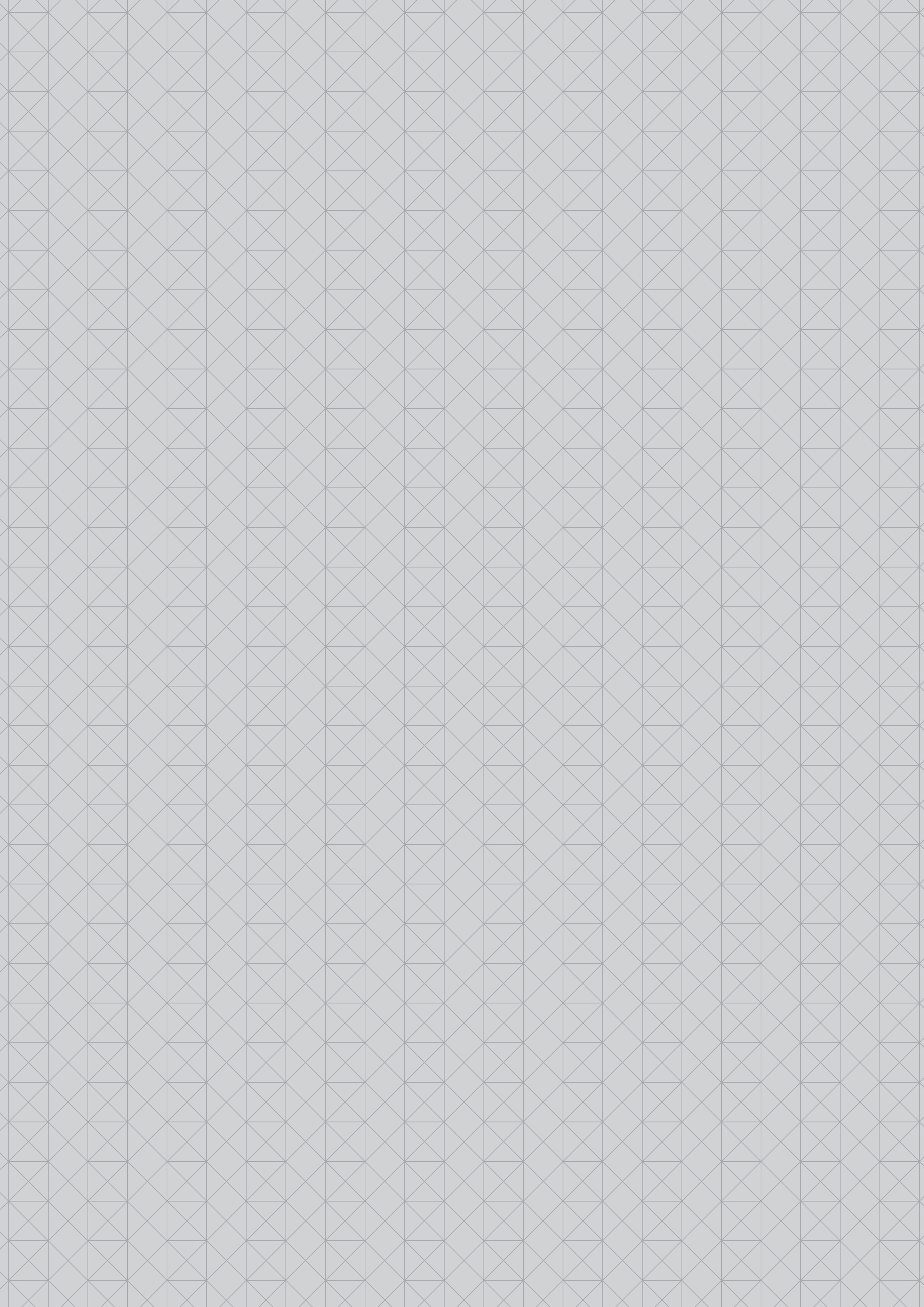
HSBC Bank Oman S.A.O.G

Annual Report and Accounts 2018

HSBC

Together we thrive

Welcome to HSBC Bank Oman's Annual Report for 2018



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

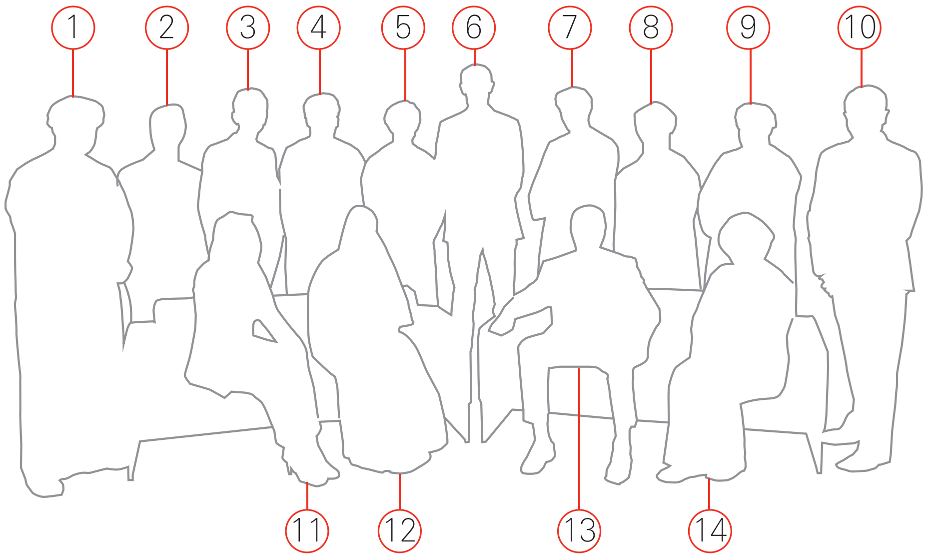
Sheikh Aimen Ahmed Sultan Al Hosni
Director

Adulfattah Sharaf
Director

Paul Lawrence
Director

Christine Lynch
Director

Management Team



1 **Sameh Al Wahaibi**
Assistant General Manager and Head of Communications

2 **Ahmed El Damaty**
General Manager and Chief Financial Officer

3 **Pierre El Ahmar**
General Manager and Treasurer, Global Markets

4 **Ali Al Abri**
General Manager and Head of Human Resources & Government Affairs

5 **Saud Al Shidhani**
General Manager and Chief Operating Officer

6 **Andrew Long**
Chief Executive Officer

7 **Abdul Qader Al Sumali**
General Manager and Head of Retail Banking and Wealth Management

8 **Sulaiman Al Lamki**
General Manager and Chief Risk Officer

9 **Khalid Al Mahari**
Assistant General Manager and Head of Regulatory Compliance

10 **Biju Thottingal**
General Manager, Legal

11 **Rahma Al Busaidi**
Company Secretary

12 **Nahla Al Kharousi**
Deputy General Manager & Acting Head of Commercial Banking

13 **Amir Bourani**
Head of Global Banking

14 **Paramita Sen**
Assitant General Manager & Head of Financial Crime Compliance

Board of Directors' Report for the year ended 31 December 2018

Dear Shareholders,

On behalf of the Board of Directors, I am pleased to present your Bank's full year financial results for 2018.

Performance Summary

I am delighted to share with you our encouraging results achieved by the Bank during 2018. Our performance shows a 64.4% increase in net profit for the year ended 31 December 2018 to RO31.4 M. This compares with RO19.1 M for 2017, the increase being driven primarily by a 14.1% growth in revenues.

Net interest income grew by 10.7% to RO60.1 M for the year due to the growth in the average loan balances of our customers as well as the rising yield on our financial investments which we made with our surplus liquidity. Net fee income stood at RO11.7 M for the year.

Net Trading income increased by 48.9% to RO13.7 M, an increase of RO4.5 M over the same period in 2017 owing to higher trading volumes from our clients' business flows and cross-border payments.

A net release of RO1.5 M has been reported in the Bank's Expected Credit Losses (ECL) and other credit impairment charges compared with a net charge of RO5.5 M for the same period last year. The Bank saw a release of RO5.3 M in the Wholesale portfolio offset by a RO3.8 M charge in the Retail portfolio. (The IFRS 9 Expected Credit Losses and other credit impairment charges for 2018 are not strictly comparable to the IAS 39 loan impairment charges for 2017. Under IFRS 9, the global banking sector has seen some increased volatility in the reported level of provisions).

Operating expenses rose by 2.1% to RO49.4 M compared with RO48.4 M for the same period in 2017. Higher IT-related expenses and operations cost offset savings in other areas.

Loans and advances to customers fell by 0.4% to RO1,389.6 M when compared with RO1,394.9 M as at 31 December 2017. The fall is mainly due to the reduction in a small number of large Wholesale Loans at the year end, notwithstanding the overall growth in average balances over the full year as referred to above.

Customer deposits fell slightly by 0.3% to RO1,926.1 M but our liquidity remains the strongest in the market with an Advances to Deposit ratio (ADR) of 72.1% at the end of 2018.

HBON's Capital Adequacy Ratio (CAR) stood at 19.4% for the year ended 31 December 2018 compared with 16.9% as at 31 December 2017. The significant increase arose from retained profits as well as to a change in the calculation of certain numbers in the ratio as directed by our regulators.

The Board of Directors proposes a total cash dividend of RO18.6 M, with a dividend pay-out ratio of 59.3%. This represents a 63.2% increase in our dividend payment as compared with last year.

Delivering the best customer experience

In Retail Banking and Wealth Management, the Bank launched several campaigns targeting customer growth in the premium segment of the market. These included an acquisition campaign that focused on Advance and Premier "new to bank" customers and this has contributed to improving our personal loan acquisition. We have also upgraded our Premier credit card from Platinum to the World credit card with a host of benefits that includes access to more than 800 airport lounges. We have also improved our Advance credit card proposition in a similar manner.

On the digital front, we continued our focus on enhancing our digital platforms aiming to meet our customers' growing expectations. As a result, we managed to increase our customers' digital engagement to 48% in December 2018 from 36% in December 2017. During the year we also launched Touch ID and Facial Recognition for mobile banking on iPhone, giving our customers the ability to securely

Board of Directors’ Report for the year ended 31 December 2018

perform certain banking transactions without the need to use a Secure Key.

Our Mandoos saving scheme was revamped to give our customers more chances to win, as well as to encourage our customers to adapt a prudent saving habit. In line with our 70 years anniversary celebrations, the scheme included 70 winners of RO 1000 each month.

In Wholesale Banking, we were delighted to be recognized, for the 7th consecutive year, as the Best Domestic Cash Manager for corporates in Oman in the Euromoney Cash Management Survey 2018. This Award demonstrates our customers’ confidence in our cash and liquidity management services and our ability to meet their requirements.

We continued to demonstrate our support to leading corporates and the Government of Oman, leveraging our local expertise and our international connectivity. At the beginning of the year we supported the Ministry of Finance in pricing its largest ever international debt capital markets offerings, raising USD 6.5 Billion across 5, 10 and 30 year tranches.

Our award winning digital platform HSBCnet was enhanced during the year with the addition of HSBCnet Plus. This is a non-transactional portal that gives our HSBCnet customers access to comprehensive cyber security and to a fraud awareness centre to help them protect their businesses.

Investing in our people and community

Supporting the Government’s national recruitment agenda, during 2018 we recruited 54 fresh graduates from different educational institutions around the Sultanate.

We achieved an Omanization rate of 93% as at 31 December 2018, which is ahead of the 90% target set by the Central Bank of Oman.

In the Corporate Sustainability (CS) field, the highlight of the year was the MoU we signed with the Ministry of Environment and Water Resources. Based on this, HSBC Bank Oman will partner with the Ministry in repairing a number of Aflaj around the Sultanate.

Our CS agenda also included a number of activities that focused on “future skills”, one of the CS pillars at the Bank. These activities included the “Next Generation” Programme that was carried out in partnership with Outward Bound Oman. “Next Generation” aims to support Omani youth in their transition from education to employment. We also launched the second phase of the “Taqadam” Programme, in partnership with the British Council and the Caledonian College for Engineering.

Conclusion

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.

In closing, 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. For most of our 70 years in the Sultanate, we have been fortunate to be able to rely on the leadership of His Majesty. We offer our full support as he continues to lead the Sultanate to further prosperity and development.

Sir Sherard Cowper-Coles
Chairman

REPORT OF FACTUAL FINDINGS

TO THE SHAREHOLDERS OF HSBC BANK OMAN SAOG

1. We have performed the procedures listed below and agreed with you pursuant to the Capital Market Authority (CMA) circular no.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 2018 and application of the corporate governance practices in accordance with amendments to the CMA Code of Corporate Governance issued under circular no.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, *Engagements to perform agreed-upon procedures regarding financial information*. The procedures were performed solely to assist the Board of Directors of the Company in complying with the requirements of the Code.

3. We performed the following procedures:

   a) We obtained the Corporate Governance Report ("the Report") issued by the Board of Directors and checked that it includes, as a minimum, all items suggested by the CMA to be covered by such reports as detailed in Annexure 3 of the Code, by comparing the Report with the suggested content in Annexure 3; and

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

4. After 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 in accordance with International Standards on Auditing or a review in accordance with 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 second 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 the the Bank's Annual Report for the year ended 31 December 2018 and does not extend to any other areas of the Annual Report or to the financial statements of the Bank taken as a whole.

PricewaterhouseCoopers

Muscat, Sultanate of Oman
4 March 2019

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PricewaterhouseCoopers LLC
C.R. No 1230865

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Corporate Governance Report
For the Annual Report 2018

'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 in order to create long-term value for its stakeholders, achieve HBON's strategic goals, and to position HBON as Oman's leading bank.

1.2 HBON's value proposition is:

- 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 and 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 periodically updated 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 (4 are independent and all are non-executive).

3.2 The term of the current Board commenced on 29 March 2018 for a period of three years. The next Board election will be in 2021.

3.3 Any vacancy arising due 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 competency, 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;
- Acquire and maintain appropriate and relevant industry specific knowledge; and
- Acquire and maintain business expertise in international markets.

Corporate Governance Report (continued)
For the Annual Report 2018

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

Name & Category	Biography
Directors in office	
Sir Sherard Cowper-Coles KCMG LVO Chairman & Non – Independent, non-executive director Qualification(s): Hertford College, Oxford (Degree in Classics, Scholar, Honorary Fellow)	Sherard 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, and Group Head of Public Affairs in June 2017. He is also Chairman of HSBC Bank Oman SAOG, and a Director of HSBC Bank Egypt SAE. From 2011 to 2013, he was Business Development Director, International, at BAE Systems plc. Earlier he spent over 30 years in the British Diplomatic Service, which he joined straight from reading Classics at Oxford, finishing his career as Ambassador to Israel, Saudi Arabia and then Afghanistan. Sherard is Chairman of the UK Financial Inclusion Commission; a member of the Financial Inclusion Policy Forum; an Ambassador for the Money Advice Trust, and for the Winston Churchill Memorial Trust; a member of the Boards of the China-Britain Business Council, the Saudi British Joint Business Council, and the Egyptian British Business Council; Chairman of the Omani-British Business Council; a Committee Member of the Hong Kong Association; and a Board Member of Asia House. He is President of the Algeria British Business Council; and Chair of Pitzhanger Manor & Gallery Trust. He sits on the International Engagement Committee of the British Academy.
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. Retired from Ministry of Defense - Oman with effect from 1st October 2011.
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.

Corporate Governance Report (continued)
For the Annual Report 2018

Name & Category	Biography
Directors in office	
Aimen Ahmed Sultan Al Hosni Independent, non-executive director Qualification(s): Masters in Public Administration and 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 which included the opening of the new Muscat International Airport in 2018. 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 SAOG, Omantel Telecommunication and HSBC Bank Oman.
Abdulfattah Sharaf Non- Independent, non-executive director and Chair of the NRC. Qualification(s): Graduate of the University of Denver, USA	Abdulfattah Sharaf is a Group General Manager and the Chief Executive Officer of HSBC Bank Middle East Limited (United Arab Emirates). He is also Head of International for HSBC Bank Middle East Limited 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 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) and Emirates Telecommunication Company (Etisalat). Before joining HSBC Bank Middle East Limited, Abdulfattah was 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 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.

Corporate Governance Report (continued)
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Name & Category	Biography
Directors in office	
Paul Lawrence Independent, non-executive director and Chair of the Audit Committee. Qualification(s): 2005 – London Business School, United Kingdom Successful completion of the Senior Executive Programme aimed at developing Leadership/Managing Stakeholder Relationships/ Developing and Implementing Strategy/Improving Operational Execution 1978 to1981 – Leicester University United Kingdom. Degree of Bachelor of Science (BSc) in Combined Studies , with the award of Honours Class II (ii)	After 32 years with the HSBC Group, Paul retired in August 2013 and now holds a small portfolio of non-executive positions. During his career he held a number of senior roles, in business leadership in Asia and the USA and finally as Head of the HSBC Group's Global Internal Audit function based in London. Paul was a member of HSBC Commercial Banking Risk Committee, one of HSBC Group's principal business lines from 2014 to 2016 and an Independent Banking Representative, consultant to HSBC in the creation of their UK ring fence bank with a specific focus on compliance with ring fencing obligations for the new ring fence board from 2014 to 2018. He is currently an Independent Non-Executive Director, Chair of the Board Risk Committee and Member of the Board Audit, Nomination and Remuneration Committees for Shawbrook Bank Limited from 2015 and Chair of Uley Community Stores, a registered Society under the Community Benefit Societies Act 2014 registered with the Financial Conduct Authority in addition to being an Independent Non-Executive Director and Chair of Audit Committee of HSBC Oman SOAG.
Christine Lynch Non-Independent, non-executive director and Chair of the Risk Committee. Qualification(s): BA (First Class) Hons degree in Modern Languages & European Studies from the University of Bath BSc (First Class) Hons in Financial Services awarded by University of Manchester Institute of Science.	Christine is a senior Chief Risk Officer with 22 years' broad experience in international banking. She joined HSBC as a graduate trainee and since then has held managerial and leadership roles across the lines of business in the UK, Germany, Switzerland and most recently the UAE. In her current role as Regional Chief Risk Officer for the Middle East, Christine leads a team of over 400 Risk professionals and is responsible for the enterprise wide risk management of HSBC's activities across Global Banking & Markets, Commercial Banking and Retail Banking & Wealth Management in the UAE, Egypt, Turkey, Oman, Qatar, Kuwait, Bahrain and Algeria. Prior to this, she was Chief Risk Officer for HSBC in Switzerland where she led a massive derisking and remediation programme for the offshore private banking operation, including strategic repositioning, large-scale client exits, embedding of Global Standards for financial crime compliance, crisis management (Swissleaks) and risk stewardship over a major core banking platform replacement project & Technology. She speaks fluent French and German and is a mum to two kids, aged 10 and 5.

Corporate Governance Report (continued)
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Directors relinquished from office (on 29 March 2018)	
Rob Underwood Independent and 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 and non-executive director Qualification(s): Fellow member of the Chartered Association of Certified Accountants	Currently Robin is the Chief Operating Officer of SABB from 1 July 2017. Prior to 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, 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. 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.

Corporate Governance Report (continued)
For the Annual Report 2018

4.4 The composition of the Board and its skill base is 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 2018, 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 during 2018 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.

2018 Dates	Board & Committee
28 January	Board, Audit, Risk, NRC
4 March	Board, Audit, NRC (via videoconferencing)
29 March	Board
29 April	Board, Audit, Risk
25 & 26 July	Board, Audit, Risk
17 October	Board, Audit, Risk, NRC

6.4 The Board met 6 times, the Audit Committee met 5 times, the Risk Committee met 4 times, and the NRC met 3 times in 2018. The AGM was held on 29 March 2018. The composition, name of members, Chairperson, and attendance record of the Board and Committees and directorships are given in the table below:

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	6	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	Yes	Yes
Aimen Ahmed Sultan Al Hosni	Board, Risk, NRC	4	N/A	4	2	Yes	Yes
Abdulfattah Sharaf	Board, Risk, NRC and Audit NRC Chairman effective 3 March 2016.	4	4	3	3	No	No
Rob Underwood	Board, Audit, Risk, and NRC. Risk Committee Chairman from 21 July 2014 - 29 March 2018)	2	N/A	1	2	No	No
Robin D. Jones	Board and Audit. Audit Committee Chairman effective from 30 March 2015 - 29 March 2018.	2	2	1	N/A	No	No
Christine Lynch	Board, Risk, and NRC. Risk Committee Chairperson effective from 29 March 2018	4	N/A	3	1	Yes	No
Paul Lawrence	Board and Audit. Audit Committee Chairman effective from 29 March 2018	4	3	N/A	N/A	Yes	No

#The full Board met for a Bank-wide Strategy session on 26 July 2018. 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 2018, Sir Sherard Cowper-Coles, Rob Underwood, Abdulfattah Sharaf, Robin D. Jones, and Christine Lynch 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 2018 amounted to RO 56,655 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	5,000	500	5,500
Abdulfattah Sharaf	-	-	-
Christine Lynch	-	-	-
Paul Lawrence	3,500	500	4,000
Rob Underwood	-	-	-
Robin D. Jones	-	-	-
Total sitting fees	**16,500**	**1,500**	**18,000**
Total hotel, travel and other board expenses (including AGM expenses)	**38,655**	**-**	**38,655**
GRAND TOTAL	**55,155**	**1,500**	**56,655**

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 for Top Management is to be deferred into HSBC Holdings Restricted Shares of HSBC, 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 555,656 reflecting a 3.4% increase over the December 2018 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 1.3%, 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 1.3% 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 2018 Pay Review Funding - Fixed and Variable Pay review funding was established during 4Q18 for each Business, Function and for HBON overall. The 2018 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 2018 Variable Pay Spend – Variable Pay spend will be OMR 3.5 million representing an increase of 2.2% over the 2017 spend with a headcount increase from PY2017 to PY2018 of 1%. Aggregate Variable Pay spend reflects a payout ratio of 9.2% of Profit before Tax (PBT) and 4.1% of overall HBON revenue (against 16 % and 4.5 % respectively in 2017).

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 2018 to the MRTs including salary, cash and non-cash benefits, bonuses, stock options and gratuity amounted to RO 4.04 million. The total remuneration paid in aggregate during 2018 to the top 5 officers amounted to RO 1.37 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 436,588 or (36%) 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 3 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 continuous 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 3,342 shareholders as at 31 December 2018.

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 2018:

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 2018	0.128	0.110	7,453.66
February 2018	0.113	0.108	7,409.69
March 2018	0.112	0.105	7,271.65
April 2018	0.110	0.101	7,274.73
May 2018	0.105	0.101	7,234.88
June 2018	0.119	0.106	7,165.38
July 2018	0.124	0.112	6,879.63
August 2018	0.119	0.115	6,824.93
September 2018	0.123	0.117	6,933.64
October 2018	0.121	0.117	6,965.74
November 2018	0.121	0.117	6,937.80
December 2018	0.121	0.118	6,915.09

13.2

% Shareholding	No of shareholders
Less than 5%	3,340
Between 5 – 10%	1
More than 10%	1
Total	3,342

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 42,000 (RO 19,000 for Year 2016; RO 15,000 for Year 2017; and RO 8000 for Year 2018) were imposed on the Bank for regulatory penalties as detailed hereunder:

Year	Entity	Regulator	Brief Description	Amount of penalties RO
2016	HBON	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
	HBON	CBO	The Bank had violated the CBO instructions with regard to Omanisation of Personnel in the Banking Sector.	4,000
	HBON	CBO	The Bank had not complied with the provisions of the CBO Circular on combating frauds where, the Bankhad not reported frauds to the CBO and the ROP within three days of knowledge/occurrence.	4,000
	HBON	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 2016				**19,000**
2017	HBON	CBO	Data Quality Issue. The BCSB was not updated.	3,000
			The Bank was not in compliance with the CBO Regulations on Outsourcing.	4,000
			The Bank had not complied with the condition stipulated by the CBO, while granting the approval for product.	4,000
			The Bank was not compliant with the Regulatory requirements on security of Electronic Banking systems.	4,000
TOTAL 2017				**15,000**
2018	HBON	CBO	The Bank had not adhered with regulatory instructions in reporting of receipt of audited financials from its borrowers.	4,000
	HBON	CBO	The Bank had charged annual debit card fee on Dormant accounts with low or nil balances, resulting in overdrawings in these accounts. Also, the Bank charged interest on these overdrawn accounts.	4,000
TOTAL 2018				**8,000**

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 2018 have been (i) disclosed in the Notes to the Financial Statements as at 31 December

2018 (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 2018.

16.2 The Shareholders of the Bank appointed PwC as the Bank's auditors for the year 2018.

16.3 PwC is a global network of firms operating in 158 countries with more than 250,000 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 4,500 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 RO 99,000 for audit services and RO 9,950 for non-audit services, totaling RO108,950, towards their engagement as the external auditor of the Bank for the year 2018.

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


HSBC

Management Discussion and Analysis

Our Values:

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

Dependable

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

Open

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

Connected

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

Our 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.

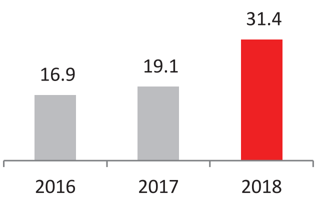
Oman's Banking Environment

Banking activities gained further traction in line with the pickup in the Sultante's overall economic activities. Credit to the private sector increased by 4.9% to RO 22 billion as at the end of December 2018. Of the total credit to the private sector, the share of the non-financial corporate sector was 45.8 % followed by the household sector (mainly under personal loans) at 45.6%, financial corporations at 5.4 % and other sectors the remaining 3.2 %.

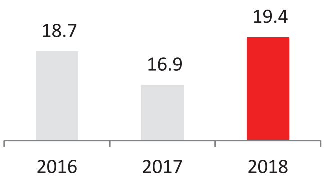
Total deposits of ODCs grew 7.8% to RO 23.3 billion as at the end of December 2018. Private sector deposits of the banking system increased by 2.6% to RO14.3 billion as at the end of December 2018.

Highlights of 2018

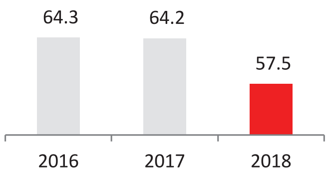
Profit for the year
RO31.4 M



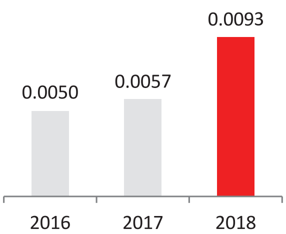
Total Capital ratio
19.4%



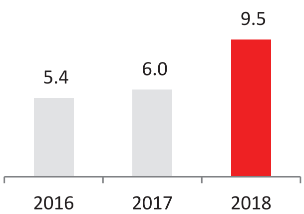
Cost efficiency ratio
57.5%



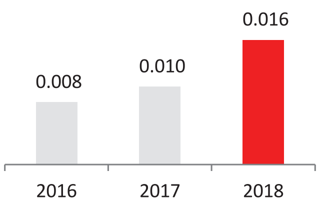
Dividend per share
RO 0.0093



Return on average equity
9.5%



Earnings per share - basic
RO0.016



Financial Performance Analysis

Profit for the year: HSBC Bank Oman reported a 64.4% increase in net profit to RO31.4 M for 2018 compared with RO19.1 M for 2017.

Total revenue grew 14.1% while operating expenses were 2.1% higher. This has contributed to positive JAWS (growth in revenue over the increase in costs) of 12.0% and a CER (Cost Efficiency Ratio) of 57.5%.

The Bank's performance in 2018 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 increased by 10.7% to RO60.1 M for the year driven both by the increase in the average balances of the customer loans as well as the rising yield on these loans. NII also came from the financial investments which we made with our surplus liquidity.

Net fee, trading and other operating income: Net fee, trading and other operating income was RO25.8 M compared to RO21.0 M in 2017. Within this growth, Net fee income remains flat at RO11.7 M compared with last year while Net trading income grew 48.9% to RO13.7 M owing to higher trading volumes from our clients' business flows and cross-border payments in addition to the optimization of our balance sheet and surplus liquidity.

Other operating and dividend income rose to RO0.5 M compared with RO0.1 M for 2017 owing primarily to the accounting gain on derecognition of financial assets measured at amortised cost.

Change in Expected Credit Losses (ECL) and other credit impairment charges: A net release of RO1.5 M has been reported in the Bank's Expected Credit Losses (ECL) and other credit impairment charges compared with a net charge of RO5.5 M for the same period in 2017. The Bank saw a release of RO5.3 M in the Wholesale portfolio offset by a RO3.8 M charge in the Retail portfolio. (The IFRS 9 Expected Credit Losses and other credit impairment charges for 2018 are not strictly comparable to the IAS 39 loan impairment charges for 2017. Under IFRS 9, the global banking sector has seen some increased volatility in the reported level of provisions).

The key drivers of the ECL release in the Wholesale portfolio were;

- Customer Risk Rating (CRR) changes resulting in upgrades from Stage 2 (Lifetime provision) to Stage 1 (12 month provision), and
- Repayment / Replacement of exposures that were in Stage 2 resulting in a release in the Lifetime provisions.
- Positive movement in Macro-Economic Variables (MEVs) was reflected in the Forward Economic Guidance (FEG) quarterly refresh resulting in an overall reduction in the IFRS 9 ECL across the portfolio.

Operating expenses: operating expenses rose by 2.1% to RO49.4 M compared with RO48.4 M for the same period in 2017. Higher IT-related expenses and operations costs offset savings in other areas. 2018 is the first year in which the Bank has reported any cost growth since 2014.

The Cost Efficiency Ratio (CER) improved to 57.5% for 2018 compared to 64.2% for 2017.

Total assets: HBON's total assets increased from RO2,333.8 M to RO2,360.6 M. The growth in assets was due to (i) RO92.4 M in amounts Due from banks, (ii) Cash and balances with Central Bank of RO46.8 M partly offset by a reduction in Financial Investments of RO113.6 M.

Loans and advances: Customer lending fell marginally by 0.4% to RO1,389.6 M compared with RO1,394.9 in 2017, owing mainly to the reduction in a small number of large Wholesale Loans at the year end, notwithstanding the overall growth in average balances over the full year as referred to above.

Customer deposits: Customer deposits fell marginally 0.3% to RO1,926.1 M compared with RO1,932.1 M as at 31 December 2017.

HBON's Advances to Deposits (ADR) ratio was little changed at 72.1% as compared to 72.2% in 2017. The ADR reflects the liquidity of the Bank as HBON continues to position itself among its peers as having the most liquid balance sheet. The regulatory average Liquidity Coverage Ratio (LCR) of the Bank stood at 225% against the regulatory limit of 90% for 2018.

Capital Adequacy Ratio: HBON's Capital Adequacy Ratio (CAR) was 19.4% at the year ended 31 December 2018 compared with 16.9% as at 31 December 2017. The significant increase arose from retained profits as well as a reversal of regulatory changes which had a positive impact to the Bank. The strong capital base support the Bank's goal to become strongest capitalised Bank among its peers in Oman.

Our approach to managing capital is designed to ensure that we exceed current regulatory requirements and to position the Bank so that we are well placed to meet future expected requirements.

HBON's growth aspirations and conservative approach to managing its balance sheet require a strong and liquid capital base. Our financial performance in 2018 has meant that Bank is well able 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), our Premier and Advance propositions are aimed at mass affluent customers who value international connectivity and benefit from our global reach and scale. For customers with simpler banking needs, RBWM offers a full range of products and services reflecting local requirements.

Key events

- HSBC made significant investment in digital transformation, reshaping the branch network and the sales force, and improving customer engagement, including the launch of Touch ID and

Face Recognition for mobile banking on iPhone. This new feature enables customers to easily login to their HSBC mobile banking app simply by using their Fingerprint or Face Recognition, which improves the security and convenience of our mobile app.

- Our Mandoos savings account scheme continued to attract customer deposits. Over the years, our Mandoos account scheme has successfully encouraged more and more customers to adopt prudent saving habits and offered our customers chances to win cash prizes.
- We ran a clients acquisition campaign focusing on the Advance and Premier New to Bank customers, which has helped us improve our personal loan acquisition.
- HSBC Premier and Advance Credit Cards holders benefited from several upgrades and improved propositions during the year. Our customers now have access to a bigger number of airport lounges around the world and can enjoy even more attractive discounts on hotel bookings using their Gold and Platinum Credit Cards.

Commercial Banking

Our Commercial Banking customers range from small enterprises focused primarily on their domestic markets to corporates operating globally. We support customers with tailored financial products and services to allow them to operate efficiently and grow.

Main Events:

- In November 2018 we hosted a Digital Summit for our top corporate customers, . They were involved in thought-leading discussions and given insight to the benefits of HSBC's transition to digital. The main objective of the event was to help our corporate customer through their digital transition and to reinforce HSBC's digital capabilities and readiness to meet our customers' evolving needs. During the event live demos were given to finance managers from different companies on how simple, easy, and efficient the Internet Trade Services (ITS) platform is to use.
- We continued to improve our key digital channels with significant improvements to our award winning digital platform HSBCnet. During the year we launched "HSBCnet Plus", which is an enhancement to our existing HSBCnet platform.
- We held the 21st HSBC Economist Roadshow, at which our customers had the opportunity to hear from HSBC Group's in-house economists as they discussed the most important global and regional trends shaping the Middle East's economies.
- Our cash management capabilities were recognized by being ranked the "Best Cash Manager for Corporates in Oman" in the Euromoney's Annual Cash Management Survey for the 7th consecutive year. This annual 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.

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.

Key events:

- HSBC acted as a joint lead and book runner on the Ministry of Finance's largest bond ever, raising USD 6.5 billion across the 5, 10, and 30 year tranches.
- HSBC acted as the Sole Financial Advisor to the Government in their USD 4bn Pre-export Finance deal. This was one of a kind transaction, where a Middle East sovereign has directly entered into a structured finance facility, against oil exports to China and invited major Chinese Financial Institutions to participate.
- HSBC acted as Joint Lead Manager & Documentation Bank for the Ministry of Finance's USD 1.5bn Sukuk offering (Oman's second Sukuk offering).
- HSBC acted as a joint lead manager in OmanTel's USD 1.5B conventional bond.

Human Resources

Our employees are key to our success. We are focused on creating a diverse and inclusive environment where people can speak up, build their skills and develop their careers. We want our employees to feel that they can contribute to our purpose and fulfil their potential with our support.

Omanisation in the bank stood at 93%, which is ahead of the Central Bank of Oman's target of 90%. Omanisation percentage at Middle Management and Senior Management were 92% and 83% respectively.

Supporting the national recruitment agenda, HSBC Bank Oman has recruited 54 fresh graduates from different universities and colleges around the Sultanate.

In 2018 we delivered 3,687 Learner Man-days. 79% of them were delivered through classroom training, 19% by E-learning and 2% in study / examination leave.

Business Continuity Planning (BCP)

HSBC Bank Oman has adopted industry leading best practices, building on the HSBC Group's global strategy and experiences. The Bank has established 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 to mitigate risks inherent with unforeseen business interruptions.

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, exercises 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. 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.

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 including third party 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 has also adopted a robust a communication plan to ensure employees receive emergency notifications and instructions via a variety of sources, including in-building announcements, emails, telephone contact, toll-free phone numbers and websites.

Corporate Sustainability

Corporate sustainability (CS) is an integral part of the way we do business. In 2018 we have delivered several programms aiming to fulfil our social commitment toward the society and aiming to foster a volunteering culture among our staff.

Key events:

Next Generation Programme: This programme was delivered in partnership with Outward Bound Oman. The programme aims to support the young people in their transition from education to employment by providing them with the skills they need to increase their employability. HSBC sponsored 72 Omanis who participated in the programme, which was conducted in Jabel Al Akhdar.

Taqadam Programme: In cooperation with the British Council and the Caledonian College for Engineering, the second phase of Taqadam Programme was delivered during the year. This programme aims to provide college students with the skills, confidence and the lifelong learning to reflect the changing needs of the work environment in the 21st century.

Ramadan Philanthropic activities: During the holy month of Ramadan the Bank organized a number of charitable activities, including the Market Fair that provide 1,600 local workers the opportunity to shop for products such as blankets, pillows, and hygiene products using gift vouchers which the Bank gave to each attendee. The Bank also distributed gift vouchers for 630 needy families across the Sultanate.

Aflaj repairing project: Responding to one of the major challenges facing the region, which is water sustainability, the Bank signed an MoU with the Ministry of Regional Municipalities and Water Resources supporting the repairing of a number of Aflaj in Oman. The objective of this partnership is to enhance the flow of water by developing the existing underground supplies, while also encouraging agricultural production in cultivated areas that are experiencing excessively dry weather conditions. HSBC staff will also get the opportunity to volunteer in the project and the Aflaj repairing work.

Looking Ahead

As announced by the Ministry of Finance, Oman's 2019 budget focuses on fiscal sustainability and implementation of priority projects to meet the aspired growth rates.

According to the Ministry's statement, the budget deficit of RO 2.8 billion is expected to be covered by internal and external borrowing of RO 2.4 billion and a withdrawal of RO 400 million from the reserves to account for the balance deficit.

HSBC Bank Oman has played an integral role in facilitating the debt issuance for the government over the last 2 years, and we are well positioned to continue supporting the government in its development and diversification plans.

With the objectives of Oman 2040 Vision now set, emphasizing the need to create wealth through economic diversification and private sector partnership, we are looking forward to playing even a bigger role in the country's development plan and in celebrating more milestone in our journey in the country.

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 30 to 49 as at and for the year ended 31 December 2018. 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, Circular No. BM 1114 dated 17 November 2013 and Circular No. BM 1149 dated 13 April 2017 amended with letter BSD/CB/FLC/2018/17 dated 26 November 2018. 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, BM 1114 dated 17 November 2013 and Circular No. BM 1149 dated 13 April 2017 amended with letter BSD/CB/FLC/2018/17 dated 26 November 2018.

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

PricewaterhouseCoopers LLC
C.R. No 1230865

Muscat, Sultanate of Oman
4 March 2019

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Chartered Accountants Licence No. L1065369, Management Consultants Licence No. L1065290, Commercial Register No. 1230865

Statutory Disclosure under Basel II - Pillar III and Basel III Framework

For the year ended 31 December 2018

1. Introduction

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, and 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.

The following qualitative and quantitative disclosures has been prepared in accordance to meet the minimum disclosure requirement as per Central Bank of Oman ('CBO') rules and regulations relating capital adequacy standards and Pillar III Disclosure requirements under Basel II and Basel III framework. The Basel II and Basel III framework is structured around three 'pillars': the Pillar 1 minimum capital requirements and Pillar 2 supervisory review process are complemented by Pillar 3 which concerns market discipline.

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.

2. Scope of Application

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

3. Capital Structure

Objectives and 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

The regulatory capital is broadly classified into two categories – Tier 1 and Tier 2 capital. Tier 1 capital is further classified into Common Equity Tier 1 capital ('CET 1') and Additional Tier 1 Capital ('AT1'). The Bank's capital structure also consist of Tier 1 and Tier 2 ('T2') capital.

CET1 capital

CET1 Capital is comprised of common shares issued by the bank, legal reserves and retained earnings. The book values of goodwill, intangible assets, and cumulative unrealised losses on fair value through other comprehensive income ('FVOCI') financial investments are deducted in arriving at CET1 capital. Currently, the Bank does not have any goodwill in its book.

AT1 capital

AT 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.

T2 capital

T2 capital comprises of the following:

Cumulative fair value gains on FVOCI financial investments. 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.

Stage 1 and stage 2 expected credit loss ('ECL') allowances under IFRS 9. The stage 2 ECL allowances under IFRS 9 is required to be phased out from Tier 2 capital over a period of four years as indicated in below table.

Year	Portion of stage 2 ECL allowance considered for Tier 2 capital
2018	80%
2019	60%
2020	40%
2021	20%
2022 onwards	0%

The total stage 1 and permitted stage 2 ECL allowance included in Tier 2 capital is subject to the ceiling of 1.25% of credit risk weighted assets and cannot exceed the total general provision amount taken under tier 2 capital as on 31 December 2017.

In line with the 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	43,016
Retained earnings*	78,981
Regulatory adjustments to CET1	(3,972)
CET1 capital	**318,056**
Additional Tier 1 capital	**-**
Total Tier 1 capital	**318,056**
ECL allowance – Stage 1	**4,554**
ECL allowance – Stage 2	**10,884**
Tier 2 capital	**15,438**
Total regulatory capital	**333,494**

*Net of proposed dividend

4. 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 Capital Market Authority's Code; and
- 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.

4.1 Remuneration policy

The scope of Bank's remuneration policy extends to all employees of the Bank. The Bank's 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.

4.2 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;

	2018 RO'000	2017 RO'000
Wages, salaries and other short term benefits	**1,839**	1,671
Post-employment benefits	**336**	27
	2,175	1,698

5. 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.

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

For the year ended 31 December 2018

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 in place Internal Capital Adequacy Process ('ICAAP') which evaluates Bank's position to meet the capital adequacy guidance as set out by CBO as well as further conservative internal targets the Bank sets for itself.

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 31.5 of the financial statements.

The details of capital, risk weighted assets and capital adequacy ratio as at 31 December 2018 are as follows:

RO '000

Details	**Gross balance (Book value)**	**Net balances (Book value)***	**Risk weighted assets**
On-balance sheet items	2,349,297	2,327,541	1,313,534
Off-balance sheet items	350,060	346,932	214,070
Derivatives	4,894	4,894	4,894
Total	**2,704,251**	**2,679,367**	**1,532,498**
Market risk			25,100
Operational risk			160,951
Total			**1,718,549**
CET 1 capital			318,056
Additional Tier 1 capital			-
Total Tier 1 capital			**318,056**
Tier 2 capital			**15,438**
Total regulatory capital			**333,494**
Capital requirement for credit risk			197,309
Capital requirement for market risk			3,232
Capital requirement for operational risk			20,722
Total required capital			**221,263**
CET1 / Tier 1 Capital ratio			**18.51%**
Total capital ratio			**19.41%**

*Net of eligible collaterals.

6. 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 31 of the financial statements.

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

On 1 January 2018, the Bank implemented IFRS 9 'Financial Instruments'. Information relevant to understanding the impact of the new accounting standard on the Bank is set out in note 30 of the financial statements.

The Bank has standalone credit policies that are aligned to HSBC group. These includes the application of a 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 are 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.

The management of credit risk, credit approval process, credit quality of loans and advances, impaired loans, credit administration is set out in note 31.3 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).

Past Dues

Past due but not impaired gross financial instruments are those loans where, although customers have failed to make payments in accordance with the contractual terms of their facilities, they have not met the impaired loan criteria. This is typically when a loan is less than 90 days past due and there are no other indicators of impairment. Further analysis of the past due financial

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)
For the year ended 31 December 2018

instruments is set out in in note 31.3 of the financial statements.

Impairment of amortised cost and FVOCI financial assets

Expected credit losses ('ECL') are recognised for loans and advances to banks and customers, non-trading reverse repurchase agreements, other financial assets held at amortised cost, debt instrument measured at fair value through other comprehensive income ('FVOCI'), and certain loan commitments, acceptances and financial guarantee contracts. At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is required for ECL resulting from default events that are possible within the next 12 months ('12-month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in 'stage 3'.

Impairment assessment

It is the Bank's policy to create allowances for impaired loans and advances promptly and consistently. For details of impairment policies on loans and advances and financial investments, see note 2.2 of the financial statements. When impairment losses occur, the Bank reduces the carrying amount of loans and advances through the use of an allowance account.

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

- **Stage 1:** Unimpaired and without significant increase in credit risk on which a 12-month allowance for ECL is recognised.
- **Stage 2:** A significant increase in credit risk has been experienced since initial recognition on which a lifetime ECL is recognised.
- **Stage 3:** Objective evidence of impairment, and are therefore considered to be in default or otherwise credit-impaired on which a lifetime ECL is recognised.
- **POCI:** Purchased or originated at a deep discount that reflects the incurred credit losses on which a lifetime ECL is recognised.

Impaired loans

Impaired loans and advances are those that meet any of the following criteria:

Wholesale loans and advances classified as Customer Risk Rating ('CRR') 9 or CRR 10. These grades are assigned when the bank considers that either the customer is unlikely to pay their credit obligations in full without recourse to security, or when the customer is more than 90 days past due on any material credit obligation to the group.

Retail loans and advances classified as Band 7. These grades are typically assigned to retail loans and advances more than 90 days past due unless individually they have been assessed as not impaired.

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 2018	31 December 2017	**31 December 2018**	31 December 2017
Overdraft	**61,224**	63,391	**66,181**	59,926
Personal loans*	**511,883**	496,510	**495,971**	484,652
Loans against trust receipts	**206,328**	266,925	**191,527**	303,905
Other loans	**684,364**	552,724	**698,617**	595,072
Bills purchased / discounted	**14,867**	23,711	**11,657**	21,278
Total	**1,478,666**	1,403,261	**1,463,953**	1,464,833

*Personal loans exclude the retail overdrafts of RO3,421 K (31 Dec 2017: RO3,907 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 2018

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	66,181	-	-	-	66,181
Personal loans*	495,651	49	127	144	495,971
Loans against trust receipts	191,527	-	-	-	191,527
Other loans	518,616	5,356	155,657	18,988	698,617
Bills purchased / discounted	11,657	-	-	-	11,657
Total	**1,283,632**	**5,405**	**155,784**	**19,132**	**1,463,953**

*Personal loans exclude the retail overdrafts of RO3,421 K which has been included under overdrafts.

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

RO'000

Economic Sector	Overdraft	Loans	Bills purchased / discounted	Total	Off-balance sheet exposure
Import trade	43,864	157,360	11,527	212,751	28,308
Wholesale & retail trade	1,764	63,285	130	65,179	4,951
Mining & quarrying*	185	12,747	-	12,932	1,745
Construction	6,186	61,065	-	67,251	62,497
Manufacturing	3,673	231,482	-	235,155	12,670
Electricity, gas and water	122	36,607	-	36,729	3,681
Transport and communication	411	4,511	-	4,922	39,923
Financial institutions	-	-	-	-	285
Services*	3,558	80,747	-	84,305	63,373
Personal loans*	3,421	495,651	-	499,072	-
Agriculture and allied activities	1,678	785	-	2,463	-
Government	75	-	-	75	5,344
Non-resident lending*	-	180,321	-	180,321	336,221
All others	1,244	61,554	-	62,798	13,921
Total	**66,181**	**1,386,115**	**11,657**	**1,463,953**	**572,919**

*Mining & quarrying sector does not include loans of RO163,051 K, which has been included under the head non-resident lending.

*Services sector does not include loans of RO16,950 K, which has been included under the head non-resident lending.

*The personal loans does not includes non-resident housing loans of RO320 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 2018

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	19,539	290,708	11,339	321,586	23,666
1-3 months	-	82,022	234	82,256	26,290
3-6 months	-	30,559	-	30,559	43,869
6-9 months	-	-	-	-	35,560
9-12 months	-	19,100	-	19,100	59,548
1-3 years	-	101,457	-	101,457	73,664
3-5 years	-	845,895	-	845,895	61,221
Over Over 5 years	46,642	16,374	84	63,100	249,101
Total	**66,181**	**1,386,115**	**11,657**	**1,463,953**	**572,919**

Risk exposure by major industry

RO'000

Economic Sector	Gross Loans	Of which, NPLs	Stage 3 ECL Allowance	Reserve interest	Net change in Stage 3 ECL allowance on loans and advances during the year	Advances written off during the year
Import trade	212,751	43,937	10,052	30,635	1	-
Wholesale & retail trade	65,179	2,354	1,054	336	965	-
Mining & quarrying*	12,932	-	-	-	-	-
Construction	67,251	3,848	2,458	1,351	987	349
Manufacturing	235,155	1,726	765	907	23	-
Electricity, gas and water	36,729	-	-	-	-	-
Transport and communication	4,922	1,317	212	1,082	11	-
Services*	84,305	3,223	1,035	1,910	2	-
Personal loans*	499,072	4,116	2,758	1,066	-	-
Agriculture and allied activities	2,463	2,460	659	1,605	2,280	6,080
Government	75	-	-	-	-	-
Non-resident lending*	180,321	-	-	-	-	-
All others	62,798	-	-	-	41	-
Total	**1,463,953**	**62,981**	**18,993**	**38,892**	**4,310**	**6,429**

*Mining & quarrying sector does not include loans of RO163,051 K, which has been included under the head non-resident lending.

*Services sector does not include loans of RO16,950 K, which has been included under the head non-resident lending.

*The personal loans does not includes non-resident housing loans of RO320 K, which has been included under the head non-resident lending.

Amount of impaired loans broken down by significant geographic areas including stage 3 ECL allowances related to each geographical area.

RO'000

Country	Gross loans	Of which, NPLs	Stage 3 ECL Allowance	Reserve interest	Net change in stage 3 ECL allowance on loans and advances during the year	Advances written off during the year
Oman	1,283,632	62,981	18,993	38,892	4,310	6,429
Other GCC countries	5,405	-	-	-	-	-
OECD countries	155,784	-	-	-	-	-
Others	19,132	-	-	-	-	-
Total	**1,463,953**	**62,981**	**18,993**	**38,892**	**4,310**	**6,429**

Movements of Gross Loans:

RO'000

Details	Stage 1	Stage 2	Stage 3	Total
Opening balance	**708,060**	**683,543**	**73,230**	**1,464,833**
Migration / changes (+/-)	200,599	(198,875)	(1,704)	20
New loans	472,147	-	-	472,147
Recovery of loans	(357,416)	(109,202)	-	(466,618)
Loans written off	-	-	(6,429)	(6,429)
Closing balance	**1,023,390**	**375,466**	**65,097**	**1,463,953**
ECL allowance	**3,946**	**12,563**	**18,993**	**35,502**
Reserve Interest	**98**	**575**	**38,219**	**38,892**

6.2 Credit Risk disclosures for 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 RO1,532.5 M as at 31 December 2018 after the application of credit risk mitigants.

The analysis of exposure with banks and sovereign by ECAI ratings is set out in note 31.3 of the financial statements.

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 the credit rist portfolio is Ro153.2 M which includes deposits under lien of Ro 24.4 M which has been reduced from the credit exposure of the counterparty when calculating risk weighted assets while other bank guarantees of Ro128.8 M which attracts the relevant risk weight of the counterparty providing the guarantees. The Bank does make use of netting whether on or off balance sheet.

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

6.3 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 31.5 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 the 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

The VAR for Global markets was as follows:

	2018	**Average**	**Maximum**	**Minimum**	2017	Average	Maximum	Minimum
	RO'000	**RO'000**	**RO'000**	**RO'000**	RO'000	RO'000	RO'000	RO'000
Total VAR	**48**	**64**	**109**	**39**	103	83	122	60
Trading VAR	**31**	**40**	**67**	**21**	33	25	44	8

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.

6.4 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:

		2018	2017
		RO'000	RO'000
1% UP -	Increase in NII by	**7,921**	7,812
1% DOWN -	Decrease in NII by	**(5,872)**	(11,260)

The capital requirements for market risk are as follows:

	RO'000
Interest rate risk	-
Equity position risk	-
Commodities position risk	-
Foreign exchange risk	2,008
Total	**2,008**

6.5 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
- Single currency liquidity management
- Contingency funding plan

Liquidity ratios- Basel III

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.

The liquidity position of the Bank remained strong as of 31 December 2018. Our liquidity coverage ratio was 287% (2017: 223%).

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

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.

Leverage ratio

The Basel III framework introduced a simple, transparent, non-risk based leverage ratio to act as a credible supplementary measure to the risk-based capital requirements.

The leverage ratio is intended to:

- restrict the build-up of leverage in the banking sector to avoid destabilising deleveraging processes that can damage the broader financial system and the economy; and
- reinforce the risk-based requirements with a simple, non-risk based "backstop" measure
- The leverage ratio disclosure template as per regulatory guidelines is disclosed in Annexure IV.

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

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

For the year ended 31 December 2018

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.

6.6 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 RO20.7m is based on the average gross income for the three year period ending 31 December 2018.

The management of operational risk is set out in note 31.7 of the financial statements.

Basic Indicator Approach calculation

RO in 000's

Year	Business line	Total gros income	Total gross (after negative GI adjustment)	Alpha	Capital charge
2016	Total business	82,369	82,369	15.00%	**12,355**
2017	Total business	82,852	82,852	15.00%	**12,428**
2018	Total business	92,301	92,301	15.00%	**13,845**
Number of years with positive total gross income					**3**
Basic Indicator approach capital charge @ 12.50					**12,876**
Total Risk Weighted Assets Operational Risk					**160,951**

6.7 Basel III common disclosures template

The Basel III common disclosure template is designed to capture the capital positions of the Bank after the transition period of the phasing-in deductions ended on 01 January 2018. (refer Annexure I).

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.

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 2018

Annexure I

Basel III common disclosure for the year ended 31 December 2018 (RO '000)		
Common Equity Tier 1 capital: instruments and reserves		
1	Directly issued qualifying common share capital plus related stock surplus / premium	200,031
2	Retained earnings	78,981
3	Accumulated other comprehensive income (and other reserves)	43,016
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**	**322,028**
Common Equity Tier 1 capital: regulatory adjustments		
7	Prudential valuation adjustments	(614)
8	Goodwill (net of related tax liability)	-
9	Other intangibles other than mortgage-servicing rights (net of related tax liability)	(954)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	(2,404)
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 banking, financial, insurance and takaful entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)	-
20	Mortgage Servicing rights (amount above 10% threshold)	-

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)
For the year ended 31 December 2018

21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)	-
22	Amount exceeding the 15% threshold	-
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	-
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**	**(3,972)**
29	**Common Equity Tier 1 capital (CET1)**	**318,056**
Additional Tier 1 capital: instruments		
30	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus (31+32)	-
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	
42	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions	-
43	**Total regulatory adjustments to Additional Tier 1 capital**	**-**
44	**Additional Tier 1 capital (AT1)**	**-**
45	**Tier 1 capital (T1 = CET1 + AT1)**	**318,056**
	Tier 2 capital: instruments and provisions	

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)
For the year ended 31 December 2018

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 (Expected Credit Loss allowances for stage 1 and 2)	15,438
51	**Tier 2 capital before regulatory adjustments**	**15,438**
	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	-
57	**Total regulatory adjustments to Tier 2 capital**	**-**
58	**Tier 2 capital (T2)**	**15,438**
59	**Total capital (TC = T1 + T2)**	**333,494**
60	**Total risk weighted assets (60a+60b+60c)**	**1,718,549**
60a	Of which: Credit risk weighted assets	1,532,498
60b	Of which: Market risk weighted assets	25,100
60c	Of which: Operational risk weighted assets	160,951
Capital Ratios		
61	**Common Equity Tier 1 (as a percentage of risk weighted assets)**	**18.51%**
62	**Tier 1 (as a percentage of risk weighted assets)**	**18.51%**
63	**Total capital (as a percentage of risk weighted assets)**	**19.41%**
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	-

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

For the year ended 31 December 2018

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 2018

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 31.12.2018	As at 31.12.2018	
Assets			
Cash and balances with CBO	270,574	270,574	
Balance with banks and money at call and short notice	132,792	132,792	
Investments :			
Of which Held to Maturity	-	-	
Out of investments in Held to Maturity:	-	-	
Investments in subsidiaries	-	-	
Investments in Associates and Joint Ventures	-	-	
FVOCI Investments of which:	498,986	498,986	
Investments in Subsidiaries	-	-	
Investments in Associates and Joint Ventures	-	-	
Held for Trading	-	-	
FVTPL investments	2,340	2,340	
Loans and advances of which :	1,463,953	1,463,953	
Loans and advances to domestic banks	-	-	
Loans and advances to non-resident banks	-	-	
Loans and advances to domestic customers	-	1,275,740	
Loans and advances to non-resident customers for domestic operations	-	-	
Loans and advances to non-resident customers for operations abroad	-	180,321	
Loans and advances to SMEs	-	7,892	
Financing from Islamic banking window	-	-	
Provision against Loans and advances of which:	**(74,394)**	**(74,394)**	
ECL Allowance	(35,502)	(35,502)	
Reserve Interest	(38,892)	(38,892)	
Fixed assets	25,521	25,521	
Other assets of which:	40,846	40,846	
Goodwill and intangible assets Out of which:			
Goodwill	-	-	**a**
Other intangibles (excluding MSRs)	954	954	**b**

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Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)
For the year ended 31 December 2018

Deferred tax assets	2,404	2,404	
Goodwill on consolidation	-	-	
Debit balance in Profit & Loss account	-	-	
Total Assets	**2,360,618**	**2,360,618**	
Capital & Liabilities			
Paid-up Capital Of which:			
Amount eligible for CET1	200,031	200,031	**h**
Amount eligible for AT1	-	-	**i**
Reserves & Surplus	140,410	140,410	
Total Capital	**340,441**	**340,441**	
Deposits Of which:			
Deposits from banks	37,778	31,483	
Customer deposits	1,926,125	1,926,125	
Deposits of Islamic Banking window	-	-	
Other deposits(please specify)	-	-	
Borrowings Of which:		6,295	
From CBO		-	
From banks		6,295	
From other institutions & agencies		-	
Borrowings in the form of bonds, Debentures and sukuks		-	
Others (Please specify)		-	
Other liabilities & provisions Of which:	56,274	56,274	
DTLs related to goodwill	-	-	**c**
DTLs related to intangible assets	-	-	**d**
TOTAL	**2,360,618**	**2,360,618**	

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

For the year ended 31 December 2018

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	200,031	**h**
2	Retained earnings	78,981	
3	Accumulated other comprehensive income	43,016	
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**	**322,028**	
7	Prudential valuation adjustments	(614)	
8	Goodwill (net of related tax liability)	-	**(a-c)**
9	Other intangibles other than mortgage-servicing rights (net of related tax liability)	(954)	
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	(2,404)	
11	Regulatory adjustments applied to Common Equity Tier 1 and Tier 2 to cover deductions	-	
	Common Equity Tier 1 capital (CET1)	**318,056**	

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)	RO 200.031 million
9	Par value of instrument	RO 200.031 million
10	Accounting classification	Common Equity Shares
11	Original date of issuance	03 June 2012
12	Perpetual or dated	Dated
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	Floting Dividend
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

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

For the year ended 31 December 2018

Annexure IV

Table 1: Summary comparison of accounting assets vs leverage ratio exposure measure

	Item	As at 31.12.2018
1	Total consolidated assets as per published financial statements	2,360,618
2	Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation	-
3	Adjustment for fiduciary assets recognised on the balance sheet pursuant to the operative accounting framework but excluded from the leverage ratio exposure measure	-
4	Adjustments for derivative financial instruments	14,632
5	Adjustment for securities financing transactions (i.e., repos and similar secured lending)	-
6	Adjustment for off-balance sheet items (i.e., conversion to credit equivalent amounts of off-balance sheet exposures)	401,982
7	Other adjustments	(3,358)
8	**Leverage ratio exposure**	**2,773,874**

Table 2: Leverage ratio common disclosure template

	Item	As at 31.12.2018
1	On-balance sheet items (excluding derivatives and SFTs, but including collateral)	2,360,618
2	(Asset amounts deducted in determining Basel III Tier 1 capital)	(3,358)
3	**Total on-balance sheet exposures** (excluding derivatives and SFTs) (sum of lines 1 and 2)	**2,357,260**
	Derivative Exposures	
4	Replacement cost associated with all derivatives transactions (i.e., net of eligible cash variation margin)	9,738
5	Add-on amounts for PFE associated with all derivatives transactions	4,894
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework	-
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	-
8	(Exempted CCP leg of client-cleared trade exposures)	-
9	Adjusted effective notional amount of written credit derivatives	-
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	-
11	**Total derivative exposures (sum of lines 4 to 10)**	**14,632**
	Securities financing transaction exposures	
12	Gross SFT assets (with no recognition of netting), after adjusting for sale accounting transactions	-
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	-
14	CCR exposure for SFT assets	-
15	Agent transaction exposures	-
16	**Total securities financing transaction exposures (sum of lines 12 to 15)**	-
	Other Off-balance sheet exposures	
17	Off-balance sheet exposure at gross notional amount	1,156,700
18	(Adjustments for conversion to credit equivalent amounts)	(754,718)
19	**Off-balance sheet items (sum of lines 17 and 18)**	**401,982**
	Capital and total exposures	
20	**Tier 1 capital**	318,056
21	**Total exposures (sum of lines 3, 11, 16 and 19)**	2,773,874
	Leverage Ratio	
22	**Basel III leverage ratio (%)**	**11.5**

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 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

What we have audited

The Bank's financial statements comprise:

- the statement of comprehensive income for the year ended 31 December 2018;
- the statement of financial position as at 31 December 2018;
- 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	• Expected credit losses on loans and advances to customers • IT access management

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 management 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.

Our audit approach (continued)

Key audit matters (continued)

Key audit matter	How our audit addressed the key audit matter
Expected credit losses on loans and advances to customers Impairment allowances represent management's best estimate of the Expected Credit Losses (ECL) within the loans and advances portfolios at the statement of financial position date. As described in the notes to the financial statements, ECL has been determined in accordance with International Financial Reporting Standard 9 'Financial Instruments' (IFRS 9) which came into effect from 1 January 2018. We focused on this area because management make complex and subjective judgements over both timing of recognition of impairment and the estimation of the size of any impairment, such as: • establishing portfolios of similar financial assets for the purposes of measuring ECL; • choosing appropriate models and assumptions for the measurement of ECL which includes estimation of Probability of default (PD), Loss Given default (LGD), and Exposure at Default (EAD); • determining criteria for significant increase in credit risk (SICR); • establishing the number and relative weightings of forward-looking scenarios for each type of product / market and the associated ECL; • for stage 3 commercial loans, management exercises judgement to determine when a default event has occurred and then estimates the expected future cash flows related to that loan to calculate ECL on such customers; and • determining disclosure requirements in accordance with accounting standards. Information on the accounting policy and credit risk management is included in notes 2.1 (l) and 31.3 to the financial statements respectively. Disclosures relating to the ECL provisions are included in notes 11 and 31.3 to the financial statements.	The relevant policies and methodologies used by the Bank, including how they comply with IFRS, were discussed by us with management and the audit committee. We assessed the appropriateness of the methodology and adequacy of ECL at the statement of financial position date. The work performed included the following: • read the Bank's IFRS 9 impairment provisioning policy and compared it with the requirements of IFRS 9; • obtained understanding and tested the completeness and accuracy of the historical and current dataset used for ECL calculation; • obtained understanding of and tested the grouping of similar financial in the loan portfolios for the purposes of measuring ECL; • assessed the appropriateness of the criteria used to determine SICR; • tested a sample of loans to determine the appropriateness and application of the staging criteria; • assessed the appropriateness of the definition of default and tested its application; • assessed the appropriateness of PD, LGD and evaluated the reasonableness of EAD; • tested the implementation of IFRS 9 methodology for the ECL calculation; • obtained an understanding of the methodology to identify and calculate individual impairment allowance for stage 3 exposures on a sample basis; • tested and assessed the reasonableness of the Bank's use of scenarios, weightings, discounting and overlays; • tested the reliability of historical macroeconomic and forward looking information and assumptions used; and • assessed the financial statement disclosures arising to determine if they are in accordance with the requirements of accounting standards.

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

Our audit approach (continued)

Key audit matters (continued)

Key audit matter	How our audit addressed the key audit matter
IT access management We focused on this area as the audit relies extensively on automated controls and therefore on the effectiveness of controls over IT systems. In previous years, we identified and reported that controls over access to applications, operating systems and databases 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. Over the past 4 years, management implemented remediation activities that have contributed to reducing the risk over access management in the financial reporting process. However, issues related to privileged access to parts of the technology infrastructure and business user access to applications remain unresolved, requiring our audit approach to respond to the risks presented.	We reviewed formal reporting on the results of work performed in relation to the HSBC Group-wide systems used by the Group. 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 changed role; • Access rights to applications, operating system and databases were periodically monitored for appropriateness; and • Highly privileged access is restricted to appropriate personnel. Other areas that were independently assessed included password policies, security configurations, controls over changes to applications and databases and that business users, developers and production support did not have access to change applications, the operating system or databases in the production environment. As a consequence of the deficiencies identified, a range of other procedures were performed: • Where inappropriate access was identified, the PwC group audit team performed procedures to understand the nature of the access, and, where possible, obtained additional evidence on the appropriateness of the activities performed; • We performed additional substantive testing in respect of selected year-end reconciliations (i.e. custodian, bank account and suspense account reconciliations) and confirmations with external counterparties; • We performed testing on other compensating controls such as business performance reviews; • Testing of toxic combination controls was performed by the PwC group audit team; and • Our group audit team obtained a list of users' access permissions 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.

pwc

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

Other information

The directors and management are responsible for the other information. The other information comprises the Board of Directors' Report, the Corporate Governance Report, Management Discussion and Analysis and Statutory Disclosure under Basel II – Pillar III and Basel III Framework, but does not include the financial statements and our auditor's report thereon, which we obtained prior to the date of this auditor's report and the Bank's Annual Report, which is expected to be made available to us after that date.

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 Bank's Annual Report, 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 in compliance with the relevant requirements of the Capital Market Authority of the Sultanate of Oman and the Commercial Companies Law of 1974, as amended, and for such internal control as management determines 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, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

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

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 the financial statements.

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

Auditor's responsibilities for the audit of the financial statements (continued)

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 management's 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 Capital Market Authority of the Sultanate of Oman and the Commercial Companies Law of 1974, as amended.

C.R. No 1230865

Kashif Kalam
Muscat, Sultanate of Oman
4 March 2019

Statement of comprehensive income
for the year ended 31 December

2017 US$'000	2018 US$'000		Notes	2018 RO'000	2017 RO'000
164,616	**183,026**	Interest income	3(a)	**70,465**	63,377
(23,699)	**(27,026)**	Interest expense	3(b)	**(10,405)**	(9,124)
140,917	**156,000**	**Net interest income**		**60,060**	54,253
37,403	**38,494**	Fee income		**14,820**	14,400
(7,070)	**(8,094)**	Fee expense		**(3,116)**	(2,722)
30,333	**30,400**	**Net fee income**		**11,704**	11,678
23,956	**35,532**	Net trading income		**13,680**	9,223
N/A	**(743)**	Changes in fair value of financial investments measured at Fair Value Through Profit and Loss (FVTPL)	12	**(286)**	N/A
288	**332**	Dividend income		**128**	111
86	**1,600**	Other operating income	4	**616**	33
195,580	**223,121**	**Net operating income before loan impairment charges and other credit risk provisions**		**85,902**	75,298
N/A	**3,922**	Change in expected credit losses and other credit impairment charges	5	**1,510**	N/A
(14,366)	**N/A**	Loan impairment charges and other credit risk provisions - net of recoveries	5	**N/A**	(5,531)
181,214	**227,043**	**Net operating income**		**87,412**	69,767
(58,132)	**(59,579)**	Employee compensation and benefits	6(a)	**(22,938)**	(22,381)
(57,322)	**(58,717)**	General and administrative expenses	6(b)	**(22,606)**	(22,069)
(4,208)	**(4,171)**	Depreciation of property and equipment	15	**(1,606)**	(1,620)
(5,935)	**(5,935)**	Amortisation of intangible assets	7	**(2,285)**	(2,285)
(125,597)	**(128,402)**	**Total operating expenses**		**(49,435)**	(48,355)
55,617	**98,641**	**Profit before tax**		**37,977**	21,412
(5,964)	**(17,171)**	Tax expense	8	**(6,611)**	(2,296)
49,653	**81,470**	**Profit for the year**		**31,366**	19,116
		Other comprehensive income			
		Items that will be reclassified subsequently to profit or loss when specific conditions are met			
		Available-for-sale investments			
1,543	**N/A**	- Fair value gain	12	**N/A**	594
(94)	**N/A**	- Fair value gain reclassified to loss on disposal		**N/A**	(36)
13	**N/A**	- Income tax	8	**N/A**	5
1,462	**-**			**-**	563
		Debt instruments at Fair Value Through Other Comprehensive Income (FVOCI)			
N/A	**4,795**	- Fair value gain	12	**1,846**	N/A
N/A	**(631)**	- Expected credit losses recognised in income statement	5	**(243)**	N/A
N/A	**(722)**	- Income tax	8	**(278)**	N/A
-	**3,442**			**1,325**	-
		Items that will not be reclassified subsequently to profit or loss			
(340)	**(91)**	Remeasurement of defined benefit liability	18(a)	**(35)**	(131)
1,122	**3,351**	**Other comprehensive income for the year - net of tax**		**1,290**	432
50,775	**84,821**	**Total comprehensive income for the year**		**32,656**	19,548
US$0.025	**US$0.041**	**Earnings per share – basic and diluted**	9(a)	**RO0.016**	RO0.010

The accompanying notes on pages 59 to 121 form an integral part of these financial statements.

Statement of financial position

as at 31 December

2017 US$'000	2018 US$'000		Notes	2018 RO'000	2017 RO'000
		Assets			
581,314	**702,790**	Cash and balances with central bank	**10(a)**	**270,574**	223,806
104,839	**344,914**	Due from banks	**10(b)**	**132,792**	40,363
3,623,083	**3,609,244**	Loans and advances to customers - net	**11**	**1,389,559**	1,394,887
N/A	**1,296,068**	Financial investments - FVOCI	**12**	**498,986**	N/A
N/A	**6,078**	Financial investments - FVTPL	**12**	**2,340**	N/A
1,597,197	**N/A**	Financial investments - AFS	**12**	**N/A**	614,921
74,787	**97,372**	Other assets	**13**	**37,488**	28,793
8,413	**2,478**	Intangible assets	**14**	**954**	3,239
68,151	**66,288**	Property and equipment	**15**	**25,521**	26,238
4,026	**6,244**	Deferred tax assets	**8**	**2,404**	1,550
6,061,810	**6,131,476**	**Total assets**		**2,360,618**	2,333,797
		Liabilities and equity			
		Liabilities			
93,397	**98,125**	Due to banks	**16**	**37,778**	35,958
5,018,312	**5,002,922**	Deposits from customers	**17**	**1,926,125**	1,932,050
98,462	**124,922**	Other liabilities	**18**	**48,095**	37,908
12,013	**21,245**	Current tax liabilities	**8**	**8,179**	4,625
5,222,184	**5,247,214**	**Total liabilities**		**2,020,177**	2,010,541
		Equity			
519,561	**519,561**	Share capital	**19**	**200,031**	200,031
103,582	**111,730**	Legal reserve	**20(a)**	**43,016**	39,879
N/A	**(494)**	FVOCI reserve	**20(b)**	**(190)**	N/A
(5,626)	**N/A**	Available-for-sale fair value reserve	**20(c)**	**N/A**	(2,166)
222,109	**253,465**	Retained earnings		**97,584**	85,512
839,626	**884,262**	**Net equity**		**340,441**	323,256
6,061,810	**6,131,476**	**Total liabilities and equity**		**2,360,618**	2,333,797
US$0.420	**US$ 0.442**	**Net assets per share – RO**	**9(b)**	**RO 0.170**	RO0.162
		Off-balance sheet items:			
		Contingent liabilities and commitments			
164,805	**80,657**	- Documentary credits		**31,053**	63,450
992,603	**1,407,444**	- Guarantees and performance bonds		**541,866**	382,152
2,179,049	**3,191,602**	- Others		**1,228,767**	838,934
3,336,457	**4,679,703**		**21(a)**	**1,801,686**	1,284,536

The accompanying notes on pages 59 to 121 form an integral part of these financial statements.

The financial statements were authorised for issue on 04 March 2019 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 2018

	Share capital	Legal reserve	FVOCI reserve*	Available-for-sale fair value reserve*	Retained earnings	Total
	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
At 1 January 2017	200,031	37,967	N/A	(2,729)	78,441	313,710
Total comprehensive income for the year						
Profit for the year	-	-	N/A	-	19,116	19,116
Other comprehensive income for the year						
Net movement in fair value of available-for-sale investments (net of tax)	-	-	N/A	563	-	563
Remeasurement of defined benefit liability	-	-	N/A	-	(131)	(131)
Total other comprehensive income for the year	-	-	N/A	563	(131)	432
Total comprehensive income for the year	-	-	N/A	563	18,985	19,548
Transfer to legal reserve	-	1,912	N/A	-	(1,912)	-
Transaction with shareholders, recorded directly in equity						
Dividend paid for 2016	-	-	N/A	-	(10,002)	(10,002)
At 31 December 2017	200,031	39,879	N/A	(2,166)	85,512	323,256
At 1 January 2018	**200,031**	**39,879**	**(2,166)**	**N/A**	**85,512**	**323,256**
Changes on initial application of IFRS 9 (see note 30)	**-**	**-**	**651**	**N/A**	**(4,720)**	**(4,069)**
Restated balances as at 1 January 2018	**200,031**	**39,879**	**(1,515)**	**N/A**	**80,792**	**319,187**
Total comprehensive income for the year						
Profit for the year	**-**	**-**	**-**	**-**	**31,366**	**31,366**
Other comprehensive income for the year						
Net movement in fair value of debt instrument carried at FVOCI (net of tax)	**-**	**-**	**1,325**	**-**	**-**	**1,325**
Remeasurement of defined benefit liability	**-**	**-**	**-**	**-**	**(35)**	**(35)**
Total other comprehensive income for the year	**-**	**-**	**1,325**	**-**	**(35)**	**1,290**
Total comprehensive income for the year	**-**	**-**	**1,325**	**-**	**31,331**	**32,656**
Transfer to legal reserve	**-**	**3,137**	**-**	**-**	**(3,137)**	**-**
Transaction with shareholders, recorded directly in equity						
Dividend paid for 2017	**-**	**-**	**-**	**-**	**(11,402)**	**(11,402)**
At 31 December 2018	**200,031**	**43,016**	**(190)**	**N/A**	**97,584**	**340,441**
At 31 December 2018 (USD 000's)	**519,561**	**111,730**	**(494)**	**N/A**	**253,465**	**884,262**
At 31 December 2017 (USD 000's)	519,561	103,582	N/A	(5,626)	222,109	839,626

*The RO2.2 M of FVOCI reserve as at 1 January 2018 represents the IAS39 Available-for-sale fair value reserve as at 31 December 2017.

The accompanying notes on pages 59 to 121 form an integral part of these financial statements.

Statement of cash flows
for the year ended 31 December

2017 US$'000	**2018 US$'000**		Notes	**2018 RO'000**	2017 RO'000
		Cash flows from operating activities			
55,617	**98,641**	Profit before tax		**37,977**	21,412
		Adjustments for:			
15,575	**735**	– non-cash items included in profit before tax	25(a)	**283**	5,997
32,478	**(9,964)**	– change in operating assets	25(b)	**(3,836)**	12,503
190,306	**2,964**	– change in operating liabilities	25(c)	**1,141**	73,268
(8,530)	**(8,867)**	– tax paid	8	**(3,414)**	(3,284)
(190)	**(587)**	– retirement benefits paid	18(a)	**(226)**	(73)
285,256	**82,922**	**Net cash generated from operating activities**		**31,925**	109,823
		Cash flows from investing activities			
(8,031,654)	**(6,068,065)**	Purchase of financial investments	12	**(2,336,205)**	(3,092,187)
7,518,366	**6,374,403**	Proceeds from maturity of financial investments		**2,454,145**	2,894,572
(3,805)	**(4,530)**	Purchase of property and equipment	15	**(1,744)**	(1,465)
39	**2,457**	Proceeds from sale of property and equipment		**946**	15
(517,055)	**304,265**	**Net cash generated from / (used in) investing activities**		**117,142**	(199,065)
		Cash flows from financing activities			
(25,979)	**(29,616)**	Dividends paid		**(11,402)**	(10,002)
(748)	**(748)**	Finance leases paid		**(288)**	(288)
(26,727)	**(30,364)**	**Net cash used in financing activities**		**(11,690)**	(10,290)
(258,525)	**356,823**	**Net change in cash and cash equivalents**		**137,377**	(99,532)
851,281	**592,756**	Cash and cash equivalents at the beginning of the year		**228,211**	327,743
592,756	**949,579**	**Cash and cash equivalents at the end of the year**	25(d)	**365,588**	228,211

The accompanying notes on pages 59 to 121 form an integral part of these financial statements.

Notes to the Financial Statements
As of 31 December 2018

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 Basis of preparation and summary of significant accounting policies

2.1 Basis of preparation

(a) Statement of compliance

The financial statements of the Bank at 31 December 2018 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 financial investment at FVOCI and FVTPL, 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 RO 0.385 to each US Dollar, and are shown for the convenience of the readers only.

(c) Standards applicable during the year

The Bank has adopted the requirements of IFRS 9 'Financial instruments' from 1 January 2018. The effect of its adoption is not considered to be significant. IFRS 9 includes an accounting policy choice to remain with IAS 39 'Financial Instruments: Recognition and Measurement' for hedge accounting, which the Bank has exercised. The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening retained earnings at the date of initial application. As permitted by IFRS 9, the Bank has not restated comparatives. Consequently, for notes disclosures, the consequential amendments to IFRS 7 'Financial Instruments disclosure' have only been applied to current period. The comparative period notes disclosures repeat those disclosures made in prior year. Adoption reduced net assets at 1 January 2018 by RO4.1 million as set out in Note 30.

In addition, the Bank has adopted the requirements of IFRS 15 'Revenue from contracts with customers' and its interpretations and amendments to standards which have had an insignificant effect on the financial statements of the Bank.

(d) Use of estimates and judgements

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 the impairment financial assets at amortised cost and the valuation of financial instruments.

(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 2019. The impact assessment of the relevant standards is set out below:

IFRS 16 'Leases'

IFRS 16 'Leases' has an effective date for annual periods beginning on or after 1 January 2019. IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the

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

Notes to the Financial Statements (continued)
As of 31 December 2018

way in which finance leases are currently accounted for under IAS 17 'Leases'. Lessees will recognise a right of use ('ROU') asset and a corresponding financial liability on the 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 under IAS 17. At 1 January 2019, the Bank expects to adopt the standard using a modified retrospective approach where the cumulative effect of initially applying the standard is recognised as an adjustment to the opening balance of retained earnings and comparatives are not restated.

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.

(f) 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 recognized in the statement of comprehensive income.

(g) Segment analysis

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.

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') customers range from small enterprises focused primarily on their domestic markets through to corporates operating globally. CMB support customers with tailored financial products and services to allow them to operate efficiently and grow. Services provided include working capital, term loans, payment services and international trade facilitation, as well as expertise in access to financial markets.

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 comprises Central Treasury, including Balance Sheet Management ('BSM') and central stewardship costs that support our businesses.

2.2 Summary of significant accounting policies

(a) Financial instruments

All financial instruments are recognized 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 recognizes 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

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initial difference in fair value indicated by the valuation model from the transaction price is not recognized immediately in the statement of comprehensive income. Instead, it is recognized 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.

(b) Financial instruments measured at amortised cost

Financial assets that are held to collect the contractual cash flows and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest, such as most loans and advances to customers and due from banks and some debt securities, are measured at amortised cost. In addition, most financial liabilities are measured at amortised cost. The Bank accounts for regular way amortised cost financial instruments using trade date accounting. The carrying value of these financial assets at initial recognition includes any directly attributable transactions costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some syndicated lending activities, the difference is deferred and recognised over the life of the loan through the recognition of interest income, unless the loan becomes impaired.

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

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

(d) Equity securities measured at fair value

Equity securities measured at fair value through profit or loss (FVTPL)

The Bank measures all equity securities at fair value through profit or loss, except where Bank's management has elected, at initial recognition, to irrevocably designate an equity securities at fair value through other comprehensive income. Gain and losses on equity investment at FVTPL are included in statement of profit or loss.

Equity securities measured at fair value and fair value movements presented in Other Comprehensive Income ('OCI')

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

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

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below and are so designated irrevocably at inception:

- the use of the designation removes or significantly reduces an accounting mismatch;
- when a group of financial assets and liabilities or a group of financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; and
- where the financial liability contains one or more non-closely related embedded derivatives.

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Designated financial assets are recognised when the Bank enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when the rights to the cash flows expire or are transferred. Designated financial liabilities are recognised when the Bank enters into contracts with counterparties, which is generally on settlement date, and are normally derecognised when extinguished. Subsequent changes in fair values are recognised in the statement of comprehensive income.

(f) 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 recognized 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 judgement 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.

(g) Derivative financial instruments and hedge accounting

Derivatives are initially recognized 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, 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.

Gains and losses from changes in the fair value of derivatives that do not qualify for hedge accounting are reported in 'Net trading income'. Gains and losses on derivatives managed in conjunction with financial instruments designated at fair value are reported in statement of profit or loss together with the gains and losses on the economically hedged items. Where the derivatives are managed with debt securities issued by the Bank that are designated at fair value, the contractual interest is shown in 'Interest expense' together with the interest payable on the issued debt.

Hedge accounting

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 'Interest income or Interest expense'.

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 amortized 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 derecognized, in which case it is released to the statement of comprehensive income immediately.

(h) 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.

(i) Money market placements

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

(j) Derecognition

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

FVOCI and FVTPL financial assets that are sold are derecognized and corresponding receivables from the buyer for the payment are recognized 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.

(k) 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 recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

(l) Impairment of amortised cost and FVOCI financial assets

Expected credit losses ('ECL') are recognised for loans and advances to customers and due from banks, other financial assets held at amortised cost, debt instrument measured at fair value through other comprehensive income ('FVOCI'), and certain loan commitments, acceptances and financial guarantee contracts. At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is required for ECL resulting from default events that are possible within the next 12 months ('12-month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in 'stage 3'.

Credit-impaired (stage 3)

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

- contractual payments of either principal or interest are past due for more than 90 days,
- there are other indications that the borrower is unlikely to pay such as that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition, and
- the loan is otherwise considered to be in default.

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due. Therefore the definitions of credit impaired and default are aligned as far as possible so that stage 3 represents all loans which are considered defaulted or otherwise credit-impaired.

Interest income is recognised by applying the effective interest rate to the amortised cost amount, i.e. gross carrying amount less ECL allowance.

Write off

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

Renegotiation

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Loans are identified as renegotiated and classified as credit impaired when we modify the contractual payment terms due to significant credit distress of the borrower. Renegotiated loans remain classified as credit impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows and retain the designation of renegotiated until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement is made on substantially different terms or if the terms of an existing agreement are modified such that the renegotiated loan is a substantially different financial instrument. Any new loans that arise following derecognition events in these circumstances are considered to be Purchased or originated credit impaired (POCI) and will continue to be disclosed as renegotiated loans.

Other than originated credit-impaired loans, all other modified loans could be transferred out of stage 3 if they no longer exhibit any evidence of being credit-impaired and, in the case of renegotiated loans, there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows over the minimum observation period, and there are no other indicators of impairment. These loans could be transferred to stages 1 or 2 based on the mechanism as described below by comparing the risk of a default occurring at the reporting date (based on the modified contractual terms) and the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms). Any amount written off as a result of the modification of contractual terms would not be reversed.

Loan modifications that are not credit impaired

Loan modifications that are not renegotiation are considered to be commercial restructuring. Where a commercial restructuring results in a modification (whether legalised through an amendment to the existing terms or the issuance of a new loan contract) such that the Bank's rights to the cash flows under the original contract have expired, the old loan is derecognised and the new loan is recognised at fair value. The rights to cash flows are generally considered to have expired if the commercial restructure is at market rates and no payment-related concession has been provided.

Significant increase in credit risk (stage 2)

An assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. The assessment explicitly or implicitly compares the risk of default occurring at the reporting date compared to that at initial recognition, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. The assessment is unbiased, probability weighted, and to the extent relevant, uses forward-looking information consistent with that used in the measurement of ECL. The analysis of credit risk is multifactor and the determination of whether a specific factor is relevant and its weight compared with other factors depends on the type of product, the characteristics of the financial instrument and the borrower. Therefore, it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk and these criteria will differ for different types of lending, particularly between retail and wholesale. However, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when 30 days past due. In addition, wholesale loans that are individually assessed, typically corporate and commercial customers, and included on a watch or worry list are included in stage 2.

For wholesale portfolios, the quantitative comparison assesses default risk using a lifetime probability of default ('PD') which encompass a wide range of information including the obligor's Credit Risk Rating (CRR), macro-economic condition forecasts and credit transition probabilities. Significant increase in credit risk is measured by comparing the average PD for the remaining term estimated at origination with the equivalent estimation at reporting date (or that the origination PD has doubled in the case of origination CRR greater than 3.3). The significance of changes in PD was informed by expert credit risk judgement, referenced to historical credit migrations and to relative changes in external market rates. The quantitative measure of significance varies depending on the credit quality at origination as follows:

Origination CRR	**Significance trigger – PD to increase by**
0.1–1.2	15bps
2.1–3.3	30bps
Greater than 3.3 and not impaired	2x

For loans originated prior to the implementation

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of IFRS 9, the origination PD does not include adjustments to reflect expectations of future macroeconomic conditions since these are not available without the use of hindsight. In the absence of this data, origination PD must be approximated assuming through-the-cycle ('TTC') PDs and TTC migration probabilities, consistent with the instrument's underlying modelling approach and the CRR at origination. For these loans, the quantitative comparison is supplemented with additional CRR deterioration based thresholds as set out in the table below:

Origination CRR	Additional significance criteria – number of CRR grade notches deterioration required to identify as significant credit deterioration (stage2) ≥
0.1	5 notches
1.1–4.2	4 notches
4.3–5.1	3 notches
5.2–7.1	2 notches
7.2–8.2	1 notches
8.3	0 notches

Further information about the 23-grade scale used for CRR set out on in note 31.3 of the financial statements.

For certain portfolios of debt securities where external market ratings are available and credit ratings are not used in credit risk management, the debt securities will be in stage 2 if their credit risk increases to the extent they are no longer considered investment grade. Investment grade is where the financial instrument has a low risk of incurring losses, the structure has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. For retail portfolios, default risk is assessed using a reporting date 12-month PD derived from credit scores which incorporate all available information about the customer. This PD is adjusted for the effect of macro-economic forecasts for periods longer than 12 months and is considered to be a reasonable approximation of a life time PD measure. Retail exposures are first segmented into homogenous portfolios, generally by product and brand. Within each portfolio, the Stage 2 accounts are defined as accounts with an adjusted 12-month PD greater than the average 12-month PD of loans in that portfolio 12 months before they become 30 days past due. This portfolio specific threshold therefore identifies loans with a PD higher than would be expected from loans that are performing as originally expected and higher from that which would have been acceptable at origination. It therefore approximates a comparison of origination to reporting date PDs.

Unimpaired and without significant increase in credit risk - (stage 1)

ECL resulting from default events that are possible within the next 12-months ('12-month ECL') are recognised for financial instruments that remain in stage 1.

Purchased or originated credit impaired (POCI)

Financial assets that are purchased or originated at a deep discount that reflects the incurred credit losses are considered to be POCI. This population includes the recognition of a new financial instrument following a renegotiation where concessions have been granted for economic or contractual reasons relating to the borrower's financial difficulty that otherwise would not have been considered. The amount of change in lifetime ECL is recognised in profit or loss until the POCI is derecognised, even if the lifetime ECL are less than the amount of ECL included in the estimated cash flows on initial recognition.

Movement between stages

Financial assets can be transferred between the different categories (other than POCI) depending on their relative deterioration in credit risk since initial recognition. Financial instruments are transferred out of stage 2 if their credit risk is no longer considered to be significantly increased since initial recognition based on the assessments described above. Except for renegotiated loans, financial instruments are transferred out of stage 3 when they no longer exhibit any evidence of credit impairment as described above. Renegotiated loans that are not POCI will continue to be in stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows [observed over a minimum of 1 year period] and there are no other indicators of impairment. For loans that are assessed for impairment on a portfolio basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by- case basis.

Measurement of ECL

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

In general, the Bank calculates ECL using three main components, a probability of default ('PD'), a loss given default ('LGD'), and the exposure at default ('EAD').

The 12-month ECL is calculated by multiplying the 12-month PD, LGD, and EAD. Lifetime ECL is calculated using the lifetime PD instead. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument respectively.

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the reporting date to the default event together with any expected drawdowns of committed facilities. The LGD represents expected losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realised and the time value of money. The Bank leverages the Basel framework where possible to recalibrate and meet the differing IFRS 9 requirements.

The ECL for Wholesale Stage 3 is determined on an individual basis using a discounted cash flow ('DCF') methodology. The expected future cash flows are based on the credit risk officer's estimates as of the reporting date reflecting reasonable and supportable assumptions and projections of future recoveries and expected future receipts of interest. Collateral is taken into account if it is likely that the recovery of the outstanding amount will include realisation of collateral based on its estimated fair value of collateral at the time of expected realisation, less costs for obtaining and selling the collateral. The cash flows are discounted at a reasonable approximation of the original effective interest rate. For significant cases, cash flows under four different scenarios are probability weighted by reference to the three economic scenarios applied more generally by the Bank and the judgement of the credit risk officer. For less significant cases, the effect of different economic scenarios and work out strategies is approximated and applied as an adjustment to the most likely outcome.

Period over which ECL is measured

Expected credit loss is measured from the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the Bank is exposed to credit risk. For wholesale overdrafts, credit risk management actions are taken no less frequently than on an annual basis and therefore this period is to the expected date of the next substantive credit review. The date of the substantive credit review also represents the initial recognition of the new facility. However, where the financial instrument includes both a drawn and undrawn commitment and the contractual ability to demand repayment and cancel the undrawn commitment does not serve to limit the Bank's exposure to credit risk to the contractual notice period, the contractual period does not determine the maximum period considered. Instead, ECL is measured over the period the Bank remains exposed to credit risk that is not mitigated by credit risk management actions. This applies to retail overdrafts and credit cards, where the period is the average time taken for stage 2 exposures to default or close as performing accounts. In addition, for these facilities it is not possible to identify the ECL on the loan commitment component separately from the financial asset component. As a result, the total ECL is recognised in the loss allowance for the financial asset unless the total ECL exceeds the gross carrying amount of the financial asset, in which case the ECL is recognised as a provision.

Forward-looking economic inputs

The Bank will in general apply three forward-looking global economic scenarios determined with reference to external forecast distributions representative of our view of forecast economic conditions, the Consensus Economic Scenario approach. This approach is considered sufficient to calculate unbiased expected loss in most economic environments. They represent a 'most likely outcome' (the Central scenario) and two, less likely, 'Outer' scenarios, referred to as the Upside and Downside scenarios. The Central scenario is used by the annual operating planning process and, with regulatory modifications, will also be used in enterprise-wide stress tests. The Upside and Downside are constructed following a standard process supported by a scenario narrative reflecting the current top and emerging risks and by consulting external and internal subject matter experts. The relationship between the Outer scenarios and Central scenario will generally be fixed with the Central scenario being assigned a weighting of 80% and the Upside and Downside scenarios 10% each, with the difference between the Central and Outer scenarios in terms of economic severity being informed by the spread of external forecast distributions among professional industry forecasts. The Outer scenarios are economically plausible, internally consistent states of the world and will not necessarily be as severe as scenarios used in stress testing. The period of forecast is five years, after which the forecasts will revert to a view based on average past experience. The spread between the central and outer scenarios is grounded on consensus distributions of projected gross domestic product. The economic factors include, but are not limited to, gross domestic product, world oil price and UAE investment.

In general, the consequences of the assessment of credit risk and the resulting ECL outputs will be probability-weighted using the standard probability weights. This probability weighting may be applied directly or the effect of the probability weighting determined on a periodic basis, at least annually, and then applied as an adjustment to the outcomes resulting from the central economic forecast. The central economic forecast is updated quarterly.

The Bank recognises that the Consensus Economic Scenario approach using three scenarios will be insufficient in certain economic environments. Additional analysis may be requested at management's discretion, including the production of extra scenarios. If conditions warrant, this could result in a management overlay for economic uncertainty which is included in the ECL.

Critical accounting estimates and judgement

In determining ECL, management is required to exercise judgement in defining what is considered to be a significant increase in credit risk and in making assumptions and estimates to incorporate relevant information about past events, current conditions and forecasts of economic conditions. Judgement has been applied in determining the lifetime and point of initial recognition of revolving facilities.

The PD, LGD and EAD models which support these determinations are reviewed regularly in light of differences between loss estimates and actual loss experience, but given that IFRS 9 requirements have only just been applied, there has been little time available to make these comparisons. Therefore, the underlying models and their calibration, including how they react to forward looking economic conditions remain subject to review and refinement. This is particularly relevant for lifetime PDs, which have not been previously used in regulatory modelling and for the incorporation of 'upside scenarios' which have not generally been subject to experience gained through stress testing.

The exercise of judgement in making estimations requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions. Many of the factors have a high degree of interdependency and there is no single factor to which loan impairment allowances as a whole are sensitive. The adjustment from the ECL determined by using the Central scenario alone, which is used to calculate an unbiased expected loss, provides an indication of the overall sensitivity of ECL to different economic assumptions.

(m) 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.

(n) Finance and operating leases

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 recognized 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 capitalized 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 recognized initially at the fair value of the asset or, if lower, the present value of the minimum lease payments. Finance charges payable are recognized 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 recognized 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 recognized 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.

(o) Intangible assets

Intangible assets are recognized separately from goodwill when they are separable or arise from contractual or other legal rights, 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 amortization and accumulated impairment losses and are amortized 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 amortized on a straight-line basis, over their useful lives as follows:

Core deposits	7 years
Customer relationships	7 years

Amortization method, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate. The remaining life of intangible assets is 0.5 years as at 31 December 2018.

(p) Provisions, contingent liabilities and guarantees

Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation which has arisen as a result of past events and for which a reliable estimate can be made.

Contingent liabilities

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security and contingent liabilities related to legal proceedings or regulatory matters, are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

Financial guarantee contracts

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received or present value of the fee receivable.

(q) Acceptances and endorsements

Acceptances arise when the Bank is under an obligation to make payments against documents drawn under letters of credit. Acceptances specify the amount of money, the date, and the person to which the payment is due. After acceptance, the instrument becomes an unconditional liability (time draft) of the Bank and is therefore recognised as a financial liability with a corresponding contractual right of reimbursement from the customer recognised as a financial asset.

(r) Income and expenses

Interest income and expense

Interest income and expense for all financial instruments except for those classified as FVOCI and FVTPL (other than debt securities issued by the Bank and derivatives managed in conjunction with such debt securities issued) are recognized in 'Interest income' and 'Interest expense' in the statement of comprehensive income using the effective interest method. 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.

Non-interest income and expenses

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:

The Bank generates fee income from services provided at a fixed price over time, such as account service and card fees, or when Bank delivers a specific transaction at the point in time such as import/export services. With the exception of certain performance fees, all other fees are generated at a fixed price. Variable fees are recognised when all uncertainties are resolved. Fee income is generally earned from short term contracts with payment terms that do not include a significant financing component.

The Bank recognises fees earned on transaction-based arrangements at a point in time when we have fully provide the service to the customer. Where the contract requires services to be provided over time, income is recognised on a systematic basis over the life of the agreement.

Where Bank offers a package of services that contains multiple non-distinct performance obligations, such as those included in account service packages, the promised services are treated as a single performance obligation. If a package of services contains distinct performance obligations, such as those including both account and insurance services, the corresponding transaction price is allocated to each performance obligation based on the estimated stand-alone selling prices.

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading.

Change in fair value of financial investments measured at fair value through profit and loss comprises of changes in fair value of financial investments measured at FVTPL.

Dividend income for FVTPL and FVOCI financial asset 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.

(s) Taxation

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognized in the statement of comprehensive income except to the extent it relates to a business combination or items recognized 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 realization 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 recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(t) 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

Notes to the Financial Statements (continued)

As of 31 December 2018

recognized 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 recognized 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 recognized in other comprehensive income in the period in which they arise.

(u) Accounting policies applied to financial instruments prior 1 January 2018

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 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, if any. 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:

i. 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.

ii. 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 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.

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 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.

Notes to the Financial Statements (continued)
As of 31 December 2018

3 Net interest income

	2018 RO'000	2017 RO'000
3(a) Interest income		
Loans and advances to customers	**62,396**	56,424
Financial investments	**5,174**	5,710
Due from banks	**3,191**	848
Others	**(296)**	395
	70,465	63,377
3(b) Interest expense		
Deposits from customers	**(10,403)**	(9,121)
Due to banks	**(2)**	(3)
	(10,405)	(9,124)
Net interest income	**60,060**	54,253

4 Other operating income

	2018 RO'000	2017 RO'000
Gain on derecognition of financial assets measured at amortised cost	**429**	-
Net (loss) / gain on sale of financial investments	**(10)**	13
Gain / (loss) on disposal property and equipment	**91**	(96)
Other income	**106**	116
	616	33

5 Change in expected credit losses and other credit impairment charges / loan impairment charges and other credit risk provisions - net of recoveries

	2018 RO'000	2017 RO'000
Change in expected credit losses and other credit impairment charges - net		
- loans and advances to customers	**(158)**	N/A
- due from Banks	**(50)**	N/A
- loan commitment and guarantees	**1,924**	N/A
- other financial assets	**(449)**	N/A
- financial investments at FVOCI	**243**	N/A
Loan impairment charges and other credit risk provisions - net of recoveries		
- net impairment charges on loans and advances	**N/A**	(5,531)
	1,510	(5,531)

6 Operating expenses

6(a) Employee compensation and benefits

	2018 RO'000	2017 RO'000
Wages and salaries	**(16,629)**	(16,276)
Social security costs	**(1,614)**	(1,380)
Post-employment benefits	**(209)**	(196)
Other employee benefits	**(4,486)**	(4,529)
	(22,938)	(22,381)

Notes to the Financial Statements (continued)
As of 31 December 2018

6(b) General and administrative expenses

	2018	2017
	RO'000	RO'000
Marketing and advertising*	(1,807)	(1,953)
Premises and equipment	(3,598)	(4,097)
Communications	(481)	(581)
Insurance	(1,084)	(1,102)
Other administrative expenses	(15,636)	(14,336)
	(22,606)	(22,069)

*Marketing and advertising expenses for the current year include RO1.2 M (December 2017: RO1.5 M) of "Mandoos Prize" draw expenses.

7 Amortisation of intangible assets

	2018	2017
	RO'000	RO'000
Core deposits	(1,758)	(1,758)
Customer relationships	(527)	(527)
	(2,285)	(2,285)

8 Taxation

	2018	2017
	RO'000	RO'000
Statement of comprehensive income:		
Current tax:		
- Current year	(6,787)	(3,296)
- Prior years	(181)	1,468
Deferred tax	357	(468)
	(6,611)	(2,296)
Statement of other comprehensive income:		
Deferred tax	(278)	5

Tax reconciliation

	2018	2017
	RO'000	RO'000
Profit before tax	37,977	21,412
Tax expenses at 15% on accounting profit before tax	(5,697)	(3,212)
Add / (less) tax effect of:		
Non-taxable income and gains	(22)	19
Permanent disallowed expenses	(724)	(776)
Adjustments in respect of prior periods	(181)	1,468
Other items	13	205
Tax charge as per the statement of comprehensive income	(6,611)	(2,296)

Notes to the Financial Statements (continued)
As of 31 December 2018

Movement of current tax liability

	2018	2017
	RO'000	RO'000
At 1 January	**4,625**	6,081
- Current year charge	**6,787**	3,296
- Prior year charge / (release)	**181**	(1,468)
- Paid during the year	**(3,414)**	(3,284)
At 31 December	**8,179**	4,625

Movement of net deferred tax assets before offsetting

	Loan impairment allowances	FVOCI Investment	Available-for-sale investments	Others*	Total
Assets - at 1 January 2018	**1,070**	**382**	**N/A**	**98**	**1,550**
Changes in initial application of IFRS 9 (see note 30)	**775**	**-**	**N/A**	**-**	**775**
Restated balances as at 1 January 2018	**1,845**	**382**	**-**	**98**	**2,325**
Income statement	**353**	**-**	**N/A**	**4**	**357**
Other comprehensive income:					
FVOCI investment	**-**	**(278)**	**N/A**	**-**	**(278)**
Assets - at 31 December 2018	**2,198**	**104**	**N/A**	**102**	**2,404**
At 1 January 2017	1,542	N/A	377	94	2,013
Income statement	(472)	N/A	-	4	(468)
Other comprehensive income:					
Available-for-sale investment	-	N/A	5	-	5
Assets - at 31 December 2017	1,070	N/A	382	98	1,550

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

The tax assessments of the Bank up to and including the tax year 2015 have been completed by the Secretariat General for Taxation (SGT). The Bank has received the tax assessment order for the years 2013 to 2015 from SGT and the Bank is in process of filling an objection against the tax assessment order issued.

The tax rate applicable to the Bank in Oman is 15%. 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 17.4% (2017: 10.7%).

The difference between the applicable tax rate of 15% and the effective tax rate of 17.4% arises mainly due to the adjustment to the accounting income in accordance to the Tax law and certain probable adjustment basis on the prior year tax 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% (2017: 15%).

Notes to the Financial Statements (continued)
As of 31 December 2018

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.

	2018	2017
Weighted average number of shares in issue (Number ‘000)	**2,000,312**	2,000,312
Profit for the year (RO’000)	**31,366**	19,116
Earnings per share – basic and diluted (RO)	**0.016**	0.010

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.

	2018	2017
Number of shares in issue (Number ‘000)	**2,000,312**	2,000,312
Net assets (RO’000)	**340,441**	323,256
Net assets per share (RO)	**0.170**	0.162

10(a) Cash and balances with central bank

	2018	2017
	RO’000	RO’000
Cash in hand	**31,065**	32,038
Balance held with central bank	**239,672**	191,768
ECL allowances	**(163)**	N/A
	270,574	223,806

10(b) Due from bank

	2018	2017
	RO’000	RO’000
Placements	**121,072**	33,884
Nostro balances	**11,770**	6,479
ECL allowances	**(50)**	N/A
	132,792	40,363

11 Loans and advances to customers - net

	2018	2017
	RO’000	RO’000
Overdrafts	**66,181**	59,926
Credit cards	**28,631**	22,376
Loans	**1,165,957**	1,057,348
Clean import loans	**191,527**	303,905
Bills discounted/purchased	**11,657**	21,278
Gross loans and advances	**1,463,953**	1,464,833
ECL allowances	**(35,502)**	N/A
Provision for loan impairment – specific	**N/A**	(18,248)
Provision for loan impairment – general*	**N/A**	(18,289)
Reserved interest**	**(38,892)**	(33,409)
Loans and advances (net)	**1,389,559**	1,394,887

* 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.

Reconciliation / movement of allowance for ECL / loan impairment and reserved interest:

The following disclosure provides a reconciliation of the Bank's gross carrying/nominal amount and allowances for loans and advances, due from banks, loan commitments and guarantees.

	Non credit - impairment Stage 1		Stage 2		Credit impairment Stage 3		Total	
	Gross carrying / nominal amount RO'000	Allowance for ECL RO'000	Gross carrying / nominal amount RO'000	Allowance for ECL RO'000	Gross carrying / nominal amount RO'000	Allowance for ECL RO'000	Gross carrying / nominal amount RO'000	Allowance for ECL RO'000
As at 01 January 2018	1,723,066	2,718	756,057	17,619	73,230	20,893	2,552,353	41,230
-Transfers from stage 1 to stage 2	(348,747)	(1,635)	348,747	1,635	-	-	-	-
-Transfers from stage 2 to stage 1	653,014	5,004	(653,014)	(5,004)	-	-	-	-
-Transfers to stage 3	-	-	(14,263)	(3,117)	14,263	3,117	-	-
-Transfers from stage 3	-	-	19,923	4,801	(19,923)	(4,801)	-	-
Net remeasurement of ECL arising from transfer of stage	-	(2,398)	-	2,373	-	2,488	-	2,463
Net new lending / (repayments) and changes to risk parameters	(317,544)	408	73,097	(4,743)	4,984	1,822	(239,463)	(2,513)
Assets written off	-	-	-	-	(6,429)	(4,546)	(6,429)	(4,546)
Others	-	-	-	-	20	20	20	20
At 31 December 2018	1,709,789	4,097	530,547	13,564	66,145	18,993	2,306,481	36,654
ECL (charge)/release for the period		1,990		2,370		(4,310)		50
Recoveries		-		-		1,666		1,666
Total ECL (charge)/release for the period		1,990		2,370		(2,644)		1,716

	At 31 December 2018		For the year ended 31 December 2018
	Gross carrying / nominal amount RO'000	Allowance for ECL RO'000	ECL (charge) / release RO'000
As above	2,306,481	36,654	1,716
Other financial assets measured at amortised cost	297,041	418	(449)
Summary of financial instruments to which the impairment requirements in IFRS 9 are applied/ Summary income statement	2,603,522	37,072	1,267
Debt instruments measured at FVOCI	498,986	80	243
Total allowance for ECL/total profit or loss ECL charge for the period	3,102,508	37,152	1,510

Wholesale lending - Reconciliation of changes in gross carrying/nominal amount and allowances for loans and customers and due from banks including loan commitments and financial guarantees

	Non credit - impairment				Credit impairment		Total	
	Stage 1		Stage 2		Stage 3			
	Gross carrying / nominal amount	Allowance for ECL	Gross carrying / nominal amount	Allowance for ECL	Gross carrying / nominal amount	Allowance for ECL	Gross carrying / nominal amount	Allowance for ECL
	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
As at 01 January 2018	1,241,426	862	741,926	15,291	62,273	16,159	2,045,625	32,312
-Transfers from stage 1 to stage 2	(329,179)	(1,555)	329,179	1,555	-	-	-	-
-Transfers from stage 2 to stage 1	639,200	4,544	(639,200)	(4,544)	-	-	-	-
-Transfers to stage 3	-	-	(4,278)	(85)	4,278	85	-	-
-Transfers from stage 3	-	-	5,562	2,059	(5,562)	(2,059)	-	-
Net remeasurement of ECL arising from transfer of stage	-	(1,920)	-	2,111	-	2,451	-	2,642
Net new lending / (repayments) and changes to risk parameters	(401,115)	(449)	77,122	(6,867)	(747)	(421)	(324,740)	(7,737)
Assets written off	-	-	-	-	(349)	-	(349)	-
Others	-	-	-	-	20	20	20	20
At 31 December 2018	1,150,332	1,482	510,311	9,520	59,913	16,235	1,720,556	27,237
		2,369		4,756		(2,030)		5,095
ECL (charge)/release for the period		-		-		571		571
Recoveries		-		-		-		-
Total ECL (charge)/release for the period		2,369		4,756		(1,459)		5,666

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As of 31 December 2018

Personal lending - Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to customers and due from banks including loan commitments and financial guarantee

	Non credit - impairment				Credit impairment		Total	
	Stage 1		Stage 2		Stage 3			
	Gross carrying / nominal amount	Allowance for ECL	Gross carrying / nominal amount	Allowance for ECL	Gross carrying / nominal amount	Allowance for ECL	Gross carrying / nominal amount	Allowance for ECL
	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
As at 01 January 2018	**481,640**	**1,856**	**14,131**	**2,328**	**10,957**	**4,734**	**506,728**	**8,918**
-Transfers from stage 1 to stage 2	(19,568)	(80)	19,568	80	-	-	-	-
-Transfers from stage 2 to stage 1	13,814	460	(13,814)	(460)	-	-	-	-
-Transfers to stage 3	-	-	(9,985)	(3,032)	9,985	3,032	-	-
-Transfers from stage 3	-	-	14,361	2,742	(14,361)	(2,742)	-	-
Net remeasurement of ECL arising from transfer of stage	-	(478)	-	262	-	37	-	(179)
Net new lending / (repayments) and changes to risk parameters	83,571	857	(4,025)	2,124	5,731	2,243	85,277	5,224
Assets written off	-	-	-	-	(6,080)	(4,546)	(6,080)	(4,546)
Others	-	-	-	-	-	-	-	-
At 31 December 2018	**559,457**	**2,615**	**20,236**	**4,044**	**6,232**	**2,758**	**585,925**	**9,417**
ECL (charge)/release for the period		(379)		(2,386)		(2,280)	-	(5,045)
Recoveries		-		-		1,095	-	1,095
Total ECL (charge)/release for the period		**(379)**		**(2,386)**		**(1,185)**	**-**	**(3,950)**

Notes to the Financial Statements (continued)
As of 31 December 2018

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

	Specific provision	General provision	Total provision
	RO'000	RO'000	RO'000
Balance at 1 January 2017	26,508	18,604	45,112
Provided during the year (note 5)	3,882	-	3,882
Provision released during the year (note 5)	(2,409)	(315)	(2,724)
Written off during the year	(9,733)	-	(9,733)
Balance at 31 December 2017	18,248	18,289	36,537

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

	2018	2017
	RO'000	RO'000
Balance at 1 January 2018	**33,409**	37,210
Reserved during the year	**6,389**	7,567
Released to the statement of comprehensive income	**(362)**	(653)
Written off during the year	**(544)**	(10,715)
Balance at 31 December 2018	**38,892**	33,409

Impairment charge and provision held as of 31 December 2018 (as per CBO illustrative disclosure)

	As per CBO norms	**As per IFRS 9**	**Difference**
	RO'000	**RO'000**	**RO'000**
Impairment loss (charged) / released to profit and loss account	**(3,469)**	**1,510**	**4,979**
Provisions required*	**33,987**	**37,152**	**3,165**
Gross NPL ratio (percentage)	**4.30%**	**4.30%**	**-**
Net NPL ratio (percentage)	**0.90%**	**0.23%**	**(0.67%)**

*Impairment loss charged in these financial statements is based on IFRS 9 as it is more than the CBO provision requirement.

Notes to the Financial Statements (continued)
As of 31 December 2018

Comparison of provision held as per IFRS 9 and provision required as per CBO norms (as per CBO illustrative disclosure)

Assets classification as per CBO Norms (1)	Assets classification as per IFRS 9 (2)	Gross carrying amount (3) RO'000	Provision required as per CBO Norms (4) RO'000	Provisions held as per IFRS 9 (5) RO'000	Difference between CBO provision required and provision held (6)=(4)-(5) RO'000	Net carrying amount (7)=(3)-(5) RO'000	Reserve interest as per CBO norms (8) RO'000
Standard	Stage 1	1,023,390	14,050	3,946	10,104	1,019,444	98
	Stage 2	356,364	3,721	9,329	(5,608)	347,035	508
	Stage 3	234	35	148	(113)	86	9
		1,379,988	17,806	13,423	4,383	1,366,565	615
Special mention	Stage 1	-	-	-	-	-	-
	Stage 2	19,102	1,800	3,234	(1,434)	15,868	67
	Stage 3	1,882	282	202	80	1,680	122
		20,984	2,082	3,436	(1,354)	17,548	189
Substandard	Stage 1	-	-	-	-	-	-
	Stage 2	-	-	-	-	-	-
	Stage 3	6,703	1,858	4,326	(2,468)	2,377	507
		6,703	1,858	4,326	(2,468)	2,377	507
Doubtful	Stage 1	-	-	-	-	-	-
	Stage 2	-	-	-	-	-	-
	Stage 3	230	96	89	7	141	13
		230	96	89	7	141	13
Loss	Stage 1	-	-	-	-	-	-
	Stage 2	-	-	-	-	-	-
	Stage 3	56,048	12,145	14,228	(2,083)	41,820	37,568
		56,048	12,145	14,228	(2,083)	41,820	37,568
Other items not covered under CBO circular BM 977 and related instructions	Stage 1	1,475,410	-	608	(608)	1,474,802	-
	Stage 2	162,097	-	1,042	(1,042)	161,055	-
	Stage 3	1,048	-	-	-	1,048	-
		1,638,555	-	1,650	(1,650)	1,636,905	-
	Stage 1	2,498,800	14,050	4,554	9,496	2,494,246	98
	Stage 2	537,563	5,521	13,605	(8,084)	523,958	575
	Stage 3	66,145	14,416	18,993	(4,577)	47,152	38,219
Total		3,102,508	33,987	37,152	(3,165)	3,065,356	38,892

Notes to the Financial Statements (continued)

As of 31 December 2018

Restructured loans and advances (as per CBO illustrative disclosure)

Assets classification as per CBO Norms	Assets classification as per IFRS 9	Gross carrying amount	Provision required as per CBO Norms	Provisions held as per IFRS 9	Difference between CBO provision required and provision held	Net carrying amount	Reserve interest as per CBO norms
(1)	(2)	(3)	(4)	(5)	(6)=(4)-(5)	(7)=(3)-(5)	(8)
		RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
Classified as performing	Stage 1	-	-	-	-	-	-
	Stage 2	9,975	1,596	1,891	(295)	8,084	25
	Stage 3	2,116	317	322	(5)	1,794	131
Sub Total		12,091	1,913	2,213	(300)	9,878	156
Classified as non-performing	Stage 1	-	-	-	-	-	-
	Stage 2	-	-	-	-	-	-
	Stage 3	27,176	7,027	8,588	(1,561)	18,588	15,148
		27,176	7,027	8,588	(1,561)	18,588	15,148
	Stage 1						
	Stage 2	9,975	1,596	1,891	(295)	8,084	25
	Stage 3	29,292	7,344	8,910	(1,566)	20,382	15,279
Total		39,267	8,940	10,801	(1,861)	28,466	15,304

Notes to the Financial Statements (continued)
As of 31 December 2018

12 Financial investments

Financial investments details by sector are provided as follows:

	Fair value 31 December 2018 RO'000	Fair value 31 December 2017 RO'000	Carrying value 31 December 2018 RO'000	Carrying value 31 December 2017 RO'000	Cost 31 December 2018 RO'000	Cost 31 December 2017 RO'000
Marketable securities – local (MSM)						
Government bonds*	**64,984**	62,036	**64,984**	62,036	**65,287**	64,911
Unquoted and other investments						
Treasury bills*	**433,752**	549,715	**433,752**	549,715	**433,765**	549,002
Unquoted Omani shares	**260**	260	**260**	260	**260**	260
Unquoted foreign shares	**7**	7	**7**	7	**7**	7
Investment fund units	**2,323**	2,903	**2,323**	2,903	**3,004**	3,289
	436,342	552,885	**436,342**	552,885	**437,036**	552,558
Total	**501,326**	614,921	**501,326**	614,921	**502,323**	617,469

*ECL allowance on financial investments amounting to RO0.08 M has been recorded in FVOCI reserve.

Carrying amount of financial investments

	31 December 2018 RO'000	31 December 2017 RO'000
Financial investments measured at fair value through other comprehensive income		
Treasury bills	**433,752**	N/A
Government bonds	**64,984**	N/A
Other investments	**250**	N/A
	498,986	N/A
Financial investments measured at fair value through profit or loss		
Equity investments	**2,340**	N/A
Available for sale financial investments		
Treasury bills	**N/A**	549,715
Government bonds	**N/A**	62,036
Equity and other investments	**N/A**	3,170
	N/A	614,921
	501,326	614,921

Movement of financial investments – FVOCI is given below:

	2018 RO'000	2017 RO'000
Balance at the beginning of the year	**614,921**	412,969
Transfer to FVTPL Equity investments	**(2,920)**	N/A
Purchased during the year	**2,336,205**	3,092,187
Matured / sold during the year	**(2,453,861)**	(2,894,595)
Gain from changes in fair value	**1,846**	594
Amortisation of discount, net	**2,795**	3,309
Exchange differences	**-**	457
Balance at the end of the year	**498,986**	614,921

Notes to the Financial Statements (continued)
As of 31 December 2018

Movement of financial investments – FVTPL is given below:

	2018 RO'000	2017 RO'000
Equity investments - FVTPL		
At 1 January	-	N/A
Transfer from available-for-sale equity investments	2,920	N/A
Additions	-	N/A
Disposals	(294)	N/A
Revaluations	(286)	N/A
At 31 December	2,340	N/A

13 Other assets

	2018 RO'000	2017 RO'000
Acceptances	24,940	19,140
ECL on acceptances	(63)	N/A
Acceptances net of ECL	24,877	N/A
Derivatives - positive mark-to-market [note 21(c)]	9,738	6,378
Prepayments	1,172	779
Others	1,701	2,496
	37,488	28,793

14 Intangible assets

	2018 RO'000	2017 RO'000
Core deposits	12,306	12,306
Customer relationships	3,691	3,691
	15,997	15,997
Less: amortised	(15,043)	(12,758)
	954	3,239

15 Property and equipment

The movement in property and equipment during the year 2018 is as follows:

	Freehold land and buildings RO'000	Leasehold property and improvements RO'000	Equipment, furniture and fixtures RO'000	Motor vehicles RO'000	Computer equipment* RO'000	Total RO'000
Cost						
1 January 2018	30,633	5,253	7,463	306	7,831	51,486
Additions	207	675	481	33	348	1,744
Disposals/write offs	(1,575)	(864)	(275)	(139)	(263)	(3,116)
31 December 2018	29,265	5,064	7,669	200	7,916	50,114
Accumulated depreciation						
1 January 2018	7,220	4,236	6,421	281	7,090	25,248
Charge for the year	355	358	450	21	422	1,606
Disposals/write offs	(761)	(828)	(273)	(139)	(260)	(2,261)
31 December 2018	6,814	3,766	6,598	163	7,252	24,593
Net book value						
31 December 2018	22,451	1,298	1,071	37	664	25,521

*Includes Automatic Teller Machines ('ATM') purchased on finance lease with net book value of RO0.2 M (2017: RO 0.5 M)

Notes to the Financial Statements (continued)
As of 31 December 2018

The movement in property and equipment for the year 2017 was as follows:

	Freehold land and buildings	Leasehold property and improvements	Equipment, furniture and fixtures	Motor vehicles	Computer equipment*	Total
	RO'000	RO'000	RO'000	RO'000	RO'000	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

16 Due to banks

	2018	2017
	RO'000	RO'000
Interbank borrowings	**6,295**	1,600
Vostro and other balances	**31,483**	34,358
	37,778	35,958

17 Deposits from customers

	2018	2017
	RO'000	RO'000
Current and call	**942,902**	951,159
Savings	**404,860**	437,849
Time deposits	**576,159**	540,845
Others	**2,204**	2,197
	1,926,125	1,932,050

18 Other liabilities

	2018	2017
	RO'000	RO'000
Acceptances	**24,940**	19,140
Accruals and deferred income	**6,905**	6,492
Obligations under finance leases [note 21(d)]	**-**	232
Provisions [note 18(b)]	**400**	473
ECL on off balance sheet exposure and other commitments	**1,102**	N/A
Retirement benefit liability [note 18(a)]	**1,246**	1,001
Derivatives - negative mark-to-market [note 21(c)]	**1,009**	71
Others	**12,493**	10,499
	48,095	37,908

Notes to the Financial Statements (continued)
As of 31 December 2018

18(a) Movement of retirement benefit liability

	2018 RO'000	2017 RO'000
Opening defined benefit obligation	**1,001**	755
Employer's current service cost	**392**	153
Interest on obligation	**44**	35
Remeasurement of defined benefit liability	**35**	131
Benefits paid	**(226)**	(73)
Present value of liabilities at the end of the period	**1,246**	1,001

18(b) Movement of provisions

	2018 RO'000	2017 RO'000
Balance at the beginning of the year	**473**	711
Provision made during the year	**87**	743
Provision utilised during the year	**(54)**	(866)
Provision released during the year	**(106)**	(115)
Balance at the end of the year	**400**	473

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 (2017: 2,000,312,790 fully paid ordinary shares of RO 0.100 each) against the authorised ordinary share capital of 7,500 million shares of RO 0.100 each (2017: 7,500 million shares of RO 0.100 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:

	2018 Number of Shares	2017 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 2018

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) Fair value through other comprehensive income (FVOCI) reserve – financial investments FVOCI reserve represents fair value changes (net of tax) of financial investments as explained in note 2.2 (c) of the financial statements.

(c) Available-for-sale fair value reserve represents fair value changes (net of tax) in available-for-sale financial investments as explained in note 2.2 (u) of the financial statements.

21 Contingent liabilities, commitments and derivatives

(a) Contingent liabilities and other commitments

	2018	2017
	RO'000	RO'000
Undrawn unconditionally cancellable commitments*	**550,495**	557,339
Undrawn unconditionally non-cancellable commitments	**33,286**	44,215
Forward foreign exchange contracts (note 21 (c))	**489,446**	160,380
Interest rate swaps (note 21 (c))	**155,540**	77,000
	1,228,767	838,934
Documentary credits	**31,053**	63,450
Guarantees and performance bonds	**541,866**	382,152
	1,801,686	1,284,536

* Undrawn unconditionally cancellable commitments of RO104 M are considered as part of loan commitments for IFRS 9

(b) Legal cases

As at 31 December 2018, 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) 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 analyzed 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 contract amounts of derivatives indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk. Forward foreign exchange contracts and interest rate swaps are measured using level 2 fair valuation hierarchy.

Notes to the Financial Statements (continued)
As of 31 December 2018

31 December 2018:

	Positive fair value RO'000	Negativ fair value RO'000	Total notional amount RO'000
Derivatives:			
Forward foreign exchange contracts (note 21 (a))	1,478	1,009	489,446
Interest rate swaps	8,260	-	155,540
	9,738	1,009	644,986

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

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.

(d) Lease commitments

Operating lease commitments

At 31 December 2018, annual commitments under non-cancellable operating leases were RO1.1 M (2017: RO 1.2 M). Operating lease expenses recognised in the statement of comprehensive income were RO1.1 M (2017: RO 1.2 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 2018**			At 31 December 2017		
	Total future minimum payments	**Future interest charges**	**Present value of finance lease commitments**	Total future minimum payments	Future interest charges	Present value of finance lease commitments
	RO'000	**RO'000**	**RO'000**	RO'000	RO'000	RO'000
- No later than one year	-	-	-	283	(51)	232
- Later than one year and up to five years	-	-	-	-	-	-
	-	-	-	283	(51)	232

Notes to the Financial Statements (continued)

As of 31 December 2018

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 2018				
Assets				
Cash and balances with central bank	**270,574**	**-**	**-**	**270,574**
Due from banks	**132,792**	**-**	**-**	**132,792**
Loans and advances to customers - net	**466,539**	**49,327**	**873,693**	**1,389,559**
Financial investments	**429,452**	**4,949**	**66,925**	**501,326**
Other assets	**31,987**	**5,501**	**-**	**37,488**
Intangible assets	**571**	**383**	**-**	**954**
Property and equipment	**-**	**-**	**25,521**	**25,521**
Deferred tax assets	**2,404**	**-**	**-**	**2,404**
Total assets	**1,334,319**	**60,160**	**966,139**	**2,360,618**
Liabilities and equity				
Due to banks	**37,778**	**-**	**-**	**37,778**
Deposits from customers	**1,671,708**	**231,343**	**23,074**	**1,926,125**
Other liabilities	**41,333**	**5,516**	**1,246**	**48,095**
Current tax liabilities	**8,179**	**-**	**-**	**8,179**
Net equity	**-**	**-**	**340,441**	**340,441**
Total liabilities and equity	**1,758,998**	**236,859**	**364,761**	**2,360,618**

	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	1,394,887
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

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 in the normal course of business.

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 2018						
Assets						
Cash and balances with central bank	0.98%	61,215	-	-	209,359	270,574
Due from banks	1.53%	121,022	-	-	11,770	132,792
Loans and advances to customers – net	4.40%	512,022	164,480	713,057	-	1,389,559
Financial investments	0.95%	428,803	5,597	64,337	2,589	501,326
Other assets		-	-	-	37,488	37,488
Intangible assets		-	-	-	954	954
Property and equipment		-	-	-	25,521	25,521
Deferred tax assets		-	-	-	2,404	2,404
Total assets		1,123,062	170,077	777,394	290,085	2,360,618
Liabilities and equity						
Due to banks	-	6,295	-	-	31,483	37,778
Deposits from customers	0.53%	544,666	544,852	22,538	814,069	1,926,125
Other liabilities		-	-	-	48,095	48,095
Current tax liabilities		-	-	-	8,179	8,179
Net equity		-	-	-	340,441	340,441
Total liabilities and equity		550,961	544,852	22,538	1,242,267	2,360,618
Interest sensitivity gap:						
- **Net**		572,101	(374,775)	754,855	(952,181)	
- **Cumulative**		572,101	197,326	952,181	-	

Notes to the Financial Statements (continued)
As of 31 December 2018

	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 2018

24 Financial assets and liabilities

Accounting classifications and fair values as at 31 December 2018

	Financial assets and liabilities at FVOCI RO'000	Financial assets and liabilities at FVTPL RO'000	Financial assets and liabilities at amortised cost RO'000	Total RO'000
Cash and balances with central bank	-	-	270,574	270,574
Due from banks	-	-	132,792	132,792
Loans and advances to customers - net	-	-	1,389,559	1,389,559
Financial investments	498,986	2,340	-	501,326
Other assets	-	9,738	26,578	36,316
Total financial assets	498,986	12,078	1,819,503	2,330,567
Total non-financial assets				30,051
Total assets				2,360,618
Due to banks	-	-	37,778	37,778
Deposits from customers	-	165,414	1,760,711	1,926,125
Other liabilities	-	1,009	45,840	46,849
Total financial liabilities	-	166,423	1,844,329	2,010,752
Total non-financial liabilities				9,425
Total liabilities				2,020,177

Accounting classifications and fair values as at 31 December 2017

	Financial assets and liabilities at fair value RO'000	Financial assets and liabilities at amortised cost RO'000	Total 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

Notes to the Financial Statements (continued)
As of 31 December 2018

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.

Financial instruments carried at fair value

	Valuation techniques		
	Level 1 RO'000	Level 2 RO'000	Total RO'000
Recurring fair value measurements			
At 31 December 2018			
Assets			
Derivatives	**-**	**9,738**	**9,738**
Financial investments at FVOCI	**264,130**	**234,856**	**498,986**
Financial investments at FVTPL	**-**	**2,340**	**2,340**
Liabilities			
Derivatives	**-**	**1,009**	**1,009**
Deposits from customers	**-**	**165,414**	**165,414**
At 31 December 2017			
Assets			
Derivatives	-	6,378	6,378
Financial investments: available-for-sale	-	614,921	614,921
Liabilities			
Derivatives	-	71	71
Deposits from customers	-	83,665	83,665

Financial instruments not carried at fair value

	Valuation techniques				
	Level 1 RO'000	Level 2 RO'000	Level 3 RO'000	Total fair value RO'000	Carrying amount RO'000
Assets and liabilities					
At 31 December 2018					
Assets					
Loans and advances to customers – net	**-**	**-**	**1,349,461**	**1,349,461**	**1,389,559**
Liabilities					
Deposits from customers	**-**	**1,761,149**	**-**	**1,761,149**	**1,760,711**

	Valuation techniques				
	Level 1 RO'000	Level 2 RO'000	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

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.

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Loans and advances to customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using valuation models that incorporate a range of input assumptions. These assumptions may include forward looking discounted cash flow models using assumptions which the bank believes are consistent with those which would be used by market participants in valuing such loans; and trading inputs from other market participants which includes observed primary and secondary trades.

Loans are grouped, as far as possible, into homogeneous groups and stratified by loans with similar characteristics to improve the accuracy of estimated valuation outputs. The stratification of a loan book considers all material factors, including vintage, origination period, estimates of future interest rates, prepayment speeds, delinquency rates, loan-to-value ratios, the quality of collateral, default probability, and internal credit risk ratings.

The fair value of a loan reflects both loan impairments at the reporting date and estimates of market participants' expectations of credit losses over the life of the loans, and the fair value effect of repricing between origination and the reporting date.

Financial investments and derivatives

Fair value is based on quoted market prices at the reporting date. 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 other assets or other liabilities.

Deposit by banks and customer deposits

Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand approximates its carrying value.

25 Notes on the statement of cash flows

25(a) Non-cash items included in profit before tax

	Notes	2018 RO'000	2017 RO'000
Changes in fair value of financial investments measured at fair value through profit and loss	12	286	-
Change in expected credit losses and other credit impairment charges	5	(1,510)	N/A
Loan impairment charges and other credit risk provisions – net of recoveries	5	N/A	5,531
Depreciation of property and equipment	15	1,606	1,620
(Gain) / loss on disposal of property and equipment	4	(91)	96
Amortisation of intangible assets	7	2,285	2,285
Net loss / (gain) on sale of financial investments	4	10	(13)
Amortisation of financial investment	12	(2,795)	(3,309)
Employer's current service cost with interest	18(a)	436	188
Finance lease charge		56	56
Effect of currency translation		-	(457)
		283	5,997

Notes to the Financial Statements (continued)
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25(b) Change in operating assets

	2018 RO'000	2017 RO'000
Change in loans and advances to customers-net	**4,925**	17,997
Change in other assets	**(8,761)**	(5,494)
	(3,836)	12,503

25(c) Change in operating liabilities

	2018 RO'000	2017 RO'000
Change in deposits from customers	**(5,925)**	65,395
Change in other liabilities	**7,066**	7,873
	1,141	73,268

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

	2018 RO'000	2017 RO'000
Statement of financial position items comprise:		
Cash and balances with central bank (note 10(a))	**270,574**	223,806
Due from banks (note 10(b))	**132,792**	40,363
Due to banks (note 16)	**(37,778)**	(35,958)
	365,588	228,211

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.

The Bank enter into transactions with other HSBC affiliates, as part of the normal course of business, such as banking and operational services. In particular, as a member of one of the world's largest financial services organizations, we share in the expertise and economies of scale provided by the HSBC Group. The Bank provide and receive services or enter into transactions with a number of HSBC Group companies, including sharing in the cost of development for technology platforms used around the world and benefit from worldwide contracts for advertising, marketing research, training and other operational areas. These related party transactions are on terms similar to those offered to non-related parties.

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:

Notes to the Financial Statements (continued)
As of 31 December 2018

	Parent entity RO'000	Other related group entities RO'000	Directors RO'000	Others RO'000	Total RO'000
As at 31 December 2018					
Loans and advances	-	-	378	124,049	124,427
Current, deposit and other accounts	-	3,165	189	16,114	19,468
Letters of credit and guarantees	-	169,301	-	10,231	179,532
Acceptances	-	-	-	911	911
Due from banks	-	45,850	-	-	45,850
Due to banks*	-	21,780	-	-	21,780
Collateral received	-	128,330	-	-	128,330
For the year ended 31 December 2018					
Net interest income	-	761	-	3,737	4,498
Net fee income**	-	(334)	-	273	(61)
Other operating expenses	-	(12,431)	(18)	(1,067)	(13,516)
Purchase of property and equipment	-	-	-	(8)	(8)

*Due to banks includes Vostro balances of RO10.6 M, Borrowings of RO6.3 M from HSBC affiliates and accrual of RO4.9 M for the expenses payable to HSBC Affiliates as of 31 December 2018.

**Net fee income includes fee expenses of RO0.6 M incurred for the indemnity received as a collateral from HSBC affiliates.

During the year Bank purchased the loans and advances of RO5.4 M from HSBC affiliates. However customer attached to these loans are not a related party of the Bank.

Notes to the Financial Statements (continued)
As of 31 December 2018

	Parent entity RO'000	Other related group entities RO'000	Directors RO'000	Others RO'000	Total 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	-	164,505	-	5,416	169,921
Acceptances	-	-	-	1,002	1,002
Due from banks	-	14,411	-	-	14,411
Due to banks	-	12,124	-	-	12,124
Collateral received	-	184,742	-	-	184,742
For the year ended 31 December 2017					
Net interest income	-	124	-	2,678	2,802
Net fee income**	-	(12)	-	219	207
Other operating expenses	-	(10,286)	(16)	(1,047)	(11,349)
Purchase of property and equipment	-	-	-	(71)	(71)

*Due to banks includes Vostro balances of RO7.8 M, Borrowings of RO1.6 M from HSBC affiliates and accrual of RO2.3 M for the expenses payable to HSBC Affiliates as of 31 December 2017.

**Net fee income includes fee expenses of RO0.2 M incurred for the indemnity received as a collateral from HSBC affiliates.

Compensation of key management personnel

	2018	2017
	RO'000	RO'000
Wages, salaries and other short term benefits	**1,839**	1,671
Post-employment benefits	**336**	27
	2,175	1,698

Balances with key management personnel

	2018	2017
	RO'000	RO'000
Loans and advances	**553**	466
Current, deposit and other accounts	**223**	317

Notes to the Financial Statements (continued)
As of 31 December 2018

27 Distribution by economic sector

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

	2018 RO'000	2017 RO'000
Personal and consumer loans	**499,392**	488,559
Corporate and commercial		
Import trade	**212,751**	233,842
Construction	**67,251**	46,574
Manufacturing	**235,155**	235,152
Wholesale and retail trade	**65,179**	70,137
Electricity, gas, water, transportation and communication	**41,651**	45,306
Services	**101,255**	170,543
Mining and quarrying	**175,983**	124,723
Others	**65,336**	49,997
	964,561	976,274
Total gross loans and advances	**1,463,953**	1,464,833
ECL allowances	**(35,502)**	N/A
Provision for loan impairment - specific	**N/A**	(18,248)
Provision for loan impairment - general	**N/A**	(18,289)
Reserved interest	**(38,892)**	(33,409)
Net loans and advances	**1,389,559**	1,394,887
Non-performing loans - gross	**62,981**	55,269

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

	2018 RO'000	2017 RO'000
Import trade	**28,308**	38,759
Construction	**62,537**	79,860
Financial institutions	**163,027**	158,729
Manufacturing	**13,424**	15,265
Wholesale and retail trade	**4,951**	12,797
Electricity, gas, water, transportation and communication	**205,199**	26,949
Services	**63,373**	67,345
Mining and quarrying	**1,745**	1,390
Others	**30,355**	44,508
Total	**572,919**	445,602

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As of 31 December 2018

28 Operating segment

The factors used to identify the Bank's reporting segments are discussed in the 'Summary of significant accounting policies' in note 2.1 (g).

	31 December 2018				
	CMB RO'000	RBWM RO'000	GB&M RO'000	Corporate center RO'000	Total RO'000
Net interest income					
- External	7,942	27,558	17,854	6,706	60,060
- Internal	11,758	3,560	(5,326)	(9,992)	-
	19,700	31,118	12,528	(3,286)	60,060
Net fee income	3,773	3,935	4,162	(166)	11,704
Net trading income	1,476	1,302	3,490	7,412	13,680
Changes in fair value of financial investments measured at fair value through profit and loss	-	-	-	(286)	(286)
Other operating income	115	(74)	226	477	744
Total operating income	25,064	36,281	20,406	4,151	85,902
Change in expected credit losses and other credit impairment charges	1,073	(3,814)	4,088	163	1,510
Net operating income	26,137	32,467	24,494	4,314	87,412
Total operating expenses	(11,768)	(30,870)	(6,326)	(471)	(49,435)
Profit before tax	14,369	1,597	18,168	3,843	37,977
Reportable segment assets	459,004	490,107	468,065	943,442	2,360,618
Reportable segment liabilities	1,096,704	594,914	294,993	33,566	2,020,177

	31 December 2017				
	CMB RO'000	RBWM RO'000	GB&M RO'000	Corporate Center RO'000	Total 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

29 Dividend per share

The Board of Directors at the forthcoming Ordinary Annual General meeting will propose a cash dividend of RO 0.0093 per share of nominal value of RO 0.100 each amounting to RO 18.6 M for the year 2018 (2017: cash dividend of RO 0.0057 per share of nominal value of RO 0.100 each amounting to RO 11.4 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 2019.

30 Effect of reclassification upon adoption of IFRS 9

The reconciliation between the statement of financial position as of 31 December 2017 (IAS 39 accounting policies) and 1 January 2018 (revised accounting policies after implementing IFRS 9)

Assets	IAS 39 measurement category	IFRS 9 measurement category	IAS 39 carrying amount as at 31 December 2017 RO'000	Reclassification: Fair value through profit or loss RO'000	Reclassification: Fair value through other comprehensive income RO'000	Reclassification: Amortised cost RO'000	Carrying amount Post reclassification RO'000	Remeasurement and IFRS 9 expected credit losses RO'000	IFRS 9 carrying amount as at 1 January 2018 RO'000
Cash and balances with central bank	AC	AC	223,806	-	-	-	223,806	(87)	223,719
Due from banks	AC	AC	40,363	-	-	-	40,363	-	40,363
Loans and advances to customers - net	AC	AC	1,394,887	-	-	-	1,394,887	(1,670)	1,393,217
Financial investments									
- Debt instruments at available for sale	AFS	FVOCI	611,751	-	-	-	611,751	-	611,751
- Equity instruments at available for sale	AFS	FVOCI	3,170	(2,920)	-	-	250	-	250
- Designated and otherwise mandatorily measured at fair value through profit or loss	FVPL	FVPL	-	2,920	-	-	2,920	-	2,920
Other assets (prepayments, accrued income and others)	AC	AC	22,415	-	-	-	22,415	(66)	22,349
Derivatives	FVPL	FVPL	6,378	-	-	-	6,378	-	6,378
Deferred tax asset	N/A	N/A	1,550	-	-	-	1,550	775	2,325
Other assets (including intangible assets and property and equipment)	N/A	N/A	29,477	-	-	-	29,477	-	29,477
Total assets			2,333,797	-	-	-	2,333,797	(1,048)	2,332,749

AC = Amortised cost, AFS = Available for sale, FVPL = Fair value through profit or loss and FVOCI = Fair value through other comprehensive income.

Notes to the Financial Statements (continued)

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Liabilities

	IAS 39 measurement category	IFRS 9 measurement category	IAS 39 carrying amount as at 31 December 2017 RO'000	Reclassification: Fair value through profit or loss RO'000	Reclassification: Fair value through other comprehensive income RO'000	Reclassification: Amortised cost RO'000	Carrying amount post reclassification RO'000	Remeasurement and IFRS 9 expected credit losses RO'000	IFRS 9 carrying amount as at 1 January 2018 RO'000
Due to banks	AC	AC	35,958	-	-	-	35,958	-	35,958
Deposits from customers	AC	AC	1,932,050	-	-	-	1,932,050	-	1,932,050
Derivatives	FVPL	FVPL	71	-	-	-	71	-	71
Other liabilities excluding derivatives	AC	AC	37,837	-	-	-	37,837	-	37,837
Provisions (ECL on off balance sheet and other commitments)	N/A	N/A	-	-	-	-	-	3,021	3,021
Current tax liabilities	N/A	N/A	4,625	-	-	-	4,625	-	4,625
Total liabilities			2,010,541	-	-	-	2,010,541	3,021	2,013,562

Net equity

	IAS 39 carrying amount as at 31 December 2017 RO'000	Reclassification RO'000	Carrying amount post reclassification RO'000	Remeasurement and IFRS 9 expected credit losses RO'000	IFRS 9 carrying amount as at 1 January 2018 RO'000
Share capital	200,031	-	200,031	-	200,031
Legal reserve	39,879	-	39,879	-	39,879
Available-for-sale fair value reserve	(2,166)	2,166	-	-	-
Financial assets at FVOCI reserve	-	(1,838)	(1,838)	323	(1,515)
Retained earnings	85,512	(328)	85,184	(4,392)	80,792
Net equity	323,256	-	323,256	(4,069)	319,187

Reconciliation of impairment allowance under IAS 39 and IFRS 9 expected credit losses is set out below

		Reclassification			Remeasurement		
	IAS 39 measurement category	Fair value through profit and loss RO'000	Fair value through profit and loss RO'000	Fair value through other comprehensive income RO'000	Stage 3 RO'000	Stage 1 and 2 RO'000	Total RO'000
Financial assets at amortised cost							
Provision as per IAS 39 as at 31 December 2017							**36,537**
Cash and balances with central bank	AC	-	-	-	-	**87**	**87**
Loans and advances to customers - net	AC	-	-	-	-	**1,670**	**1,670**
Financial investments	AC	-	-	-	-	**323**	**323**
Other assets (prepayments, accrued income and other assets)	AC	-	-	-	-	**66**	**66**
Provisions (ECL on off balance sheet and other commitments)	AC	-	-	-	-	**3,021**	**3,021**
Expected credit loss allowance/provisions at 1 Jan 2018		-	-	-	-	**5,167**	**41,704**

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As of 31 December 2018

31 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.

31.1 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.

31.2 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 key categories: earnings, capital, liquidity and funding, credit risk covering impairment and diversification, and other risk categories. 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.

31.3 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 the Bank incurs.

Credit risk management

The Wholesale 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

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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 or sector 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.

Adoption of IFRS 9 'Financial Instruments'

The implementation of IFRS 9, did not result in any significant change to the Bank's business model. This included our strategy, country presence, product offerings and target customer segments. The Bank has established credit risk management processes in place and actively assess the impact of economic developments in key markets on specific customers, customer segments or portfolios. If the Bank foresee changes in credit conditions, Bank takes mitigating action, including the revision of risk appetites or limits and tenors, as appropriate. In addition, Bank continues to evaluate the terms under which the Bank provide credit facilities within the context of individual customer requirements, the quality of the relationship, local regulatory requirements, market practices and our local market position.

As a result of IFRS 9 adoption, management has additional insight and measures not previously utilised which, over time, may influence our risk appetite and risk management processes

IFRS 9 process

The IFRS 9 process comprises three main areas: modelling, data and implementation.

Modelling

Prior to the implementation of IFRS 9 the risk function had preexisting Basel and behavioural scorecards. These were then enhanced or supplemented to address the IFRS 9 requirements, with the appropriate governance and independent review.

Implementation

A centralised impairment engine has been implemented to perform the ECL calculation in a globally consistent manner which adequately takes into account classification and measurement requirements of IFRS 9.

Credit quality of financial instruments

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.

For details of impairment policies on loans and advances and financial investments, see note 2.2 in these financial statements. When impairment losses occur, the Bank reduces the carrying amount of loans and advances through the use of an allowance account.

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.

Summary of credit risk

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

The IFRS 9 allowance for ECL has decreased from RO41.7 M at 1 January 2018 to RO37.2 M at 31 December 2018.

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

	Gross carrying / nominal amount (net of reserved interest) RO'000	**Allowanc for ECL RO'000**
Cash and balances with central bank	**270,737**	**(163)**
Due from banks	**132,842**	**(50)**
Loans and advances to customers		
-RBWM	**498,326**	**(9,417)**
-Wholesale	**926,735**	**(26,085)**
Other assets	**26,305**	**(255)**
Total gross carrying amount on balance sheet	**1,854,945**	**(35,970)**
Loans and other credit related commitments	**709,685**	**(1,102)**
Total nominal amount off balance sheet	**709,685**	**(1,102)**

	Fair value RO'000	**Memorandum Allowance for ECL RO'000**
Financial investments at FVOCI	**498,986**	**(80)**

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

Stage 1: Unimpaired and without significant increase in credit risk on which a 12-month allowance for ECL is recognised.

Stage 2: A significant increase in credit risk has been experienced since initial recognition on which a lifetime ECL is recognised.

Stage 3: Objective evidence of impairment, and are therefore considered to be in default or otherwise credit-impaired on which a lifetime ECL is recognised.

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

Gross Exposure	Gross Exposure				Allowances / Provision for ECL				ECL coverage %			
	Stage1 RO'000	Stage 2 RO'000	Stage 3 RO'000	Total RO'000	Stage1 RO'000	Stage 2 RO'000	Stage 3 RO'000	Total RO'000	Stage1 RO'000	Stage 2 RO'000	Stage 3 RO'000	Total RO'000
Loans and advances to customers (net of reserved interest)	1,023,292	374,891	26,878	1,425,061	3,946	12,563	18,993	35,502	0.39%	3.35%	70.66%	2.49%
Due from banks	132,842	-	-	132,842	50	-	-	50	0.04%	-	-	0.04%
Other financial assets measured at amortised cost	290,025	7,017	-	297,042	377	41	-	418	0.13%	0.59%	-	0.14%
Loans and other credit related commitments	119,569	17,197	-	136,766	22	41	-	63	0.02%	0.24%	-	0.05%
Financial guarantees and similar contracts	433,988	137,883	1,048	572,919	79	960	-	1,039	0.02%	0.70%	-	0.18%
At 31 December 2018	1,999,716	536,988	27,926	2,564,630	4,474	13,605	18,993	37,072	0.22%	2.53%	68.01%	1.45%

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Measurement uncertainty and sensitivity analysis of ECL estimates

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

Methodology for Developing Forward Looking Economic Scenarios

The bank has adopted the use of three economic scenarios representative of HSBC's view of forecast economic conditions, sufficient to calculate unbiased expected loss in most economic environments. They represent a 'most likely outcome', (the Central scenario) and tow, less likely, 'outer' scenarios referred to as the Upside and Downside scenarios. Each outer scenario is consistent with a probability of 10% while the Central scenario is assigned the remaining 80%, according to the decision of senior management. This weighting scheme is deemed appropriate for the unbiased estimation of ECL in most circumstances.

For the Central scenario, Bank sets key assumptions such as GDP growth, world oil price and UAE Investment. An external vendor's global macro model, which is conditioned to follow the consensus forecasts, projects the other paths required as inputs to credit models. This vendor model is subject to HSBC's risk governance framework with oversight by a specialist internal unit.

Upside and downside scenarios are designed to be cyclical in that GDP growth, world oil price and UAE Investment usually revert back to the Central after the first three years for major economies. The Central, Upside and Downside scenarios selected with reference to external forecast distributions using the above approach are termed the 'Consensus Economic Scenarios'.

Wholesale analysis

HSBC at group level has developed a globally consistent methodology for the application of economic scenarios into the calculation of ECL by incorporating those scenarios into the estimation of the term structure of probability of default ('PD') and loss given default ('LGD'). For PDs, Bank consider the correlation of economic guidance to default rates for a particular industry. For LGD calculations we consider the correlation of economic guidance to collateral values and realisation rates for a particular industry. PDs and LGDs are estimated for the entire term structure of each instrument.

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

IFRS 9 ECL sensitivity to future economic conditions[1]

ECL coverage of financial instruments at 31 December 2018[2]	RO'000
Reported ECL (RO in million)	11.5
Gross carrying / nominal amount (RO in million)[3]	2,543.2
Reported ECL coverage (percentage)	0.45%
Coverage ratio by scenario (percentage)	
Coverage Upside scenario	0.41%
Coverage Downside scenario	0.50%
Coverage Central scenario	0.45%

1 Excludes ECL and financial instruments relating to defauled obligons.

2 Includes off-balance sheet financial instruments that are subject to significant measurment uncertaninly.

3 Includes low credit risk financial instruments such as debt instruments at FVOCI, which have low ECL coverage ratios under all the above scenarios.

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Retail analysis

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

IFRS 9 ECL sensitivity to future economic conditions[1]

ECL coverage of loans and advance to customer at 31 December 2018[2]	RO'000
Reported ECL (RO in million)	9.4
Gross carrying amount (RO in million)	499.4
Reported ECL coverage (percentage)	1.88%
Coverage ratio by scenario (percentage)	
Coverage Upside scenario	1.35%
Coverage Downside scenario	1.82%
Coverage Central scenario	1.53%

1 ECL sensitivities exclude portfolios utilising less complex modelling approaches.

2 ECL sensitivitiy include only on-balance sheet financial instruments to which IFRS9 impairment requlrements are appled.

Economic scenarios sensitivity analysis of ECL estimates

The ECL outcome is sensitive to judgement and estimations made with regards to the formulation and incorporation of multiple forward looking economic conditions described above. As a result, management assessed and considered the sensitivity of the ECL outcome against the forward looking economic conditions as part of the ECL governance process by recalculating the ECL under each scenario described above for selected portfolios, applying a 100% weighting to each scenario in turn. The weighting is reflected in both the determination of significant increase in credit risk as well as the measurement of the resulting ECL.

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.

The following table presents the Bank's maximum exposure to credit risk from on balance sheet and off-balance sheet financial instruments before taking account of any collateral held or other credit enhancements (unless such enhancements meet accounting offsetting requirements). 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.

The offset in the table relate to amounts where there is a legally enforceable right of offset in the event of counterparty default and where, as a result, there is a net exposure for credit risk purposes. However, as there is no intention to settle these balances on a net basis under normal circumstances, they do not qualify for net presentation for accounting purposes.

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Maximum exposure to credit risk	31 December 2018			31 December 2017		
	Maximum exposure RO'000	Offset RO'000	Net RO'000	Maximum exposure RO'000	Offset RO'000	Net RO'000
On balance sheet						
Derivatives	**9,738**	**-**	**9,738**	6,378	-	6,378
Loans and advances to customers held at amortised cost						
– RBWM	**488,914**	**-**	**488,914**	476,154	-	476,154
– Wholesale	**900,645**	**(21,756)**	**878,889**	918,733	(24,343)	894,390
Balances with central bank (note 10(a))	**239,509**	**-**	**239,509**	191,768	-	191,768
Due from banks (note 10 (b))	**132,792**	**-**	**132,792**	40,363	-	40,363
Financial investments - FVOCI	**498,986**	**-**	**498,986**	N/A	N/A	N/A
Financial investments - FVTPL	**2,340**	**-**	**2,340**	N/A	N/A	N/A
Financial investments - AFS	**N/A**	**N/A**	**N/A**	614,921	-	614,921
Other assets	**53,271**	**-**	**53,271**	48,653	-	48,653
	2,326,195	**(21,756)**	**2,304,439**	2,296,970	(24,343)	2,272,627
Off balance sheet						
Financial guarantees and similar contracts	**572,919**	**(3,128)**	**569,791**	445,602	(2,502)	443,100
Loans and other credit related commitments	**583,781**	**-**	**583,781**	601,554	-	601,554
Total	**3,482,895**	**(24,884)**	**3,458,011**	3,344,126	(26,845)	3,317,281

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.

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

	2018 RO'000	2017 RO'000
Property	**152,785**	136,273
Equity	**509**	397
Fixed deposits	**24,884**	26,845
Vehicle	**5,243**	4,540
Guarantees	**128,330**	186,343
Total	**311,751**	354,398

The table below presents an analysis of financial investments as at 31 December 2018 and 2017:

	2018 RO'000	2017 RO'000
Unrated equity investments	**2,590**	3,170
Sovereign securities	**498,736**	611,751
Total	**501,326**	614,921

The table below presents an analysis of due from banks and balances with central bank as at 31 December 2018, based on Fitch and Standard & Poor's ratings or equivalent.

	2018 RO'000	2017 RO'000
Sovereign	**239,672**	191,768
A	**27,442**	10,652
A+	**123**	-
A-	**1,158**	1,216
AA+	**-**	33
AA-	**82,722**	28,336
BBB+	**207**	126
BB+	**21,190**	-
ECL allowances	**(213)**	N/A
Total	**372,301**	232,131

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.

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	Gross loans and advances		Due from banks		Financial investments		Balances with central bank	
	2018	2017	**2018**	2017	**2018**	2017	**2018**	2017
	RO'000	RO'000	**RO'000**	RO'000	**RO'000**	RO'000	**RO'000**	RO'000
Concentration by sector:								
Sovereign	**75**	2	**-**	-	**498,736**	611,751	**239,672**	191,768
Corporate	**964,486**	976,272	**-**	-	**-**	-	**-**	-
Banks	**-**	-	**132,792**	40,363	**-**	-	**-**	-
Retail	**499,392**	488,559	**-**	-	**-**	-	**-**	-
Carrying amount	**1,463,953**	1,464,833	**132,792**	40,363	**498,736**	611,751	**239,672**	191,768

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.

Credit Review and Risk Identification teams regularly review exposures and processes in order to provide an independent, rigorous assessment of the credit risk management framework, reinforce secondary risk management controls and share best practice. Internal audit, as a tertiary control function, focuses on risks with a global perspective and on the design and effectiveness of primary and secondary controls, carrying out oversight audits via the sampling of control frameworks, themed audits of key or emerging risks and project audits to assess major change initiatives. The Bank complies with all regulatory requirements as regards credit quality classification.

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

There is no direct correlation between the internal and external ratings at granular level, except to the extent each falls within a single quality classification.

Credit quality classification	Debt securities and other bills - external credit ratings	Wholesale lending – Internal credit rating	Retail lending – Internal credit rating[2]
Strong	A– and above	CRR1[1] to CRR2	Band 1 and 2
Good	BBB+ to BBB–	CRR3	Band 3
Satisfactory	BB+ to B and unrated	CRR4 to CRR5	Band 4 and 5
Sub-standard	B– to C	CRR6 to CRR8	Band 6
Impaired	Default	CRR9 to CRR10	Band 7

1. *Customer risk rating.*
2. *12-month point-in-time ('PIT') probability weighted probability of default ('PD').*

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Quality classification definitions

- 'Strong' exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss.
- 'Good' exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk.
- 'Satisfactory' exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk.
- 'Sub-standard' exposures require varying degrees of special attention and default risk is of greater concern.
- 'Impaired' exposures have been assessed as impaired. These also include retail accounts classified as Band 1 to Band 6 that are delinquent by more than 90 days, unless individually they have been assessed as not impaired; and renegotiated loans that have met the requirements to be disclosed as impaired and have not yet met the criteria to be returned to the unimpaired portfolio.

Risk rating scales

The customer risk rating ('CRR') 10-grade scale summarises a more granular underlying 23-grade scale of obligor probability of default ('PD'). All customers are rated using the 10 grade or 23-grade scale, depending on the degree of sophistication of the Basel II approach adopted for the exposure.

Retail lending credit quality is disclosed on an IFRS 9 basis, which is based on a 12-month point-in-time ('PIT') probability weighted probability of default ('PD'). For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications. The ratings of Standard and Poor's are cited, with those of other agencies being treated equivalently. Debt securities with short-term issue ratings are reported against the long-term rating of the issuer of those securities. If major rating agencies have different ratings for the same debt securities, a prudent rating selection is made in line with regulatory requirements.

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

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

	Gross carrying/notional amount							
	Strong RO'000	Good RO'000	Satisfactory RO'000	Substandard RO'000	Credit impaired RO'000	Total RO'000	Allowance provision for ECL RO'000	Net RO'000
Cash and balances at central bank	31,065	239,672	-	-	-	270,737	(163)	270,574
Due from banks	111,656	21,186	-	-	-	132,842	(50)	132,792
Loans and advances to customers (net of reserved interest)	158,050	878,677	319,416	47,854	21,064	1,425,061	(35,502)	1,389,559
Financial investments – FVOCI	-	-	498,986	-	-	498,986	(80)	498,906
Other assets	-	-	26,305	-	-	26,305	(255)	26,050
At 31 December 2018 (on balance sheet)	300,771	1,139,535	844,707	47,854	21,064	2,353,931	(36,050)	2,317,881
Loan and other credit related commitments for loans and advances to customers	108,051	21,090	6,402	1,223	-	136,766	(63)	136,703
Financial guarantee and similar contracts	338,647	110,726	105,714	16,784	1,048	572,919	(1,039)	571,880
At 31 December 2018 (off balance sheet)	446,698	131,816	112,116	18,007	1,048	709,685	(1,102)	708,583

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

	Strong RO'000	Good RO'000	Satisfactory RO'000	Substandard RO'000	Credit impaired RO'000	Total RO'000	Allowance provision for ECL RO'000	Net RO'000
Gross carrying amount on balance sheet								
- stage 1	288,488	947,403	708,948	306	-	1,945,145	(4,453)	1,940,692
- stage 2	12,283	192,132	135,759	41,734	-	381,908	(12,604)	369,304
- stage 3	-	-	-	5,814	21,064	26,878	(18,993)	7,885
Nominal amount off balance sheet								
- stage 1	432,978	51,513	67,862	1,204	-	553,557	(101)	553,456
- stage 2	13,720	80,303	44,254	16,803	-	155,080	(1,001)	154,079
- stage 3	-	-	-	-	1,048	1,048	-	1,048
At 31 December 2018	747,469	1,271,351	956,823	65,861	22,112	3,063,616	(37,152)	3,026,464

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Past due but not impaired gross financial instruments

Past due but not impaired gross financial instruments are those loans where, although customers have failed to make payments in accordance with the contractual terms of their facilities, they have not met the impaired loan criteria. This is typically when a loan is less than 90 days past due and there are no other indicators of iimpairment.

Further examples of exposures past due but not impaired include individually assessed mortgages that are in arrears more than 90 days, but there are no other indicators of impairment and the value of collateral is sufficient to repay both the principal debt and all potential interest for at least one year or short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation but there is no concern over the creditworthiness of the counterparty. When groups of loans are collectively assessed for impairment, collective impairment allowances are recognised for loans classified as past due but not impaired.

The following table provides an analysis of gross loans and advances to customers held at amortised cost which are past due but not considered impaired.

	2018	2017
	RO'000	RO'000
Loans and advances to customers held at amortised cost		
Past due 1-30 days	**10,954**	7,210
Past due 31-60 days	**33,871**	3,275
Past due 61-89 days	**2,523**	2,045
Total	**47,348**	12,530

Impaired loans

Impaired and stage 3 loans and advances are those that meet any of the following criteria:

- Wholesale loans and advances classified as Customer Risk Rating ('CRR') 9 or CRR 10. These grades are assigned when the bank considers that either the customer is unlikely to pay their credit obligations in full without recourse to security, or when the customer is more than 90 days past due on any material credit obligation to the Bank.

- Retail loans and advances classified as Band 7. These grades are typically assigned to retail loans and advances more than 90 days past due unless individually they have been assessed as not impaired.

- Renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet its contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

31.4 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') categorisation;
- 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

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- Single currency liquidity management
- Contingency Funding Plan

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 2018

The liquidity position of the Bank remained strong as of 31 December 2018. As per LFRF framework Bank's liquidity coverage ratio as of 31 December 2018 was 287% (2017: 223%) and net stable funding ('NSFR') ratio as of 31 December 2018 was 142% (2017:N/A).

The Bank also calculates the LCR as per the CBO requirement and same has been disclosed separately in note 32 and 33 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 customers and due from banks continued to exceed deposits by banks.

31.5 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.

Forwards

Forward contracts are commitments to either purchase or sell a designated financial

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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:

	2018	**Average**	**Maximum**	**Minimum**	2017	Average	Maximum	Minimum
	RO'000	**RO'000**	**RO'000**	**RO'000**	RO'000	RO'000	RO'000	RO'000
Total VAR	**48**	**64**	**109**	**39**	103	83	122	60
Trading VAR	**31**	**40**	**67**	**21**	33	25	44	8

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.

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	**2018**	2017
US Dollars	**23,815**	34,222
Pound Sterling	**28**	2
Euro	**7**	3
UAE Dirhams	**29**	118
Indian Rupee	**-**	5
Other currencies	**189**	166
Total exposure	**24,068**	34,516

31.6 Legal risk

The Bank implements processes and procedures in place to manage legal risk that conform to HSBC Group standards. Legal risk falls within the definition of operational risk and includes the risk of a member of the group suffering financial loss, legal or regulatory action or reputational damage due to:

- Contractual risk, which is the risk that the Bank enters into inadequate or unenforceable customer contracts or ancillary documentation, inadequate or unenforceable non-customer contracts or ancillary documentation and/or contractual fiduciary;
- Dispute adjudication risk, which is the risk arising due to an adverse dispute environment or a failure to take appropriate steps to defend, prosecute and/or resolve actual or threatened legal claims brought against or by the Bank, including for the avoidance of doubt, regulatory matters;
- Legislative risk, which is the risk that the Bank fails to or is unable to identify, analyse, track, assess or correctly interpret applicable legislation, case law or regulation, or new regulatory, legislative or doctrinal interpretations of existing laws or regulations, or decisions in the Courts or regulatory bodies;
- Non-contractual rights risk, which is the risk that the Banks's assets are not properly owned or protected or are infringed by others, or a group member infringes another party's rights; and
- Non-contractual obligations risk, which is the risk arising due to infringement of third-party rights and/or breach of common law duties.

The Bank has a legal function to assist management in controlling legal risk. The function provides legal advice to manage and control legislative, contractual and non-contractual risks and support in managing litigation claims and significant regulatory enforcement against group companies, as well as in respect of non-routine debt recoveries or other litigation against third parties.

In December 2012, among other agreements, HSBC Holdings entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions, consented to a cease-and-desist order with the Federal Reserve Board ('FRB'), entered into a 5 year deferred prosecution agreement with, among others, the US Department of Justice (DOJ) (the "US DPA") and agreed to an undertaking with the UK Financial Conduct Authority ('FCA') to comply with certain forward-looking AML and sanctions-related obligations and to retain an independent compliance monitor to produce annual assessments of the HSBC Group's AML and sanctions compliance programme (the "Independent Consultant"). In February 2018, the Independent Consultant delivered his fourth annual follow-up review report and the fifth annual follow-up review report is expected to be delivered in February 2019. The Independent Consultant will continue working in his capacity as a skilled person and independent consultant for a period of time at the FCA's and FRB's discretion.

Through his country-level reviews, the Independent Consultant identified potential anti-money laundering and sanctions compliance issues that HSBC is reviewing further with the FRB and/or FCA. In December 2017, the US DPA expired and the charges deferred by the US DPA were dismissed. Additionally, HSBC is the subject of other ongoing investigations and reviews by the DOJ and HSBC Bank plc is the subject of an investigation by the FCA into its compliance with UK money laundering regulations and financial crime systems and controls requirements.

These settlements with US and UK authorities have led to private litigation, and do not preclude further private litigation related to HSBC's compliance with applicable BSA, AML and sanctions laws or other regulatory or law enforcement actions for BSA, AML, sanctions or other matters not covered by the various agreements.

In September 2017, HBSC Holdings and 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 US$175 million to the FRB.

In January 2018, HSBC Holdings entered into a three-year deferred prosecution agreement with the Criminal Fraud Division of the DOJ, regarding fraudulent conduct in connection with two particular transactions in 2010 and 2011. This concluded the DOJ's investigation into HSBC's historical foreign exchange activities. Under the terms of the FX DPA, HSBC has a number of ongoing obligations, including continuing to cooperate with authorities and implementing enhancements to its internal controls and procedures in its Global Markets business, which will be the subject of annual reports to the DOJ. In addition, HSBC agreed to pay a financial penalty and restitution.

31.7 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, unauthorized 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 centralized 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.

31.8 Compliance risk management

Compliance risk is the risk that the Bank fails to observe the relevant laws and regulations imposed

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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 organization.

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.

31.9 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 12.875% including capital conservation buffer for 2018 (2017: 13.25%) in accordance with CBO stipulated guidelines.

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

	2018	2017
	RO'000	RO'000
Common Equity Tier 1 capital ('CET 1') / Tier 1 capital		
Ordinary share capital	**200,031**	200,031
Legal reserve	**43,016**	39,879
Retained earnings	**78,981**	74,110
Regulatory adjustments to CET1	**(3,972)**	(8,099)
CET 1/Tier 1 capital	**318,056**	305,921
Additional Tier 1 capital (AT1)	**-**	-
Total Tier 1 capital (T1 = CET1+AT1)	**318,056**	305,921
Tier 2 capital (T2)		
Fair value reserve for available-for-sale equity securities	**-**	18
ECL allowance – Stage 1	**4,554**	N/A
ECL allowance – Stage 2	**10,884**	N/A
Provision for loan impairment – general	**N/A**	18,289
Total	**15,438**	18,307
Total regulatory capital	**333,494**	324,228
Risk-weighted assets		
Banking book	**1,532,498**	1,738,327
Operational risk	**160,951**	152,247
Market risk	**25,100**	25,521
Total risk-weighted assets	**1,718,549**	1,916,095
Capital ratios		
CET 1 / Tier 1 capital ratio	**18.51%**	15.97%
Total capital ratio	**19.41%**	16.92%

Notes to the Financial Statements (continued)

As of 31 December 2018

32 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 90% for 2018 (2017: 80%) in accordance with CBO stipulated guidelines.

Liquidity coverage ratio disclosure for the period ended 31 December 2018:

		31 December 2018		31 December 2017	
		Total Unweighted Value (average*)	Total Weighted Value (average*)	Total Unweighted Value (average*)	Total Weighted Value (average*)
		RO'000	RO'000	RO'000	RO'000
	High quality liquid assets				
1	Total High quality liquid assets (HQLA)		**640,103**		760,565
	Cash outflows				
2	Retail deposits and deposits from small business customers, of which:	**586,709**	**43,554**	631,326	47,013
3	- Stable deposits	**302,339**	**15,117**	322,390	16,199
4	- Less stable deposits	**284,370**	**28,437**	308,936	30,894
5	Unsecured wholesale funding, of which:	**991,938**	**422,710**	1,001,505	415,618
6	- Operational deposits (all counterparties) and deposits in networks of cooperative banks	**-**	**-**	-	-
7	- Non-operational deposits (all counterparties)	**991,938**	**422,710**	1,001,505	415,618
8	- Unsecured debt	**-**	**-**	-	-
9	Secured wholesale funding	**-**	**-**	-	-
10	Additional requirements, of which	**31,214**	**2,920**	42,223	3,957
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	**31,214**	**2,920**	42,223	3,957
14	Other contractual funding obligations	**-**	**-**	-	-
15	Other contingent funding obligations	**528,554**	**26,428**	584,151	29,208
16	**Total cash outflows (2+5+10+15)**		**495,612**		495,796
	Cash inflows				
17	Secured lending (e.g. reverse repos)	**-**	**-**	-	-
18	Inflows from fully performing exposures	**227,956**	**211,736**	104,091	82,591
19	Other cash inflows	**-**	**-**	-	-
20	**Total cash inflows (17+18+19)**	**227,956**	**211,736**	104,091	82,591
21	**Total HQLA**		**640,103**		760,596
22	**Total net cash outflows (16-20)**		**283,876**		413,205
23	**Liquidity coverage ratio (21/22)**		**225%**		184%

*simple average of daily observations over the last three months (October – December 2018 and October-December 2017)

Notes to the Financial Statements (continued)
As of 31 December 2018

33 Net Stable Funding Ratio (NSFR)

Net Stable Funding Ratio is guided by the CBO through circular BM 1147 (Guidelines on NSFR and NSFR disclosures). NSAR ratio is calculated on monthly intervals and reported to the CBO. The standard for NSFR become effective from 1 January 2018 with a minimum ratio of 100%.

Net Stable Funding Ratio disclosure for the period ended 31 December 2018:

	Available Stable funding (ASF) items	**Unweighted value by residual maturity**				
		No maturity	**< 6 months**	**6 months to < 1yr**	**≥ 1yr**	**Weighted value**
1	Capital:	355,827	-	-	-	355,827
2	Regulatory capital	337,414	-	-	-	337,414
3	Other capital instruments	18,413	-	-		18,413
4	Retail deposits and deposits from small business customers	552,980	22,892	9,076	2,429	543,988
5	Stable deposits	301,581	380	151	-	287,006
6	Less stable deposits	251,399	22,512	8,925	2,429	256,982
7	Wholesale funding:	852,540	382,574	115,822	19,296	694,763
8	Operational deposits	31,484	-	-	-	15,742
9	Other wholesale funding	821,056	382,574	115,822	19,296	679,021
10	Liabilities with matching interdependent assets	-	-	-	-	-
11	Other liabilities:	31,852	27,863	3,372	-	-
12	NSFR derivative liabilities	-			-	-
13	All other liabilities and equity not included in above categories	31,852	27,863	3,372	-	-
14	**Total ASF**					**1,594,578**
	Require Stable Funding (RSF) items					
15	Total NSFR high-quality liquid assets (HQLA)					24,937
16	Deposits held at other financial institutions for operational purposes	11,768	-	-	-	5,884
17	Performing loans and securities:	2,590	554,469	19,455	863,300	1,017,756
18	Performing loans to financial institutions secured by Level 1 HQLA	-	-	-	-	-
19	Performing loans to financial institutions secured by non- Level 1 HQLA and unsecured performing loans to financial institutions		121,075	-	-	18,161
20	Performing loans to non-financial corporate clients, loans to retail and small business customers, and loans to sovereigns, central banks and PSEs, of which		429,358	16,899	762,953	880,563
21	- With a risk weight of less than or equal to 35% under the Basel II Standardised approach for credit risk				84,821	55,134
22	Performing residential mortgages, of which:		4,036	2,556	100,347	61,697
23	- With a risk weight of less than or equal to 35% under the Basel II Standardised Approach for credit risk		4,036	2,556	100,347	61,697

Notes to the Financial Statements (continued)
As of 31 December 2018

24	Securities that are not in default and do not qualify as HQLA, including exchange-traded equities	**2,590**	**-**	**-**	**-**	**2,202**
25	Assets with matching interdependent liabilities					
26	Other Assets:	**30,997**	**31,449**	**-**	**5,529**	**71,147**
27	Physical traded commodities, including gold					
28	Assets posted as initial margin for derivative contracts and contributions to default funds of CCPs					
29	NSFR derivative assets				**8,729**	**8,729**
30	NSFR derivative liabilities before deduction of variation margin posted					
31	All other assets not included in the above categories	**30,997**	**22,720**	**3,172**	**5,529**	**62,418**
32	Off-balance sheet items		**652,966**	**118,259**	**385,475**	**57,835**
33	TOTAL RSF					**1,177,559**
34	**NET STABLE FUNDING RATIO (%)**					**135**

34 Corresponding figures

Certain corresponding figures for 2017 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.


HSBC