments, acceptances, due to banks, deposits from customers and other financial assets and liabilities.

2.3.1 Reclassification of financial assets

Non-derivative financial assets (other than those designated at fair value through profit or loss upon initial recognition) may be reclassified out of the fair value through profit or loss category in the following circumstances:

- financial assets that would have met the definition of loans and receivables at initial recognition (if the financial asset had not been required to be classified as held for trading) may be reclassified out of the fair value through profit or loss category if there is the intention and ability to hold the financial asset for the foreseeable future or until maturity; and
- financial assets (except financial assets that would have met the definition

2 Summary of significant accounting polices *(continued)*

2.3 Financial instruments *(continued)*

2.3.1 Reclassification of financial assets (continued)

of loans and receivables at initial recognition) may be reclassified out of the fair value through profit or loss category and into another category in rare circumstances.

When a financial asset is reclassified as described in the above circumstances, the financial asset is reclassified at its fair value on the date of reclassification. Any gain or loss already recognised in the statement of comprehensive income is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

2.3.2 Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated by the Bank which are not classified either as held for trading or designated at fair value. Loans and advances are recognised when cash is advanced to a borrower. They are derecognised when either the borrower repays their obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less any reduction for impairment or uncollectibility. Where exposures are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment relating only to the hedged risk.

Loans and advances are reclassified to held for sale when their carrying amounts are to be recovered principally through sale, they are available for sale in their present condition and their sale is highly probable; however, such loans and advances continue to be measured in accordance with the policy described above.

The Bank may commit to underwrite loans on fixed contractual terms for specified periods of time, where the drawdown of the loan is contingent upon certain future events outside the control of the Bank. Where the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative and measured at fair value through profit or loss. On drawdown, the loan is classified as held for trading and measured at fair value through profit or loss. Where it is not the Bank's intention to trade but hold the loan, a provision on the loan commitment is only recorded where it is probable that the Bank will incur a loss. This may occur, for example, where a loss of principal is probable or the interest rate charged on the loan is lower than the cost of funding. On inception of the loan, the held portion is recorded at its fair value and subsequently measured at amortised cost using the effective interest method. For certain transactions, such as leverage finance and syndicated lending activities, the cash advanced is not necessarily the best evidence of the fair value of the loan. For these loans, where the initial fair value is lower than the cash amount advanced (for example, due to the rate of interest charged on the loan being below the market rate of interest), the write-down is charged to the statement of comprehensive income. The write-down will be recovered over the life of the loan, through the recognition of interest income using the effective interest method, unless the loan becomes impaired. The write down is recorded as a reduction to other operating income.

Financial assets which have been reclassified into the loans and receivables category are initially recorded at the fair value at the date of reclassification and are subsequently measured at amortised cost, using the effective interest rate determined at the date of reclassification.

2.3.3 Available-for-sale financial assets

Treasury bills, debt securities and equity shares intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale. Financial investments are recognised on trade date, when the Bank enters into contractual arrangements with counterparties to purchase securities, and are normally derecognised when either the securities are sold or the borrowers repay their obligations. Available-for-sale financial assets are initially measured at fair value plus direct and

Notes to the Financial Statements (continued)

As of 31 December 2017

2 Summary of significant accounting polices *(continued)*

2.3 Financial instruments *(continued)*

2.3.3 Available-for-sale financial assets (continued)

incremental transaction costs. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income in 'Available-for-sale investments – fair value reserve' until the financial assets are either sold or become impaired. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less impairment. When available-for-sale financial assets are sold, cumulative gains or losses previously recognised in other comprehensive income are recognised in the profit or loss as 'Gains or losses from financial investments'.

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

At each reporting date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset. Impairment losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in other comprehensive income, is removed from other comprehensive income and recognised in the profit or loss. Impairment losses for available-for-sale debt securities are recognised within 'Loan impairment charges and other credit risk provisions' in the statement of comprehensive income and impairment losses for available-for-sale equity securities are recognised within 'Gains or losses from financial investments' in the statement of comprehensive income. The impairment methodologies for available-for-sale financial assets are set out in more detail below:

a. Available-for-sale debt securities: When assessing available-for-sale debt securities for objective evidence of impairment at the reporting date, the Bank considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. These events may include a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial reorganization, or the disappearance of an active market for the debt security because of financial difficulties relating to the issuer. These types of specific event and other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment of a debt security

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

   A significant or prolonged decline in the fair value of the asset below its cost is also an objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. Decline in excess of 20 percent from the original cost at initial recognition, is always, except in very rare cases, be regarded as significant. In assessing whether it is prolonged, the decline is evaluated against the period in which the fair value of the asset has been

2 **Summary of significant accounting polices *(continued)***

2.3 Financial instruments *(continued)*

2.3.3 Available-for-sale financial assets (continued)

below its original cost at initial recognition. Decline in equity investments market price that persists for nine months is considered prolonged; however it may be appropriate to consider a shorter period.

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

For an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in the statement of comprehensive income when there is further objective evidence of impairment as a result of further decrease in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in fair value of the financial asset is recognised in other comprehensive income. If the fair value of the 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 statement of comprehensive income, the impairment loss is reversed through the statement of comprehensive income, and otherwise, any increase in fair value is recognised in other comprehensive income.

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

2.3.4 Fair value hierarchy

The Bank measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

Level 1: Quoted market price (unadjusted) in an active market for fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations.

Level 2: Valuation techniques based on observable inputs, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

Level 3: Valuation techniques using significant unobservable inputs. This category included all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like interest rate swaps and forward foreign exchange contracts that use only observable market data and require little management judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps.

2.4 Derivative financial instruments and hedge accounting

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques,

Notes to the Financial Statements (continued)

As of 31 December 2017

2 Summary of significant accounting polices *(continued)*

2.4 Derivative financial instruments and hedge accounting *(continued)*

including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Hedge accounting

At the inception of a hedging relationship, the Bank documents the relationship between the hedging instruments and hedged items, its risk management objective and its strategy for undertaking the hedge. The Bank also requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments, primarily derivatives, that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items. Interest on designated qualifying hedges is included in 'Net interest income'.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the statement of comprehensive income, along with changes in the fair value of the hedged assets, liabilities or group thereof that are attributable to the hedged risk.

If a hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment to the carrying amount of the hedged item is amortised in the statement of comprehensive income based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised, in which case it is released to the statement of comprehensive income immediately.

2.5 Cash and cash equivalents

Cash and cash equivalents consist of cash balances in hand; balances with banks and other financial institutions and Central bank of Oman (CBO); items in the course of collection from other banks; deposits with banks and other financial institutions maturing within three months of the date of acquisition; and amounts due to banks and other financial institutions payable within three months.

2.6 Money market placements

Money market placements are initially recorded at fair value and are subsequently measured at amortised cost.

2.7 Derecognition

A financial asset is derecognised when the Bank loses control over the contractual rights that comprise that asset. This occurs when the rights are realised, expired or are surrendered. A financial liability is derecognised when it is extinguished, cancelled or expired.

Available-for-sale assets and assets held for trading that are sold are derecognised and corresponding receivables from the buyer for the payment are recognised as of the date the Bank commits to sell the assets. The Bank uses the specific identification method to determine the gain or loss on derecognition.

2.8 Offsetting

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

2.9 Impairment - loans and advances

Specific provisions are made against the carrying amount of loans and advances that are identified as being impaired based on regular reviews of outstanding balances to reduce those loans and advances to their recoverable amounts. The recoverable amount of loans and advances is calculated at the present value of expected future cash flows discounted at the original effective interest rate. Short term balances are not discounted.

Collective impairment provisions are maintained in respect of incurred losses, which have not yet been specifically identified within the portfolio of loans and advances.

When a loan is known to be uncollectible, all the necessary legal procedures have been completed, and the final loss has been

Notes to the Financial Statements (continued)

As of 31 December 2017

2 Summary of significant accounting polices *(continued)*

2.9 Impairment - loans and advances *(continued)*

determined, the loan is written off directly. The expected cash flows for portfolios of similar assets are estimated based on previous experience and considering the credit rating of the underlying customers and late payments of interest or penalties.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the write-down, the write-down or allowance is reversed through the statement of comprehensive income.

2.10 Property and equipment

Items of property and equipment are stated at cost less accumulated depreciation and accumulated impairment losses, if any. Depreciation is calculated so as to write off the depreciable cost of property and equipment, other than freehold land, by equal installments over the estimated economic useful lives from the date the asset is brought into use, as follows:

Buildings	25 years
Leasehold property and improvements	3-5 years
Motor vehicles	5 years
Equipment, furniture and fixtures	3-7 years
Computer equipment	3-7 years

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit for the year. Repairs and renewals are charged to the statement of comprehensive income when the expense is incurred. Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property and equipment. All other expenditure is recognised in the statement of comprehensive income as an expense as incurred. Management annually reviews the appropriateness of useful lives, residual values and depreciation methods for property and equipment. Property and equipment are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

2.11 Finance and operating lease

Agreements which transfer to counterparties substantially all the risks and rewards incidental to the ownership of assets, but not necessarily legal title, are classified as finance leases. When the Bank is a lessor under finance leases the amounts due under the leases, after deduction of unearned charges, are included in 'Loans and advances - net'. The finance income receivable is recognised in 'Interest income' over the periods of the leases so as to give a constant rate of return on the net investment in the leases.

When the Bank is a lessee under finance leases, the leased assets are capitalised and included in 'Property and equipment' and the corresponding liability to the lessor is included in 'Other liabilities'. A finance lease and its corresponding liability are recognised initially at the fair value of the asset or, if lower, the present value of the minimum lease payments. Finance charges payable are recognised in 'Interest expense' over the period of the lease based on the interest rate implicit in the lease so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are classified as operating leases. When acting as lessor, the Bank includes the assets subject to operating leases in 'Property and equipment' and accounts for them accordingly. Impairment losses are recognised to the extent that residual values are not fully recoverable and the carrying value of the assets is thereby impaired. When the Bank is the lessee, leased assets are not recognised on the statement of financial position. Rentals payable and receivable under operating leases are accounted for on a straight-line basis over the periods of the leases and are included in 'General and administrative expenses' and 'Other operating income', respectively.

2.12 Intangible assets

Intangible assets are recognised separately from goodwill when they are separable or arise from contractual or other legal rights,

2 Summary of significant accounting polices *(continued)*

2.12 Intangible assets *(continued)*

and their fair value can be measured reliably. Intangible assets includes core deposit relationships and customer relationships. Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable. Intangible assets that have a finite useful life are stated at cost less amortisation and accumulated impairment losses and are amortised over their estimated useful lives. Estimated useful life is the lower of legal duration and expected useful life.

Intangible assets with finite useful lives are amortised on a straight-line basis, over their useful lives as follows:

Core deposits	7 years
Customer relationships	7 years

Amortisation method, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate. The remaining life of intangible assets is 1.5 years as at 31 December 2017.

2.13 Provisions

A provision is recognised in the statement of financial position when the Bank has present (legal or constructive) obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows using a rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. The unwinding of the discount is recognised as cost.

2.14 Other payables

Other payables are initially recorded at fair value and are subsequently measured at amortised cost.

2.15 Revenue recognition

2.15.1 Interest income and expense

Interest income and expense for all financial instruments except for those classified as held-for-trading or designated at fair value (other than debt securities issued by the Bank and derivatives managed in conjunction with such debt securities issued) are recognised in 'Interest income' and 'Interest expense' in the statement of comprehensive income using the effective interest method. The effective interest method is a way of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the Bank that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

2.15.2 Non-interest income

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

- income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as an arrangement for the acquisition of shares or other securities);
- income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees); and
- income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and recorded in 'Interest income'

Net trading income comprises all gains

2 Summary of significant accounting polices *(continued)*

2.15 Revenue recognition *(continued)*

2.15.2 Non-interest income *(continued)*

and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with related interest income, expense and dividends.

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 have approved the dividend for unlisted equity securities.

Other income is credited to income at the time of effecting the transaction.

2.16 Taxation

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the statement of comprehensive income except to the extent it relates to a business combination or items recognised directly in other comprehensive income. Current tax comprises tax payable calculated on the basis of the expected taxable income, using the tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is calculated in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Temporary differences are not provided for in respect of initial recognition of assets and liabilities that affect neither accounting nor taxable profit. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

2.17 Employee terminal benefits

Contributions to defined contribution retirement plans, for Omani employees in accordance with the Oman Social Insurance Scheme, and for international employees in accordance with the HSBC International Staff Retirement Benefit Scheme, are recognised as expenses in the statement of comprehensive income as incurred.

The Bank's obligation in respect of non-Omani terminal benefits, which is an unfunded defined benefit retirement plan, is the amount of future benefit that such employees have earned in return for their service in the current and prior periods. The obligation is calculated using the projected unit credit method and is discounted to its present value. The discount rate used is the yield at the reporting date on government bonds that have maturity dates approximating to the terms of the Bank's obligations.

Remeasurement of the net defined benefit liability, which comprises actuarial gains and losses, are recognised immediately in other comprehensive income.

Actuarial gains and losses comprise experience adjustments (the effect of differences between the previous actuarial assumptions and what has actually occurred), as well as the effects of changes in actuarial assumptions. Actuarial gains and losses are recognised in other comprehensive income in the period in which they arise.

2.18 Operating segment reporting

An operating segment is a component of the Bank that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Bank's other components. The Executive Committee ('EXCO') is the chief operating decision maker which operates as a managing committee under the authority of the Board and review the operating segment results, make decisions about resources allocation and assess the segment performance.

Notes to the Financial Statements (continued)
As of 31 December 2017

3 Net interest income

	2017 RO'000	2016 RO'000
3(a) Interest income		
Loans and advances to customers	**56,424**	56,279
Financial investments	**5,710**	4,559
Due from banks	**848**	238
Other	**395**	792
	63,377	61,868
3(b) Interest expense		
Deposits from customers	**(9,121)**	(7,597)
Due to banks	**(3)**	(5)
	(9,124)	(7,602)
Net interest income	**54,253**	54,266

4 Other operating income

	2017 RO'000	2016 RO'000
Gains on sale of financial investments - net	**13**	510
Loss on disposal property and equipment	**(96)**	-
Impairment of available-for-sale equity securities	**-**	(56)
Other income	**116**	173
	33	627

5 Loan impairment charges and other credit risk provisions - net of recoveries

	2017 RO'000	2016 RO'000
Provided during the year – specific (note 11)	**(10,164)**	(8,495)
Released / (provided) during the year – general (note 11)	**315**	(2,169)
Written-off loans recovered	**1,923**	1,943
Provisions released during the year (note 11)	**2,409**	3,356
Adjustments as a result of fair value unwind	**657**	349
Reserved interest released	**28**	36
Bad debts directly written off to the statement of comprehensive income	**(699)**	(665)
	(5,531)	(5,645)

6 Operating expenses

	2017 RO'000	2016 RO'000
Employee compensation and benefits		
Wages and salaries	**(16,276)**	(16,786)
Social security costs	**(1,380)**	(1,416)
Post-employment benefits	**(196)**	(237)
Other employee benefits	**(4,529)**	(4,377)
	(22,381)	(22,816)
Depreciation of property and equipment (note 15)	**(1,620)**	(1,705)
Marketing and advertising*	**(1,953)**	(1,872)
Premises and equipment	**(4,097)**	(4,042)
Communications	**(581)**	(638)
Insurance	**(1,102)**	(1,007)
Other administrative expenses	**(14,336)**	(14,001)
	(46,070)	(46,081)

*Marketing and advertising expenses for the current year include RO1.5m (December 2016: RO1.1m) of "Mandoos Prize" draw expenses.

Notes to the Financial Statements (continued)
As of 31 December 2017

7 Amortisation of intangible assets

	2017 RO'000	2016 RO'000
Core deposits	**(1,758)**	(1,758)
Customer relationships	**(527)**	(527)
	(2,285)	(2,285)

8 Taxation

	2017 RO'000	2016 RO'000
Statement of comprehensive income:		
Current tax:		
- Current year	**(3,296)**	(3,148)
- Prior years	**1,468**	(1,287)
Deferred tax	**(468)**	144
	(2,296)	(4,291)
Statement of other comprehensive income:		
Deferred tax	**5**	516

Tax reconciliation

	2017 RO'000	2016 RO'000
Profit before tax	**21,412**	21,190
Tax expenses at 15% (December 2016: 12%) on accounting profit before tax	**(3,212)**	(2,543)
Add / (less) tax effect of:		
Non-taxable income and gains	**19**	81
Permanent disallowed expenses	**(776)**	(542)
Adjustments in respect of prior periods	**1,468**	(1,287)
Other items	**205**	-
Tax charge as per the statement of comprehensive income	**(2,296)**	(4,291)

Movement of current tax liability

	2017 RO'000	2016 RO'000
At 1 January	**6,081**	2,343
- Current year charge	**3,296**	3,148
- Prior year (release) / charge	**(1,468)**	1,287
- Paid during the year	**(3,284)**	(920)
- Other transfers	**-**	223
At 31 December	**4,625**	6,081

Notes to the Financial Statements (continued)
As of 31 December 2017

8 Taxation *(continued)*

Movement of net deferred tax assets before offsetting

	Loan impairment allowances	Available-for-sale investments	Others*	Total
Assets - at 1 January 2017	**1,542**	**377**	**94**	**2,013**
Income statement	**(472)**	**-**	**4**	**(468)**
Other comprehensive income:				
- available-for-sale investment	**-**	**5**	**-**	**5**
Assets - at 31 December 2017	**1,070**	**382**	**98**	**1,550**
Assets	1,401	-	91	1,492
Liabilities	-	(362)	-	(362)
At 1 January 2016	1,401	(362)	91	1,130
Income statement	141	-	3	144
Other comprehensive income:				
- available-for-sale investment	-	516	-	516
Other transfers	-	223	-	223
Assets - at 31 December 2016	1,542	377	94	2,013

*Others include deferred tax assets on expense provisions and temporary difference between accounting and tax base of property and equipments.

The tax assessments of the Bank including HSBC Oman Branches have been completed by the Secretariat General for Taxation (SGT) upto the tax year 2012. The SGT has taken up the assessment of the Bank for the tax year 2013.

The tax rate applicable to the Bank in Oman is 15% (2016: 12%). For the purpose of determining the tax expense for the year, the accounting profit has been adjusted for tax purposes. After giving effect to these adjustments, the average effective tax rate is 10.7% (2016: 20.3%).

The difference between the applicable tax rate of 15% and the effective tax rate of 10.7% arises mainly due to certain expenses considered to be disallowed for tax provisioning purposes were allowed as a tax deduction by the SGT and tax effect of certain expenses considered to be disallowed for tax provisioning purposes for open years on the basis of prior tax years' assessments. The adjustments are based on the current understanding of the existing laws, regulations and practices.

Deferred tax asset has been computed at the tax rate of 15% (2016: 12%).

Notes to the Financial Statements (continued)
As of 31 December 2017

9(a) Earnings per share – basic and diluted

Basic earnings per share is calculated by dividing profit for the year attributable to ordinary equity holders of the Bank by the weighted average number of ordinary shares outstanding during the year.

The following reflects the income and share data used in the basic and diluted earnings per share computations:

	2017	2016
Weighted average number of shares in issue (Number '000)	**2,000,312**	2,000,312
Profit for the year (RO'000)	**19,116**	16,899
Earnings per share – basic and diluted (RO)	**0.010**	0.008

9(b) Net asset per share

Net assets (book value) per share is calculated by dividing the net equity at 31 December by the number of ordinary shares in issue at 31 December.

	2017	2016
Number of shares in issue (Number '000)	**2,000,312**	2,000,312
Net assets (RO'000)	**323,256**	313,710
Net assets per share (RO)	**0.162**	0.157

10(a) Cash and balances with central bank

	2017 **RO'000**	2016 RO'000
Cash in hand	**32,038**	34,180
Balance held with central bank	**191,768**	250,767
	223,806	284,947

10(b) Due from banks

	2017 **RO'000**	2016 RO'000
Placements	**33,884**	70,041
Nostro balances	**6,479**	10,181
	40,363	80,222

11 Loans and advances to customers - net

	2017 **RO'000**	2016 RO'000
Overdrafts	**59,926**	63,745
Credit cards	**22,376**	23,543
Loans	**1,057,348**	1,145,680
Clean import loans	**303,905**	258,076
Bills discounted/purchased	**21,278**	9,693
Gross loans and advances	**1,464,833**	1,500,737
Provision for loan impairment – specific	**(18,248)**	(26,508)
Provision for loan impairment – general*	**(18,289)**	(18,604)
Reserved interest**	**(33,409)**	(37,210)
Loans and advances (net)	**1,394,887**	1,418,415

* General provision represents collective provision on a portfolio of loans and advances to customers.

** Reserved interest forms part of specific provision for the purpose of IFRS.

Notes to the Financial Statements (continued)

As of 31 December 2017

11 Loans and advances to customers (*continued*)

Provision for loan impairment and reserved interest:

The movement on provision for loan impairment for the year ended 31 December 2017 is analysed in the table below:

	Specific provision RO'000	**General provision RO'000**	**Total provision RO'000**
Balance at 1 January 2017	**26,508**	**18,604**	**45,112**
Provided during the year (note 5)	**10,164**	**-**	**10,164**
Provision released during the year (note 5)	**(2,409)**	**(315)**	**(2,724)**
Written off during the year	**(16,015)**	**-**	**(16,015)**
Balance at 31 December 2017	**18,248**	**18,289**	**36,537**

The movement on provision for loan impairment for the year ended 31 December 2016 is analysed in the table below:

	Specific provision RO'000	General provision RO'000	Total provision RO'000
Balance at 1 January 2016	28,380	16,435	44,815
Provided during the year (note 5)	8,495	2,169	10,664
Provision released during the year (note 5)	(3,356)	-	(3,356)
Written off during the year	(7,011)	-	(7,011)
Balance at 31 December 2016	26,508	18,604	45,112

The movement on reserved interest during the year is analysed as follows:

	2017 RO'000	2016 RO'000
Balance at 1 January 2017	**37,210**	38,441
Reserved during the year	**7,567**	7,678
Released to the statement of comprehensive income	**(653)**	(630)
Written off during the year	**(10,715)**	(8,279)
Balance at 31 December 2017	**33,409**	37,210

12 Financial investments

	2017 RO'000	2016 RO'000
Available-for-sale investments	**614,921**	412,969

Notes to the Financial Statements (continued)
As of 31 December 2017

12 Financial investments (*continued*)

Financial investments details by sector are provided as follows:

	Fair value 31 December 2017 RO'000	Fair value 31 December 2016 RO'000	**Carrying value 31 December 2017 RO'000**	Carrying value 31 December 2016 RO'000	**Cost 31 December 2017 RO'000**	Cost 31 December 2016 RO'000
Marketable securities – local (MSM)						
Insurance	**-**	371	**-**	371	**-**	330
Government bonds	**62,036**	70,697	**62,036**	70,697	**64,911**	74,454
	62,036	71,068	**62,036**	71,068	**64,911**	74,784
Unquoted and other investments						
Treasury bills	**549,715**	338,362	**549,715**	338,362	**549,002**	337,712
Unquoted Omani shares*	**260**	260	**260**	260	**260**	260
Unquoted foreign shares*	**7**	7	**7**	7	**7**	7
Investment fund units	**2,903**	3,272	**2,903**	3,272	**3,289**	3,312
	552,885	341,901	**552,885**	341,901	**552,558**	341,291
Total	**614,921**	412,969	**614,921**	412,969	**617,469**	416,075

*Unquoted Omani shares and unquoted foreign shares are carried at cost, less provision for impairment, if any.

Details of classification of investments are given below:

	2017 RO'000	2016 RO'000
Cost of:		
Quoted - Equity and other securities	**64,911**	74,784
Other investments	**552,558**	341,291
	617,469	416,075
Revaluation loss of:		
Quoted equity and other securities	**(2,548)**	(3,106)
	614,921	412,969

Movement of investments is given below:

	2017 RO'000	2016 RO'000
Balance at the beginning of the year	**412,969**	632,920
Purchased during the year	**3,092,187**	1,542,496
Matured / sold during the year	**(2,894,595)**	(1,760,087)
Gain / (loss) from changes in fair value	**594**	(4,138)
Amortisation of discount, net	**3,309**	1,960
Exchange differences	**457**	(182)
Balance at the end of the year	**614,921**	412,969

Notes to the Financial Statements (continued)
As of 31 December 2017

13 Other assets

	2017 RO'000	2016 RO'000
Acceptances	19,140	15,639
Derivatives - positive mark-to-market [note 21(d)]	6,378	5,445
Prepayments	779	1,084
Others	2,496	1,131
	28,793	23,299

14 Intangible assets

	2017 RO'000	2016 RO'000
Core deposits	12,306	12,306
Customer relationships	3,691	3,691
	15,997	15,997
Less: amortised	(12,758)	(10,473)
	3,239	5,524

15 Property and equipment

The movement in property and equipment during the year 2017 is as follows:

	Freehold land and buildings RO'000	Leasehold property and improve-ments RO'000	Equipment, furniture and fixtures RO'000	Motor vehicles RO'000	Computer equip-ment* RO'000	Total RO'000
Cost						
1 January 2017	30,097	4,809	7,853	321	7,821	50,901
Additions	536	630	289	-	10	1,465
Disposals/write offs	-	(186)	(679)	(15)	-	(880)
31 December 2017	30,633	5,253	7,463	306	7,831	51,486
Accumulated depreciation						
1 January 2017	6,861	4,126	6,453	261	6,696	24,397
Charge for the year	359	282	555	30	394	1,620
Disposals/write offs	-	(172)	(587)	(10)	-	(769)
31 December 2017	7,220	4,236	6,421	281	7,090	25,248
Net book value						
31 December 2017	23,413	1,017	1,042	25	741	26,238

*Includes Automatic Teller Machines ('ATM') purchased on finance lease with net book value of RO0.5 M (2016: RO0.6 M)

Notes to the Financial Statements (continued)
As of 31 December 2017

15 Property and equipment *(continued)*

The movement in property and equipment for the year 2016 was as follows:

	Freehold land and buildings	Leasehold property and improve-ments	Equipment, furniture and fixtures	Motor vehicles	Computer equip-ment*	Total
	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
Cost						
1 January 2016	29,500	4,652	7,506	330	7,653	49,641
Additions	597	157	370	-	168	1,292
Disposals/write offs	-	-	(23)	(9)	-	(32)
31 December 2016	30,097	4,809	7,853	321	7,821	50,901
Accumulated depreciation						
1 January 2016	6,518	3,839	5,888	234	6,245	22,724
Charge for the year	343	287	588	36	451	1,705
Disposals/write offs	-	-	(23)	(9)	-	(32)
31 December 2016	6,861	4,126	6,453	261	6,696	24,397
Net book value						
31 December 2016	23,236	683	1,400	60	1,125	26,504

16 Due to banks

	2017	2016
	RO'000	RO'000
Interbank borrowings	**1,600**	7,389
Vostro and other balances	**34,358**	30,037
	35,958	37,426

17 Deposits from customers

	2017	2016
	RO'000	RO'000
Current and call	**951,159**	929,613
Savings	**437,849**	461,143
Time deposits	**540,845**	473,452
Others	**2,197**	2,447
	1,932,050	1,866,655

Notes to the Financial Statements (continued)
As of 31 December 2017

18 Other liabilities

	2017 RO'000	2016 RO'000
Acceptances	**19,140**	15,639
Accruals and deferred income	**6,492**	6,650
Obligations under finance leases [note 21(e)]	**232**	464
Provisions [note 18(b)]	**473**	711
Retirement benefit liability [note 18(a)]	**1,001**	755
Derivatives - negative mark-to-market [note 21(d)]	**71**	228
Others	**10,499**	5,574
	37,908	30,021

18(a) Movement of retirement benefit liability

	2017 RO'000	2016 RO'000
Opening defined benefit obligation	**755**	636
Employer's current service cost	**153**	157
Interest on obligation	**35**	16
Actuarial losses on obligations	**131**	135
Benefits paid	**(73)**	(189)
Present value of liabilities at the end of the period	**1,001**	755

18(b) Movement of provisions

	2017 RO'000	2016 RO'000
Balance at the beginning of the year	**711**	535
Provision made during the year	**743**	674
Provision utilised during the year	**(866)**	(454)
Provision released during the year	**(115)**	(44)
Balance at the end of the year	**473**	711

19 Share capital

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

The share capital of the Bank is divided into 2,000,312,790 fully paid ordinary shares of RO 0.100 each (2016: 2,000,312,790 fully paid ordinary shares of RO0.100 each) against the authorised ordinary share capital of 7,500 million shares of RO 0.100 each (2016: 7,500 million shares of RO0.100 each).

Major shareholder

All those shareholders of the Bank who own 10% or more of the Bank's shares in their name, and the number of shares they hold are as follows:

	2017 Number of Shares	2016 Number of shares
HSBC Middle East Holdings BV	**1,020,159,523**	1,020,159,523

Notes to the Financial Statements (continued)

As of 31 December 2017

20 Reserves

(a) Legal reserve

In accordance with the Commercial Companies Law of Oman 1974, as amended, annual appropriations of 10% of the profit for the year, are made to the legal reserve until the accumulated balance of the reserve is equal to one-third of the value of the Bank's paid-up share capital. This reserve is not available for distribution.

b) Available-for-sale fair value reserve

Available-for-sale fair value reserve represents fair value changes (net of tax) in available-for-sale financial investments.

21 Contingent liabilities, commitments and derivatives

(a) Contingent liabilities and other commitments

	2017 RO'000	2016 RO'000
Undrawn unconditionally cancellable commitments	**557,339**	643,566
Undrawn unconditionally non-cancellable commitments	**44,215**	97,385
Forward forex contracts outstanding (note 21 (d))	**160,380**	85,708
Interest rate swaps (note 21 (d))	**77,000**	77,000
	838,934	903,659
Documentary credits	**63,450**	52,976
Guarantees and performance bonds	**382,152**	356,423
	1,284,536	1,313,058

(b) Legal cases

As at 31 December 2017, there were certain legal suits pending against the Bank. Based on the opinion of the Bank's legal counsel, the Bank's management believes that no additional liability is expected to arise from these cases and therefore does not consider it necessary to make any additional provisions in this regard.

(c) Capital and investment commitments

At 31 December 2017, there were capital and investment commitments amounting to RO0.1m (2016: RO0.04m).

(d) Derivatives

In the ordinary course of business, the Bank enters into various types of transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in the price in one or more underlying financial instruments, reference rate or index. Derivative instruments include forwards, futures, swaps and options.

The table below sets out the positive and negative fair values of derivative financial instruments, together with the notional amounts analysed by the term to maturity. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured.

The notional amounts indicate the volume of transactions outstanding at the year end and does not expose the bank to the market risk or credit risk.

Notes to the Financial Statements (continued)
As of 31 December 2017

21 Contingent liabilities, commitments and derivatives (*continued*)

(d) Derivatives (*continued*)

Forward foreign exchange contracts are measured using level 1 and interest rate swaps are measured using level 2 fair valuation hierarchy.

31 December 2017:

	Positive fair value RO'000	Negative fair value RO'000	Total notional amount RO'000
Derivatives:			
Forward foreign exchange contracts (note 21 (a))	**151**	**71**	**160,380**
Interest rate swaps	**6,227**	**-**	**77,000**
	6,378	**71**	**237,380**

31 December 2016:

	Positive fair value RO'000	Negative fair value RO'000	Total notional amount RO'000
Derivatives:			
Forward foreign exchange contracts (note 21 (a))	421	228	85,708
Interest rate swaps	5,024	-	77,000
	5,445	228	162,708

Derivative product types

Forwards are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market.

The Bank's fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term deposits due to movements in market interest rates.

(e) Lease commitments

Operating lease commitments

At 31 December 2017, annual commitments under non-cancellable operating leases were RO1.2 M (2016: RO1.4 M). Operating lease expenses recognised in the statement of comprehensive income were RO1.2 M (2016: RO1.4 M).

Finance lease commitments

The Bank leases Automatic Teller Machines ('ATM') from third parties under finance lease arrangements to support its operations.

Lease commitments:	**At 31 December 2017**			At 31 December 2016		
	Total future minimum payments RO'000	**Future interest charges RO'000**	**Present value of finance lease commitments RO'000**	Total future minimum payments RO'000	Future interest charges RO'000	Present value of finance lease commitments RO'000
– No later than one year	**283**	**(51)**	**232**	283	(57)	226
– Later than one year and up to five years	**-**	**-**	**-**	283	(45)	238
	283	**(51)**	**232**	566	(102)	464

Notes to the Financial Statements (continued)
As of 31 December 2017

22 Maturities of assets and liabilities

Maturity analysis of assets and liabilities is as follows:

	On demand or within 3 months RO'000	3 to 12 months RO'000	Over 1 year RO'000	Total RO'000
At 31 December 2017				
Assets				
Cash and balances with central bank	**223,806**	**-**	**-**	**223,806**
Due from banks	**40,363**	**-**	**-**	**40,363**
Loans and advances to customers - net	**471,486**	**127,600**	**795,801**	**1394,887**
Financial investments	**420,555**	**141,036**	**53,330**	**614,921**
Other assets	**18,339**	**3,971**	**6,483**	**28,793**
Intangible assets	**571**	**1,714**	**954**	**3,239**
Property and equipment	**-**	**-**	**26,238**	**26,238**
Deferred tax assets	**-**	**-**	**1,550**	**1,550**
Total assets	**1,175,120**	**274,321**	**884,356**	**2,333,797**
Liabilities and equity				
Due to banks	**35,958**	**-**	**-**	**35,958**
Deposits from customers	**1,479,355**	**206,928**	**245,767**	**1,932,050**
Other liabilities	**32,448**	**4,203**	**1,257**	**37,908**
Current tax liabilities	**4,625**	**-**	**-**	**4,625**
Net equity	**-**	**-**	**323,256**	**323,256**
Total liabilities and equity	**1,552,386**	**211,131**	**570,280**	**2,333,797**

	On demand or within 3 months RO'000	3 to 12 months RO'000	Over 1 year RO'000	Total RO'000
At 31 December 2016				
Assets				
Cash and balances with central bank	284,947	-	-	284,947
Due from banks	80,222	-	-	80,222
Loans and advances to customers - net	520,310	43,498	854,607	1,418,415
Financial investments	238,388	116,726	57,855	412,969
Other assets	15,514	2,761	5,024	23,299
Intangible assets	571	1,714	3,239	5,524
Property and equipment	-	-	26,504	26,504
Deferred tax assets	-	-	2,013	2,013
Total assets	1,139,952	164,699	949,242	2,253,893
Liabilities and equity				
Due to banks	37,426	-	-	37,426
Deposits from customers	1,485,545	179,364	201,746	1,866,655
Other liabilities	26,041	2,987	993	30,021
Current tax liabilities	6,081	-	-	6,081
Net equity	-	-	313,710	313,710
Total liabilities and equity	1,555,093	182,351	516,449	2,253,893

Although the contractual repayments of many customer accounts are on demand or at short notice, in practice short-term deposit balances remain stable as inflows and outflows broadly match also in the normal course of business, a proportion of customer loans contractually repayable within one year will be extended.

Notes to the Financial Statements (continued)
As of 31 December 2017

23 Interest rate sensitivity gap

Sensitivity to interest rates arises from mismatches in the year to repricing of assets and that of the corresponding liability funding. The Bank manages these mismatches in accordance with HSBC Group policy guidelines and reduces risk by matching the repricing of assets and liabilities through various means. Significant changes in gap positions can be made to adjust the profile as market outlooks change. Additionally, whilst mismatches exist, liabilities maturing are to a great extent historically rolled over rather than withdrawn.

	Effective average interest rate %	Within 3 months RO'000	3 to 12 months RO'000	Over 1 year RO'000	Not interest sensitive RO'000	Total RO'000
At 31 December 2017						
Assets						
Cash and balances with central bank	0.48%	65,450	-	-	158,356	223,806
Due from banks	0.72%	33,884	-	-	6,479	40,363
Loans and advances to customers – net	4.26%	492,087	224,026	678,774	-	1,394,887
Financial investments	0.85%	420,555	141,036	50,160	3,170	614,921
Other assets		-	-	-	28,793	28,793
Intangible assets		-	-	-	3,239	3,239
Property and equipment		-	-	-	26,238	26,238
Deferred tax assets		-	-	-	1,550	1,550
Total assets		1,011,976	365,062	728,934	227,825	2,333,797
Liabilities and equity						
Due to banks	0.01%	1,600	-	-	34,358	35,958
Deposits from customers	0.46%	331,659	515,213	236,917	848,261	1,932,050
Other liabilities		-	-	-	37,908	37,908
Current tax liabilities		-	-	-	4,625	4,625
Net equity		-	-	-	323,256	323,256
Total liabilities and equity		333,259	515,213	236,917	1,248,408	2,333,797
Interest sensitivity gap:						
- **Net**		678,717	(150,151)	492,017	(1,020,583)	-
- **Cumulative**		678,717	528,566	1,020,583	-	

Notes to the Financial Statements (continued)
As of 31 December 2017

23 Interest rate sensitivity gap *(continued)*

	Effective average interest rate	Within 3 months	3 to 12 months	Over 1 year	Not interest sensitive	Total
	%	RO'000	RO'000	RO'000	RO'000	RO'000
At 31 December 2016						
Assets						
Cash and balances with central bank		-	-	-	284,947	284,947
Due from banks	0.24%	70,041	-	-	10,181	80,222
Loans and advances to customers – net	4.07%	617,117	281,886	519,412	-	1,418,415
Financial investments	0.87%	238,388	116,726	53,945	3,910	412,969
Other assets		-	-	-	23,299	23,299
Intangible assets		-	-	-	5,524	5,524
Property and equipment		-	-	-	26,504	26,504
Deferred tax assets		-	-	-	2,013	2,013
Total assets		925,546	398,612	573,357	356,378	2,253,893
Liabilities and equity						
Due to banks	0.01%	7,389	-	-	30,037	37,426
Deposits from customers	0.41%	333,169	471,823	201,745	859,918	1,866,655
Other liabilities		-	-	-	30,021	30,021
Current tax liabilities		-	-	-	6,081	6,081
Net equity		-	-	-	313,710	313,710
Total liabilities and equity		340,558	471,823	201,745	1,239,767	2,253,893
Interest sensitivity gap:						
- Net		584,988	(73,211)	371,612	(883,389)	
- Cumulative		584,988	511,777	883,389	-	

Notes to the Financial Statements (continued)
As of 31 December 2017

24 Financial assets and liabilities

Accounting classifications and fair values as at 31 December 2017

	Financial assets and liabilities at fair value	Financial assets and liabilities at amortised cost	Total
	RO'000	RO'000	RO'000
Cash and balances with central bank	-	223,806	223,806
Due from banks	-	40,363	40,363
Loans and advances to customers - net	-	1,394,887	1,394,887
Financial investments	614,654	267	614,921
Other assets	6,378	21,636	28,014
Total financial assets	621,032	1,680,959	2,301,991
Total non-financial assets			31,806
Total assets			2,333,797
Due to banks	-	35,958	35,958
Deposits from customers	83,665	1,848,385	1,932,050
Other liabilities	71	36,836	36,907
Total financial liabilities	83,736	1,921,179	2,004,915
Total non-financial liabilities			5,626
Total liabilities			2,010,541

Accounting classifications and fair values as at 31 December 2016

	Financial assets and liabilities at fair value	Financial assets and liabilities at amortised cost	Total
	RO'000	RO'000	RO'000
Cash and balances with central bank	-	284,947	284,947
Due from banks	-	80,222	80,222
Loans and advances to customers - net	-	1,418,415	1,418,415
Financial investments	412,702	267	412,969
Other assets	5,445	16,770	22,215
Total financial assets	418,147	1,800,621	2,218,768
Total non-financial assets			35,125
Total assets			2,253,893
Due to banks	-	37,426	37,426
Deposits from customers	82,404	1,784,251	1,866,655
Other liabilities	228	29,038	29,266
Total financial liabilities	82,632	1,850,715	1,933,347
Total non-financial liabilities			6,836
Total liabilities			1,940,183

Notes to the Financial Statements (continued)
As of 31 December 2017

24 Financial assets and liabilities *(continued)*

24.1 Fair value information

The table below analyses financial instruments carried at fair value, by using valuation techniques.

The fair values of derivatives and certain financials investments have determined using the following hierarchy of valuation levels.

Fair values of financial instruments carried at fair value

	Valuation techniques: Quoted market price Level 1 RO'000	Valuation techniques: Using observable inputs Level 2 RO'000	Total RO'000
Recurring fair value measurements			
At 31 December 2017			
Assets			
Derivatives	**-**	**6,378**	**6,378**
Financial investments: available-for-sale	**-**	**614,654**	**614,654**
Liabilities			
Derivatives	**-**	**71**	**71**
Deposits from customers	**-**	**83,665**	**83,665**
At 31 December 2016			
Assets			
Derivatives	-	5,445	5,445
Financial investments: available-for-sale	371	412,331	412,702
Liabilities			
Derivatives	-	228	228
Deposits from customers	-	82,404	82,404

Fair values of financial instruments not carried at fair value

	Valuation techniques: Quoted market price Level 1 RO'000	Valuation techniques: Using observable inputs Level 2 RO'000	Valuation techniques: Significant unobservable inputs Level 3 RO'000	Total fair value RO'000	Carrying amount RO'000
Assets and liabilities					
At 31 December 2017					
Assets					
Loans and advances to customers – net	**-**	**-**	**1,375,401**	**1,375,401**	**1,394,887**
Liabilities					
Deposits from customers	**-**	**1,848,384**	**-**	**1,848,384**	**1,848,385**

Notes to the Financial Statements (continued)
As of 31 December 2017

24 Financial assets and liabilities *(continued)*

24.1 Fair value information *(continued)*

	Valuation techniques				
	Quoted market price Level 1	Using observable inputs Level 2	Significant unobservable inputs Level 3	Total fair value	Carrying amount
	RO'000	RO'000	RO'000	RO'000	RO'000
Assets and liabilities					
At 31 December 2016					
Assets					
Loans and advances to customers – net	-	-	1,395,232	1,395,232	1,418,415
Liabilities					
Deposits from customers	-	1,786,499	-	1,786,499	1,784,251

Other financial instruments not carried at fair value are typically short-term in nature and re-priced to current market rates frequently. Accordingly, their carrying amounts are reasonable approximation of their fair values.

Loans and advances to customers

Fair value is calculated based on discounted expected future principal and interest cash flows. Loan repayments are assumed to occur at contractual repayment dates, where applicable. For loans that do not have fixed repayment dates or that are subject to prepayment risk, repayments are estimated based on experience in previous years when interest rates were at levels similar to current levels, adjusted for any differences in interest rate outlook. Expected future cash flows are estimated considering credit risk and any indication of impairment. Expected future cash flows for homogeneous categories of loans are estimated on a portfolio basis and discounted at current rates offered for similar loans to new borrowers with similar credit profiles. The estimated fair values of loans reflect changes in credit status since the loans were made along with changes in interest rates in the case of fixed rate loans.

Financial investments and derivatives

Fair value is based on quoted market prices at the reporting date without any deduction for transaction costs. If a quoted market price is not available, fair value is estimated using pricing models or discounted cash flow techniques.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate for a similar instrument at the reporting date.

Foreign exchange contracts are valued based on market prices. The market value adjustment of foreign exchange contracts are classified as value of other assets or other liabilities.

Bank and customer deposits

For demand deposits and deposits with no defined maturities, fair value is taken to be the amount payable on demand at the reporting date. The estimated fair value of fixed-maturity deposits, including certificates of deposit, is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. The value of long-term relationships with depositors is not taken into account in estimating fair values.

25 Cash and cash equivalents

The reconciliation of the components of cash and cash equivalents with the equivalent items shown in the statement of financial position is shown below:

	2017	2016
	RO'000	RO'000
Statement of financial position items comprise:		
Cash and balances with central bank (note 10(a))	**223,806**	284,947
Due from banks (note 10(b))	**40,363**	80,222
Due to banks (note 16)	**(35,958)**	(37,426)
	228,211	327,743

Notes to the Financial Statements (continued)

As of 31 December 2017

26 Related parties and holders of 10% of the Bank's shares

The Bank's related parties include the parent, HSBC Group and related entities, key management personnel, close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced by Key Management Personnel or their close family members.

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Bank and includes members of the Boards of Directors of the Bank.

Holders of 10% or more of the Bank's shares may include companies, individuals, or families. Families are included if the shares of the family members total 10% or more of the Bank's shares. Members of the family of an individual are those that may be expected to influence, or be influenced by that person in their dealings with the Bank.

Analysis of the related party transactions with related parties or holders of 10% or more of the Bank's shares, ("Significant shareholders") or their family members during the year is as follows:

	Parent entity	**Other related group entities**	**Directors**	**Others**	**Total**
	RO'000	**RO'000**	**RO'000**	**RO'000**	**RO'000**
As at 31 December 2017					
Loans and advances	**-**	**-**	**400**	**175,889**	**176,289**
Current, deposit and other accounts	**-**	**2,255**	**256**	**24,565**	**27,076**
Letters of credit and guarantees	**-**	**115,179**	**-**	**5,416**	**120,595**
Acceptances	**-**	**-**	**-**	**1,002**	**1,002**
Due from banks	**-**	**14,411**	**-**	**-**	**14,411**
Due to banks	**-**	**12,124**	**-**	**-**	**12,124**
For the year ended 31 December 2017					
Net interest income	**-**	**124**	**-**	**2,678**	**2,802**
Net fee (expenses) / income	**-**	**(12)**	**-**	**219**	**207**
Other operating expenses	**-**	**(10,286)**	**(16)**	**(1,047)**	**(11,349)**
Purchase of property and equipment	**-**	**-**	**-**	**(71)**	**(71)**

	Parent entity	Other related group entities	Directors	Others	Total
	RO'000	RO'000	RO'000	RO'000	RO'000
As at 31 December 2016					
Loans and advances	-	-	-	62,064	62,064
Current, deposit and other accounts	-	1,432	337	9,151	10,920
Letters of credit and guarantees	-	87,005	-	6,410	93,415
Acceptances	-	-	-	1,418	1,418
Due from banks	-	14,727	-	-	14,727
Due to banks	-	16,509	-	-	16,509
For the year ended 31 December 2016					
Net interest income	-	(13)	-	1,443	1,430
Net fee income / (expenses)	-	43	-	200	243
Other operating expenses	-	(10,026)	(21)	(113)	(10,160)
Purchase of property and equipment	-	-	-	(6)	(6)

Notes to the Financial Statements (continued)
As of 31 December 2017

26 Related parties and holders of 10% of the Bank's shares *(continued)*

Compensation of key management personnel

	2017 RO'000	2016 RO'000
Wages, salaries and other short term benefits	**1,376**	1,328
Post-employment benefits	**87**	96
	1,463	1,424

Balances with key management personnel

	2017 RO'000	2016 RO'000
Loans and advances	**466**	357
Current, deposit and other accounts	**317**	202

27 Distribution by economic sector

The table below analyses the concentration of gross loans and advances by economic sector:

	2017 RO'000	2016 RO'000
Personal and consumer loans	**488,559**	484,581
Corporate and commercial		
Import trade	**233,842**	208,713
Construction	**46,574**	42,760
Manufacturing	**235,152**	213,011
Wholesale and retail trade	**70,137**	61,868
Electricity, gas, water, transportation and communication	**45,306**	141,979
Services	**170,543**	119,276
Mining and quarrying	**124,723**	87,869
Others	**49,997**	140,680
	976,274	1,016,156
Total gross loans and advances	**1,464,833**	1,500,737
Provision for loan impairment - specific	**(18,248)**	(26,508)
Provision for loan impairment - general	**(18,289)**	(18,604)
Reserved interest	**(33,409)**	(37,210)
Net loans and advances	**1,394,887**	1,418,415
Non-performing loans - gross	**55,269**	69,127

Specific provision for loan impairment and reserved interest represent 93.5% (2016: 92.2%) of gross non-performing loans and advances.

27 Distribution by economic sector *(continued)*

The table below analyses the concentration of letters of credit and guarantees commitments by economic sector:

	2017	2016
	RO'000	RO'000
Import trade	**38,759**	42,996
Construction	**79,860**	73,244
Financial institutions	**158,729**	143,931
Manufacturing	**15,265**	20,263
Wholesale and retail trade	**12,797**	8,992
Electricity, gas, water, transportation and communication	**26,949**	29,579
Services	**67,345**	81,439
Mining and quarrying	**1,390**	1,899
Others	**44,508**	7,056
	445,602	409,399

28 Operating segment

The factors used to identify the Bank's reporting segments are discussed in the 'Summary of significant accounting policies' in note 2.18.

Products and services

The Bank provides a comprehensive range of banking and related financial services to its customers.

- Retail Banking and Wealth Management ('RBWM') offers a broad range of products and services to meet the personal banking needs, consumer finance and wealth management needs of individual customers. Typically, customer offerings include personal banking products (current and savings accounts, mortgages and personal loans, credit cards, debit cards and local and international payment services) and wealth management services (insurance and investment products and financial planning services).

- Commercial Banking ('CMB') product offerings include the provision of receivables financing services, payments and cash management, international trade finance, treasury and capital markets, commercial cards, cash and derivatives in foreign exchange and rates, and online and direct banking offerings.

- Global Banking and Markets ('GB&M') provides tailored financial solutions to government, corporate and institutional clients. The client focused business lines deliver a full range of banking capabilities including financing, advisory and transaction services; a markets business that provides services in credit, rates, foreign exchange, money markets and securities services; and principal investment activities.

- Corporate Centre: During 2017, the HBON management realigned certain functions into a Corporate Center, including Other and Balance Sheet Management ('BSM').

Notes to the Financial Statements (continued)

As of 31 December 2017

28 Operating segment *(continued)*

	31 December 2017				
	CMB	RBWM	GB&M	Corporate Center	Total
	RO'000	RO'000	RO'000	RO'000	RO'000
Net interest income					
- External	8,151	27,807	12,573	5,722	54,253
- Internal	7,340	2,612	(3,248)	(6,704)	-
	15,491	30,419	9,325	(982)	54,253
Net fee income	3,457	3,687	4,705	(171)	11,678
Net trading income	1,358	1,238	3,629	2,998	9,223
Other operating income	21	65	32	26	144
Total operating income	20,327	35,409	17,691	1,871	75,298
Loan impairment charges and other credit risk provisions - net of recoveries	(2,793)	(3,684)	946	-	(5,531)
Net operating income	17,534	31,725	18,637	1,871	69,767
Total operating expenses	(11,276)	(30,704)	(5,893)	(482)	(48,355)
Profit before tax	6,258	1,021	12,744	1,389	21,412
Reportable segment assets	488,003	478,411	452,377	915,006	2,333,797
Reportable segment liabilities	1,023,955	640,955	304,887	40,744	2,010,541

	31 December 2016				
	CMB	RBWM	GB&M	Corporate Center	Total
	RO'000	RO'000	RO'000	RO'000	RO'000
Net interest income					
- External	11,130	28,858	10,014	4,264	54,266
- Internal	2,859	2,087	(1,957)	(2,989)	-
	13,989	30,945	8,057	1,275	54,266
Net fee income	4,430	3,960	4,086	(164)	12,312
Net trading income	1,416	1,415	3,559	1,385	7,775
Other operating income	304	326	66	152	848
Total operating income	20,139	36,646	15,768	2,648	75,201
Loan impairment charges and other credit risk provisions - net of recoveries	446	(4,167)	(1,924)	-	(5,645)
Net operating income	20,585	32,479	13,844	2,648	69,556
Total operating expenses	(10,560)	(31,390)	(5,961)	(455)	(48,366)
Profit before tax	10,025	1,089	7,883	2,193	21,190
Reportable segment assets	421,898	473,664	546,187	812,144	2,253,893
Reportable segment liabilities	918,119	663,851	319,971	38,242	1,940,183

29 Dividend per share

The Board of Directors at the forthcoming Ordinary Annual General meeting will propose a cash dividend of RO0.0057 per share of nominal value of RO0.100 each amounting to RO11.4 M for the year 2017 (2016: cash dividend of RO0.005 per share of nominal value of RO0.100 each amounting to RO10.0 M). These financial statements do not reflect these dividends, which will be accounted for in shareholders' equity as an appropriation of retained earnings for the year ending 31 December 2018.

Notes to the Financial Statements (continued)
As of 31 December 2017

30 Risk management

All of the Bank's activities involve, to varying degrees, the analysis, evaluation, acceptance and management of risks or combinations of risks. The most important categories of risk that the Bank is exposed to are credit risk (including cross-border country risk), market risk, operational risks in various forms, liquidity risk, reputational risk, legal risk and sustainability (environmental and social) risks. The Bank continues to enhance its capabilities and coverage of financial crime control. Market risk includes foreign exchange, interest rate and equity price risks. The management of these various risk categories is discussed below.

The risk profiles of the Bank change constantly under the influence of a wide range of factors. The risk management framework established by the Bank fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interdependencies.

This section provides details of the Bank's exposure to risk and describes the methods used by management to manage risk.

30.1 Risk governance and ownership

A well-established risk governance and ownership structure ensures oversight of and accountability for the effective management of risk. The Board approves the Bank's risk appetite framework, plans and performance targets, the appointment of senior officers, the delegation of authorities for credit and other risks and the establishment of effective control procedures.

The Board's Audit and Risk Committees are responsible for advising the Board on material risk matters and providing non-executive oversight of risk.

Under authority delegated by the Board, the separately convened monthly Risk Management Meeting ('RMM') oversees risk management policy and the implementation of risk appetite and controls. The RMM together with the Asset and Liability Committee (ALCO) monitors all categories of risk, receives reports on actual performance and emerging issues, determines action to be taken and reviews the efficacy of the Bank's risk management framework.

In its oversight and stewardship of risk management, RMM is supported by a dedicated Risk function headed by the Chief Risk Officer (CRO), who is the chairperson of RMM and reports to the Board Risk Committee chairman.

Risk has functional responsibility for the principal financial risk types, namely retail and wholesale credit, market, operational, security and fraud risks. For these it establishes policy, exercises bank-wide oversight and provides reporting and analysis of portfolio composition.

30.2 Risk appetite

The Bank's approach to risk is encapsulated within our Risk Appetite Statement (RAS) which is approved by the Board.

The Risk Appetite Statement defines the qualitative and quantitative expressions of the risks which the Bank is prepared to embrace in alignment with its strategy and business plans. Quantitative metrics are assigned to eight key categories: earnings, capital, liquidity and funding, credit risk covering impairment and diversification, other risk categories, financial crime and internal audit. Measurement against the metrics serves to:

- guide underlying business activity, ensuring it is aligned to the Risk Appetite Statement;
- enable the key underlying assumptions to be monitored and, where necessary, adjusted through subsequent business planning cycles; and
- promptly identify business decisions needed to mitigate risk.

Notes to the Financial Statements (continued)
As of 31 December 2017

30 Risk management *(continued)*

30.3 Credit risk

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from direct lending and trade finance, but also from off-balance sheet products such as guarantees and from the Bank's holdings of debt and other securities. Credit risk generates the largest regulatory capital requirement of the risks we incur.

Credit risk management

The Wholesale (corporate) and Retail Risk functions report to the CRO. Their responsibilities include:

- Formulating and recording detailed credit policies and procedures, consistent with local regulations and HSBC Group policy.
- Issuing policy guidelines on appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain high-risk sectors.
- Undertaking independent reviews and objective assessment of risk. Wholesale Risk assesses all commercial non-bank credit facilities and exposures prior to the facilities being committed to customers or transactions being undertaken. Above certain designated limits exposures require Board approval and HSBC Group concurrence.
- Monitoring the performance and management of portfolios.
- Maintaining policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to the Bank's capital base and remain within regulatory and internal limits.
- Maintaining the governance and operation of the Bank's risk rating framework and systems, to classify exposures taking into account regulatory requirements.
- Reporting on retail portfolio performance, high risk portfolios, risk concentrations, country limits and cross-border exposures, large impaired accounts, impairment allowances and stress testing results and recommendations to the Risk Management Meeting, the Audit and Risk Committees and the Board of Directors.
- Acting on behalf of the Bank as the primary interface, for credit-related issues, with external parties.

The Bank implements credit policies, procedures and lending guidelines that meet local requirements and conform to the HSBC Group standards.

Credit quality

The Bank's 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 Bank's retail business, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

Special attention is paid to problem exposures in order to accelerate remedial action. The Bank uses a specialist unit to manage non-performing accounts and provide customers with support in order to help them avoid default wherever possible.

Periodic risk-based audits of the Bank's credit processes and portfolios are undertaken by an independent function.

Impairment assessment

It is the Bank's policy to create allowances for impaired loans and advances promptly and consistently.

Impairment allowances may be assessed and created either for individually significant accounts or on a collective basis for groups of individually significant accounts for which no evidence of impairment has been individually identified or for high-volume groups of homogeneous loans that are not considered individually significant.

Impairment allowances are taken in conformity with regulatory requirements and HSBC Group policy.

Notes to the Financial Statements (continued)

As of 31 December 2017

30 Risk management *(continued)*

30.3 Credit risk *(continued)*

Write-off of loans and advances:

Loans are normally written off, either partially or in full, when there is no realistic prospect of further recovery. For secured loans and advances, write-off generally occurs after receipt of any proceeds from the realisation of security.

Unsecured personal facilities, including credit cards, are generally written off at the end of the month in which the account becomes 180 days contractually delinquent.

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

Cross-border exposures

Cross border exposures are subject to limits which are centrally managed by the HSBC Group and are subject to HSBC Group approval concurrence.

Maximum exposure to credit risk

The Bank's exposure to credit risk is spread across a broad range of asset classes, including derivatives, trading assets, loans and advances to customers, due from banks, and financial investments.

For financial assets recognised on the statement of financial position, the maximum exposure to credit risk equals their carrying amount; for financial guarantees and similar contracts granted, it is the maximum amount that the Bank would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, the maximum exposure to credit risk, it is generally the full amount of the committed facilities.

Exposure to credit risk – loans and advances to customer - net

	2017	2016
	RO'000	RO'000
Individually impaired	**55,269**	69,127
Allowance for impairment	**(51,657)**	(63,718)
Carrying amount	**3,612**	5,409
Past due and not impaired		
1-30 days	**7,210**	7,544
31-60 days	**3,275**	3,823
61-89 days	**2,045**	1,744
Neither past due nor impaired	**1,397,033**	1,418,499
Provision for loan impairment – general	**(18,289)**	(18,604)
Carrying amount	**1,394,887**	1,418,415

Exposure to credit risk – neither past due nor impaired assets

	2017	2016
	RO'000	RO'000
Balances with central bank (note 10(a))	**191,768**	250,767
Due from banks (note 10 (b))	**40,363**	80,222
Financial investments (note 12)	**611,751**	409,059
Other assets	**28,014**	22,215
	871,896	762,263

Notes to the Financial Statements (continued)
As of 31 December 2017

30 Risk management *(continued)*

30.3 Credit risk *(continued)*

Collateral and other credit enhancements

Although collateral can be an important mitigants of credit risk, it is the Bank'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. However, for other lending decisions a charge over collateral is obtained and is considered in determining the credit decision and pricing. In the event of default, the Bank may utilise the collateral as a source of repayment.

An estimate of the fair value of collateral and other security enhancements held against loans and advances is shown below:

	2017 RO'000	2016 RO'000
Property	**136,273**	130,216
Equity	**397**	628
Fixed deposits	**26,845**	25,844
Vehicle	**4,540**	5,572
Guarantees	**186,343**	113,427
Total	**354,398**	275,687

The table below presents an analysis of financial investments as at 31 December 2017 and 2016:

	2017 RO'000	2016 RO'000
Unrated equity investments	**3,170**	3,910
Sovereign securities	**611,751**	409,059
Total	**614,921**	412,969

The table below presents an analysis of due from banks and balances with central bank as at 31 December 2017, based on Fitch and Standard & Poor's ratings or equivalent.

	2017 RO'000	2017 RO'000
Sovereign	**191,768**	250,767
A	**10,652**	29,469
A+	**-**	501
A-	**1,216**	-
AA+	**33**	-
AA-	**28,336**	50,056
BBB+	**126**	196
Total	**232,131**	330,989

Notes to the Financial Statements (continued)

As of 31 December 2017

30 Risk management *(continued)*

30.3 Credit risk *(continued)*

Concentration of exposure

Exposure to a person, company or group (the Single Borrower Lending Limit) is restricted to a maximum 15% of the Bank's regulatory net worth or 10% of the Bank's regulatory net worth for related parties, subject to any regulatory dispensations. In addition, the total of all facilities granted to related parties must not exceed 35% of the Bank's net worth.

	Gross loans and advances		Due from banks		Financial investments		Balances with central bank	
	2017	2016	**2017**	2016	**2017**	2016	**2017**	2016
	RO'000	RO'000	**RO'000**	RO'000	**RO'000**	RO'000	**RO'000**	RO'000
Concentration by sector:								
Sovereign	**2**	96,292	**-**	-	**611,751**	409,059	**191,768**	250,767
Corporate	**976,272**	919,864	**-**	-	**-**	-	**-**	-
Banks	**-**	-	**40,363**	80,222	**-**	-	**-**	-
Retail	**488,559**	484,581	**-**	-	**-**	-	**-**	-
Carrying amount	**1,464,833**	1,500,737	**40,363**	80,222	**611,751**	409,059	**191,768**	250,767

Credit quality of financial instruments

All loans and advances in the Bank are classified according to asset quality. Standard accounts include all facilities which demonstrate good financial condition, risk factors and capacity to pay in line with the original terms of sanction.

Accounts categorised as 'Specially Mentioned' carry no impairment provision but are below standard and require monitoring by reason of one or more adverse factors. This may for example relate to poor profitability, low tangible net worth or deteriorating business prognosis. The Bank complies with all regulatory requirements as regards credit quality classification.

The Bank has standalone credit policies that are aligned to the HSBC Group. This includes application of credit risk rating system for corporate counterparties for which the Bank uses a 23 point credit risk rating system called Credit Risk Rating ('CRR'). Each CRR is mapped to a Probability of Default (PD), which is also reviewed and updated periodically. Since such accounts are individually significant, risk ratings are reviewed regularly and amendments made as and when appropriate. Within the Bank's retail business, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

30.4 Liquidity and funding

Liquidity risk is the risk that the Bank does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.

Funding risk (a form of liquidity risk) arises when the liquidity needed to fund illiquid asset positions cannot be obtained on the expected terms and when required.

Liquidity and funding risk management framework

The objective of the Bank's liquidity and funding risk framework ('LFRF') management is to allow it to withstand severe liquidity stresses. It is designed to be adaptable to changing business models and regulations.

The LFRF is delivered using the following key aspects:

- minimum LCR requirement depending on inherit liquidity risk ('ILR') categorization;
- minimum NSFR requirement depending on ILR categorization;
- depositor concentration limit;
- three-month and 12-month cumulative rolling term contractual maturity limits covering deposits from bank, deposits from non-bank financial institutions and securities issued; and
- minimum LCR requirement by currency.

Notes to the Financial Statements (continued)
As of 31 December 2017

30 Risk management *(continued)*

30.4 Liquidity and funding *(continued)*

The management of the LFRF is implemented in accordance with the limits and practices set by the Board and the HSBC Group and is in line with the guidelines provided by the CBO.

Liquidity and funding for the year ended 2017

The liquidity position of the Bank remained strong as of 31 December 2017. Our liquidity coverage ratio was 223% (2016: 364%).

The Bank also calculates the LCR as per the CBO requirement and same has been disclosed separately in note 31 of these financial statements.

Management of liquidity and funding risk

Liquidity coverage ratio

The LCR metric is designed to promote the short-term resilience of a bank's liquidity profile. It 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. HQLAs consist of cash or assets that can be converted into cash at little or no loss of value in markets.

Net stable funding ratio

The 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.

Sources of funding

The current accounts, savings deposits and term deposits are the Bank's primary source of funding. The Bank places considerable importance on the stability of these deposits.

The level of customer accounts continued to exceed the level of loans and advances to customers. The positive funding gap was predominantly deployed into liquid assets, cash and balances with central banks and financial investments, as required by the LFRF. Loans and other advances to banks continued to exceed deposits by banks.

30.5 Market risk management

The objective of the Bank's market risk management is to manage and control market risk exposures in order to optimize return on risk while maintaining a market profile consistent with the Bank's status as a premier provider of financial products and services.

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

The Bank is required to assess the market risks which arise on each product in its business and to transfer these risks to its Global Markets unit for management. The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to professionally manage such risks.

Derivative financial instruments

Derivative financial instruments used by the Bank include swaps, forwards and other similar types of contracts whose value changes in response to changes in interest rates, foreign exchange rates, or other market forces. Derivatives are individually negotiated over-the-counter contracts (referred to as OTC-products). A description of the main types of derivative instruments used by the Bank is set out below.

Swaps

Swaps are over-the-counter agreements between the Bank and other parties to exchange future cash flows based upon agreed notional amounts. Swaps most commonly used by the Bank is interest rate swaps. Under interest rate swaps, the Bank agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and floating-rate interest amounts calculated by reference to an agreed notional amount. The Bank is subject to credit risk arising from the respective counterparties' failure to perform. Market risk arises from the possibility of unfavorable movements in interest rates relative to the contractual rates of the contract and the Bank covers the market risk by entering into offsetting transactions.

Notes to the Financial Statements (continued)

As of 31 December 2017

30 Risk management *(continued)*

30.5 Market risk management *(continued)*

Forwards

Forward contracts are commitments to either purchase or sell a designated financial instrument, or currency, at a specified future date for a specified price and may be settled in cash or another financial asset. Forwards are individually-traded over-the-counter contracts. Forward contracts result in credit exposure to the counterparty. Forward contracts result in exposure to market risk based on changes in market prices relative to contracted amounts. The market risk on such transaction is managed within pre-approved limits.

Value at risk ('VaR')

VaR is a measure that estimates the potential losses that could occur 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 (for the Bank, 99 per cent). The Bank calculates VaR daily. The VaR model used by the Bank is predominantly based on historical simulation. The historical simulation model derives plausible future scenarios from historical market rates time series which would naturally take into account inter-relationships between different market rates, for example between interest rates and foreign exchange rates.

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

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

The Bank recognises these limitations by augmenting its VaR limits with other position and sensitivity limit structures. The VAR for Global Markets was as follows:

	2017	**Average**	**Maximum**	**Minimum**	2016	Average	Maximum	Minimum
	RO'000	**RO'000**	**RO'000**	**RO'000**	RO'000	RO'000	RO'000	RO'000
Total VAR	**103**	**83**	**122**	**60**	73	67	94	35
Trading VAR	**33**	**25**	**44**	**8**	22	9	23	1

Trading

Market risk in trading portfolios is monitored and controlled at both portfolio and position levels using a complementary set of techniques, such as VaR, together with stress and sensitivity testing and concentration limits.

Other controls include restricting individual operations to trading within a list of pre-approved permissible instruments, and enforcing rigorous new product approval procedures.

Non-trading

The principal objective of market risk management of non-trading portfolios is to optimise net interest income. Market risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost as result of interest rate changes. Analysis of this risk is complicated by having to make behavioral assumptions regarding the economic duration of liabilities which are contractually repayable on demand, for example, current accounts, in order to manage this risk optimally. Market risk in non-trading portfolios is transferred to Global Markets or to separate books managed under the auspices of the ALCO. ALCO regularly reviews that these portfolios are managed within pre-approved interest risk limits.

Notes to the Financial Statements (continued)
As of 31 December 2017

30 Risk management *(continued)*

30.5 Market risk management *(continued)*

Currency risk

As a risk control mechanism limits are put in place for foreign exchange open positions. Positions are managed and monitored on an ongoing basis by the Treasury. Periodical reporting is made to ALCO who deliberate on the issue and give necessary guidance to the Treasury.

The Bank had the following net exposures denominated in foreign currencies as at 31 December:

	Overall exposure in RO' 000	
Currency	**2017**	2016
US Dollars	**34,222**	28,003
Pound Sterling	**2**	23
Euro	**3**	12
UAE Dirhams	**118**	4
Indian Rupee	**5**	4
Other currencies	**166**	36
Total exposure	**34,516**	28,082

30.6 Legal risk

The Bank is required to implement procedures to manage legal risk that conform to HSBC Group standards. Legal risk falls within the definition of operational risk and includes contractual risk, dispute risk, legislative risk and non-contractual rights risk.

- Contractual risk is the risk that the rights and/or obligations of the Bank within a contractual relationship are defective.
- Dispute Adjudication risk is the risk that the Bank may be subject to actual or threatened litigation.
- Legislative risk is the risk that the Bank fails to adhere to the laws of the jurisdictions in which it operates.
- Non-contractual rights risk is the risk that the Bank's intellectual property rights are not properly owned or are infringed by others, or the Bank infringes another party's Intellectual property rights.

The Bank has a legal function to assist management in controlling legal risk. The legal department must be immediately advised of any action by a regulatory authority, where the proceedings are criminal, or where the claim might materially affect the Bank's reputation.

In December 2012, HSBC Holdings and HSBC Bank USA entered into agreements with US and UK government agencies regarding past inadequate compliance with the Bank Secrecy Act ('BSA'), anti-money laundering ('AML') and sanctions laws.

Among those agreements, HSBC Holdings and HSBC Bank USA entered into a five-year deferred prosecution agreement with the DoJ, the US Attorney's Office for the Eastern District of New York, and the US Attorney's Office for the Northern District of West Virginia (the 'US DPA'). HSBC Holdings also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions and an undertaking with the UK Financial Conduct Authority ("UK FCA") to comply with certain forward-looking AML and sanctions-related obligations.

An independent compliance monitor (the 'Monitor') was appointed in 2013 under the agreements entered into with the DoJ and the FCA to produce annual assessments of the effectiveness of HSBC's AML and sanctions compliance programme.

In December 2017, the US DPA entered into in December 2012 had expired. HSBC fulfilled its commitments, and, therefore, under the DPA, the Department of Justice will file a motion with the US District Court for the Eastern District of New York seeking the dismissal of the charges deferred by the agreement.

Notes to the Financial Statements (continued)

As of 31 December 2017

30 Risk management (continued)

30.6 Legal risk (continued)

The Monitor overseeing HSBC's progress under the US DPA has also been serving since July 2013 as HSBC's Skilled Person under a 2012 direction issued by the UK Financial Conduct Authority and will continue in that capacity for a period of time at the discretion of the UK FCA.

Various regulators and competition and law enforcement authorities around the world, including in the US, EU, Switzerland, Brazil, South Korea and South Africa, are conducting or have conducted civil and criminal investigations and reviews into trading by HSBC Holdings, HSBC Bank USA and other HSBC Group entities and others on the foreign exchange markets. HSBC is cooperating with these investigations and reviews.

In September 2017, HBSC Holdings and HSBC North America Holdings ("HNAH") consented to a civil money penalty order with the FRB in connection with its investigation into HSBC's historic foreign exchange activities. Under the terms of the order, HSBC Holdings and HNAH agreed to pay a civil money penalty of USD 175 Mn to the FRB.

In January 2018, HSBC Holdings entered into a three-year deferred prosecution agreement with the Criminal Fraud Division of the DoJ, covering conduct in 2010 and 2011, and received a declination from the Antitrust Division of the DoJ, concluding its investigation into HSBC's historic foreign exchange activities. Under the terms of the deferred prosecution agreement, HSBC Holdings agreed to pay a penalty of USD 101.5 Mn and restitution.

30.7 Operational risk management

The Bank defines operational risk as "the risk to achieving your strategy or objectives as a result of inadequate or failed internal processes, people and systems, or from external events". Losses arising through fraud, unauthorised activities, errors, omission, inefficiency, systems failure or from external events all fall within the operational risk definition.

A formal governance structure provides oversight over the management of operational risk. The Risk Management Meeting convenes monthly to discuss operational risk issues and the effectiveness of internal controls.

In order to manage operational risks, the Bank has an Operational Risk Management Framework (ORMF), which includes adoption of the Three Lines of Defense risk governance framework:

1) The First Line of Defense owns the operational risks. They are responsible for identifying, recording, reporting and managing risks, and ensuring that the right controls and assessments are in place to mitigate these risks. Most of the Bank's people are in The First Line of Defense, including Risk Owners, Control Owners and Business Risk & Control Managers (BRCMs).
2) The Second Line of Defense sets policy and guidelines for managing operational risk, and provides advice and guidance on effective risk management. The Second Line are risk management specialists comprising Risk Stewards and the Operational Risk Function.
3) The Third Line of Defense is Internal Audit who independently ensure that the Bank is managing operational risk effectively.

A centralised database is used to record the results of the operational risk management process. Operational risk and control assessments, and losses, are input and maintained by the business units. Management is responsible for implementing the required standards of operational risk control throughout their operations and where deficiencies are evident, rectifying them within a reasonable timeframe.

The Bank maintains and tests contingency facilities to support operations in the event of unforeseen disasters.

30.8 Compliance risk management

Compliance risk is the risk that the Bank fails to observe the relevant laws and regulations imposed by the various governing authorities and regulators where the Bank operates. Failure to comply with regulations may lead not only to penalties and financial losses but is also detrimental to the reputation and long term prosperity of any organisation.

30 Risk management (continued)

30.8 Compliance risk management (continued)

The Bank's management is primarily responsible for managing the compliance risks that the Bank is exposed to and is supported by the Compliance department in discharging this duty within the various business units. The compliance function in the Bank is set up in accordance with the CBO guidance on compliance function for banks issued in 2006 and facilitates the management of compliance risk by:

- Setting policies and standards to cover compliance issues.
- Advising management, the business and other parts of the Bank, the impact of applicable regulations on their business, activity or behavior.
- Providing, an independent reporting mechanism for all executives.
- Fostering an open and transparent relationship with the regulators in Oman.
- Managing the relationship with the Bank's regulators including coordination of all contact, coordination of all regulatory submissions, monitoring and control of regulator's access to HBON's premises, staff and materials.
- Report immediately to the Risk Committee of the Board and relevant senior management on all material or significant breaches of which they are aware as soon as practicable and issue half-yearly certificates, outlining any breaches, to the Central Bank and quarterly to CMA.

30.9 Capital management

Capital management is guided by the CBO through circular BM 1009 (Guidelines on BASEL II) and regulatory capital under BASEL III framework. Capital adequacy is calculated on quarterly intervals and reported to the CBO. Banks are required to maintain minimum capital adequacy ratio of 13.25% including capital conservation buffer for 2017 (2016: 12.625%) in accordance with CBO stipulated guidelines.

The Bank's regulatory capital position at 31 December was as follows:

	2017 RO'000	2016 RO'000
Common Equity Tier 1 capital ('CET 1') / Tier 1 capital		
Ordinary share capital	**200,031**	200,031
Legal reserve	**39,879**	37,967
Retained earnings	**74,110**	68,439
Regulatory adjustments to CET1	**(8,099)**	(11,391)
CET 1/Tier 1 capital	**305,921**	295,046
Additional Tier 1 capital (AT1)	**-**	-
Total Tier 1 capital (T1 = CET1+AT1)	**305,921**	295,046
Tier 2 capital (T2)		
Fair value reserve for available-for-sale equity securities	**18**	36
Provision for loan impairment – general	**18,289**	18,604
Total	**18,307**	18,640
Total regulatory capital	**324,228**	313,686
Risk-weighted assets		
Banking book	**1,738,327**	1,510,638
Operational risk	**152,247**	151,480
Market risk	**25,521**	17,332
Total risk-weighted assets	**1,916,095**	1,679,450
Capital ratios		
CET 1 / Tier 1 capital ratio	**15.97%**	17.57%
Total capital ratio	**16.92%**	18.68%

Notes to the Financial Statements (continued)
As of 31 December 2017

31 Liquidity coverage ratio (LCR)

Liquidity coverage ratio (LCR) is guided by the CBO through circular BM 1127 (BASEL III : Framework on Liquidity coverage ratio and LCR disclosure standards). Liquidity coverage ratio is calculated on monthly intervals and reported to the CBO. The Banks are required to maintain minimum liquidity coverage ratio of 80% for 2017 (2016: 70%) in accordance with CBO stipulated guidelines.

Liquidity coverage ratio disclosure for the period ended 31 December 2017:

		31 December 2017		31 December 2016	
		Total Unweighted Value (average*) RO'000	**Total Weighted Value (average*) RO'000**	Total Unweighted Value (average**) RO'000	Total Weighted Value (average**) RO'000
High quality liquid assets					
1	Total High quality liquid assets (HQLA)		**702,245**		654,297
	Cash outflows				
2	Retail deposits and deposits from small business customers, of which:	**631,168**	**46,996**	668,227	49,853
3	- Stable deposits	**322,407**	**16,120**	339,396	16,970
4	- Less stable deposits	**308,761**	**30,876**	328,831	32,883
5	Unsecured wholesale funding, of which:	**1,451,361**	**599,040**	1,291,777	536,730
6	- Operational deposits (all counterparties) and deposits in networks of cooperative banks	**-**	**-**	-	-
7	- Non-operational deposits (all counterparties)	**1,451,361**	**599,040**	1,291,777	536,730
8	- Unsecured debt	**-**	**-**	-	-
9	Secured wholesale funding	**-**	**-**	-	-
10	Additional requirements, of which	**42,252**	**3,960**	99,092	9,619
11	- Outflows related to derivative exposures and other collateral requirements	**-**	**-**	-	-
12	- Outflows related to loss of funding on debt products	**-**	**-**	-	-
13	- Credit and liquidity facilities	**42,252**	**3,960**	99,092	9,619
14	Other contractual funding obligations	**-**	**-**	-	-
15	Other contingent funding obligations	**597,007**	**29,850**	1,014,820	50,741
16	**Total cash outflows (2+5+10+15)**		**679,846**		646,943
	Cash inflows				
17	Secured lending (e.g. reverse repos)	**-**	**-**	-	-
18	Inflows from fully performing exposures	**106,395**	**83,806**	245,606	166,980
19	Other cash inflows	**-**	**-**	-	-
20	**Total cash inflows (17+18+19)**	**106,395**	**83,806**	245,606	166,980
					Total Adjusted Value
21	**Total HQLA**		**702,245**		654,297
22	**Total net cash outflows (16-20)**		**596,040**		479,963
23	**Liquidity coverage ratio (21/22)**		**118%**		136%

*simple average of daily observations over the last three months (October – December 2017).
**simple average of monthly observations over the last three months (October - December 2016).

32 Corresponding figures

Certain corresponding figures for 2016 have been reclassified in order to conform to the presentation adopted in the current period. Such reclassifications have not resulted in any change in the prior period reported profit or equity.