Connecting customers to opportunities worldwide

HSBC Bank Oman S.A.O.G.

Annual Report and Accounts 2016

Welcome to HSBC Bank Oman's
Annual Report for 2016

His Majesty Sultan Qaboos bin Said

Contents

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

Aimen Ahmed Sultan Al Hosni
Director

Abdulfattah Sharaf
Director

Robert Adrian Underwood
Director

Robin Dougles Jones
Director

Management Team

Ali Al Abri
General Manager
and Head of
Human Resources

Daniel Felton,
General Manager
and Head of
Commercial Banking

Sulaiman Al Lamki
General Manager
and Chief Risk Officer

Andrew P Long
Chief Executive Officer

Sameh Al Wahaibi
Assistant General Manager
and Head of Communications

Baha Uddin
Assistant General Manager
and Head of
Financial Crime Compliance

Biju Thottingal
General Manager
and Head of Legal

HSBC HSBC Bank Oman S.A.O.G.

Ahmed El Damaty
General Manager
and Chief Financial Officer

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

Saud Al Shidhani
General Manager and
Chief Operating Officer

Mumtaz Yousuf
General Manager and
Treasurer, Global Markets

Amir Bourani
Head of Global Banking

Khalid Al Mahari
Assistant General Manager
and Head of
Regulatory Compliance

Ifzal Nawaz
Assistant General Manager
and Head of Internal Audit

Gopal Lohiya
Company Secretary

Board of Directors' Report for the year ended 31 December 2016

Dear Shareholders,

On behalf of the Board of Directors, I am pleased to present your Bank's full year financial results for 2016.

Our performance in 2016 demonstrated the fundamental strength of our business, notwithstanding the challenges posed by the economic environment and the status of the oil market. Our strong capital and prudent risk appetite helped us achieve revenue growth in a difficult market environment.

This success was evidenced by continuous recognition in various global awards, most notably being ranked "safest Bank in Oman in 2016" by Global Finance Magazine.

Economic overview

2016 was marked by the continuation of the sharp decline of the oil prices. The Omani government has taken bold steps to cut non-core expenditure in favour of additional attention towards investment spending on selected key projects and to increase its revenues from non-oil sectors. Some encouragement is to be taken from the recent development, where higher oil prices have offered the Oman 2017 budget some support.

With the Sultanate's ninth five year plan now in place, efforts are underway to lay the groundwork to support the identified strategic sectors, driving social development, economic diversification and better utilization of Oman's natural resources. The announced budget for 2017 and the significant deficit reduction efforts given by the government will help the country to face the uncertainty around the global economy and the oil market.

Performance Summary

I am pleased to share with you our encouraging results for the year ended 31 December 2016. We have reported a 31.0% increase in net profit for the year ended 31 December 2016 to RO16.9m compared to RO12.9m for the year ended 31 December 2015. Profit grew due to a combination of higher operating income and lower operating expenses partly offset by higher loan impairment charges.

Net operating income before loan impairment charges, increased by 2.3% to RO75.2m compared to last year during which we had some significant one-off transactions which boosted last year's performance, including the sale of our branches in India and Pakistan.

Net interest income grew by 10.4% to RO54.3m for the year ended 31 December 2016 up from RO49.2m for the same period in 2015. This underlying strength was due to higher interest income from corporate lending coupled with rising yields from the investment of surplus liquidity in government securities, partially offset by lower interest income received from retail customers due to the run-off of older high yield retail loans. Net fee income decreased by 1.6% to RO12.3m for the year ended 31 December 2016 largely due to lower custody fees reflecting the MSM performance and lower trade finance fees reflecting declining trade numbers for Oman.

Net trading income increased by 11.4% to RO7.8m compared to RO7.0m for the year ended 31 December 2015 mainly due to the non-repeat of the RO0.5m one-off foreign exchange loss incurred in 2015 related to the sale of our operations in India and Pakistan.

Other operating income fell to RO0.6m compared to RO4.5m for the year ended 31 December 2015 primarily due to the non-repeat of the gain on the disposal of legacy investments of RO4.6m being booked in 2015.

A net charge of RO5.6m has been reported for loan impairment charges (RO3.4m in 2015) with the increase driven by both retail-specific provisions of RO4.1m and the corporate general provision of RO2.1m attributed to the growth in corporate loans and advances.

Operating expenses decreased by 11.5% to RO48.4m due to our continuing focus on firm cost control. Our Cost Efficiency Ratio improved to 64.3% compared to 74.4% for the same period in 2015. Our global focus on financial crime compliance continues, but at a cost to our financial performance.

Board of Directors' Report for the year ended 31 December 2016

Loans and advances, net of provisions and reserved interest, increased by 18.1% to RO1,418.4m with growth largely in our wholesale book.

Customer deposits increased by 3.6% to RO1,866.7m resulting in a net loans to deposits ratio (ADR) of 76.0% compared to 66.6% as at 31 December 2015.

HBON's capital adequacy ratio stood at 18.7% for the year ended 31 December 2016 compared to 19.4% as at 31 December 2015, leaving HBON as the strongest capitalized bank amongst our Peers in Oman.

The Board of Directors proposes a total cash dividend of RO10.0m, with a dividend pay-out ratio of 59.2%.

Delivering the best customer experience

In 2016 we heightened our focus on delivering an excellent customer experience that sets us apart from our competitors. With our Absher programme aiming to foster a customer centric culture at all levels in the Bank, we managed to improve our Customer Recommendation Index in our key segment of Premier clients to 91% in 2016, up from 89% in 2015.

In Retail Banking & Wealth Management (RBWM), our Home Loans acquisition showed strong growth YoY while our other retail lending sustained momentum despite the challenging macro environment. During the year we redesigned our Mandoos prizes draw scheme to give our customers more chances to win, and we launched a Sukuk investment product for the first time in Oman.

We continued to invest in our branch network infrastructure and relocated 3 branches in 2016, demonstrating our commitment to providing our customers with the most convenient and up-to-date banking environment. This branch network investment is complemented by our ongoing enhancements to our digital banking platforms. We released a new version of our mobile banking App, which gave an enhanced and enriched experience to our customers. As a result of these efforts we saw a sizeable increase in our customers' digital engagement to 42% in Q4 2016 up from 21% in Q4 2015.

We ended the year with the launch of our RBWM Corporate Employee Programme, through which we identify the top companies with business potential for growth and target them with a competitive package of products and services in order to maximize business opportunities with their staff.

In Commercial Banking we continued to demonstrate our ability to combine our global strength with our local expertise. HSBC Bank Oman was one of the lead arranger on the USD 6.4 billion project financing the Liwa Plastic Industries Complex signed with ORPIC.

We continued to demonstrate our support to Small and Medium Enterprises (SMEs) in Oman through the ongoing Growth Series events that are designed to provide ambitious small businesses with the insight they need to prosper in the local and international markets.

In October we were delighted to win, for the 5th consecutive year, the Euromoney Award for the best Cash Management Bank in Oman, reflecting the strength of our liquidity and cash management solutions, which we leverage from the significant investment made into our Global Liquidity & Cash Management platform by the HSBC Group.

Investing in our people

We continued to make progress in supporting the country's Omanization agenda, achieving 94% Omanizaion by 31st December 2016. During 2016 we have appointed more Omani nationals into senior positions in the bank as part of our ongoing commitment to developing our local talent.

Throughout the year our staff went through several Anti Money Laundering and Sanctions training programmes in line with the Bank's continuous efforts to enhance staff awareness in the area of financial crime compliance.

Supporting the Bank's female staff to achieve their career aspirations and complementing the Bank's efforts to achieve gender diversity at all levels, a tailormade Springboard programme was developed for our female staff. The program aims to identify clear and practical steps towards achieving their personal and career goals.

In 2015 we developed a "Branch Manager Certification Programme", in coordination with the College of Banking and Financial Studies, and we are proud to celebrate the graduation of two batches from this programme in 2016.

Contributing to the communities we serve

We have increased our efforts in the corporate sustainability (CS) field in 2016 by nurturing a volunteering culture in the Bank and by having more successful partnerships with different organizations including Oman Association for the Disabled,

Board of Directors’ Report for the year ended 31 December 2016

Environment Society of Oman, the Ministry of Environment & Climate Affairs and the British Council.

During the year the Bank’s staff donated 768 hours in voluntary activities that included beach cleaning campaigns, distributing food hampers to needy families and visits to the children wards in different hospitals in Oman.

As a corporate member of the Environment Society of Oman we were the Gold sponsor of their intercollege public speaking event, and we continued to support their different environmental awareness activities throughout the year.

During the last quarter of the year we introduced a new CS initiative in the Bank titled “Once upon a time”, where volunteers from the Bank visited six hospitals in different regions and conducted story telling sessions to the children admitted at these hospitals. This initiative not only adds value to the reading skills of the children, but it also gives them moral support during the difficult time they spend in the hospitals.

Conclusion

With the Government’s heightened focus on diversifying its economy and leveraging the untapped potential in the Sultanate, we are positive for the opportunities that will arise in 2017. Initiatives such as the National Programme for Enhancing Economic Diversification (Tanfeedh) and the projects that will come out from that programme will, we hope, contribute to increasing the sustainable non-oil revenue of the country.

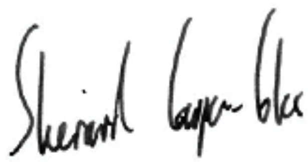
For 2017 we remain focused on delivering our strategic objectives of growing our revenue, streamlining our processes and procedures and implementing the highest global standards to protect the Bank and its customers from the risk of financial crime. We will continue to focus on further improving our customers’ experience and always going an extra mile to meet their requirements.

On behalf of the Board of Directors, I would like to thank all of our customers for their trust in us, our staff and management for what they have achieved so far, as well as the Central Bank of Oman and the Capital Market Authority for their continued support and guidance.

Before closing, I must also state my thanks for the leadership which my predecessor, David Eldon, has shown over these last three years in Oman. With his significant banking expertise, David’s wisdom has been invaluable in bringing HSBC Bank Oman to where we are today. I would like to share with you David’s final comments as chairman:

“As this is also my last opportunity to write about the performance of the Bank in Oman as its Chairman, given my recent resignation from that position to undertake new challenges within the HSBC Group elseswhere, let me offer my thanks to my fellow directors as well as to all of my colleagues within the Bank in Oman for their considerable efforts over many years. My own association with the British Bank of Middle East and HSBC in the Sultanate goes back many years, indeed to the currency exchange in 1970. Oman will always remain a part of my career, of which I will be very proud” David Eldon.

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.



Sir Sherard Cowper-Coles
Chairman

Connecting banking to the digital age

REPORT OF FACTUAL FINDINGS

TO THE SHAREHOLDERS OF HSBC BANK OMAN SAOG

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

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

3. We have performed the following procedures:

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

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

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

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

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

7. Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose. This report relates only to the Board of Directors' corporate governance report included in its annual report for the year ending 31 December 2016 and does not extend to any financial statements of the Bank taken as a whole.

PricewaterhouseCoopers

5 March 2017
Muscat, Sultanate of Oman

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Corporate Governance Report
For the Annual Report 2016

'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:

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

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

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

2. Governance philosophy

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

- An effective and accountable Board of Directors;
- A clear 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 and all members are non-executive and independent.

3.2 The term of the current Board commenced on 30 March 2015 for a period of three years. The next Board election will be in 2018, unless required earlier under the provisions of the law and HBON's Articles of Association ('Articles').

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;
- 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;
- To acquire and maintain appropriate and relevant industry specific knowledge;
- To acquire and maintain business expertise in international markets.

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

Corporate Governance Report (continued)
For the Annual Report 2016

Name & Category	Biography
Directors in office	
Sir Sherard Cowper-Coles KCMG LVO *Chairman & non-executive director* *Qualification(s):* *Hertford College, Oxford (Degree in Classics, Scholar, Honorary Fellow)*	Sherard has nearly 40 years' experience of working in the region and internationally. He spent over 30 years in the British Diplomatic Service and was Ambassador to Saudi Arabia from 2003 to 2007. He joined HSBC Holdings in 2013 as Senior Adviser to the Group Chairman and Group Chief Executive, and was appointed Group Head of Government Affairs in 2015. Sherard is also a Director of HSBC Bank Egypt SAE. In addition, he is a member of the Boards of the Egyptian British Business Council, the Saudi British Joint Business Council, and Asia House and is UK Chairman of the Omani-British Friendship Association.
Brig. (Retd.) Waleed Omar Al Zawawi *Deputy Chairman & independent non-executive director* *Qualification(s):* *Masters from Kings College – London (United Kingdom) – 2007* *Graduated from The Royal College of Defence Studies (UK) – 2006* *Graduated from Camberly (United Kingdom) – 1992* *Graduated from Sandhurst (United Kingdom) – 1982*	Director on the Board of various companies in Oman (since 1984), and abroad including on the Board of Oman International Bank SAOG since 1996 to end May 2012. Currently, Deputy Chairman of HSBC Bank Oman SAOG with effect from 31 May 2012. Served in the Oman Armed Forces for 30 years.
Dr. Juma Ali Juma Al Juma *Independent senior non-executive director* *Qualification(s):* *PhD in Political Science*	Dr. Juma worked with the Royal Office from 1982 to 1996; and thereafter worked as the General Secretary of the Tender Council from 1996 to 2001; as the Minister of Manpower from 2001 to 2008; as the Chairman of Oman Airports Maintenance Company SAOC from 2010 to 2015. Dr. Juma is the Chairman of Al Maha Petroleum Products Marketing Company SAOG from 2016.
Aimen Ahmed Sultan Al Hosni *Independent, non-executive director* *Qualification(s):* *Masters in Public Administration* *Bachelor in Political Science*	Al-Hosni is the Chief Executive Officer of Oman Airports Management Company (OAMC) after handling the position of Muscat international Airport as General Manager for more than 3 years. In addition, Al-Hosni is the Chairman of Oman National Engineering and Investment Co. SAOG and Muscat National Holding Company SAOG; a Board member of Oman Telecommunications Co. SAOG; Board member of ACI Regional Board Director- Asia Pacific; and ACI world Board member. For the last twenty years of a professional career path, Al-Hosni has been leading different organisations holding executive positions in various sectors such as Banking, Telecommunications, Services and Insurance. Al-Hosni has served OAMC with his past 20 years of experience in different sectors on both an international and local level. He has achieved to create and bring significant work environment and knowledge as he led major projects not only during his former position as Muscat International Airport General Manager such as Phase 1 opening of New Muscat International Airport and Solar Impulse 2 reception in its first leg in Muscat. But also in his current

Name & Category	Biography
Directors in office	
	position as CEO, he led the opening of new Salalah Airport. As OAMC CEO, he is working with a promise to make Oman Airports a world-class airports and the connecting link between the east and west of the World. OAMC is managing and operating Muscat International and Salalah Airports, and other regional airports in Sohar and Duqm.
Abdulfattah Sharaf *Independent, non-executive director* *Qualification(s):* *Graduate of the University of Denver, USA*	Abdulfattah Sharaf is a Group General Manager and the Chief Executive Officer, United Arab Emirates, 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). Before joining HBME, 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 Emirates Telecommunications Corporation (Etisalat) and Noor Dubai Foundation. He is also a member of the Mastercard MEA Advisory Board, a member of the Advisory Board Council of the American University of Sharjah's School of Business and Management and a Board Member of the Emirates Golf Federation.
Rob Underwood *Independent, non-executive director* *Qualification(s):* *BSc Economics and Politics, Bath University, Bath, UK* *Associate of Chartered Institute of Bankers, London, UK*	From 1987 to 2000: Various roles in HSBC Group in London, Hong Kong and Saudi Arabia covering Credit Risk, Credit Training, Corporate Lending and Specialised Industries and Shipping Lending. From November 2000 to February 2004: was Senior Manager, Group HR. From February 2004 to September 2007 was CEO of HSBC Chile. From September 2007 to February 2010 was Head of Wholesale Risk for HSBC Latin America based in Mexico. From February 2010 to June 2014 was Regional Head of Wholesale and Market Risk, HSBC Middle East, and from June 2014 to date is Chief Risk Officer, HSBC Middle East and North Africa based in Dubai.
Robin D. Jones *Independent, non-executive director* *Qualification(s):* *Fellow member of the Chartered Association of Certified Accountants*	Robin joined HSBC Bank Middle East Limited ('HBME') in October 2013 as Deputy CEO MENA and Head of Strategy & Planning MENA, from HSBC Bank plc, London, where he was Chief Risk and Administration Officer from July 2011 to September 2013, reporting to HSBC Group Chief Operating Officer. In this capacity Robin ensured HSBC pro-actively manages Risk and Quality across all HOST functions. In addition, Robin was responsible for operational support to ensure key governance processes operate effectively. Robin also oversaw cross HOST programmes, such as, OE, Recovery and Resolution, Global Transaction Team and Data Strategy. Prior to his role in London, Robin was seconded to Saudi British Bank as Executive Director and Chief Operating Officer.

Corporate Governance Report (continued)
For the Annual Report 2016

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

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 2016, 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 management 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 2016 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.

2016 Dates	Board & Committee
27 January	Board, Audit, Risk
3 March	Board, Audit, NRC
30 March	Board
27 April	Board, Audit, Risk
27 July	Board, Audit, Risk
30 October	Board, Audit, Risk, NRC
31 October	Board, Audit

6.4 The Board met 7 times, the Audit Committee met 6 times, the Risk Committee met 4 times, and the NRC met 2 times in 2016. The AGM was held on 30 March 2016. 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 Share-holders Meeting	Director of any other SAOG Company
		Board #	Audit	Risk	NRC	AGM	
David Gordon Eldon	Board Chairman	7	N/A	N/A	N/A	Yes	No
Brig. (Retd.) Waleed Omar Al Zawawi	Board Deputy Chairman, and Audit	7	6	N/A	N/A	Yes	Yes
Dr. Juma Ali Juma Al Juma	Board	5	N/A	N/A	N/A	No	Yes
Aimen Ahmed Sultan Al Hosni	Board, Risk, NRC	7	N/A	4	2	Yes	Yes
Abdulfattah Sharaf	Board, Risk, Remuneration. NRC Chairman effective 3 March 2016.	6	N/A	4	2	No	No
Rob Underwood	Board, Audit, Risk, and NRC. Risk Committee Chairman effective from 21 July 2014.	7	6	4	2	Yes	No
Robin D. Jones	Board, Audit, and Risk. Audit Committee Chairman effective from 30 March 2015.	6	6	3	N/A	Yes	No

The full Board met for a Bank-wide Strategy session. 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 2016, Rob Underwood, Abdulfattah Sharaf, and Robin D. Jones each waived their entitlement to be paid the whole or any part of their Board/ Committee sitting fees.

7.1.4 The total Board/Committee sitting fees and expenses paid during 2016 amounted to RO64,991 in accordance with the following table:

Name of the Director	Sitting fees RO	Strategy Session fees RO	Total Sitting fees RO
David Gordon Eldon	3,500	500	4,000
Brig. (Retd.) Waleed Omar Al Zawawi	6,500	500	7,000
Dr. Juma Ali Juma Al Juma	2,500	500	3,000
Aimen Ahmed Sultan Al Hosni	6,500	500	7,000
Abdulfattah Sharaf	-	-	-
Rob Underwood	-	-	-
Robin D. Jones	-	-	-
Total sitting fees	**19,000**	**2,000**	**21,000**
Total hotel, travel and other board expenses	43,991	-	43,991
GRAND TOTAL	**62,991**	**2,000**	**64,991**

7.2 **Staff & Senior Management**

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

- An assessment of performance with a reference to clear and relevant objectives set within a performance scorecard framework;
- A focus on the total compensation (fixed plus variable pay) with variable pay (namely bonus payments and the value of long-term incentives) differentiated by performance;
- The use of discretion to assess the extent to which performance has been achieved rather than applying a formulaic approach which, by its nature, cannot cover all scenarios and may encourage inappropriate risk taking or mis-selling;
- A significant proportion of variable pay to be deferred into HSBC Holdings Restricted Shares 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.

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 2016 Pay Review Funding** - Fixed and Variable Pay review funding was established during 4Q16 for each Business, Function and for HBON overall. The 2016 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 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.

7.2.5 **The 2016 Variable Pay Spend** - The Variable Pay Spend for 2016 is RO3.25 million representing a decrease of 3% over the previous year's spend.

Aggregate Variable Pay Spend reflects a payout ratio of 4.3% of overall HBON revenue (against 4.6% in 2015).

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 (34 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 2016 to the MRTs including salary, cash and non-cash benefits, bonuses, stock options, gratuity and pensions amounted to RO3.44 million. The total remuneration paid in aggregate during 2016 to the top 5 officers amounted to RO 1.24 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 RO300,000/- of the senior management and all MRTs Variable Pay will be in the form of restricted stock and/or deferred cash.

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 executive committee ('EXCO').

8.2 The Audit Committee comprises 3 members, the Risk Committee 4 members, and the NRC 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 3,553 shareholders as at 31 December 2016.

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 2016:

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 2016	0.101	0.097	6,130.78
February 2016	0.100	0.094	6,637.61
March 2016	0.101	0.095	6,694.93
April 2016	0.128	0.098	7,354.70
May 2016	0.122	0.103	7,669.19
June 2016	0.105	0.098	7,356.81
July 2016	0.100	0.097	7,423.02
August 2016	0.103	0.098	7,523.91
September 2016	0.101	0.098	7,382.72
October 2016	0.118	0.101	7,257.77
November 2016	0.115	0.110	7,124.38
December 2016	0.120	0.114	7,568.18

13.2 The following table sets out the distribution of HBON share ownership during 2016:

% Shareholding	No of shareholders
Less than 5%	3,552
Between 5 – 10%	0
More than 10%	1
Total	3,553

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

14. Details of non-compliance by HBON

14.1 During the last 3 years total fines of RO 55,180 (RO 2,410 for Year 2014; RO 33,770 for Year 2015 and RO 19,000 for Year 2016) were imposed on the Bank and its Pakistan operations for regulatory penalties as detailed hereunder:

Year	Entity	Regulator	Brief Description	Amount of penalties RO
2014	HBON – Pakistan	State Bank of Pakistan	Cumulative fines	2,410
Total Fines 2014				**2,410**
2015	HBON - Oman	CBO	The Bank had not put in place a separate Policy on Small & Medium Enterprises ('SME') lending and had not appointed Assistant General Manager or above to head the SME unit.	2,500
		CBO	There was no clean break between the loan approval and the risk classification authority as the Chief Risk Officer responsible for the risk classification also had lending powers. Besides, a few customers of the Bank had not been classified as per the CBO guidelines.	2,500
		CBO	The customers were not separated into risk categories on the basis of their risk profile except for a few high risk businesses, customers from high risk countries and Politically Exposed Persons (PEPs).	10,000
		CBO	The Bank has not conducted periodic reviews of security and operational aspects of the electronic banking activities to ensure adequacy of security and access controls.	2,500
		CBO	Data Quality Issue. The Bank Credit and Statistical Bureau ('BCSB') was not updated. A total fine of RO 9,600 was imposed on three occasions (RO 600; RO 8,200; and RO 800).	9,600
		Telecom Regulatory Authority ('TRA')	HBON had procured walkie-talkie radio units from a TRA approved vendor. However, the TRA inspection team concluded that the radio units had not been authorised by the TRA.	6,670
Total Fines 2015				**33,770**

Corporate Governance Report (continued)
For the Annual Report 2016

Year	Entity	Regulator	Brief Description	Amount of penalties RO
2016	HBON - Oman	CBO	The Bank had signed several new Intra Group Service Agreements with Group entities and had failed to obtain prior approval from the CBO for the changes to the outsourcing arrangements that had been hitherto approved by the CBO.	10,000
		CBO	The Bank had violated the CBO instructions with regard to Omanisation of Personnel in the Banking Sector.	4,000
		CBO	The Bank had not complied with the provisions of the CBO Circular on combating frauds where, the Bank had not reported frauds to the CBO and the ROP within three days of knowledge/occurrence.	4,000
		CBO	Data Quality Issue. The Bank Credit and Statistical Bureau ('BCSB') was not updated. A total fine of RO 1,000 was imposed on two occasions (RO 200; and RO 800).	1,000
Total Fines 2016				**19,000**

The Chairman has responded to the CBO and a Board approved action plan is in place to rectify the issues. The Bank's Pakistan operations has been disposed of during the year 2015.

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 2016 have been (i) disclosed in the Notes to the Financial Statements as at 31 December 2016 (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 2016.

16.2 The Shareholders of the Bank appointed PwC as the Bank's auditors for the year 2016.

16.3 PwC is a global network of firms operating in 157 countries with more than 223,000 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 around 4,000 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 140 professionals and support staff. Expert 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 is due fees of RO90,000 for audit services and RO9,950 for non-audit services, totalling RO99,950, towards their engagement as the external auditor of the Bank for the year 2016. In addition, RO4,250 was paid to PwC for rendering tax advisory services.

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;
- 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

Connecting talent to higher aspirations

Management Discussion and Analysis

HSBC Bank Oman at a glance

HSBC Bank Oman (HBON) is a proud local bank and part of one of the largest banking and financial services organisations in the world. We are part of the HSBC Group, which in totality serves customers worldwide from over 4400 offices in over 71 countries and territories in Europe, Asia, North and Latin America, and the Middle East and North Africa.

Our Values:

Open, Connected, Dependable

Our Purpose

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

Our Vision

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

Our Business Groups

Retail Banking and Wealth Management (RBWM)	**Commercial Banking (CMB)**	**Global Banking and Markets (GB&M)**
We help people to manage their finances, buy their homes, and save and invest for the future. We aim to capture the opportunities arising from social mobility and wealth creation.	We support our corporate customers and help them with their financial needs whether small enterprises up to large multinationals. Our customers range from small enterprises focused primarily on their domestic markets, through to large companies operating globally.	We provide financial services and products to companies, governments and institutions. Our comprehensive range of products and solutions, across capital financing, advisory and transaction banking services, can be customised to meet our clients' specific objectives.

Highlights of 2016

Profit for the year
RO 16.9m

Net operating income
RO 75.2m

Loan impairment (charges)/release
RO 5.6m

Return on average equity
5.4%

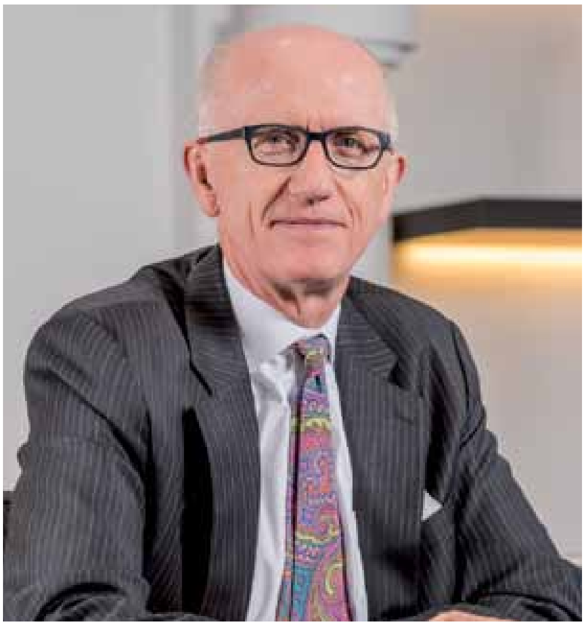
Cost efficiency ratio
64.3%

Capital adequacy ratio
18.7%

Over
210,000
active retail customers

891
employees

Over
3,500
active corporate customers



Oman's Banking Environment

The banking sector remained resilient supporting the economic diversification initiatives, credit needs and serving requirements of the community. Credit to the private sector increased by 10.1% to RO 19.7 billion as at the end of December 2016. Of the total credit to the private sector, the household sector (mainly under personal loans) stood at 46.5% closely followed by the non-financial corporate sector at 45.2%, financial corporations at 5.1% and other sectors the remaining 3.2%.

Total deposits registered a growth of 5.2% to RO 20.4 billion as at the end of December 2016. Private sector deposits of the banking system registered a growth of 4.9% to RO 13.3 billion as at the end of December 2016.

Strategic Priorities

We have three inter-connected and equally weighted priorities to help us deliver our strategy:

- Grow the business;
- Implement Global Standards; and
- Streamline processes and procedures.

Each priority is complementary and underpinned by initiatives within our day-to-day business. Together, they create value for our customers and shareholders and contribute to the long-term sustainability of HSBC Bank Oman. In the process, we will maintain a robust, resilient and environmentally sustainable business in which our customers can have confidence, our employees can take pride and our communities can place their trust.

Grow the business

We aim to achieve growth by leveraging HSBC Group's international network coupled with our local expertise to improve HSBC Bank Oman's market position in products aligned to our strategy.

Implement Global Standards

HSBC Bank Oman is a safer bank today in terms of our approach to financial crime compliance. We are adopting the highest or most effective financial crime controls and deploying them everywhere we operate.

Streamline processes and procedures

We continue to refine our operational processes, implement consistent business models and streamline our IT operations.

Sustainable savings arise from the reduction or elimination of complexity, inefficiencies or unnecessary activities, and then release capital that can be reinvested in growing our business as well as increasing returns to shareholders.

Financial Performance Analysis

Profit for the year: HBON recorded a 31.0% increase in net profit to RO16.9m for the year ended 31 December 2016 compared to RO12.9m for the year ended 31 December 2015. This increase was due to a combination of higher operating income and lower operating expenses partly offset by higher loan impairment charges. The financial results are further analysed as follows:

Net Interest Income (NII): NII grew by 10.4% to RO54.3m for the year ended 31 December 2016 up from RO49.2m for the same period in 2015. The positive growth in NII is largely from corporate customers due to higher volumes and repricing activities coupled with rising yields from the investment of surplus liquidity in government securities.

Net fee, trading and other operating income: Net fee, trading and other operating income was RO20.9m compared to RO24.4m in 2015. The reasons for the underlying movements were:

Net fee income stood at RO12.3m compared to RO12.5m for the previous year. This is largely due to lower custody fees reflecting the MSM's performance over the year and from lower trade finance fees reflecting declining trade numbers for Oman.

Net trading income increased by RO0.8m compared to the previous year.

Dividend income decreased by RO0.2m primarily due to lower dividends from equity investments.

Other operating income fell to RO0.6m compared to RO4.5m for the year ended 31 December 2015 primarily due to the non-repeat of the gain on the disposal of legacy investments of RO4.6m being booked in 2015.

Loan impairment charges net of recoveries: A net charge of RO5.6m has been reported for loan impairment charges compared to RO3.4m for 2015. Retail provisions witnessed an increase of RO0.5m due to the stress which has been observed in certain Retail segments and unaccounted losses from deceased cases with no insurance cover. Corporate provisions showed an increase of RO1.7m mainly attributed to the growth in corporate loans and advances.

Operating expenses: Total operating expenses reduced by 11.5% to RO48.4m reflecting our strong focus on firm cost control. The reduction was primarily due to a decrease in staff costs of RO1.2m, marketing and advertisement costs of RO0.4m, premises and equipment costs of RO0.9m and other administrative costs of RO3.1m.

The Cost Efficiency Ratio improved to 64.3% compared to 74.4% for the same period in 2015.

Total assets: HBON's total assets increased from RO2,199.9m to RO2,253.9m. The major upturn in assets comprised of RO217.6m in Loans and Advances to customers and amounts Due from banks of RO70.0m. This was partly offset by a reduction in Financial Investments of RO220.0m and Other assets of RO18.7m. HBON's balance sheet composition has strategically changed with a shift from Financial Investments to better yielding customer assets. HBON's Advances to Deposits (ADR) ratio stood at 76.0% as compared to 66.6% in 2015.

Loans and advances: Customer lending increased by 18.1% from RO1,200.8m in 2015 to RO1,418.4m as at 31 December 2016, primarily due to an increase in corporate loans and advances.

Customer deposits: Deposits from customers increased by 3.6% from RO1,802.3m in 2015 to RO1,866.7m for the year ended 31 December 2016. HBON's strategy is to maintain and further develop diversified relationships across the corporate, institutional banking and retail businesses.

Capital Adequacy Ratio: HBON continues to maintain a high capital adequacy ratio at 18.7% leaving HBON as the strongest capitalized bank amongst our Peers in Oman, in line with HBON's policy of preserving capital strength to support future growth. In the near future, under Basel III guidelines, banks will be required to keep additional buffers over and above the minimum capital requirement. Our approach to managing capital is designed to ensure that we exceed current regulatory requirements and we are well placed to meet those which are expected in the future.

HBON's growth aspirations and conservative approach to managing its balance sheet require a strong capital base. Our financial performance in 2016 has kept HBON well capitalised to support these aspirations. We seek to position ourselves to deliver sustainable shareholder returns over the coming years. Accordingly, HBON's dividend payout has been set in line with capital and growth targets to support these returns.

Retail Banking and Wealth Management

Retail Banking and Wealth Management (RBWM) serves more than 210,000 active customers in Oman. We provide services to individuals under our HSBC Premier and Advance propositions as well as for customer who have simple every day banking needs.

In 2016 we continued our branch refurbishment programme and transformed three more branches, with a total of 19 branches refurbished during the last three years. This refurbishment programme demonstrates a significant ongoing investment in our branch network. The renovations offer a more modern and aesthetically appealing environment, in line with the Bank's focus on delivering a superior and consistent customer experience at all times, through all channels.

We continued to improve our Digital banking proposition, as we realise that our customers habits are changing. With such a young demographic in Oman, digital will play an ever-increasing role in banking for the future. Therefore, we have introduced several enhancements to our digital platforms, released a new version of our mobile banking App and upgraded our Call Centre. We will continue to invest in leading digital technologies, leveraging the buying power and scale of the HSBC Group to bring cost effective digital solutions to our customers in Oman.

In 2016 we re-designed our Mandoos prize draw scheme to give customers even more chances to win, with the introduction of new monthly prizes and increasing the total number of winners to more than 500 this year. We also offered our customers an opportunity to win cash prizes through a lucky draw scheme where they use their credit cards both in Oman and abroad.

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

Commercial Banking

Our Commercial Banking serves more than 3500 active customers in Oman. Our customers range from small enterprises focusing mainly on the Oman market through to corporates operating globally.

We support our customers with tailored financial products and services to allow them to operate efficiently and to grow. We offer them our global expertise and provide them access to financial markets.

In 2016 the quality of our service was recognised by several leading awards. As one example, for the 5th consecutive year we were recognised by the Euromoney Award as the Best Cash Management Bank in Oman.

Our clients continued to enjoy the advantages of HSBCnet, our global online business platform, where they can log in securely to manage payments, receivables, liquidity and trade transactions, all with a single log in any time, anywhere.

We recognize the critical role that SMEs have in the future of Oman's economy. They play an important role and have a unique opportunity to increase their contribution to its growth and diversification. Aiming to support the SMEs and the internationally aspirant businesses we continued our "Growth Series" seminars, where our clients have the chance to listen and interact with leading industry experts to help them grow and expand their business.

In 2016 we hosted the 19th Middle East Economist Roadshow in Muscat, where seasoned HSBC experts discuss the most important global and regional trends shaping the Middle East's economies. This annual roadshow is a great opportunity for HSBC Bank Oman to connect its customers across the Sultanate to global industry experts to support their future growth ambitions. We will continue to bring a distinctive advantage to our corporate clients through the unique strengths of our local expertise, combined with HSBC Group's international connectivity, providing access to a wide range of products and services for SMEs through to large Corporates.

Global Banking & Markets

Global Banking & Markets (GB&M) supports major government, corporate and institutional clients worldwide in achieving their long-term strategic goals through tailored and innovative solutions. GB&M operates a long-term relationship management approach to build a full understanding of clients' financial requirements. Sector-focused client service teams comprising relationship managers and product specialists develop financial solutions to meet individual clients' needs.
A major achievement for HSBC Bank Oman last year was playing a critical role in a strategically important Financial Advisory mandate by the Omani Government, which demonstrates the position HSBC Bank Oman occupies around the table of some of the most important discussions taking place to help develop and diversify the Omani economy. This is in addition to being one of the lead arranger on the USD6.4 billion project financing for the Liwa Plastic Industries Complex signed with ORPIC.

Human Resources

We are pleased to have achieved an Omanisation rate of over 94% as at 31 December 2016, noticeably ahead of the 90% target set by the Central Bank of Oman.

Our training programmes reinforce a culture grounded in our values. In 2016 HSBC Bank Oman's employees took advantage of a variety of different training activities and through alternative media. In addition, all the Bank's employees have regular access to e.learning modules developed by the Group.

Focus on Fraud Control and Anti Money Laundering & Sanctions training continued and an embedded champions model was kicked off where the champions will, on an ongoing basis, enhance the overall knowledge and understanding of their teams on AML and Sanctions. In 2016 we introduced the 'At our Best' on-line recognition tool for all employees in HSBC Bank Oman. This tool allows them to recognize colleagues' actions by awarding points to their colleagues which can be redeemed for gifts and benefits.

Our partnership with Outward Bound to help staff discover their potential continued. This year a team of six HSBC Bank Oman staff completed Outward Bound Oman's week-long expedition crossing 120 kilometers from Al Ashkharah finishing in Duqm to commemorate the country's maritime past and its advancement into the future.

We remain fully focused on identifying and developing existing Omani talent and on strengthening talent development through local and overseas programmes.

Internal Control

Our management of risk is reflected in our strategic priorities. We ensure that risk is maintained at appropriate levels while HBON is positioned for growth and capital is deployed accordingly to maximise revenue opportunities. Our management of financial crime risk is strengthened by the implementation of HSBC's Global Standards programme, which includes enhancing the procedures, policies, capabilities and controls that govern how we do business and with whom.

Our risk culture is fundamental to the delivery of our strategic objectives. It may be characterized as conservative, control-based and collegiate. It is reinforced by our Values and our Global Standards, and forms the basis on which our risk appetite and risk management framework are established. These are instrumental in aligning our behaviour of individuals with HBON's attitude to assuming and managing risk.

We have adopted a risk management and internal control structure referred to as the "three lines of defence" to ensure we achieve our commercial aims while meeting regulatory and legal requirements. It is a key part of our operational risk management framework:

- *First line* – every employee is responsible for the risks that are part of their day jobs. The first line of defence ensures that all key risks within their operations are identified, mitigated and monitored by appropriate internal controls within an overall control environment
- *Second line* – functional teams, such as Risk, Finance and Human Resources form the second line of defence. They have similar responsibilities to the first line of defence for the processes and activities they own. In addition, they are responsible for setting policy and providing oversight and challenge of the activities conducted by the first line.
- *Third line* – Internal Audit forms the third line of defence, providing independent assurance to senior management and the HBON Board over the design and operations of HBON's risk management, governance and internal control processes.

Business Continuity Planning

HSBC Bank of Oman has adopted industry leading best practices in establishing a set of operating principles which govern how risks of a significant business disruption are mitigated to protect the Banks customers, employees and stakeholders.

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

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

The Bank's Business Continuity function continuously works towards strengthening the business continuity preparedness of the Bank. The Bank's Business continuity program is developed to manage the impact of significant disruptions and will endeavor to resume business and operations to an acceptable level within a reasonable time in the event of a disaster. While the Maximum Disruption Time (MDT) have been defined and documented in the plans, various external factors beyond our control could affect the actual recovery time.

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

Corporate Sustainability

HSBC Bank Oman recognizes its responsibility to invest in the long term prosperity of the community in the Sultanate of Oman. Our Corporate Sustainability strategy focuses on education, environment and the community.

In 2016 we worked extensively with different organizations aiming to enhance our level of engagement in social and voluntary activities around the Sultanate. These activities included structured programmes developed with the British Council such as the "Once Upon a Time" voluntary project, which is a story telling activity that targets children in hospital. In addition, environmental activities were developed with the Environment Society of Oman and the Ministry of Environment. In 2016 the Bank's staff donated 768 hours in different voluntary activities, and we have an ongoing plan to further strengthen the voluntary culture in the Bank.

Management Discussion and Analysis (continued)

Looking Ahead

Oman's 2017 Budget continues to focus on rationalizing public expenditure and maximising non-oil and gas revenues. The budget supports the Government initiatives such as the Tanfeedh programme and the development of public-private partnership projects, in order to stimulate growth and sustain employment.

The projected 2017 deficit of RO 3bn is expected to be covered through domestic and international borrowings according to the Government's statement. We are confident that we are well positioned to work with the government of Oman to facilitate such borrowing.

In the coming year we will build on our existing relationships and introduce new ways to connect customers to local and international opportunities and deliver an increasingly consistent and superior customer experience as we aim the become the leading bank in Oman.

Andrew P Long
Chief Executive Officer

Connecting lives to financial goals

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

We have performed the procedures agreed with you and as prescribed in the Central Bank of Oman (CBO) Circular No. BM 1027 dated 4 December 2007 with respect to the Basel II - Pillar III Disclosures and Basel III related Disclosures (the disclosures) of HSBC Bank Oman SAOG (the bank) set out on pages 34 to 52 as at and for the year ended 31 December 2016. The disclosures were prepared by the management in accordance with the CBO's Circular No. BM 1009 dated 13 September 2006, Circular No. BM 1027 dated 4 December 2007 and Circular No. BM 1114 dated 17 November 2013. Our engagement was undertaken in accordance with the International Standard on Related Services applicable to agreed-upon-procedures engagements. The procedures, as set out in Circular No. BM 1027 dated 4 December 2007, were performed solely to assist you in evaluating the bank's compliance with the disclosure requirements set out in CBO's Circular No. BM 1009 dated 13 September 2006 and BM 1114 dated 17 November 2013.

We report our findings as follows:

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

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

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

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose or to be distributed to any other parties other than Central Bank of Oman. 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

5 March 2017
Muscat, Sultanate of Oman

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PricewaterhouseCoopers LLC
C.R. No 1230865

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Chartered Accountants Licence No. APC/17/2015, Management Consultants Licence No. OPC/11/2015, Commercial Register No. 1230865

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

For the year ended 31 December 2016

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

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

Disclosure Policy

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

Scope of Application

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

Capital Structure

Objectives & Strategy:

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

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

Qualitative Disclosures:

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

Quantitative Disclosures:

Capital Structure:

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

Additional Tier 1 Capital (AT1)

Additional Tier 1 Capital consisting of the following:

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

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

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

The Composition of the Capital structure is as follows:

	RO in 000's
Paid up share capital	200,031
Legal reserve	37,967
Retained earnings*	68,439
Regulatory adjustments to CET1	(11,391)
CET1 capital	**295,046**
Additional Tier 1 capital	-
Total Tier 1 capital	**295,046**
Fair value reserve for available-for-sale equity securities	36
Provision for loan impairment - general	18,604
Tier 2 capital	**18,640**
Total regulatory capital	**313,686**

*Net of proposed dividend

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

For the year ended 31 December 2016

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

Basel III common disclosures during the transition phase

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

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

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

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

Disclosure for 3 step approach reconciliation

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

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

Disclosure for main feature of regulatory capital instruments

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

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

Compensation policy

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

Qualitative Disclosures

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

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

Remuneration policy

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

Material Risk Takers ('MRT')

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

Quantitative Disclosures

The below table provide the details of Compensation to the key management personnel

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

For the year ended 31 December 2016

	2016 RO'000	2015 RO'000
Wages, salaries and other short term benefits	**1,678**	1,869
Post-employment benefits	**195**	143
	1,873	2,012

Capital Adequacy:

The Bank's policy is to maintain a strong capital base so as to maintain investor, depositor and market confidence and to sustain future business developments.
The Bank is fully committed in implementing the Basel III Norms as adopted by the CBO and currently follows the Standardised approach for credit and market risk and the Basic Indicator Approach for operational risk.

The Bank has currently set the internal minimum target Capital Adequacy Ratio (CAR) at 17% for 2017 and 17.5% for 2018.

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

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

Credit Risk

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

Operational Risk

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

Market Risk

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

The details of capital, risk weighted assets and capital adequacy ratio as at 31 December 2016 are as follows:

RO '000

Details	Gross balance (Book value)	Net balances (Book value)*	Risk weighted assets
On-balance sheet items	2,249,319	2,225,141	1,301,087
Off-balance sheet items	282,378	280,713	208,309
Derivatives	1,242	1,242	1,242
Total	**2,532,939**	**2,507,096**	**1,510,638**
Market risk			17,332
Operational risk			151,480
Total			**1,679,450**
CET 1 capital			295,046
Additional Tier 1 capital			-
Total Tier 1 capital			**295,046**
Tier 2 capital			**18,640**
Total regulatory capital			**313,686**
Capital requirement for credit risk			190,718
Capital requirement for market risk			2,188
Capital requirement for operational risk			19,124
Total required capital			**212,030**
CET1 / Tier 1 Capital ratio			**17.57%**
Tier 1 Capital ratio			**17.57%**
Total capital ratio			**18.68%**

*Net of eligible collaterals.

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

For the year ended 31 December 2016

Risk Exposure and Assessment

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

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

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

Credit Risk

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

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

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

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

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

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

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

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

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

Risk reporting

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

Policies for hedging and/or mitigating risk

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

Past Dues

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

Impairment

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

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

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

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

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

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

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

Non-performing loans

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

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

RO'000

Type of Credit Exposure	Average gross exposure		Total gross exposure	
	31 Dec 2016	31 Dec 2015	**31 Dec 2016**	31 Dec 2015
Overdraft	**71,793**	78,069	**63,745**	66,130
Personal loans*	**489,558**	467,626	**480,665**	462,900
Loans against trust receipts	**185,135**	134,924	**258,076**	108,554
Other loans	**691,406**	635,340	**688,558**	633,086
Bills purchased / discounted	**15,375**	30,305	**9,693**	13,394
Total	**1,453,267**	1,346,264	**1,500,737**	1,284,064

*Personal loans are excluding the personal overdrafts of RO3,916K (31 Dec 2015: RO3,852K) which has been included under Overdrafts.

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

For the year ended 31 December 2016

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	63,745	-	-	-	**63,745**
Personal loans*	479,163	569	771	162	**480,665**
Loans against trust receipts	180,923	-	77,153	-	**258,076**
Other loans	659,207	-	29,351	-	**688,558**
Bills purchased / discounted	8,429	1,264	-	-	**9,693**
Total	**1,391,467**	**1,833**	**107,275**	**162**	**1,500,737**

*Personal loans are excluding the personal overdrafts of RO3,916Kwhich 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	35,673	169,242	3,798	208,713	42,996
Export trade	-	-	-	-	-
Wholesale & retail trade	8,716	36,511	59	45,286	8,992
Mining & quarrying*	1,026	9,690	-	10,716	1,899
Construction	6,169	52,809	363	59,341	73,244
Manufacturing	2,353	234,061	5,424	241,838	19,705
Electricity, gas and water	111	104,951	-	105,062	2,977
Transport and communication	422	7,669	-	8,091	995
Financial institutions	-	-	-	-	22,447
Services*	2,554	87,371	-	89,925	81,439
Personal loans*	3,916	479,163	-	483,079	-
Agriculture and allied activities	1,297	827	-	2,124	11
Government	-	96,292	-	96,292	997
Non-resident lending*	-	108,006	-	108,006	147,650
All others	1,508	40,707	49	42,264	6,048
Total	**63,745**	**1,427,299**	**9,693**	**1,500,737**	**409,399**

*Services sector does not include loans of RO29,351K, which has been included under the head non-resident lending.
*Mining & quarrying sector does not include loans of RO77,153K, which has been included under the head non-resident lending.
*The personal loans does not includes non-resident housing loans of RO1,502K, 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 2016

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
Up to1 month	17,494	455,511	6,828	479,833	128,194
1-3 months	-	38,539	1,940	40,479	30,766
3-6 months	-	23,706	782	24,488	44,411
6-9 months	-	4,213	-	4,213	23,206
9-12 months	-	14,798	-	14,798	17,351
1-3 years	-	69,042	-	69,042	83,749
3-5 years	-	287,077	-	287,077	11,392
Over 5 years	46,251	534,414	143	580,808	70,330
Total	**63,745**	**1,427,299**	**9,693**	**1,500,737**	**409,399**

Risk exposure by major industry

RO'000

Economic Sector	Gross Loans	Of which, NPLs	General provisions held	Specific provisions held	Reserve interest	Provisions made during the year**	Advances written off during the year
Import trade	208,713	35,450	1,727	10,254	21,563	1	153
Export trade	-	-	-	-	-	-	-
Wholesale & retail trade	45,286	766	442	241	404	59	5,639
Mining & quarrying*	10,717	1	107	1	-	-	-
Construction	59,341	16,628	421	7,539	8,117	192	2,045
Manufacturing	241,838	1,962	2,399	750	803	5	-
Electricity, gas and water	105,062	946	1,041	506	440	-	4
Transport and communication	8,091	3,662	44	1,550	2,057	-	43
Financial institutions	-	-	-	-	-	-	-
Services*	89,925	3,100	867	1,691	1,588	635	1,121
Personal loans*	483,079	3,661	9,084	2,938	847	7,575	6,889
Agriculture and allied activities	2,124	2,123	-	435	1,194	22	-
Government	96,292	-	963	-	-	-	-
Non-resident lending*	108,006	573	1,084	425	118	-	-
All others	42,263	255	425	178	79	6	61
Total	**1,500,737**	**69,127**	**18,604**	**26,508**	**37,210**	**8,495**	**15,955**

*Services sector does not include loans of RO29,351K, which has been included under the head non-resident lending.
*Mining & quarrying sector does not include loans of RO77,153K, which has been included under the head non-resident lending.
*The personal loans does not includes non-resident housing loans of RO1,502K, which has been included under the head non-resident lending.
**Provision made during the year contains specific provision made during the year

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)
For the year ended 31 December 2016

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

RO'000

Country	Gross loans	Of which, NPLs	General provision held	Specific provision held	Reserve interest	Provisions made during the year*	Advances written off during the year.
Oman	1,391,467	68,554	17,520	26,083	37,092	8,495	15,955
Other GCC countries	1,833	389	4	241	118	-	-
OECD countries	107,275	184	1,077	184	-	-	-
India	-	-	-	-	-	-	-
Others	162	-	3	-	-	-	-
Total	**1,500,737**	**69,127**	**18,604**	**26,508**	**37,210**	**8,495**	**15,955**

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

Movements of Gross Loans:

RO'000

Details	Performing loans		Non-performing loans			Total
	Standard	S.M	Sub-standard	Doubtful	Loss	
Opening balance	**1,167,645**	**44,538**	**2,370**	**854**	**68,656**	**1,284,063**
Migration / changes (+/-)	(44,534)	27,498	7,996	(451)	9,491	-
New loans	2,207,416	26,847	-	-	-	**2,234,263**
Recovery of loans	(1,945,624)	(52,176)	(621)	(103)	(3,110)	**(2,001,634)**
Loans written off	-	-	(6,827)	(2)	(9,126)	**(15,955)**
Closing balance	**1,384,903**	**46,707**	**2,918**	**298**	**65,911**	**1,500,737**
Provisions held	**19,500**	**1,068**	**1,172**	**193**	**23,179**	**45,112**
Reserve Interest	**594**	**25**	**119**	**58**	**36,414**	**37,210**

Credit Risk disclosures relating to the Standardised Approach

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

The total Banking Book risk weighted assets amounted to RO 1,511m as at 31 December 2016 after the application of credit risk mitigants.

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

Credit Risk Mitigation: Disclosures for Standardised Approach

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

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

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

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

The total value of eligible financial collateral, for example deposits under lien and other bank guarantees, for the credit risk portfolio is RO25.8m. The Bank does make use of netting whether on or off balance sheet.

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

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

Market risks in the trading book

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

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

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

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

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

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

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

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

The VAR for Global markets was as follows:

	2016	**Average**	**Maximum**	**Minimum**	2015	Average	Maximum	Minimum
	RO'000	**RO'000**	**RO'000**	**RO'000**	RO'000	RO'000	RO'000	RO'000
Total VAR	**73**	**67**	**94**	**35**	67	252	587	67
Trading VAR	**22**	**9**	**23**	**1**	4	2	12	-

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

For the year ended 31 December 2016

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

Interest Rate Risk:

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

	2016	2015
	RO'000	RO'000
1% UP - Increase in NII by	**5,104**	1,633
1% DOWN - Decrease in NII by	**(8,987)**	(1,771)
Ramp up scenario		
25bp increase per quarter	**3,501**	358
25bp decrease per quarter	**(4,581)**	(387)

The capital requirements for market risk are as follows:

	RO'000
Interest rate risk	-
Equity position risk	-
Commodities position risk	-
Foreign exchange risk	1,387
Total	**1,387**

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.

On 1 January 2016, the Bank introduced a new LFRF. It uses the liquidity coverage ratio ('LCR') and net stable funding ratio ('NSFR') regulatory framework as a foundation. The LFRF is delivered using the following key aspects:

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

Liquidity and funding for the year ended 2016

The liquidity position of the Bank remained strong as of 31 December 2016. Our liquidity coverage ratio was 364%.

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

Management of liquidity and funding risk

Liquidity coverage ratio

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

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

Net stable funding ratio

The NSFR requires institutions to maintain sufficient stable funding relative to required stable funding, and reflects a bank's long-term funding profile (funding with a term of more than a year). It is designed to complement the LCR.

Sources of funding

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

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

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 RO19.1m is based on the average gross income for the three year period ending 31 December 2016.

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

Basic Indicator Approach calculation

RO in 000's

Year	**Business line**	**Total gross income**	**Total gross (after negative GI adjustment)**	**Alpha**	**Capital charge**
2014	Total business	81,625	81,625	15.00%	**12,244**
2015	Total business	78,374	78,374	15.00%	**11,756**
2016	Total business	82,369	82,369	15.00%	**12,355**
Number of years with positive total gross income					**3**
Basic Indicator approach capital charge @ 12.50					**12,118**
Total Risk Weighted Assets - Operational Risk					**151,480**

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 2016

Annexure I

	Basel III common disclosure during the transition of regulatory adjustments (i.e. from 1 January 2013 to 1 January 2018) (RO '000)		AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT
	Common Equity Tier 1 capital: instruments and reserves		
1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	200,031	
2	Retained earnings	68,439	
3	Accumulated other comprehensive income (and other reserves)	37,967	
4	*Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies)*	-	
	Public sector capital injections grandfathered until 1 January 2018	-	
5	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)	-	
6	**Common Equity Tier 1 capital before regulatory adjustments**	**306,437**	**-**
	Common Equity Tier 1 capital: regulatory adjustments		
7	Prudential valuation adjustments	(3,083)	(771)
8	Goodwill (net of related tax liability)	-	-
9	Other intangibles other than mortgage-servicing rights (net of related tax liability)	(4,419)	(1,105)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	(1,610)	(403)
11	Cash-flow hedge reserve	-	-
12	Shortfall of provisions to expected losses	-	-
13	Securitisation gain on sale (as set out in paragraph 14.9 of CP-1)	-	-
14	Gains and losses due to changes in own credit risk on fair valued liabilities.	-	-
15	Defined-benefit pension fund net assets	-	-
16	Investments in own shares (if not already netted off paid-in capital on reported balance sheet)	-	-
17	Reciprocal cross-holdings in common equity	-	-
18	Investments in the capital of banking, financial, insurance and takaful entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)	-	-
19	Significant investments in the common stock of	-	-
20	Mortgage Servicing rights (amount above 10% threshold)	-	-
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)	-	-

22	Amount exceeding the 15% threshold	-	-
23	of which: significant investments in the common stock of financials	-	-
24	of which: mortgage servicing rights	-	-
25	of which: deferred tax assets arising from temporary differences	-	-
26	National specific regulatory adjustments	-	-
	REGULATORY ADJUSTMENTS APPLIED TO COMMON EQUITY TIER 1 IN RESPECT OF AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT	-	-
27	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions	(2,279)	(2,279)
28	**Total regulatory adjustments to Common equity Tier 1**	**(11,391)**	
29	**Common Equity Tier 1 capital (CET1)**	**295,046**	
Additional Tier 1 capital: instruments			
30	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus	-	
31	of which: classified as equity under applicable accounting standards [5]	-	
32	of which: classified as liabilities under applicable accounting standards [6]	-	
33	*Directly issued capital instruments subject to phase out from Additional Tier* [1]	-	
34	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)	-	
35	*of which: instruments issued by subsidiaries subject to phase out*	-	
36	**Additional Tier 1 capital before regulatory adjustments**	-	
	Additional Tier 1 capital: regulatory adjustments		
37	Investments in own Additional Tier 1 instruments	-	-
38	Reciprocal cross-holdings in Additional Tier 1 instruments	-	-
39	Investments in the capital of banking, financial, insurance and takaful entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)	-	-
40	Significant investments in the capital of banking, financial, insurance and takaful entities that are outside the scope of regulatory consolidation (net of eligible short positions)	-	-
41	National specific regulatory adjustments	-	-
	REGULATORY ADJUSTMENTS APPLIED TO ADDITIONAL TIER 1 IN RESPECT OF AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT	-	-
	OF WHICH*:* Prudential valuation adjustments	-	-
	OF WHICH : Other intangibles other than mortgage-servicing rights (net of related tax liability)	-	-
	OF WHICH*:* Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	-	-

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

For the year ended 31 December 2016

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)**	**295,046**	
	Tier 2 capital: instruments and provisions		
46	Directly issued qualifying Tier 2 instruments plus related stock surplus	-	
47	*Directly issued capital instruments subject to phase out from Tier 2*	-	
48	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)	-	
49	*of which: instruments issued by subsidiaries subject to phase out*	-	
50	Provisions *(General loan loss provision and Cumulative fair value gain on AFS investments)*	18,640	
51	**Tier 2 capital before regulatory adjustments**	**18,640**	
	Tier 2 capital: regulatory adjustments	-	
52	Investments in own Tier 2 instruments	-	
53	Reciprocal cross-holdings in Tier 2 instruments	-	
54	Investments in the capital of banking, financial, insurance and takaful entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above the 10% threshold)	-	
55	Significant investments in the capital banking, financial, insurance and takaful entities that are outside the scope of regulatory consolidation (net of eligible short positions)	-	
56	National specific regulatory adjustments		
	REGULATORY ADJUSTMENTS APPLIED TO TIER 2 IN RESPECT OF AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT.		
	OF WHICH: [INSERT NAME OF ADJUSTMENT]		
	OF WHICH: [INSERT NAME OF ADJUSTMENT]		
	OF WHICH: [INSERT NAME OF ADJUSTMENT]		
57	**Total regulatory adjustments to Tier 2 capital**		
58	**Tier 2 capital (T2)**	**18,640**	
59	**Total capital (TC = T1 + T2)**	**313,686**	
	RISK WEIGHTED ASSETS IN RESPECT OF AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT		
	OF WHICH: [INSERT NAME OFADJUSTMENT]		
	OF WHICH…..		
60	**Total risk weighted assets (60a+60b+60c)**	**1,679,450**	
60a	*Of which: Credit risk weighted assets*	1,510,638	
60b	*Of which: Market risk weighted assets*	17,332	
60c	*Of which: Operational risk weighted assets*	151,480	

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)
For the year ended 31 December 2016

Capital Ratios			
61	**Common Equity Tier 1 (as a percentage of risk weighted assets)**	**17.57%**	
62	**Tier 1 (as a percentage of risk weighted assets)**	**17.57%**	
63	**Total capital (as a percentage of risk weighted assets)**	**18.68%**	
64	Institution specific buffer requirement (minimum CET1 requirement plus capital conservation buffer plus countercyclical buffer requirements plus G-SIB/D-SIB buffer requirement expressed as a percentage of risk weighted assets)	-	
65	*of which: capital conservation buffer requirement*	-	
66	*of which: bank specific countercyclical buffer requirement*	-	
67	*of which: D-SIB/G-SIB buffer requirement*	-	
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets	-	
National minima (if different from Basel III)			
69	National Common Equity Tier 1 minimum ratio (if different from Basel 3 minimum)	-	
70	National Tier 1 minimum ratio (if different from Basel 3 minimum)	-	
71	National total capital minimum ratio (if different from Basel 3 minimum)	-	
	Amounts below the thresholds for deduction (before risk weighting)		
72	Non-significant investments in the capital of other financials	-	
73	Significant investments in the common stock of financials	-	
74	Mortgage servicing rights (net of related tax liability)	-	
75	Deferred tax assets arising from temporary differences (net of related tax liability)	-	
Applicable caps on the inclusion of provisions in Tier 2			
76	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	-	
77	Cap on inclusion of provisions in Tier 2 under standardised approach	-	
78	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap)	-	
79	Cap for inclusion of provisions in Tier 2 under internal ratings-based approach	-	
	Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2018 and 1 Jan 2022)		
80	*Current cap on CET1* instruments *subject to phase out arrangements*	-	
81	*Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)*	-	
82	*Current cap on AT1 instruments subject to phase out arrangements*	-	
83	*Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)*	-	
84	*Current cap on T2 instruments subject to phase out arrangements*	-	
85	*Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)*	-	

Statutory Disclosure under Basel II - Pillar III and Basel III Framework (continued)
For the year ended 31 December 2016

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 As at 31.12.2016	Under regulatory scope of consolidation As at 31.12.2016	Reference
Assets			
Cash and balances with CBO	284,947	284,947	
Balance with banks and money at call and short notice	80,222	80,222	
Investments :			
Of which Held to Maturity	-	-	
Out of investments in Held to Maturity:	-	-	
Investments in subsidiaries	-	-	
Investments in Associates and Joint Ventures	-	-	
Available for Sale Of which:	412,969	412,969	
Investments in Subsidiaries	-	-	
Investments in Associates and Joint Ventures	-	-	
Held for Trading	-	-	
Loans and advances of which :	1,500,737	1,500,737	
Loans and advances to domestic banks	-	-	
Loans and advances to non-resident banks	-	-	
Loans and advances to domestic customers	-	1,382,407	
Loans and advances to non-resident customers for domestic operations	-	-	
Loans and advances to non-resident customers for operations abroad	-	108,006	
Loans and advances to SMEs	-	10,324	
Financing from Islamic banking window	-	-	
Provision against Loans and advances of which:	**(82,322)**	**(82,322)**	
Provision for Loan impairment - Specific	(26,508)	(26,508)	
Provision for Loan impairment – general	(18,604)	(18,604)	
Reserve Interest	(37,210)	(37,210)	
Fixed assets	26,504	26,504	
Other assets of which:	30,836	30,836	

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

For the year ended 31 December 2016

	Balance sheet as in published financial statements As at 31.12.2016	Under regulatory scope of consolidation As at 31.12.2016	Reference
Goodwill and intangible assets Out of which:			
goodwill			**a**
Other intangibles (excluding MSRs)	5,524	5,524	**b**
Deferred tax assets	2,013	2,013	
Goodwill on consolidation			
Debit balance in Profit & Loss account			
Total Assets	**2,253,893**	**2,253,893**	
Capital & Liabilities			
Paid-up Capital Of which:			
Amount eligible for CET1	200,031	200,031	**h**
Amount eligible for AT1	-	-	**i**
Reserves & Surplus	113,679	113,679	
Total Capital	**313,710**	**313,710**	
Deposits Of which:			
Deposits from banks	37,426	30,037	
Customer deposits	1,866,655	1,866,655	
Deposits of Islamic Banking window	-	-	
Other deposits(please specify)	-	-	
Borrowings Of which:	7,389	7,389	
From CBO	-	-	
From banks	7,389	7,389	
From other institutions & agencies	-	-	
Borrowings in the form of bonds, Debentures and sukuks	-	-	
Others (Please specify)	-	-	
Other liabilities & provisions Of which:	36,102	36,102	
DTLs related to goodwill	-	-	**c**
DTLs related to intangible assets	-	-	**d**
TOTAL	**2,253,893**	**2,253,893**	

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

For the year ended 31 December 2016

Step 3

Common Equity Tier 1 capital: instruments and reserves			
		Component of regulatory capital reported by bank	**Source based on reference numbers/letters of the balance sheet under the regulatory scope of consolidation from step 2**
1	Directly issued qualifying common share (and equivalent for non- joint stock companies) capital plus related stock surplus	200,031	**h**
2	Retained earnings	68,439	
3	Accumulated other comprehensive income (and other reserves)	37,967	
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**	**306,437**	
7	Prudential valuation adjustments	(3,083)	
8	Goodwill (net of related tax liability)	-	**(a-c)**
9	Other intangibles other than mortgage-servicing rights (net of related tax liability)	(4,419)	
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	(1,610)	
11	Regulatory adjustments applied to Common Equity Tier 1 and Tier 2 to cover deductions	(2,279)	
	Common Equity Tier 1 capital (CET1)	**295,046**	

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

For the year ended 31 December 2016

Annexure III

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

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 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

What we have audited

The Bank's financial statements comprise:

- the statement of financial position as at 31 December 2016;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

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

Independence

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements that are relevant to our audit of the financial statements in the Sultanate of Oman. We have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Our audit approach

Overview

Key audit matters	• Impairment of loans and advances to customers • Access to technology: operating systems, applications and data • Impact of the deferred prosecution agreement (DPA) and affiliated risk programme

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we considered where the directors made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

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

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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.

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

Key audit matter	How our audit addressed the key audit matter
Access to technology: operating systems, applications and data All banks are highly dependent on technology due to the significant number of transactions that are processed daily. The audit approach relies extensively on automated controls and therefore procedures are designed to test access and control over IT systems. Access rights are important as they ensure that changes to applications and data are authorised and made in an appropriate manner. Ensuring staff have only appropriate access, and that the access is monitored, are key controls to mitigate the potential for fraud or error as a result of a change to an application or underlying data. In 2015, it was identified that controls over individuals' access rights to operating systems and applications required improvement in relation to certain key HSBC Group systems used by the Bank in Oman. A number of enhancements to the control environment have been made by management during the year, but certain weaknesses in the access controls were not fully remediated and validated by the year end.	The planned approach to address the significant risk was presented to the Audit Committee by us, outlining the additional control and substantive procedures required to obtain evidence that access controls to databases, operating systems and applications were effective in mitigating the potential for fraud or error as a result of a change to an application or underlying data. At the Audit Committee meeting there was a discussion on the status of the control remediation programme and the work performed by management. The audit team outlined changes to the planned approach to mitigate risks where controls had not been fully remediated during the audit period. Specific procedures were designed to address controls that had not yet been fully remediated or when the remediation did not cover the full audit period. The procedures performed by the audit team to support our discussions and conclusions included the following: Access rights were tested over the various aspects of technology relied upon for financial reporting, including the following: • new access requests for joiners were properly reviewed and authorised; • application user access rights were removed on a timely basis when an individual left or moved role; • access rights to applications were periodically monitored for appropriateness; and • highly privileged access is restricted to appropriate personnel. Other areas that were independently assessed by the audit team included password policies, security configurations, controls over changes to applications and databases and that business users, developers and production support did not have access to change applications, the operating system or databases in the production environment. As a consequence of the deficiencies, the following additional procedures were performed: • Where inappropriate access was identified, we understood the nature of the access and, where possible, obtained additional evidence on the appropriateness of the activities performed; • Additional substantive testing was performed on specific year-end balances and confirmations were sent to external counterparties; • Testing was performed on other compensating controls; and • Segregation of duties risk was assessed, taking into account mitigating controls, and additional work was performed where segregation of duties was deemed to be of higher risk. The work was completed to our satisfaction and our final conclusions were presented and discussed with senior management and the Audit Committee.

Key audit matter	How our audit addressed the key audit matter
Impact of the deferred prosecution agreement (DPA) and affiliated risk programme In 2012, HSBC Holdings plc and HSBC Bank USA NA (HBUS) entered into a DPA with the US Department of Justice (DoJ) and UK Financial Conduct Authority regarding non-compliance with the US Bank Secrecy Act, anti-money laundering rules, and sanctions laws. The duration of the DPA is five years. If the DOJ were to conclude in the remaining period of the DPA that a breach had occurred, there are a number of potential penalties that could be imposed that could have a material adverse effect on HSBC Group's business. This could have some impact on all HSBC affiliates' businesses, including HSBC Bank Oman. One theoretical consequence of this might be to require HSBC Bank Oman to find an alternative US $ clearing provider. The DPA required HBUS to treat HSBC affiliates as third parties. Under the affiliate programme HBUS is required to perform a review of all HSBC affiliates. Control deficiencies identified by HBUS after performing this exercise require urgent remediation by the affiliate. If the affiliate does not remediate the identified deficiencies it could result in curtailment of USD currency clearing services for them.	The audit team held meetings with the Bank's Risk, Financial Crime Compliance ('FCC'), Compliance and Legal teams to discuss the status of the Global Standards programme, which aims to address all of the DPA recommendations, and the affiliate risk programme. The likelihood of the DPA being breached was independently assessed by the HSBC Group audit team. The result of their assessment was shared with us. During 2016, HSBC Bank Oman has been engaged in the affiliate risk review process. We have discussed with senior management and the Audit Committee the progress of this exercise. Management have informed us that HSBC Bank Oman have been in compliance with the requirements arising out of this exercise and that they are on track in relation to the agreed timelines for any remediation suggested by HBUS.

Other information

The directors are responsible for the other information. The other information which we obtained prior to the date of our auditors report comprises of:

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

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

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

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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

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

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

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

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

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by 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.

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

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

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

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

Report on other legal and regulatory requirements

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

PricewaterhouseCoopers

Kashif Kalam

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C.R. No 1230865
PricewaterhouseCoopers LLC

Muscat, Sultanate of Oman
5 March 2017

Statement of comprehensive income
for the year ended 31 December

2015 US$'000	2016 US$'000		Notes	2016 RO'000	2015 RO'000
145,603	**160,696**	Interest income	**3(a)**	**61,868**	56,057
(17,904)	**(19,745)**	Interest expense	**3(b)**	**(7,602)**	(6,893)
127,699	**140,951**	**Net interest income**		**54,266**	49,164
39,114	**38,808**	Fee income		**14,941**	15,059
(6,618)	**(6,829)**	Fee expense		**(2,629)**	(2,548)
32,496	**31,979**	**Net fee income**		**12,312**	12,511
18,190	**20,195**	Net trading income		**7,775**	7,003
974	**574**	Dividend income		**221**	375
11,642	**1,629**	Other operating income	**4**	**627**	4,482
191,001	**195,328**	**Net operating income before loan impairment charges and other credit risk provisions**		**75,201**	73,535
(8,919)	**(14,662)**	Loan impairment charges and other credit risk provisions - net of recoveries	**5**	**(5,645)**	(3,434)
182,082	**180,666**	**Net operating income**		**69,556**	70,101
(136,247)	**(119,691)**	Operating expenses	**6**	**(46,081)**	(52,455)
(5,935)	**(5,935)**	Amortisation of intangible assets	**7**	**(2,285)**	(2,285)
(142,182)	**(125,626)**	**Total operating expenses**		**(48,366)**	(54,740)
39,900	**55,040**	**Profit before tax**		**21,190**	15,361
(6,314)	**(11,145)**	Tax expense	**8**	**(4,291)**	(2,431)
33,586	**43,895**	**Profit for the year**		**16,899**	12,930
		Other comprehensive income/(loss)			
		Items that will be reclassified subsequently to profit or loss when specific conditions are met			
		Available-for-sale investments			
1,218	**(10,748)**	- Fair value (loss) / gain	**12**	**(4,138)**	469
(11,597)	**(639)**	- Fair value gain reclassified to profit or loss on disposal		**(246)**	(4,465)
57	**145**	- Amount reclassified to profit or loss in respect of impairment	**4**	**56**	22
1,195	**1,341**	- Income tax	**8**	**516**	460
(9,127)	**(9,901)**			**(3,812)**	(3,514)
		Exchange differences			
1,291	**-**	- Foreign exchange loss reclassified to profit or loss on disposal of India and Pakistan operations		**-**	497
96	**-**	- Effect of currency translation		**-**	37
1,387	**-**			**-**	534
		Items that will not be reclassified subsequently to profit or loss			
(744)	**(351)**	Remeasurement of defined benefit liability	**18(a)**	**(135)**	(287)
(8,484)	**(10,252)**	**Other comprehensive loss for the period - net of tax**		**(3,947)**	(3,267)
25,102	**33,643**	**Total comprehensive income for the year**		**12,952**	9,663
US$0.016	**US$0.022**	**Earnings per share – basic and diluted**	**9(a)**	**RO0.008**	RO0.006

The accompanying notes on pages 63 to 105 form an integral part of these financial statements.

Statement of financial position
as at 31 December

2015 US$'000	2016 US$'000		Notes	2016 RO'000	2015 RO'000
		Assets			
721,392	**740,122**	Cash and balances with central bank	**10(a)**	**284,947**	277,736
26,678	**208,369**	Due from banks	**10(b)**	**80,222**	10,271
3,118,982	**3,684,195**	Loans and advances to customers - net	**11**	**1,418,415**	1,200,808
1,643,948	**1,072,647**	Financial investments	**12**	**412,969**	632,920
109,063	**60,516**	Other assets	**13**	**23,299**	41,989
20,283	**14,348**	Intangible assets	**14**	**5,524**	7,809
69,914	**68,842**	Property and equipment	**15**	**26,504**	26,917
3,876	**5,229**	Deferred tax assets	**8**	**2,013**	1,492
5,714,136	**5,854,268**	**Total assets**		**2,253,893**	2,199,942
		Liabilities and equity			
		Liabilities			
94,055	**97,210**	Due to banks	**16**	**37,426**	36,211
4,681,397	**4,848,455**	Deposits from customers	**17**	**1,866,655**	1,802,338
130,317	**77,977**	Other liabilities	**18**	**30,021**	50,172
6,086	**15,795**	Current tax liabilities	**8**	**6,081**	2,343
940	**-**	Deferred tax liabilities	**8**	**-**	362
4,912,795	**5,039,437**	**Total liabilities**		**1,940,183**	1,891,426
		Equity			
519,561	**519,561**	Share capital	**19**	**200,031**	200,031
94,227	**98,616**	Legal reserve	**20(a)**	**37,967**	36,277
2,813	**(7,088)**	Available-for-sale fair value reserve	**20(b)**	**(2,729)**	1,083
184,740	**203,742**	Retained earnings		**78,441**	71,125
801,341	**814,831**	**Net equity**		**313,710**	308,516
5,714,136	**5,854,268**	**Total equity and liabilities**		**2,253,893**	2,199,942
US$0.401	**US$0.407**	**Net assets per share**	**9(b)**	**RO0.157**	RO0.154
		Off-balance sheet items:			
		Contingent liabilities and other commitments			
179,426	**137,600**	- Documentary credits		**52,976**	69,079
956,010	**925,774**	- Guarantees and performance bonds		**356,423**	368,064
2,922,691	**2,347,166**	- Others		**903,659**	1,051,974
4,058,127	**3,410,540**		**21(a)**	**1,313,058**	1,489,117

The accompanying notes on pages 63 to 105 form an integral part of these financial statements.

The financial statements were authorised for issue on 5 March, 2017 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 2016

	Share capital	Legal reserve	Statutory reserve	Available-for-sale fair value reserve	Foreign exchange reserve	Retained earnings	Total
	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
At 1 January 2015	200,031	34,984	1,446	4,597	(497)	69,316	309,877
Total comprehensive income for the year							
Profit for the year	-	-	-	-	-	12,930	12,930
Other comprehensive income / (loss) for the year							
Effect of currency translation	-	-	23	-	-	14	37
Foreign exchange loss reclassified to profit or loss on disposal of India and Pakistan operations	-	-	-	-	497	-	497
Net movement in fair value of available-for-sale investments (net of tax)	-	-	-	(3,514)	-	-	(3,514)
Remeasurement of defined benefit liability	-	-	-	-	-	(287)	(287)
Total other comprehensive income / (loss) for the year	-	-	23	(3,514)	497	(273)	(3,267)
Total comprehensive income / (loss) for the year	-	-	23	(3,514)	497	12,657	9,663
Transfer to retained profits on sale of India operations	-	-	(1,469)	-	-	1,469	-
Transfer to legal reserve	-	1,293	-	-	-	(1,293)	-
Transaction with shareholders, recorded directly in equity							
Dividend paid for 2014	-	-	-	-	-	(11,024)	(11,024)
At 31 December 2015	200,031	36,277	-	1,083	-	71,125	308,516
Total comprehensive income for the year							
Profit for the year	-	-	-	-	-	**16,899**	**16,899**
Other comprehensive loss for the year							
Net movement in fair value of available-for-sale investments (net of tax)	-	-	-	**(3,812)**	-	-	**(3,812)**
Remeasurement of defined benefit liability	-	-	-	-	-	**(135)**	**(135)**
Total other comprehensive loss for the year	-	-	-	**(3,812)**	-	**(135)**	**(3,947)**
Total comprehensive (loss) / income for the year	-	-	-	**(3,812)**	-	**16,764**	**12,952**
Transfer to legal reserve	-	**1,690**	-	-	-	**(1,690)**	-
Transaction with shareholders, recorded directly in equity							
Dividend paid for 2015	-	-	-	-	-	**(7,758)**	**(7,758)**
At 31 December 2016	**200,031**	**37,967**	-	**(2,729)**	-	**78,441**	**313,710**
At 31 December 2016 (USD 000's)	**519,561**	**98,616**	-	**(7,088)**	-	**203,742**	**814,831**
At 31 December 2015 (USD 000's)	519,561	94,227	-	2,813	-	184,740	801,341

The accompanying notes on pages 63 to 105 form an integral part of these financial statements.

Statement of cash flows

for the year ended 31 December 2016

2015 US$'000	2016 US$'000		Notes	2016 RO'000	2015 RO'000
		Cash flows from operating activities			
39,900	**55,040**	Profit before tax		**21,190**	15,361
		Adjustments for:			
8,919	**14,662**	– Loan impairment charges and other credit risk provisions – net of recoveries		**5,645**	3,434
4,865	**4,429**	– Depreciation of property and equipment		**1,705**	1,873
257	**-**	– Property and equipment written off		**-**	99
5,935	**5,935**	– Amortisation of intangible assets		**2,285**	2,285
(11,974)	**(1,325)**	– Net gain on sale of financial investments		**(510)**	(4,610)
(577)	**(4,946)**	– Amortisation and impairment of financial investment		**(1,904)**	(222)
(171)	**-**	– Gain on sale of property and equipment		**-**	(66)
(2,117)	**-**	– Gain on sale of India operations		**-**	(815)
3,049	**-**	– Loss on sale of Pakistan operations		**-**	1,174
330	**449**	– Employer's current service cost with interest		**173**	127
257	**213**	– Finance lease charge		**82**	99
1,426	**473**	– Effect of currency translation		**182**	549
		– change in operating assets			
(111,610)	**(579,875)**	change in loans and advances to customers-net		**(223,252)**	(42,970)
(15,368)	**48,547**	change in other assets		**18,690**	(5,917)
		– change in operating liabilities	**28**		
(109,870)	**167,058**	change in deposits from customers		**64,317**	(42,300)
6,054	**(51,351)**	change in other liabilities		**(19,770)**	2,331
(2,377)	**(2,390)**	– Tax paid (note 8)		**(920)**	(915)
(574)	**(491)**	– Retirement benefits paid		**(189)**	(221)
(183,646)	**(343,572)**	**Net cash used in operating activities**		**(132,276)**	(70,704)
		Cash flows from investing activities			
(10,487,584)	**(4,006,483)**	Purchase of financial investments		**(1,542,496)**	(4,037,720)
10,571,604	**4,572,340**	Proceeds from maturity of financial investments		**1,760,351**	4,070,068
(4,787)	**(3,356)**	Purchase of property and equipment		**(1,292)**	(1,843)
1,927	**-**	Proceeds from sale of property and equipment		**-**	742
(6,608)	**-**	Cash out flow from sale of India operation, net of cash and cash equivalents		**-**	(2,544)
37,145	**-**	Cash flow from sale of Pakistan operation, net of cash and cash equivalents		**-**	14,301
111,697	**562,501**	**Net cash generated from investing activities**		**216,563**	43,004
		Cash flows from financing activities			
(28,634)	**(20,151)**	Dividends paid		**(7,758)**	(11,024)
(748)	**(1,511)**	Finance leases paid		**(582)**	(288)
(29,382)	**(21,662)**	**Net cash used in financing activities**		**(8,340)**	(11,312)
(101,331)	**197,267**	**Net change in cash and cash equivalents**		**75,947**	(39,012)
755,345	**654,014**	Cash and cash equivalents at the beginning of the year		**251,796**	290,808
654,014	**851,281**	**Cash and cash equivalents at the end of the year**	**25**	**327,743**	251,796

The accompanying notes on pages 63 to 105 form an integral part of these financial statements.

Notes to the Financial Statements
As of 31 December 2016

1 Legal status and principal activities

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

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

2 Summary of significant accounting policies

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

2.1 Basis of preparation

(a) Statement of compliance

The financial statements of the Bank at 31 December 2016 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"), Central Bank of Oman ("CBO") and Commercial Companies Law of 1974, as amended.

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

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

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

(b) Functional and presentation currency

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

(c) Use of estimates and assumptions

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

(d) Standards applicable during the year

There are no standards, interpretations or amendments to existing standards that are effective for the first time for the financial year beginning on 1 January 2016 which have a material impact on the financial statements of the Bank.

(e) Future accounting developments

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning on or after 1 January 2017. None of these are expected to have a significant effect on the financial statements of the Bank except for the following set out below:

IFRS 9 'Financial Instruments'

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

Classification and measurement

The classification and measurement of financial assets will depend on how these are

Notes to the Financial Statements (continued)

As of 31 December 2016

2 Summary of significant accounting policies *(continued)*

2.1 Basis of preparation *(continued)*

(e) Future accounting developments (continued)

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

For financial liabilities designated to be measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in other comprehensive income.

Impairment

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

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

Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks, but do not explicitly address macro hedge accounting strategies, which are particularly important for banks. As a result, IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting.

The mandatory application date for the standard as a whole is 1 January 2018, but it is possible to apply the revised presentation for certain liabilities measured at fair value from an earlier date. The Bank is currently assessing the impact IFRS 9 will have on the financial statements but due to the complexity of the classification and measurement, impairment, and hedge accounting requirements and their inter-relationship, it is not possible at this stage to quantify the potential impact as at the date of the approval of these financial statements.

IFRS 15 'Revenue from Contracts with Customers'

In May 2014, the IASB issued IFRS 15 'Revenue from Contracts with Customers'. The original effective date of IFRS 15 has been delayed by one year and the standard is now effective for annual periods beginning on or after 1 January 2018 with early application permitted. IFRS 15 provides a principles-

2 Summary of significant accounting policies *(continued)*

2.1 Basis of preparation *(continued)*

(e) Future accounting developments (continued)

based approach for revenue recognition, and introduces the concept of recognising revenue for performance obligations as they are satisfied. The standard should be applied retrospectively, with certain practical expedients available. The Bank is currently assessing the impact of this standard but it is not possible to quantify the potential impact at the date of approval of these financial statements.

IFRS 16 'Leases'

In January 2016, the IASB issued IFRS 16 'Leases' with an effective date of annual periods beginning on or after 1 January 2019. IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under IAS 17 'Leases'. Lessees will recognise a 'right of use' asset and a corresponding financial liability on the statement of financial position. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as in IAS 17. The Bank is currently assessing the impact of this standard but it is not possible to quantify the potential impact as at the date of approval of these financial statements.

2.2 Foreign currency transactions and balances

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

2.3 Financial instruments

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

2.3.1 Reclassification of financial assets

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

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

2 Summary of significant accounting policies *(continued)*

2.3 Financial instruments *(continued)*

2.3.1 Reclassification of financial assets (continued)

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

2.3.2 Loans and advances to banks and customers

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

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

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

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

2.3.3 Available-for-sale financial assets

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

Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. They

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

2.3 Financial instruments *(continued)*

2.3.3 Available-for-sale financial assets (continued)

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

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

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

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

Impairment losses for available-for-sale debt securities are recognised within 'Loan impairment charges and other credit risk provisions' in the statement of comprehensive income and impairment losses for available-for-sale equity securities are recognised within 'Gains or losses from financial investments' in the statement of comprehensive income. The impairment methodologies for available-for-sale financial assets are set out in more detail below:

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

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

   A significant or prolonged decline in the fair value of the asset below its cost is also an objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against

Notes to the Financial Statements (continued)

As of 31 December 2016

2 Summary of significant accounting policies *(continued)*

2.3 Financial instruments *(continued)*

2.3.3 Available-for-sale financial assets (continued)

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, otherwise, any increase in fair value is recognised in other comprehensive income.

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

2.3.4 Fair value hierarchy

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

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

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

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

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like interest rate swaps and forward foreign exchange contracts that use only observable market data and require little management

2 Summary of significant accounting policies *(continued)*

2.3 Financial instruments *(continued)*

2.3.4 Fair value hierarchy (continued)

judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps.

2.4 Derivative financial instruments and hedge accounting

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Hedge accounting

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

Fair value hedge

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

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

2.5 Cash and cash equivalents

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

2.6 Money market placements

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

2.7 Derecognition

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

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

2.8 Offsetting

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

2 Summary of significant accounting policies *(continued)*

2.9 Impairment - loans and advances

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

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

When a loan is known to be uncollectible, all the necessary legal procedures have been completed, and the final loss has been determined, the loan is written off directly. The expected cash flows for portfolios of similar assets are estimated based on previous experience and considering the credit rating of the underlying customers and late payments of interest or penalties.

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

2.10 Property and equipment

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

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

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

2.11 Finance and operating lease

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

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

All other leases are classified as operating leases. When acting as lessor, the Bank includes the assets subject to operating leases in 'Property and equipment' and accounts

2 Summary of significant accounting policies *(continued)*

2.11 Finance and operating lease *(continued)*

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

2.12 Intangible assets

Intangible assets are recognised separately from goodwill when they are separable or arise from contractual or other legal rights, and their fair value can be measured reliably.

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

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

Core deposits	7 years
Customer relationships	7 years

Amortisation method, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate. The remaining life of intangible assets is 2.5 years as at 31 December 2016.

2.13 Provisions

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

2.14 Other payables

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

2.15 Revenue recognition

2.15.1 Interest income and expense

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

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

2.15.2 Non-interest income

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

Notes to the Financial Statements (continued)
As of 31 December 2016

2 Summary of significant accounting policies *(continued)*

2.15 Revenue recognition *(continued)*

2.15.2 Non-interest income *(continued)*

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

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

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders have approved the dividend for unlisted equity securities.

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

2.16 Taxation

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

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

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

2.17 Employee terminal benefits

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

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

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

Notes to the Financial Statements (continued)
As of 31 December 2016

2 Summary of significant accounting policies *(continued)*

2.17 Employee terminal benefits *(continued)*

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

2.18 Operating segment reporting

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

3 Net interest income

	2016 RO'000	2015 RO'000
3(a) Interest income		
Loans and advances to customers	**56,279**	51,872
Financial investments	**4,559**	2,570
Due from banks	**238**	510
Other	**792**	1,105
	61,868	56,057
3(b) Interest expense		
Deposits from customers	**(7,597)**	(6,591)
Due to banks	**(5)**	(302)
	(7,602)	(6,893)
Net interest income	**54,266**	49,164

4 Other operating income

	2016 RO'000	2015 RO'000
Gains on sale of financial investments - net	**510**	4,610
Gain on sale of India operations	**-**	815
Gain on sale of property and equipment	**-**	66
Loss on sale of Pakistan operations	**-**	(1,174)
Impairment of available-for-sale equity securities	**(56)**	(22)
Other income	**173**	187
	627	4,482

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

	2016 RO'000	2015 RO'000
Provided during the year – specific (note 11)	**(8,495)**	(7,483)
Provided during the year – general (note 11)	**(2,169)**	(558)
Written-off loans recovered	**1,943**	2,205
Provisions released during the year (note 11)	**3,356**	1,856
Adjustments as a result of fair value unwind	**349**	770
Reserved interest released	**36**	298
Bad debts directly written off to the statement of comprehensive income	**(665)**	(522)
	(5,645)	(3,434)

Notes to the Financial Statements (continued)
As of 31 December 2016

6 Operating expenses

	2016 RO'000	2015 RO'000
Employee compensation and benefits		
Wages and salaries	**(16,786)**	(17,462)
Social security costs	**(1,416)**	(1,475)
Post-employment benefits	**(237)**	(199)
Other employee benefits	**(4,377)**	(4,830)
	(22,816)	(23,966)
Depreciation of property and equipment (note 15)	**(1,705)**	(1,873)
Marketing and advertising*	**(1,872)**	(2,277)
Premises and equipment	**(4,042)**	(4,971)
Communications	**(638)**	(986)
Insurance	**(1,007)**	(1,237)
Other administrative expenses	**(14,001)**	(17,145)
	(46,081)	(52,455)

*Marketing and advertising expenses for the current year include RO1.1m (December 2015 : RO1.2m) of "Mandoos Prize" draw expenses.

7 Amortisation of intangible assets

	2016 RO'000	2015 RO'000
Core deposits	**(1,758)**	(1,758)
Customer relationships	**(527)**	(527)
	(2,285)	(2,285)

8 Taxation

	2016 RO'000	2015 RO'000
Statement of comprehensive income:		
Current tax:		
- Current year	**(3,148)**	(2,173)
- Prior years	**(1,287)**	1,277
Deferred tax	**144**	(1,535)
	(4,291)	(2,431)
Statement of other comprehensive income:		
Deferred tax	**516**	460

Tax reconciliation

	2016 RO'000	2015 RO'000
Profit before tax	**21,190**	15,361
Tax expenses at 12% on accounting profit before tax	**(2,543)**	(1,843)
Add / (less) tax effect of:		
Non-taxable income and gains	**81**	49
Permanent disallowed expenses	**(542)**	(1,914)
Adjustments in respect of prior periods	**(1,287)**	1,277
Tax charge as per the statement of comprehensive income	**(4,291)**	(2,431)

Notes to the Financial Statements (continued)
As of 31 December 2016

8 Taxation *(continued)*

Movement of current tax liability

	2016 RO'000	2015 RO'000
At 1 January	**2,343**	2,368
- Current year charge	**3,148**	2,173
- Prior year charge / (release)	**1,287**	(1,277)
- Paid during the year	**(920)**	(915)
- Other transfers	**223**	(6)
At 31 December	**6,081**	2,343

Movement of net deferred tax assets before offsetting

	Loan impairment allowances	Available-for-sale investments	Revaluation of property	Others*	Total
Assets	**1,401**	**-**	**-**	**91**	**1,492**
Liabilities	**-**	**(362)**	**-**	**-**	**(362)**
At 1 January 2016	**1,401**	**(362)**	**-**	**91**	**1,130**
Income statement	**141**	**-**	**-**	**3**	**144**
Other comprehensive income:					
- available-for-sale investment	**-**	**516**	**-**	**-**	**516**
Other transfers	**-**	**223**	**-**	**-**	**223**
Assets - at 31 December 2016	**1,542**	**377**	**-**	**94**	**2,013**
Assets	2,703	-	-	323	3,026
Liabilities	-	(822)	(269)	(37)	(1,128)
At 1 January 2015	2,703	(822)	(269)	286	1,898
Movement due to sale of India operations	-	-	269	38	307
Income statement	(1,302)	-	-	(233)	(1,535)
Other comprehensive income:					
- available-for-sale investment	-	460	-	-	460
	1,401	(362)	-	91	1,130
Assets	1,401	-	-	91	1,492
Liabilities	-	(362)	-	-	(362)
At 31 December 2015	1,401	(362)	-	91	1,130

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

The tax assessments of the HSBC Oman Branches have been completed upto the year 2011 and the tax assessments of Oman International Bank SAOG (OIB) have been completed by the Secretariat General for Taxation (SGT) up to 2011. The SGT has taken up the assessment for the year 2012.

The tax rate applicable to the Bank in Oman is 12% (2015: 12%). For the purpose of determining the tax expense for the year, the accounting profit has been adjusted for tax purposes. After giving effect to these adjustments, the average effective tax rate is 20.3% (2015: 15.8%).

Notes to the Financial Statements (continued)

As of 31 December 2016

8 Taxation *(continued)*

The difference between the applicable tax rates of 12% and the effective tax rate of 20.3% arises mainly due to certain expenses considered to be disallowed for tax provisioning purposes were allowed as a tax deduction by the SGT and tax effect of certain expenses considered to be disallowed for tax provisioning purposes for open years on the basis of prior years assessments. The adjustments are based on the current understanding of the existing laws, regulations and practices.

Deferred tax asset has been computed at the tax rate of 12% (2015: 12%).

9(a) Earnings per share – basic and diluted

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

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

	2016	2015
Weighted average number of shares in issue (Number ‘000)	**2,000,312**	2,000,312
Profit for the year (RO’000)	**16,899**	12,930
Earnings per share – basic and diluted (RO)	**0.008**	0.006

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.

	2016	2015
Number of shares in issue (Number ‘000)	**2,000,312**	2,000,312
Net assets (RO’000)	**313,710**	308,516
Net assets per share (RO)	**0.157**	0.154

10(a) Cash and balances with central bank

	2016	2015
	RO’000	RO’000
Cash in hand	**34,180**	44,505
Balance held with central bank	**250,767**	233,231
	284,947	277,736

10(b) Due from banks

	2016	2015
	RO’000	RO’000
Placements	**70,041**	8,317
Nostro balances	**10,181**	1,954
	80,222	10,271

Notes to the Financial Statements (continued)
As of 31 December 2016

11 Loans and advances to customers - net

	2016	2015
	RO'000	RO'000
Overdrafts	**63,745**	66,130
Credit cards	**23,543**	17,880
Loans	**1,145,680**	1,078,106
Clean import loans	**258,076**	108,554
Bills discounted/purchased	**9,693**	13,394
Gross loans and advances	**1,500,737**	1,284,064
Provision for loan impairment – specific	**(26,508)**	(28,380)
Provision for loan impairment – general*	**(18,604)**	(16,435)
Reserved interest*	**(37,210)**	(38,441)
Loans and advances (net)	**1,418,415**	1,200,808

*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.

Provision for loan impairment and reserved interest:

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

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

The movement on provision for loan impairment for the year ended 31 December 2015 is analysed in the table below:

	Specific provision RO'000	General provision RO'000	Total provision RO'000
Balance at 1 January 2015	36,192	15,880	52,072
Currency translation effect on opening balance	(34)	-	(34)
Movement due to sale of India and Pakistan operations	(758)	(3)	(761)
Provided during the year (note 5)	7,483	558	8,041
Provision released during the year (note 5)	(1,856)	-	(1,856)
Written off during the year	(12,647)	-	(12,647)
Balance at 31 December 2015	28,380	16,435	44,815

Notes to the Financial Statements (continued)
As of 31 December 2016

11 Loans and advances to customers - net *(continued)*

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

	2016 RO'000	2015 RO'000
Balance at 1 January 2016	**38,441**	47,774
Currency translation effect on opening balance	**-**	(5)
Movement due to sale of Pakistan operations	**-**	(91)
Reserved during the year	**7,678**	9,090
Released to the statement of comprehensive income	**(630)**	(847)
Written off during the year	**(8,279)**	(17,480)
Balance at 31 December 2016	**37,210**	38,441

12 Financial investments

	2016 RO'000	2015 RO'000
Available-for-sale investments	**412,969**	632,920

Financial investments details by sector are provided as follows:

	Fair value 31 December 2016 RO'000	Fair value 31 December 2015 RO'000	Carrying value 31 December 2016 RO'000	Carrying value 31 December 2015 RO'000	Cost 31 December 2016 RO'000	Cost 31 December 2015 RO'000
Marketable securities – local (MSM)						
Finance	**-**	2,288	**-**	2,288	**-**	1,911
Insurance	**371**	398	**371**	398	**330**	340
Government bonds	**70,697**	85,424	**70,697**	85,424	**74,454**	85,036
	71,068	88,110	**71,068**	88,110	**74,784**	87,287
Other investments						
Treasury bills	**338,362**	540,957	**338,362**	540,957	**337,712**	540,496
Unquoted Omani shares*	**260**	260	**260**	260	**260**	260
Unquoted foreign shares*	**7**	67	**7**	67	**7**	67
Investment fund units	**3,272**	3,526	**3,272**	3,526	**3,312**	3,590
	341,901	544,810	**341,901**	544,810	**341,291**	544,413
Total	**412,969**	632,920	**412,969**	632,920	**416,075**	631,700

*Unquoted Omani shares and unquoted foreign shares are carried at cost.

Notes to the Financial Statements (continued)
As of 31 December 2016

12 Financial investments *(continued)*

Details of classification of investments are given below:

	2016 RO'000	2015 RO'000
Cost of:		
Quoted - Equity and other securities	**74,784**	87,287
Other investments	**341,291**	544,413
	416,075	631,700
Revaluation (loss) / gain	**(3,106)**	1,220
	412,969	632,920

Movement of investments is given below:

	2016 RO'000	2015 RO'000
Balance at the beginning of the year	**632,920**	666,151
Movement due to sale of India operations	**-**	(1,904)
Purchased during the year	**1,542,496**	4,037,720
Sold during the year	**(1,760,087)**	(4,069,923)
(Loss) / gain from changes in fair value	**(4,138)**	469
Amortisation of discount, net	**1,960**	244
Exchange differences	**(182)**	163
Balance at the end of the year	**412,969**	632,920

13 Other assets

	2016 RO'000	2015 RO'000
Acceptances	**15,639**	35,477
Derivatives - positive mark-to-market [note 21(d)]	**5,445**	3,733
Prepayments	**1,084**	1,159
Others	**1,131**	1,620
	23,299	41,989

14 Intangible assets

	2016 RO'000	2015 RO'000
Core deposits	**12,306**	12,306
Customer relationships	**3,691**	3,691
	15,997	15,997
Less: amortised	**(10,473)**	(8,188)
	5,524	7,809

Notes to the Financial Statements (continued)
As of 31 December 2016

15 Property and equipment

The movement in property and equipment during the year 2016 is 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 2016	29,500	4,652	7,506	330	7,653	49,641
Additions	597	157	370	-	168	1,292
Disposals/write offs	-	-	(23)	(9)	-	(32)
31 December 2016	30,097	4,809	7,853	321	7,821	50,901
Accumulated depreciation						
1 January 2016	6,518	3,839	5,888	234	6,245	22,724
Charge for the year	343	287	588	36	451	1,705
Disposals/write offs	-	-	(23)	(9)	-	(32)
31 December 2016	6,861	4,126	6,453	261	6,696	24,397
Net book value						
31 December 2016	23,236	683	1,400	60	1,125	26,504

*Includes Automatic Teller Machines ('ATM') purchased on finance lease with net book value of RO0.6m (2015: RO0.8m)

The movement in property and equipment for the year 2015 was as follows:

	Freehold land and buildings	Leasehold property and improvements	Equipment, furniture and fixtures	Motor vehicles	Computer equipment	Capital work in progress	Total
	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
Cost							
1 January 2015	33,774	4,392	8,667	863	6,441	19	54,156
Currency translation effect on opening balances	66	(1)	(1)	-	1	-	65
Movement due to sale of India and Pakistan operations	(4,337)	(33)	(194)	(27)	(385)	-	(4,976)
Reclassification	-	51	(1,717)	(5)	1,671	-	-
Additions	657	243	751	-	192	-	1,843
Disposals/write offs	(660)	-	-	(501)	(267)	(19)	(1,447)
31 December 2015	29,500	4,652	7,506	330	7,653	-	49,641
Accumulated depreciation							
1 January 2015	8,128	3,539	7,124	716	4,637	-	24,144
Currency translation effect on opening balances	28	(1)	(2)	-	2	-	27
Movement due to sale of India and Pakistan operations	(2,031)	(28)	(183)	(25)	(381)	-	(2,648)
Reclassification	-	44	(1,611)	-	1,567	-	-
Charge for the year	396	285	560	44	588	-	1,873
Disposals/write offs	(3)	-	-	(501)	(168)	-	(672)
31 December 2015	6,518	3,839	5,888	234	6,245	-	22,724
Net book value							
31 December 2015	22,982	813	1,618	96	1,408	-	26,917

Notes to the Financial Statements (continued)
As of 31 December 2016

16 Due to banks

	2016 RO'000	2015 RO'000
Interbank borrowings	**7,389**	1,925
Vostro and other balances	**30,037**	34,286
	37,426	36,211

17 Deposits from customers

	2016 RO'000	2015 RO'000
Current and call	**929,613**	965,245
Savings	**461,143**	470,161
Time deposits	**473,452**	364,589
Others	**2,447**	2,343
	1,866,655	1,802,338

18 Other liabilities

	2016 RO'000	2015 RO'000
Acceptances	**15,639**	35,477
Accruals and deferred income	**4,003**	4,930
Obligations under finance leases [note 21(e)]	**464**	964
Provisions [note 18(b)]	**711**	535
Retirement benefit liability [note 18(a)]	**755**	636
Derivatives - negative mark-to-market [note 21(d)]	**228**	204
Others	**8,221**	7,426
	30,021	50,172

18(a) Movement of retirement benefit liability

	2016 RO'000	2015 RO'000
Opening defined benefit obligation	**636**	446
Employer's current service cost	**157**	117
Interest on obligation	**16**	10
Actuarial losses on obligations	**135**	287
Benefits paid	**(189)**	(221)
Movement due to sale of India operations	**-**	(3)
Present value of liabilities at the end of the period	**755**	636

Notes to the Financial Statements (continued)
As of 31 December 2016

18 Other liabilities *(continued)*

18(b) Movement of provisions

	2016 RO'000	2015 RO'000
Balance at the beginning of the year	**535**	1,963
Provision made during the year	**674**	193
Provision utilised during the year	**(454)**	(1,339)
Provision released during the year	**(44)**	(282)
Balance at the end of the year	**711**	535

These provisions are relating to legal proceedings, restructuring, customer remediation and other provisions.

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 RO0.100 each (2015: 2,000,312,790 fully paid ordinary shares of RO0.100 each) against the authorised ordinary share capital of 7,500 million shares of RO0.100 each (2015: 7,500 million shares of RO0.100 each).

Major shareholder

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

	2016 Number of Shares	2015 Number of shares
HSBC Middle East Holdings BV	**1,020,159,523**	1,020,159,523

20 Reserves

(a) Legal reserve

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

b) Available-for-sale fair value reserve

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

21 Contingent liabilities, commitments and derivatives

(a) Contingent liabilities and other commitments

	2016 RO'000	2015 RO'000
Undrawn unconditionally cancellable commitments	**643,566**	576,767
Undrawn unconditionally non-cancellable commitments	**97,385**	204,612
Forward forex contracts outstanding	**85,708**	193,595
Interest rate swaps	**77,000**	77,000
	903,659	1,051,974
Documentary credits	**52,976**	69,079
Guarantees and performance bonds	**356,423**	368,064
	1,313,058	1,489,117

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

(b) Legal cases

As at 31 December 2016, there were certain legal suits pending against the Bank. Based on the opinion of the Bank's legal counsel, the Bank's management believes that no additional liability is expected to arise from these cases and therefore does not consider it necessary to make any additional provisions in this regard.

(c) Capital and investment commitments

At 31 December 2016, there were capital and investment commitments amounting to RO0.4m (2015: RO0.03m).

(d) Derivatives

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

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

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

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

31 December 2016:

	Positive fair value RO'000	**Negative fair value RO'000**	**Total notional amount RO'000**
Derivatives held for trading:			
Forward foreign exchange contracts	**421**	**228**	**85,708**
Interest rate swaps	**5,024**	**-**	**77,000**
	5,445	**228**	**162,708**

31 December 2015:

	Positive fair value RO'000	Negative fair value RO'000	Total notional amount RO'000
Derivatives held for trading:			
Forward foreign exchange contracts	167	204	193,595
Interest rate swaps	3,566	-	77,000
	3,733	204	270,595

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.

Notes to the Financial Statements (continued)
As of 31 December 2016

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

(e) Lease commitments

Operating lease commitments

At 31 December 2016, annual commitments under non-cancellable operating leases were RO1.4m (2015: RO1.7m). Operating lease expenses recognised in the statement of comprehensive income were RO1.4m (2015: RO1.7m).

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 2016**			At 31 December 2015		
	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**	**(57)**	**226**	565	(82)	483
– Later than one year and up to five years	**283**	**(45)**	**238**	565	(84)	481
	566	**(102)**	**464**	1,130	(166)	964

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 2016				
Assets				
Cash and balances with central bank	**284,947**	**-**	**-**	**284,947**
Due from banks	**80,222**	**-**	**-**	**80,222**
Loans and advances to customers - net	**520,310**	**43,498**	**854,607**	**1,418,415**
Financial investments	**238,388**	**116,726**	**57,855**	**412,969**
Other assets	**15,514**	**2,761**	**5,024**	**23,299**
Intangible assets	**-**	**-**	**5,524**	**5,524**
Property and equipment	**-**	**-**	**26,504**	**26,504**
Deferred tax assets	**-**	**-**	**2,013**	**2,013**
Total assets	**1,139,381**	**162,985**	**951,527**	**2,253,893**
Liabilities and equity				
Due to banks	**37,426**	**-**	**-**	**37,426**
Deposits from customers	**1,485,545**	**179,364**	**201,746**	**1,866,655**
Other liabilities	**26,041**	**2,987**	**993**	**30,021**
Current tax liabilities	**6,081**	**-**	**-**	**6,081**
Net equity	**-**	**-**	**313,710**	**313,710**
Total liabilities and equity	**1,555,093**	**182,351**	**516,449**	**2,253,893**

Notes to the Financial Statements (continued)

As of 31 December 2016

22 Maturities of assets and liabilities *(continued)*

	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 2015				
Assets				
Cash and balances with central bank	277,736	-	-	277,736
Due from banks	10,271	-	-	10,271
Loans and advances to customers - net	395,823	44,566	760,419	1,200,808
Financial investments	337,350	216,646	78,924	632,920
Other assets	35,932	2,491	3,566	41,989
Intangible assets	-	-	7,809	7,809
Property and equipment	-	-	26,917	26,917
Deferred tax assets	-	-	1,492	1,492
Total assets	1,057,112	263,703	879,127	2,199,942
Liabilities and equity				
Due to banks	36,211	-	-	36,211
Deposits from customers	1,563,796	49,186	189,356	1,802,338
Other liabilities	46,342	2,714	1,116	50,172
Current tax liabilities	2,343	-	-	2,343
Deferred tax liabilities	362	-	-	362
Net equity	-	-	308,516	308,516
Total liabilities and equity	1,649,054	51,900	498,988	2,199,942

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

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

23 Interest rate sensitivity gap *(continued)*

	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 2015						
Assets						
Cash and balances with central bank		53,900	-	-	223,836	277,736
Due from banks	0.28%	8,317	-	-	1,954	10,271
Loans and advances to customers – net	4.40%	560,041	129,394	511,373	-	1,200,808
Financial investments	0.46%	337,350	216,646	72,385	6,539	632,920
Other assets		-	-	-	41,989	41,989
Intangible assets		-	-	-	7,809	7,809
Property and equipment		-	-	-	26,917	26,917
Deferred tax assets		-	-	-	1,492	1,492
Total assets		959,608	346,040	583,758	310,536	2,199,942
Liabilities and equity						
Due to banks	0.56%	1,925	-	-	34,286	36,211
Deposits from customers	0.35%	350,133	299,647	188,982	963,576	1,802,338
Other liabilities		-	-	-	50,172	50,172
Current tax liabilities		-	-	-	2,343	2,343
Deferred tax liabilities		-	-	-	362	362
Net equity		-	-	-	308,516	308,516
Total liabilities and equity		352,058	299,647	188,982	1,359,255	2,199,942
Interest sensitivity gap:						
- Net		607,550	46,393	394,776	(1,048,719)	-
- Cumulative		607,550	653,943	1,048,719	-	-

Sensitivity analysis – equity price risk

Quoted equity investments of the Bank are listed on Muscat Securities Market ("MSM"). For such investments classified as available-for-sale investments, a 5% increase in the MSM 30 index would have increased other comprehensive income by RO18.6k (2015: RO134.3k); an equal change in the opposite direction would have decreased other comprehensive income by RO18.6k (2015: RO134.3K).

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As of 31 December 2016

24 Financial assets and liabilities

Accounting classifications and fair values as at 31 December 2016

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

Accounting classifications and fair values as at 31 December 2015

	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	-	277,736	277,736
Due from banks	-	10,271	10,271
Loans and advances to customers - net	-	1,200,808	1,200,808
Financial investments	632,593	327	632,920
Other assets	3,733	37,097	40,830
Total financial assets	636,326	1,526,239	2,162,565
Total non-financial assets			37,377
Total assets			2,199,942
Due to banks	-	36,211	36,211
Deposits from customers	80,859	1,721,479	1,802,338
Other liabilities	204	49,332	49,536
Total financial liabilities	81,063	1,807,022	1,888,085
Total non-financial liabilities			3,341
Total liabilities			1,891,426

24 Financial assets and liabilities *(continued)*

24.1 Fair value information

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

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

Fair values of financial instruments carried at fair value

	Valuation techniques		
	Quoted market price Level 1 RO'000	Using observable inputs Level 2 RO'000	Total RO'000
Recurring fair value measurements			
At 31 December 2016			
Assets			
Derivatives	**-**	**5,445**	**5,445**
Financial investments: available-for-sale	**371**	**412,331**	**412,702**
Liabilities			
Derivatives	**-**	**228**	**228**
Deposits from customers	**-**	**82,404**	**82,404**
At 31 December 2015			
Assets			
Derivatives	-	3,733	3,733
Financial investments: available-for-sale	2,686	629,907	632,593
Liabilities			
Derivatives	-	204	204
Deposits from customers	-	80,859	80,859

Fair values of financial instruments not carried at fair value

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

24 Financial assets and liabilities *(continued)*

24.1 Fair value information *(continued)*

	Valuation techniques				
	Quoted market price Level 1 RO'000	Using observable inputs Level 2 RO'000	Significant unobservable inputs Level 3 RO'000	Total fair value RO'000	Carrying amount RO'000
Assets and liabilities					
At 31 December 2015					
Assets					
Loans and advances to customers – net	-	-	1,180,044	1,180,044	1,200,808
Liabilities					
Deposits from customers	-	1,711,136	-	1,711,136	1,721,479

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

Loans and advances to customers

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

Financial investments and derivatives

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

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

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

Bank and customer deposits

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

25 Cash and cash equivalents

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

	2016 **RO'000**	2015 RO'000
Statement of financial position items comprise:		
Cash and balances with central bank (note 10(a))	**284,947**	277,736
Due from banks (note 10(b))	**80,222**	10,271
Due to banks (note 16)	**(37,426)**	(36,211)
	327,743	251,796

Notes to the Financial Statements (continued)
As of 31 December 2016

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

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

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

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

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

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

Related party loans and advances written off in 2016: nil (2015: RO6.9m).

	Parent entity RO'000	Other related group entities RO'000	Directors RO'000	Others RO'000	Total RO'000
As at 31 December 2015					
Loans and advances	-	-	-	37,406	37,406
Current, deposit and other accounts	-	10,608	77	18,038	28,723
Letters of credit and guarantees	-	60,185	-	10,200	70,385
Due from banks	-	4,896	-	-	4,896
Due to banks	-	21,856	-	-	21,856
For the year ended 31 December 2015					
Net interest income	-	76	-	753	829
Net fee income / (expenses)	-	(135)	-	361	226
Other income	-	-	9	-	9
Other operating expenses	(5,254)	(7,014)	(18)	(208)	(12,494)
Purchase of property and equipment	-	-	-	(2)	(2)

Notes to the Financial Statements (continued)
As of 31 December 2016

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

Compensation of key management personnel

	2016	2015
	RO'000	RO'000
Wages, salaries and other short term benefits	**1,678**	1,869
Post-employment benefits	**195**	143
	1,873	2,012

Balances with key management personnel

	2016	2015
	RO'000	RO'000
Loans and advances	**357**	610
Current, deposit and other accounts	**297**	263

27 Distribution by economic sector

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

	2016	2015
	RO'000	RO'000
Personal and consumer loans	**484,581**	466,752
Corporate and commercial		
Import trade	**208,713**	165,280
Construction	**59,341**	86,934
Manufacturing	**241,838**	218,935
Wholesale and retail trade	**45,286**	45,217
Electricity, gas, water, transportation and communication	**113,153**	90,854
Services	**119,276**	148,316
Mining and quarrying	**87,869**	12,528
Others	**140,680**	49,248
	1,016,156	817,312
Total gross loans and advances	**1,500,737**	1,284,064
Provision for loan impairment - specific	**(26,508)**	(28,380)
Provision for loan impairment - general	**(18,604)**	(16,435)
Reserved interest	**(37,210)**	(38,441)
Net loans and advances	**1,418,415**	1,200,808
Non-performing loans - gross	**69,127**	71,881

Specific provision for loan impairment and reserved interest represent 92.2% (2015: 93.0%) of gross non-performing loans and advances.

Notes to the Financial Statements (continued)
As of 31 December 2016

27 Distribution by economic sector *(continued)*

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

	2016 RO'000	2015 RO'000
Import trade	**42,996**	52,851
Construction	**73,244**	72,005
Financial institutions	**143,931**	155,178
Manufacturing	**20,263**	10,635
Wholesale and retail trade	**8,992**	12,831
Electricity, gas, water, transportation and communication	**29,579**	41,764
Services	**81,439**	79,656
Mining and quarrying	**1,899**	759
Others	**7,056**	11,464
	409,399	437,143

28 Operating segment

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

Products and services

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

- Retail Banking and Wealth Management ('RBWM') offers a broad range of products and services to meet the personal banking needs, consumer finance and wealth management needs of individual customers. Typically, customer offerings include personal banking products (current and savings accounts, mortgages and personal loans, credit cards, debit cards and local and international payment services) and wealth management services (insurance and investment products and financial planning services).
- Commercial Banking ('CMB') product offerings include the provision of receivables financing services, payments and cash management, international trade finance, treasury and capital markets, commercial cards, cash and derivatives in foreign exchange and rates, and online and direct banking offerings. Global Banking ('GB') provides tailored financial solutions to government, corporate and institutional clients and delivering a full range of banking capabilities including financing, advisory and transaction services.
- Global Markets ('GM') provides tailored financial solutions, a markets business that provides services in credit, rates, foreign exchange, money markets and securities services; and principal investment activities.

Notes to the Financial Statements (continued)

As of 31 December 2016

28 Operating segment *(continued)*

	31 December 2016				
	CMB / GB	RBWM	GM	Unallocated	Total
	RO'000	RO'000	RO'000	RO'000	RO'000
Net interest income					
- External	21,062	28,859	4,424	(79)	54,266
- Internal	687	2,086	(2,621)	(152)	-
	21,749	30,945	1,803	(231)	54,266
Net fee income	7,387	3,960	1,132	(167)	12,312
Net trading income	2,236	1,415	4,034	90	7,775
Other operating income	304	326	54	164	848
Total operating income	31,676	36,646	7,023	(144)	75,201
Loan impairment charges and other credit risk provisions - net of recoveries	(1,478)	(4,167)	-	-	(5,645)
Net operating income	30,198	32,479	7,023	(144)	69,556
Total operating expenses	(14,098)	(31,282)	(2,343)	(643)	(48,366)
Profit / (loss) before tax	16,100	1,197	4,680	(787)	21,190
Reportable segment assets	967,574	473,664	730,346	82,309	2,253,893
Reportable segment liabilities	1,224,199	663,851	18,175	33,958	1,940,183

	31 December 2015				
	CMB / GB	RBWM	GM	Unallocated	Total
	RO'000	RO'000	RO'000	RO'000	RO'000
Net interest income					
- External	17,219	29,365	2,580	-	49,164
- Internal	(1,058)	1,414	(268)	(88)	-
	16,161	30,779	2,312	(88)	49,164
Net fee income	6,594	4,590	1,327	-	12,511
Net trading income	2,346	1,311	3,256	90	7,003
Other operating income	2,034	2,432	151	240	4,857
Total operating income	27,135	39,112	7,046	242	73,535
Loan impairment charges and other credit risk provisions - net of recoveries	265	(3,699)	-	-	(3,434)
Net operating income	27,400	35,413	7,046	242	70,101
Total operating expenses	(17,244)	(34,992)	(1,863)	(641)	(54,740)
Profit / (loss) before tax	10,156	421	5,183	(399)	15,361
Reportable segment assets	789,720	456,358	867,732	86,132	2,199,942
Reportable segment liabilities	1,091,931	737,980	21,752	39,763	1,891,426

Unallocated items comprise mainly property and equipment, other assets and other items which are not reported under operating business segments.

29 Dividend per share

The Board of Directors at the forthcoming Ordinary Annual General meeting will propose a cash dividend of RO0.005 per share of nominal value of RO0.100 each amounting to RO10.0m for the year 2016 (2015: cash dividend of RO0.0039 per share of nominal value of RO0.100 each amounting to RO7.8m). 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 2017.

30 Risk management

All of the Bank's activities involve, to varying degrees, the analysis, evaluation, acceptance and management of risks or combinations of risks. The

30 Risk management ***(continued)***

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

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

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

30.1 Risk governance and ownership

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

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

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

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

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

30.2 Risk appetite

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

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

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

30.3 Credit risk

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

Credit risk management

The Wholesale (corporate) and Retail

Notes to the Financial Statements (continued)
As of 31 December 2016

30 Risk management *(continued)*

30.3 Credit risk *(continued)*

Risk functions report to the CRO. Their responsibilities include:

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

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

Credit quality

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

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

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

Impairment assessment

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

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

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

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

30 Risk management *(continued)*

30.3 Credit risk *(continued)*

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

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

Cross-border exposures

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

Maximum exposure to credit risk

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

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

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

	2016 RO'000	2015 RO'000
Individually impaired	**69,127**	71,881
Allowance for impairment	**(63,718)**	(66,821)
Carrying amount	**5,409**	5,060
Past due and not impaired		
1-30 days	**7,544**	14,428
31-60 days	**3,823**	2,706
61-89 days	**1,744**	1,837
Neither past due nor impaired	**1,418,499**	1,193,212
Provision for loan impairment – general	**(18,604)**	(16,435)
Carrying amount	**1,418,415**	1,200,808

Exposure to credit risk – neither past due nor impaired assets

	2016 RO'000	2015 RO'000
Balances with central bank (note 10(a))	**250,767**	233,231
Due from banks	**80,222**	10,271
Financial investments (note 12)	**409,059**	626,381
Other assets	**22,215**	40,830
	762,263	910,713

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.

Notes to the Financial Statements (continued)
As of 31 December 2016

30 Risk management *(continued)*

30.3 Credit risk *(continued)*

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

	2016 RO'000	2015 RO'000
Property	**130,216**	110,521
Equity	**628**	1,511
Fixed deposits	**25,844**	28,233
Vehicle	**5,572**	6,980
Guarantees	**113,427**	142,350
Total	**275,687**	289,595

The table below presents an analysis of financial investments as at 31 December 2016 and 2015:

	2016 RO'000	2015 RO'000
Unrated equity investments	**3,910**	6,539
Sovereign securities	**409,059**	626,381
Total	**412,969**	632,920

The table below presents an analysis of due from banks and balances with central bank as at 31 December 2016, based on Fitch and Standard & Poor's ratings or equivalent.

	2016 RO'000	2015 RO'000
Sovereign	**250,767**	233,231
A	**29,469**	695
A+	**501**	584
AA-	**50,056**	8,992
BBB+	**196**	-
Total	**330,989**	243,502

Concentration of exposure

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

	Gross loans and advances		Due from banks		Financial investments		Balances with central bank	
	2016 RO'000	2015 RO'000	2016 RO'000	2015 RO'000	2016 RO'000	2015 RO'000	2016 RO'000	2015 RO'000
Concentration by sector:								
Sovereign	**96,292**	-	**-**	-	**409,059**	626,381	**250,767**	233,231
Corporate	**919,864**	817,312	**-**	-	**-**	-	**-**	-
Banks	**-**	-	**80,222**	10,271	**-**	-	**-**	-
Retail	**484,581**	466,752	**-**	-	**-**	-	**-**	-
Carrying amount	**1,500,737**	1,284,064	**80,222**	10,271	**409,059**	626,381	**250,767**	233,231

30 Risk management *(continued)*

30.3 Credit risk *(continued)*

Credit quality of financial instruments

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

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

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

30.4 Liquidity and funding

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

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

Liquidity and funding risk management framework

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

On 1 January 2016, the Bank introduced a new LFRF. It uses the liquidity coverage ratio ('LCR') and net stable funding ratio ('NSFR') regulatory framework as a foundation. The LFRF is delivered using the following key aspects:

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

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 2016

The liquidity position of the Bank remained strong as of 31 December 2016. Our liquidity coverage ratio was 364%.

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

Management of liquidity and funding risk

Liquidity coverage ratio

The LCR metric is designed to promote the short-term resilience of a bank's liquidity profile. It aims to ensure that a bank has sufficient unencumbered high-quality liquid assets ('HQLA') to meet its liquidity needs in a 30-calendar-day liquidity stress scenario. HQLAs consist of cash or assets that can be converted into cash at little or no loss of value in markets.

Net stable funding ratio

The NSFR requires institutions to maintain

Notes to the Financial Statements (continued)
As of 31 December 2016

30 Risk management *(continued)*

30.4 Liquidity and funding *(continued)*

sufficient stable funding relative to required stable funding, and reflects a bank's long-term funding profile (funding with a term of more than a year). It is designed to complement the LCR.

Sources of funding

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

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

30.5 Market risk management

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

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

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

Derivative financial instruments

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

Swaps

Swaps are over-the-counter agreements between the Bank and other parties to exchange future cash flows based upon agreed notional amounts. Swaps most commonly used by the Bank are 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 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

30 Risk management *(continued)*

30.5 Market risk management *(continued)*

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:

	2016	**Average**	**Maximum**	**Minimum**	2015	Average	Maximum	Minimum
	RO'000	**RO'000**	**RO'000**	**RO'000**	RO'000	RO'000	RO'000	RO'000
Total VAR	**73**	**67**	**94**	**35**	67	252	587	67
Trading VAR	**22**	**9**	**23**	**1**	4	2	12	-

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 significant net exposures denominated in foreign currencies as at 31 December:

	Overall exposure in RO' 000	
Currency	**2016**	2015
US Dollars	**28,003**	4,228
Pound Sterling	**23**	4
Euro	**12**	37
Japanese Yen	**-**	1
UAE Dirhams	**4**	12
Indian Rupee	**4**	3
Other currencies	**36**	196
Total exposure	**28,082**	4,481

30 Risk management *(continued)*

30.6 Legal risk

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

- Contractual risk is the risk that the rights and/or obligations of the Bank within a contractual relationship are defective.
- Dispute risk is the risk that the Bank is subject to when it is involved in or managing a potential or actual dispute.
- Legislative risk is the risk that the Bank fails to adhere to the laws of the jurisdictions in which it operates.

Non-contractual rights risk is the risk that the Bank's assets are not properly owned or are infringed by others, or the Bank infringes another party's rights.

The Bank has a legal function to assist management in controlling legal risk. The function provides legal advice and support in managing claims against the Bank, as well as in respect of non-routine debt recoveries or other litigation against third parties.

The legal department must be immediately advised of any action by a regulatory authority, where the proceedings are criminal, or where the claim might materially affect the Bank's reputation.

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

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

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

Under the terms of the US DPA, the DoJ has absolute discretion to determine whether HSBC has breached the terms and conditions of the agreement at any time, including if HSBC has committed any crime under US federal law subsequent to the signing of the US DPA. Potential consequences of breaching the US DPA could include the imposition of additional terms and conditions on HSBC, an extension of the US DPA, including the monitorship, or the criminal prosecution of HSBC, which could, in turn, entail further financial penalties and collateral consequences. Breach of the US DPA or related agreements and consent orders could have a material adverse effect on HSBC Group's business, financial condition and results of operations, including loss of business and withdrawal of funding, restrictions on performing dollar-clearing functions through HSBC Bank USA or revocation of bank licences in the USA.

30.7 Operational risk management

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

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

In order to manage operational risks, the Bank has an Operational Risk Management Framework (ORMF), which includes adoption

30 Risk management *(continued)*

30.7 Operational risk management *(continued)*

of the Three Lines of Defense risk governance framework:

1) The First Line of Defense owns the operational risks. They are responsible for identifying, recording, reporting and managing risks, and ensuring that the right controls and assessments are in place to mitigate these risks. Most of the Bank's people are in The First Line of Defense, including Risk Owners, Control Owners and Business Risk & Control Managers (BRCMs).

2) The Second Line of Defense sets policy and guidelines for managing operational risk, and provides advice and guidance on effective risk management. The Second Line are risk management specialists comprising Risk Stewards and the Operational Risk Function.

3) The Third Line of Defense is Internal Audit who independently ensure that the Bank is managing operational risk effectively.

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

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

30.8 Compliance risk management

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

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

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

30.9 Capital management

Capital management is guided by the CBO through circular BM 1009 (Guidelines on BASEL II) and regulatory capital under BASEL III framework. Capital adequacy is calculated on quarterly intervals and reported to the CBO. Banks are required to maintain minimum capital adequacy ratio of 12.625% including capital conservation buffer for 2016 (2015: 12.625%) in accordance with CBO stipulated guidelines.

Notes to the Financial Statements (continued)
As of 31 December 2016

30 Risk management *(continued)*

30.9 Capital management

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

	2016 RO'000	2015 RO'000
Common Equity Tier 1 capital ('CET 1') / Tier 1 capital		
Ordinary share capital	**200,031**	200,031
Legal reserve	**37,967**	36,277
Retained earnings	**68,439**	63,367
Regulatory adjustments to CET1	**(11,391)**	(9,745)
CET 1/Tier 1 capital	**295,046**	289,930
Additional Tier 1 capital (AT1)	**-**	-
Total Tier 1 capital (T1 = CET1+AT1)	**295,046**	289,930
Tier 2 capital (T2)		
Fair value reserve for available-for-sale equity securities	**36**	247
Provision for loan impairment – general	**18,604**	16,435
Total	**18,640**	16,682
Total regulatory capital	**313,686**	306,612
Risk-weighted assets		
Banking book	**1,510,638**	1,421,141
Operational risk	**151,480**	149,947
Market risk	**17,332**	7,730
Total risk-weighted assets	**1,679,450**	1,578,818
Capital ratios		
CET 1 / Tier 1 capital ratio	**17.57%**	18.36%
Total capital ratio	**18.68%**	19.42%

Notes to the Financial Statements (continued)
As of 31 December 2016

31 Liquidity coverage ratio (LCR)

Liquidity coverage ratio (LCR) is guided by the CBO through circular BM 1127 (BASEL III : Framework on Liquidity coverage ratio and LCR disclosure standards). Liquidity coverage ratio is calculated on monthly intervals and reported to the CBO. The Banks are required to maintain minimum liquidity coverage ratio of 70% for 2016 (2015: 50%) in accordance with CBO stipulated guidelines.

Liquidity coverage ratio disclosure for the period ended 31 December 2016:

	31 December 2016		31 December 2015	
	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)	**-**	**654,297**	-	608,791
Cash outflows				
2 Retail deposits and deposits from small business customers, of which:	**668,227**	**49,853**	736,877	56,546
3 - Stable deposits	**339,396**	**16,970**	342,823	17,141
4 - Less stable deposits	**328,831**	**32,883**	394,054	39,405
5 Unsecured wholesale funding, of which:	**1,291,777**	**536,730**	1,130,813	471,737
6 - Operational deposits (all counterparties) and deposits in networks of cooperative banks	**-**	**-**	-	-
7 - Non-operational deposits (all counterparties)	**1,291,777**	**536,730**	1,130,813	471,737
8 - Unsecured debt	**-**	**-**	-	-
9 Secured wholesale funding	**-**	**-**	-	-
10 Additional requirements, of which	**99,092**	**9,619**	178,529	17,633
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	**99,092**	**9,619**	178,529	17,633
14 Other contractual funding obligations	**-**	**-**	-	-
15 Other contingent funding obligations	**1,014,820**	**50,741**	1,081,094	54,055
16 Total cash outflows (2+5+10+15)	**-**	**646,943**	-	599,971
Cash inflows				
17 Secured lending (e.g. reverse repos)	**-**	**-**	-	-
18 Inflows from fully performing exposures	**245,606**	**166,980**	351,281	225,006
19 Other cash inflows	**-**	**-**	-	-
20 Total cash inflows (17+18+19)	**245,606**	**166,980**	351,281	225,006
		Total Adjusted Value		Total Adjusted Value
21 Total HQLA	**-**	**654,297**		608,791
22 Total net cash outflows (16-20)	**-**	**479,963**		374,965
23 Liquidity coverage ratio (21/22)		**136%**		162%

*simple average of monthly observations over the last three months (October - December 2016 and October – December 2015)

32 Corresponding figures

Certain corresponding figures for 2015 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.