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

**FINANCIAL STATEMENTS**
**31 DECEMBER 2012**

Domiciled in Malaysia.
Registered Office:
2, Leboh Ampang,
50100 Kuala Lumpur

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

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**HSBC AMANAH MALAYSIA BERHAD**
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Incorporated in Malaysia

## BOARD OF DIRECTORS

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Non-Independent Non-Executive Director/Chairman

Mukhtar Malik Hussain
Non-Independent Non-Executive Director

Mohamed Rafe bin Mohamed Haneef
Chief Executive Officer, Non-Independent Executive Director

Mohamed Ross bin Mohd Din
Independent Non-Executive Director

Azlan bin Abdullah
Independent Non-Executive Director

Mohamed Ashraf bin Mohamed Iqbal
Independent Non-Executive Director

Lee Choo Hock
Independent Non-Executive Director

## PROFILE OF DIRECTORS

**Louisa Cheang Wai Wan**
Non-Independent Non-Executive Director/Chairman

Ms Cheang was appointed on 1 January 2012. She graduated from the University of Hong Kong majoring in Political Science and Management Studies. Ms Cheang is currently the Group General Manager, Regional Head of Retail Banking and Wealth Management Asia-Pacific of HSBC, Hong Kong. She has been Regional Director of Personal Financial Services Asia-Pacific since June 2009 overseeing HSBC's personal financial services business in Hong Kong and 18 other countries and territories in the region. Prior to this, Ms Cheang was Head of Personal Financial Services Hong Kong and Head of Marketing in Asia-Pacific. Before joining HSBC, Ms Cheang was the marketing head at Citibank, Smartone Mobile Communications and American Express.

Ms Cheang's other current roles include management committee member of the Pacific Credit Card Centre under the collaboration of Bank of Communications and HSBC, International Advisor of Visa International and China Union Pay, Director of the MasterCard Asia/Pacific, Middle East and Africa Regional Advisory Board, Director of HSBC Insurance (Asia) Limited and HSBC Life (International) Limited, HSBC Director of Asset Management (Hong Kong) Limited, Director of HSBC Bank (Taiwan) Limited, Director of Hubei Suizhou Cengdu HSBC Rural Bank Company Limited and Honorary Certified Financial Management Planner of the Hong Kong Institute of Bankers.

**Mukhtar Malik Hussain**
Non-Independent Non-Executive Director

Mr Hussain was appointed on 15 December 2009. He graduated from University of Wales, United Kingdom with a Bachelor of Science in Economics. Mr Hussain first joined the HSBC Group in 1982 as a Graduate Trainee in Midland Bank International. He was then appointed as Assistant Director in Samuel Montagu in 1991. After close to 11 years of working in the HSBC Group's London offices, Mr Hussain then held numerous posts in Dubai including Chief Executive Officer of HSBC Financial Services (Middle East) Limited from 1995 to 2003 and established the initiative to create the first foreign investment bank in Saudi Arabia for HSBC. In 2003, he assumed the position of Chief Executive Officer, Corporate and Investment Banking and became the Co-Head of Global Banking in 2005. He headed back to London as the Global Head of Principal Investments, the proprietorial and fund investment arm of HSBC from 2006 to 2008. He was the Deputy Chairman of HSBC Bank Middle East Limited, Global Chief Executive Officer of HSBC Amanah and Chief Executive Officer of Global Banking and Markets, Middle East and North Africa, a dual role with global responsibilities for Islamic Finance and HSBC's wholesale banking activities in the Middle East and North Africa before he came to Malaysia.

In addition to his current role, Mr Hussain is also the Deputy Chairman and Chief Executive Officer of HSBC Bank Malaysia Berhad, Chairman of HSBC Takaful (Malaysia) Sdn Bhd and a Non-Executive Director of HSBC Bank Middle East Limited.

## PROFILE OF DIRECTORS (Cont'd)

**Mohamed Rafe bin Mohamed Haneef**
Chief Executive Officer, Non-Independent Executive Director

En Rafe was appointed on 22 November 2010. He serves as a member of the Nominating Committee of the Bank. En Rafe holds a Bachelors of Law from International Islamic University of Malaysia and a Masters of Law from Harvard Law School, United States of America. He was admitted to the Malaysian Bar and practised law specialising in Islamic finance with Messrs. Mohamed Ismail & Co before joining the banking industry. En Rafe first joined HSBC Investment Bank plc, London in 1999 and thereafter HSBC Financial Services Middle East, Dubai from 2001-2004.He then assumed several positions including the Head of Global Islamic Finance of ABN Amro Bank NV, Dubai, Head of Islamic Banking of Citigroup Asia and Managing Director, Investments of Fajr Capital before rejoining HSBC Amanah as Managing Director Global Markets for the Asia Pacific region in July 2010.

**Mohamed Ross bin Mohd Din**
Independent Non-Executive Director

En Ross was appointed on 26 February 2008. He is the Chairman of the Risk Management Committee and a member of the Audit Committee and Nominating Committee of the Bank. En Ross joined HSBC Bank Malaysia Berhad in 1972 and served in various capacities ranging from Corporate and Retail Banking to Area and Branch Management. He also served as Head of Treasury and Head of Group Audit Malaysia between 1987 and 1996. During this period, he also worked in Hong Kong, London and New York in the areas of Foreign Exchange and Treasury. In his last appointment prior to his retirement from HSBC Bank Malaysia Berhad on 31 December 2007, he was the Managing Director of the HSBC Amanah Onshore business franchise in Malaysia and was responsible for the Islamic retail and corporate business emanating from the branch network. En Ross joined HSBC Amanah Takaful (Malaysia) Sendirian Berhad as the Executive Director and Senior Advisor from 1 January 2008 to 31 December 2008.

En Ross is currently a council member of the Outward Bound Trust of Malaysia and a Director of Kumpulan Perangsang Selangor Berhad.

**Azlan bin Abdullah**
Independent Non-Executive Director

En Azlan was appointed on 6 August 2008. He is a member of the Audit Committee and Nominating Committee of the Bank. En Azlan graduated from Trinity University, United States of America with a Bachelor of Science in Business Administration and Morehead State University, United States of America with a Masters in Business Administration. En Azlan began his career in Citibank N.A in the World Corporate Group, a division within the Corporate Banking Group in 1983. After 5 years, he then moved on to United Asian Bank which later merged with Bank of Commerce. In 1994, he joined Citibank Berhad as Vice President and Head of the Public Sector, a division in the Corporate Banking Group focusing on lending to government-owned entities.

En Azlan is currently the Executive Director of Melewar Industrial Group Berhad and the Chief Executive Officer of Mycron Steel Berhad and Mycron Steel CRC Sdn Bhd. He is also an Independent Director of Malaysian General Investment Corporation Berhad and several other private limited companies. In addition, he is a council member of Malaysian Iron and Steel Industry Federation and an alumni member of International Association of Traffic and Safety Sciences based in Japan.

## PROFILE OF DIRECTORS (Cont'd)

**Mohamed Ashraf bin Mohamed Iqbal**
Independent Non-Executive Director

En Ashraf was appointed on 6 August 2008. He is the Chairman of Nominating Committee and a member of the Risk Management Committee of the Bank. En Ashraf graduated from California State University, United States of America with a Bachelor of Science in Mechanical Engineering and thereafter obtained a Masters in Business Administration from the same institution. His earlier career included a period of over 5 years with Shell Malaysia involved in a variety of human resource and business re-engineering projects. He then moved on to Proton Berhad where he assumed the positions of Managing Director of Proton Cars (UK) Ltd, Executive Director of Proton Cars (Europe) Ltd and Director of Proton Cars (Australia) Ltd. He then assumed the position of Director of Hay Group, Asia from 1999 to 2002 and Managing Director of Federal Auto Holdings Berhad from 2002 to 2005.He was formerly a Partner of CEO Solutions Sdn Bhd and an Advisor to Maestro Planning Solutions Sdn Bhd.

En Ashraf is currently a Director of MindSpring Sdn Bhd, a one person consulting firm that he started after 17 years of working in various industries. During the year, he has been appointed as a Director of Fairview Schools Berhad.

**Lee Choo Hock**
Independent Non-Executive Director

Mr Lee was appointed on 2 January 2009. He is the Chairman of the Audit Committee and a member of the Risk Management Committee and Nominating Committee of the Bank. Mr Lee is a member of the Institute of Chartered Accountants in England and Wales as well as the Malaysian Institute of Accountants. He began his career with Miller, Brener & Co., London, a professional accounting firm in 1975 and joined Maybank in 1982. Having worked with Malayan Banking Berhad for 27 years, Mr Lee has built a successful career as a professional accountant. He served various management positions during his tenure with Malayan Banking Berhad until he retired in 2008 and his last position was as the Executive Vice President, Head of Accounting Services and Treasury Back Office Operations. He has also served as a Director of a number of subsidiaries of Malayan Banking Berhad.

## BOARD RESPONSIBILITY AND OVERSIGHT

### BOARD OF DIRECTORS

#### Composition of the Board

At the date of this report, the Board consists of seven (7) members; comprising one (1) non-independent executive Director, two (2) non-independent non-executive Directors and four (4) independent non-executive Directors.

The concept of independence adopted by the Board is as defined in paragraph 2.27 of Bank Negara Malaysia's Guidelines on Corporate Governance for Licensed Islamic Banks (BNM/GP1-i).

There is a clear separation between the roles of Chairman and Chief Executive Officer to ensure an appropriate balance of role, responsibility, authority and accountability. The Board of Directors was led by Madam Louisa Cheang Wai Wan as the Chairman, Non-Independent Non-Executive Director and the executive management of the Bank is led by En Mohamed Rafe bin Mohamed Haneef, the Chief Executive Officer, Non-Independent Executive Director. Paragraph 2.38 of the Revised BNM/GP1-i prescribes that the Chairman of the Board should be in a non-executive capacity and should not have an executive position or responsibility at the parent or related institutions.

#### Roles and Responsibilities

The primary responsibility of the Board Directors is to adopt an effective and high standard of corporate governance practices by the Bank which include reviewing and approving the Bank's strategies; the annual business plans and performance targets; the significant policies and procedures for monitoring and control of operations; appointments of key senior officers; acquisitions and disposals above pre-determined thresholds; and monitor management's performance in implementing them.

The Board of Directors also carries out other various functions and responsibilities as laid down by the guidelines and directives issued by Bank Negara Malaysia from time to time.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### BOARD OF DIRECTORS (Cont'd)

**Frequency and Conduct of Board Meetings**

To discharge its duties effectively, the Board has met six (6) times during the year.

The Board receives reports on the progress of the Bank's business operations and minutes of meetings of Management Committees for review at each of its meetings. At these meetings, the members also consider a variety of matters including the Bank's financial results, strategic decisions and corporate governance matters. The Board also receives presentations from each key business area, and on any other topic as they request.

The agenda for every Board meeting, together with comprehensive management reports, proposal papers and supporting documents are distributed to the Directors in advance of all Board meetings, to allow time for appropriate review and to enable full discussion at the Board meetings. All proceedings from the Board meetings are minuted. Minutes of every Board meeting are circulated to all Directors for their perusal prior to confirmation of the minutes at the following Board meeting.

The Revised BNM/GP1-i requires non-executive Directors to have a minimum attendance of at least 75% of all Board meetings. All non-executive Directors have complied with this requirement during the financial year.

The attendance of Directors at the Board meetings held in the financial year ended 31 December 2012 was as follows:

| Name of members | Designation | Attendance / No. of meetings |
|---|---|---|
| Louisa Cheang Wai Wan | Chairman, Non-Independent Non-Executive Director | 5 / 6 |
| Mukhtar Malik Hussain | Non-Independent Non-Executive Director | 5 / 6 |
| Mohamed Rafe bin Mohamed Haneef | Chief Executive Officer, Non-Independent Executive Director | 6 / 6 |
| Mohamed Ross bin Mohd Din | Independent Non-Executive Director | 6 / 6 |
| Azlan bin Abdullah | Independent Non-Executive Director | 6 / 6 |
| Mohamed Ashraf bin Mohamed Iqbal | Independent Non-Executive Director | 6 / 6 |
| Lee Choo Hock | Independent Non-Executive Director | 6 / 6 |

**BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)**

## BOARD COMMITTEES

The Board of Directors has established the Board Committees to assist them in the overall management and the running of the Bank's operation. The appointments of the members to these committees were approved by the Board of Directors upon recommendation by the Nominating Committee. The functions and the terms of reference of each committee, as well as the authority delegated by the Board of Directors to these committees, have been clearly defined by the Board of Directors.

The Board Committees in the Bank are as follows:

- Audit Committee
- Risk Management Committee
- Nominating Committee
- Connected Party Transactions Committee
- Shariah Committee
- Executive Committee
- Asset and Liability Management Committee

Pursuant to the Revised BNM/GP1-i, the Audit Committee, Risk Management Committee, Shariah Committee and Nominating Committee were established in September 2008. The revised BNM/GP1-i also requires the Board to establish a Remuneration Committee. The Bank, however, has obtained an exemption from Bank Negara Malaysia on 8 July 2008 from this requirement.

The Connected Party Transactions Committee was established in June 2009 pursuant to the requirements under the Bank Negara Malaysia Guidelines on Credit Transactions and Exposures with Connected Parties.

In addition to the above Board Committees, the Bank has established various sub-committees to assist the Executive Committee and the Asset and Liability Management Committee in performing their roles and responsibilities and to assist the Chief Executive Officer in the day to day running of the Bank.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### AUDIT COMMITTEE

#### Composition

The present members of the Audit Committee are as follows:

- Lee Choo Hock (Chairman)
- Azlan bin Abdullah
- Mohamed Ross bin Mohd Din

#### Frequency of Meetings

A total of five (5) Audit Committee meetings were held during the financial year 2012 and all members attended every meeting held.

#### Terms of Reference

The revised Terms of Reference as set out below were approved at the Audit Committee and Board of Directors' meetings held on 24 April 2012.

#### Membership

The Committee shall comprise not less than three (3) members. All members shall be non-executive directors of which the majority shall be independent non-executive directors.

The Chairman of the Committee shall be appointed by the Board. Members of the Committee and the Chairman shall be appointed subject to endorsement by Group Audit Committee.

The Board may from time to time appoint to the Committee additional members it has determined to be independent. In the absence of sufficient independent non-executive directors, the Board may appoint individuals from elsewhere in the HSBC Group with no line or functional responsibility for the activities of the Group.

The Chairman of the Committee shall be an independent director.

The Committee may invite any director, executive, external auditor or other person to attend any meeting(s) of the Committee as it may from time to time consider desirable to assist the Committee in the attainment of its objective.

**BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)**

**AUDIT COMMITTEE (Cont'd)**

**Meetings and Quorum**

The Committee shall meet with such frequency and at such times as it may determine. It is expected that the Committee shall meet at least four times each year.

The quorum for meetings shall be two non-executive directors, including one independent non-executive director.

At all meetings of the Committee, the Chairman of the Committee, if present, shall preside. If the Chairman is absent, the members present at the meeting shall elect a chairman of the meeting, who shall be an independent non-executive director.

**Objective**

The Committee shall be accountable to the Board and shall have non-executive responsibility for oversight of and advice to the Board on matters relating to financial reporting.

**Responsibilities of the Committee**

Without limiting the generality of the Committee's objective, the Committee shall have the following non-executive responsibilities, powers, authorities and discretion.

1. To monitor the integrity of the financial statements of the Company, and any formal announcements relating to the Company's financial performance or supplementary regulatory information, reviewing significant financial reporting judgments contained in them. In reviewing the Company's financial statements before submission to the Board, the Committee shall focus particularly on:

   (i) any changes in accounting policies and practices;
   (ii) major judgmental areas;
   (iii) significant adjustments resulting from audit;
   (iv) the going concern assumptions and any qualifications;
   (v) compliance with accounting standards;
   (vi) compliance with legal requirements in relation to financial reporting;
   (vii) regulatory guidance on disclosure of areas of special interest;
   (viii) comment letters from appropriate regulatory authorities; and
   (ix) matters drawn to the attention of the Committee by the Company's external auditor.

   In regard to the above:

   (i) members of the Committee shall liaise with the Board, members of senior management, the external auditor and head of internal audit; and
   (ii) the Committee shall consider any significant or unusual items that are, or may need to be, highlighted in the annual report and accounts and shall give due consideration to any matters raised by the principal financial officer, head of internal audit, head of compliance or external auditor.
   (iii) the Committee shall ensure that the accounts are prepared and published in a timely and accurate manner with frequent reviews of the adequacy of provisions against contingencies and bad and doubtful debts.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### AUDIT COMMITTEE (Cont'd)

#### Responsibilities of the Committee (Cont'd)

2. To review the Company's financial and accounting policies and practices.

3. To review and discuss with management the effectiveness of the Company's internal control systems relating to financial reporting and, where appropriate, to endorse the content of the statement relating to internal controls over financial reporting in the annual report for submission to the Board including Shariah compliance.

4. To monitor and review the effectiveness of the internal audit function, consider the major findings of internal investigations and management's response, and ensure that the internal audit function is adequately resourced, has appropriate standing within the Company and is free from constraint by management or other restrictions. Where applicable, the Committee shall recommend to the Board the appointment and removal of the Head of Internal Audit.

5. To satisfy itself that there is appropriate co-ordination between the internal and external auditors.

6. To make recommendations to the Board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and shall be directly responsible for the approval of the remuneration and terms of engagement of the external auditor.

7. To review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements and reports from the external auditors on their own policies and procedures regarding independence and quality control and to oversee the appropriate rotation of audit partners with the external auditor.

8. To implement the HSBC Group policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; where required under that policy to approve in advance any non-audit services provided by the external auditor that are not prohibited by the Sarbanes-Oxley Act of 2002 (in amounts to be pre-determined by the Group Audit Committee) and the fees for any such services; to report to the Board, identifying any matters in respect of which it considers that action or improvement is needed and make recommendations as to the steps to be taken.

   For this purpose "external auditor" shall include any entity that is under common control, ownership or management with the audit firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as part of the audit firm nationally or internationally.

9. To review the external auditor's annual report on the progress of the audit, its management letter, any material queries raised by the external auditor to the management in respect of the accounting records, financial accounts or systems of control and in each case, responses from management., Any material issues arising which relate to the management of risk or internal controls (other than internal financial controls) shall be referred to the Risk Management Committee as appropriate.

10. To require a timely response to be provided to the financial reporting and related control issues raised in the external auditor's management letter.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### AUDIT COMMITTEE (Cont'd)

#### Responsibilities of the Committee (Cont'd)

11. To discuss with the external auditor their general approach, nature and scope of their audit and reporting obligations before the audit commences including, in particular, the nature of any significant unresolved accounting and auditing problems and reservations arising from their interim reviews and final audits, major judgmental areas (including all critical accounting policies and practices used by the Company and changes thereto), all alternative accounting treatments that have been discussed with management together with the potential ramifications of using those alternatives, the nature of any significant adjustments, the going concern assumption, compliance with accounting standards and stock exchange and legal requirements, reclassifications or additional disclosures proposed by the external auditor which are significant or which may in the future become material, the nature and impact of any material changes in accounting policies and practices, any written communications provided by the external auditor to management and any other matters the external auditor may wish to discuss (in the absence of management where necessary).

12. To review and discuss the adequacy of resources, qualifications and experience of staff of the accounting and financial reporting function, and their training programmes and budget and succession planning for key roles throughout the function.

13. To consider any findings of major investigations of internal control over financial reporting matters as delegated by the Board or on the Committee's initiative and assess management's response.

14. To receive an annual report, and other reports from time to time as may be required by applicable laws and regulations, from the principal executive officer and principal financial officer to the effect that such persons have disclosed to the Committee and to the external auditor all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which could adversely affect the Company's ability to record and report financial data and any fraud, whether material or not, that involves management or other employees who have a significant role in the Company's internal controls over financial reporting.

15. To provide to the Board such assurances as it may reasonably require regarding compliance by the Company, its subsidiaries and those of its associates for which it provides management services with all supervisory and other regulations to which they are subject.

16. To provide to the Board such additional assurance as it may reasonably require regarding the reliability of financial information submitted to it.

17. To receive from the Compliance function reports on the treatment of substantiated complaints regarding accounting, internal accounting controls or auditing matters received through the Group Disclosure Line (or such other system as the Group Audit Committee may approve) for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

18. To report any significant actual, suspected or alleged fraud (involving misconduct or unethical behaviour related to financial reporting) or misrepresentation of assets, which has not been included in a report submitted by management to the Committee, to the committee responsible for oversight of risk established within the Company's Regional Holding Company within the Group.

19. To agree the Company's policy for the employment of former employees of the external auditor, within the terms of the HSBC Group's policy.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### AUDIT COMMITTEE (Cont'd)

#### Responsibilities of the Committee (Cont'd)

20. The Committee shall meet alone with the external auditor and with the Head of Internal Audit at least once each year to ensure that there are no unresolved issues or concerns.

21. Where applicable to review the composition, powers, duties and responsibilities of subsidiaries' non-executive audit committee. The Group Audit Committee and/or Group Risk Committee (as appropriate) will review the core terms of reference for adoption by such committees and approve material deviations from such core terms.

22. To undertake or consider on behalf of the Chairman or the Board such other related tasks or topics as the Chairman or the Board may from to time entrust to it.

23. The Committee may appoint, employ or retain such professional advisors as the Committee may consider appropriate. Any such appointment shall be made through the Secretary to the Committee, who shall be responsible for the contractual arrangements and payment of fees by the Company on behalf of the Committee.

24. The Committee shall review annually the Committee's terms of reference and its own effectiveness and recommend to the Board any necessary changes.

25. To report to the Board on the matters set out in these terms of reference.

26. To provide half-yearly certificates to the Group Audit Committee, or to any audit committee of an immediate holding company in the form required by the Group Audit Committee. Such certificates to include a statement that the members of the Committee are independent.[1]

27. To review any related party transactions that may arise within the Company pursuant to the applicable laws and regulations.

28. To investigate any matter within these terms of reference, to have full access to and co-operation by management and to have full and unrestricted access to information.

The Committee may consider any matter relating to, and may request any information as it considers appropriate, from any audit committee, risk committee or other committee which has responsibility for the oversight of risk within the Company.

Where there is a perceived overlap of responsibilities between this Committee and the Risk Management Committee, the respective Committee Chairmen shall have the discretion to agree the most appropriate Committee to fulfill any obligation. An obligation under the terms of reference of this Committee or the Risk Management Committee will be deemed by the Board to have been fulfilled providing it is dealt with by either the Committee.

Where the Committee's monitoring and review activities reveal cause for concern or scope for improvement, it shall make recommendations to the Board on action needed to address the issue or to make improvements and, where necessary, shall report any such concerns to the Group Audit Committee and/or Group Risk Committee as appropriate; or to any audit and/or risk committee of an immediate holding company as appropriate.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### RISK MANAGEMENT COMMITTEE

#### Composition

The present members of the Risk Management Committee comprise:

- Mohamed Ross bin Mohd Din (Chairman)
- Lee Choo Hock
- Mohamed Ashraf bin Mohamed Iqbal

#### Frequency of Meetings

A total of five (5) Risk Management Committee meetings were held during the financial year 2012 and all members attended every meeting held.

#### Terms of Reference

The revised Terms of Reference as set out below were approved at the Risk Management Committee and Board of Directors' meetings held on 15 February 2012.

#### Membership

The Committee shall comprise not less than three (3) non-executive directors. All members shall be non-executive directors.

The Chairman of the Committee shall be appointed by the Board. Members of the Committee and the Chairman shall be subject to endorsement by Group Risk Committee.

The Chairman of the Committee shall be an independent non-executive director. The Board may from time to time appoint to the Committee additional members it has determined to be independent. In the absence of sufficient independent non-executive directors, the Board may appoint individuals from elsewhere in the HSBC Group[3] with no line or functional responsibility for the activities of the Company.

The Committee may invite any director, executive or other person to attend any meeting(s) of the Committee as it may from time to time consider desirable to assist the Committee in the attainment of its objective.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### RISK MANAGEMENT COMMITTEE (Cont'd)

#### Meetings and Quorum

The Committee shall meet with such frequency and at such times as it may determine but in any event, not less than once every quarter.

The quorum for meetings shall be two non-executive directors, including one independent non-executive director.

At all meetings of the Committee, the Chairman of the Committee, if present, shall preside. If the Chairman is absent, the members present at the meeting shall elect a chairman of the meeting, who shall be an independent non-executive director.

#### Objective

The Committee shall be accountable to the Board and shall have non-executive responsibility for oversight of and advice to the Board on matters relating to high level risk related matters and risk governance.

The purpose of the Committee is to oversee senior management's activities in managing financing, market, liquidity, operational, legal and other risk (including reputational risk) and to ensure that the risk management process is in place and functioning.

#### Responsibilities of the Committee

Without limiting the generality of the Committee's objective, the Committee shall have the following non-executive responsibilities, powers, authorities and discretion:

1. To oversee and advise the Board on all high level risk related matters.

   In providing such oversight and preparing advice to the Board, the Committee shall oversee (i) current and forward-looking risk exposures; (ii) the Company's risk appetite and future risk strategy, including capital and liquidity management strategy; and (iii) management of risk within the Company.

2. To advise the Board on risk appetite and tolerance in determining strategy.

   In preparing advice to the Board on risk appetite and tolerance the Committee shall (i) satisfy itself that risk appetite informs the Company's strategy; (ii) seek such assurance as it may deem appropriate that account has been taken of the current and prospective macroeconomic and financial environment, drawing on financial stability assessments published by authoritative sources that may be relevant; (iii) review and approve the methodology used in establishing the Company's risk appetite including for example risk asset ratios, limits on exposures and concentrations, leverage ratios, economic capital ratios and stress and scenario testing; and (iv) review the results of appropriate stress and scenario testing.

3. To advise the Board on alignment of remuneration with risk appetite.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### RISK MANAGEMENT COMMITTEE (Cont'd)

#### Responsibilities of the Committee (Cont'd)

4. To consider and advise the Board on the risks associated with proposed strategic acquisitions or disposals as requested from time to time by any Director in consultation with the Chairman of the Committee. In preparing such advice, the Committee shall satisfy itself that a due diligence appraisal of the proposition is undertaken, focusing in particular on risk aspects and implications for the risk appetite and tolerance of the HSBC Group[3], drawing on independent external advice where appropriate and available, before the Board takes a decision whether to proceed.

5. To require regular risk management reports from management which:

   (i) enable the Committee to assess the risks involved in the Group's business and how they are controlled and monitored by management; and

   (ii) give clear, explicit and dedicated focus to current and forward-looking aspects of risk exposure which may require a complex assessment of the Group's vulnerability to hitherto unknown or unidentified risks.

6. To review the effectiveness of the Company's risk management framework and internal control systems (other than internal financial control systems).

   In undertaking this responsibility, the Committee shall:

   (i) satisfy itself that there are adequate procedures for monitoring in a sufficiently timely and accurate manner, large exposures or risk types whose relevance may become of critical importance;

   (ii) satisfy itself that there are adequate procedures in place for requiring compliance with HSBC Group policies;

   (iii) consider any material findings from regulatory reviews and interactions with regulators in relation to risk governance or risk assessment or management process;

   (iv) discuss the internal control systems with management and satisfy itself that management has discharged its duty to have an effective internal control system. The Audit Committee of HSBC Bank Malaysia Berhad shall have primary responsibility in this regard in relation to internal financial controls;

   (v) satisfy itself that the risk management function is adequately resourced (including taking into account qualifications and experience of staff and training programmes and budget), has appropriate standing within Company and is free from constraint by management or other restrictions; and

   (vi) seek assurance from internal audit that internal control processes for risk management are adequate for the strategy determined by the Board.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### RISK MANAGEMENT COMMITTEE (Cont'd)

#### Responsibilities of the Committee (Cont'd)

7. Where applicable, the Committee shall approve the appointment and removal of the Chief Risk Officer.

   The Committee shall seek such assurance as it may deem appropriate that the Chief Risk Officer:

   (i) participates in the risk management and oversight process at the highest level on an enterprise-wide basis;

   (ii) has satisfied himself or herself that risk originators in the business units are aware of and aligned with the Company's risk appetite;

   (iii) has a status of total independence from individual business units;

   (iv) reports to the Committee alongside an internal functional reporting line to the Group Chief Risk Officer;

   (v) cannot be removed from office without the prior agreement of the Board; and

   (vi) has direct access to the chairman of the Committee in the event of need.

8. To seek to embed and maintain throughout the Company a supportive culture in relation to the management of risk and maintenance of internal controls alongside prescribed rules and procedures.

9. To review any issue which arises from any report from internal audit, the external auditor's annual report on the progress of the external audit, the management letter from the external auditor, any queries raised by the external auditor to management or, in each case, responses from management, which relates to the management of risk or internal control and has been referred to the Committee by the Audit Committee or as this Committee shall consider appropriate.

10. To require a timely response to be provided by management on material issues relating to the management of risk or internal control (other than internal financial control) raised in the external auditor's management letter which are considered by the Committee.

11. To review and endorse the content of the statements made in relation to internal controls (other than internal financial controls) in the annual report and accounts for submission to the Board.

12. Where applicable, to (i) review at least annually the terms of reference for the executive risk management meetings; and (ii) to review the minutes of such meetings and such further information as the executive risk management meeting may request from time to time.

13. To provide to the Board such additional assurance as it may reasonable require regarding the reliability of risk information submitted to it.

14. Where applicable, to review the composition, powers, duties and responsibilities of subsidiaries' risk management committees. The Group Risk Committee will review the core terms of reference for adoption by such committees and approve material deviations from such core terms.

15. To undertake or consider on behalf of the Chairman or the Board such other related tasks or topics as the Chairman or the Board may from to time entrust to it.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### RISK MANAGEMENT COMMITTEE (Cont'd)

#### Responsibilities of the Committee (Cont'd)

16. The Committee may appoint, employ or retain such professional advisors as the Committee may consider appropriate. In particular, the Committee shall consider whether external advice on risk matters should be taken to challenge analysis undertaken and assessments made by the Committee and the risk management function, for example an external advisor might be asked for input on the stress and scenario testing of a business strategy. Any such appointment shall be made through the Secretary to the Committee, who shall be responsible for the contractual arrangements and payment of fees by the Company on behalf of the Committee.

17. The Committee shall review annually the Committee's terms of reference and its own effectiveness and recommend to the Board, any necessary changes.

18. To report to the Board on the matters set out in these terms of reference.

19. To ensure a comprehensive risk management infrastructure is in place for managing all risks including unique Shariah risks. This includes risks associated with all Shariah contracts for all asset and liability based products (ALM) as well as those under the Treasury and Islamic Risk Management Tools such as derivatives. The comprehensive Shariah risk management infrastructure includes but is not limited to:

    (i) identifying and understanding the inherent Shariah non-compliance risks, taking into account existing controls that have been put in place and their effectiveness in mitigating such risks;
    (ii) measuring the potential impact of such risks to the Company for instance based on the historical and actual de-recognition of income derived from Shariah non-compliant activities;
    (iii) monitoring of Shariah non-compliance risks and a report on the Shariah non-compliance risks indicators shall be escalated to the Board, the Shariah Committee;
    (iv) keeping track of income not recognised arising from Shariah non-compliant activities and assessing the probability of similar cases arising in the future in conjunction with the Shariah Department;
    (v) formulating and recommending appropriate Shariah non-compliance risk management policies and guidelines in consultation with Shariah Department;
    (vi) developing and implementing processes for Shariah non-compliance risk awareness programme in the Company in consultation with Shariah Department.

20. To ensure a comprehensive risk management infrastructure is in place for managing all risks including Shariah risks. This includes risk associated with contracts under the Mudharabah and Musharakah financing or investments, which encompasses at the minimum:

    (i) Establishment of a process of periodic review on performance of Mudharabah and Musharakah financing or investments;
    (ii) Identification and establishment of exit strategies for Mudharabah and Musharakah financing or investments, including extension and redemptions;
    (iii) Update the Board on any material progress of Mudharabah and Musharakah financing or investments in a timely manner.

    The Committee may consider any matter relating to, and may request any information as it considers appropriate, from the Shariah Committee, any audit committee, risk committee or other committee which has responsibility for the oversight of risk within the Company.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### RISK MANAGEMENT COMMITTEE (Cont'd)

#### Responsibilities of the Committee (Cont'd)

Where there is a perceived overlap of responsibilities between the Company's Audit Committee and Risk Committee, the respective Committee Chairmen shall have the discretion to agree the most appropriate Committee to fulfill any obligation. An obligation under the terms of reference of the Company's Audit Committee or the Risk Committee will be deemed by the Board to have been fulfilled providing it is dealt with by either of the Committees.

Where the Committee's monitoring and review activities reveal cause for concern or scope for improvement, it shall make recommendations to the Board on action needed to address the issue or to make improvements and shall report any such concerns to the Group Audit Committee and/or Group Risk Committee as appropriate; or to any audit and/or risk committee of an intermediate holding company as appropriate.

#### Written or Circulating Resolution

Any resolution in writing, signed or assented to by all the members of the Committee shall be as valid and effectual as if it had been passed at a meeting of the Committee duly called and constituted and may consist of several documents in the like form each signed by one or more of the members of the Committee.

## NOMINATING COMMITTEE

### Composition

The present members of the Nominating Committee comprise:

- Mohamed Ashraf bin Mohamed Iqbal (Chairman)
- Mohamed Ross bin Mohd Din
- Azlan bin Abdullah
- Lee Choo Hock
- Mohamed Rafe bin Mohamed Haneef

### Frequency of Meetings

A total of five (5) Nominating Committee meetings were held during the financial year 2012. The attendance of the Directors at the Nominating Committee meeting held was as follows:

| Name of members | Designation | Attendance / No. of meetings |
|---|---|---|
| Mohamed Ashraf bin Mohamed Iqbal | Chairman, Independent Non-Executive Director | 5 / 5 |
| Mohamed Ross bin Mohd Din | Independent Non-Executive Director | 5 / 5 |
| Azlan bin Abdullah | Independent Non-Executive Director | 5 / 5 |
| Lee Choo Hock | Independent Non-Executive Director | 5 / 5 |
| Mohamed Rafe bin Mohamed Haneef | Chief Executive Officer, Non-Independent Executive Director | 4 / 5 |

### Terms of Reference

The revised Terms of Reference as set out below were approved at the Board of Directors meeting held on 5 December 2012.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### NOMINATING COMMITTEE (Cont'd)

#### Membership

The Committee shall consist of five (5) members, of which at least four (4) must be non-executive directors. The fifth person shall be an executive, who shall be the Chief Executive Officer of the Bank.

The Chairman of the Committee shall be an independent non-executive director appointed by the Board. In order to avoid conflict of interest, a member of the Committee shall abstain from participating in discussions and decisions on matters involving themselves.

The Committee may invite any director, executive or other person to attend any meeting(s) of the Committee as it may from time to time consider appropriate to assist the Committee in the attainment of its objective.

#### Meetings and Quorum

The Committee shall meet with such frequency and at such times as it may determine but in any event, not less than twice a year.

The quorum for meetings shall be three (3) directors.

At all meetings of the Committee, the Chairman of the Committee, if present, shall preside. If the Chairman is absent, the members present at the meeting shall elect a Chairman, who shall be an independent non-executive director.

#### Objective

The Committee shall be responsible for ensuring that there are formal and transparent procedures for the assessment of the effectiveness of the Board and the Board's various committees, and the performance of the key Senior Management Officers of the Bank.

**NOMINATING COMMITTEE (Cont'd)**

**Responsibilities of the Committee**

1. Without limiting the generality of the Committee's objective, the Committee shall have the following responsibilities:

    (a) To assess and recommend the nominees for directorship, board committee members, Shariah Committee members as well as nominees for the CEO. This includes assessing and recommending directors and Shariah Committee members for reappointment, before an application is submitted to Bank Negara Malaysia for approval;

    (b) To review the structure, size and composition (including skills, knowledge and experience and other core competencies) required of the Board and make recommendations to the Board with regards to any changes through an annual review;

    (c) To make recommendations to the Board concerning the renewal of the terms of office of non-executive directors and any matters relating to the continuation in office of any director at any time;

    (d) To recommend to the Board the removal of any director, CEO or Shariah Committee member or key Senior Management Officers if he/she is ineffective, errant and negligent in discharging his/her responsibilities;

    (e) To ensure the establishment of performance evaluation processes on the effectiveness of the Board as a whole and the contribution of each director to the effectiveness of the Board, the contribution of the Board's various committee, the performance of the CEO and other key Senior Management Officers of the Bank. Annual assessment should be that are conducted based on objective performance criteria and such performance criteria should be approved by the full Board;

    (f) To give full consideration to succession planning for directors in the course of its work, taking into account the challenges and opportunities facing the Company, and what skills and expertise are therefore needed on the Board in the future;

    (g) To make recommendations to the Board concerning the re-election by shareholders of directors retiring by rotation;

    (h) To ensure that all directors and Shariah Committee members receive an appropriate continuous training program in order to keep abreast with the latest developments in the industry;

    (i) To assess on an annual basis, to ensure that the directors and key Senior Management Officers are not disqualified under section 23 of the Islamic Banking Act 1983 and the Shariah Committee members are not disqualified under the Bank Negara Malaysia Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions (BNM/GPS 1).

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### NOMINATING COMMITTEE (Cont'd)

**Responsibilities of the Committee (Cont'd)**

(j) To assess and recommend to the Board any proposal for appointments and reappointments of CEO and Key Senior Management and ensure that there are established procedures to oversee succession planning for Key Senior Management. Key Senior Management is defined as direct reports of the CEO.

(k) To review the list of key responsible persons and be satisfied that the list is comprehensive and has taken into account all key positions within the Bank.

(l) To ensure that all key responsible persons fulfill fit and proper requirements and be responsible for conducting assessments of the fitness and propriety of directors, members of Shariah Committee and the CEO. For other key responsible persons, this function may be performed by the CEO or a designated committee under the delegated authority of the Board and the Committee.

2. In respect of the Board of Directors, the Committee shall:

(i) Before recommending an appointment, evaluate the balance of skills, knowledge and experience on the Board, and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment. In identifying suitable candidates the Committee shall:

(a) use such method or methods to facilitate the search as it may deem appropriate;
(b) consider candidates from a wide range of backgrounds;
(c) consider candidates on merit and against objective criteria, taking care that appointees have enough time available to devote to the position; and
(d) have due regard for the benefits of diversity on the board, including gender;

(ii) keep under review the leadership needs of HBMS, both executive and non-executive, with a view to ensuring the continued ability of HBMS to compete effectively in the marketplace;

(iii) keep up to date and fully informed about strategic issues and commercial changes affecting HBMS and the market in which it operates;

(iv) review annually the time required from non-executive directors. Performance evaluation should be used to assess whether the non-executive directors are spending enough time to fulfill their duties; and

(v) ensure that on appointment to the Board, non-executive directors receive a formal letter of appointment setting out clearly what is expected of them in terms of time commitment, committee service and involvement outside board meetings.

(vi) The Committee may appoint, employ or retain such professional advisers as the Committee may consider appropriate. Any such appointment shall be made through the Secretary to the Committee, who shall be responsible for the contractual arrangements and payment of fees by HBMS on behalf of the Committee.

3. In order to be consistent with HSBC Group's global strategies, where strategies and policies related to the objective of this Committee are driven by the parent company, the Committee shall:

(i) Discuss, evaluate and provide input on strategies and policies to suit the local environment; and
(ii) Deliberate and make the necessary recommendations on such strategies and policies to assist the Board when approving major issues and strategies.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### NOMINATING COMMITTEE (Cont'd)

#### Responsibilities of the Committee (Cont'd)

4. Where major decisions related to the objective of this Committee are made by the parent company, the Committee shall evaluate the issues before making recommendations to the Board for adoption.

5. The Committee will not be delegated with decision making powers but shall report its recommendation to the Board for decision.

#### Written or Circulating Resolution

Any resolution in writing, signed or assented to by all the members of the Committee shall be as valid and effectual as if it had been passed at a meeting of the Committee duly called and constituted. Any such resolution may consist of several documents in the like form each signed by one or more directors.

#### Amendment

The Committee shall from time to time review the Committees' terms of reference and its own effectiveness and recommend to the Board any necessary changes.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### CONNECTED PARTY TRANSACTIONS COMMITTEE

#### Terms of Reference

The Terms of Reference was revised and approved at the Board meeting on 15 February 2012.

#### Composition

The Committee shall consist of at least four (4) members, of which two (2) must be non-executive directors. The other two (2) members are as follows:

- Chief Risk Officer ("CRO")
- Head of Wholesale Credit and Risk

The CRO is empowered to delegate the exercise of his authorities as a member of the Committee, in his absence, to such executive(s) as he sees fit.

#### Quorum

A minimum of three (3) members' authorisation shall constitute an approval by the Committee, one of whom must be the CRO, or in his absence, his delegate.

#### Meetings and Chairman

The meetings of the Committee may be arranged in any form other than physical meetings. Alternatively, meetings held via teleconferencing or video-conferencing are deemed valid and are in the best interests of the Committee.

The Chairman of the meeting shall be elected by the Committee who has formed the quorum.

#### Written Circular Resolution

Any resolution in writing, signed or assented to by a minimum of three (3) members of the Committee, one of whom must be the CRO, shall be as valid and effectual as if it had been passed at a meeting of the Committee duly called and constituted and may consist of several documents in the like form each signed by one or more of the members of the Committee.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### CONNECTED PARTY TRANSACTIONS COMMITTEE (Cont'd)

**Powers delegated by the Board**

The Committee is delegated with the authority of the Board to approve all corporate/commercial credit transactions up to RM50 million (inclusive of existing credit facilities) with a connected party of HBMS. This authority limit may be changed from time to time as delegated by the Board.

The exercise of the above authority by the Committee shall be subject to the HBMS' normal credit evaluation process as well as the existing credit policies and lending guidelines, which include the following:

- Guidelines on Credit Transactions and Exposures with Connected Parties
- Business Instruction Manual – Volume 3 Credit
- Country Risk Plan
- Large Credit Exposure Policy
- Bank Negara Malaysia Guidelines on Single Customer Limit
- Bank Negara Guidelines on Credit Transactions and Exposure with Connected Parties
- Companies Act 1965
- Hong Kong Banking Ordinance
- Applicable laws and regulations

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### SHARIAH COMMITTEE

#### Terms Of Reference

#### Membership

Assoc. Prof. Dr. Younes Soualhi (Chairman)
Khairul Anuar Ahmad
Professor Dr. Obiyathulla Ismath Bacha
Dr. Muhammad Yusuf Saleem Ghulam Nabi
Professor Dr Abdul Rahim Abdul Rahman

#### Composition

The Shariah Committee shall consist of at least five (5) members who must be individuals appointed upon recommendation of the Bank's Nominating Committee and approval of the Bank's Board of Directors and only after obtaining prior written approval of Bank Negara Malaysia. Such appointment shall be valid for a renewable term of two (2) years.

#### Meetings, Quorum, Frequency and Decision Making

a. The Shariah Committee should hold meeting(s) at least once in every two months and whenever required, and should report regularly to the Board of Directors.

b. The minimum quorum of a Shariah Committee meeting shall comprise of four (4) members with two (2) of attending members must be members with Shariah background.

c. At all meetings of the Shariah Committee, the Chairman of the Committee with qualified Shariah background, if present, shall preside.

d. If the Chairman of the Shariah Committee is unable to attend the meeting, the members shall elect one (1) member among themselves to become the alternate Chairman to preside over the meeting. The alternate Chairman shall be a member with qualified Shariah background.

e. Decisions shall be made on the basis of two-thirds of the members present, with majority of the two-thirds votes shall be members with Shariah background.

f. A total of eleven (11) Shariah Committee meetings were held during the financial year 2012. The attendance of the members at the Shariah Committee meeting held was as follows:

| Name of members | Designation | Attendance / No. of meetings |
|---|---|---|
| Assoc. Prof. Dr. Younes Soualhi | Chairman | 11 / 11 |
| Khairul Anuar Ahmad | Member | 11 / 11 |
| Dr. Muhammad Yusuf Saleem Ghulam Nabi | Member | 10 / 11 |
| Prof. Dr. Obiyathulla Ismath Bacha | Member | 10 / 11 |
| Prof. Dr. Abdul Rahim Abdul Rahman | Member | 9/11 |

**BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)**

**SHARIAH COMMITTEE (Cont'd)**

**Objectives**

The primary objective of the Shariah Committee is to ensure that the Bank is operated and managed in accordance with the Shariah by performing its responsibilities as set out below.

**Responsibilities**

Without limiting the generality of the Shariah Committee's objectives, the Shariah Committee shall have the following responsibilities, authorities and discretion:

a. to make decisions on Shariah matters in an independent and objective manner without undue influence or duress and to be responsible and accountable for its Shariah decisions, opinions and views;

b. to advise the Board and provide input on Shariah matters to help the Bank to comply with the Shariah principles at all times;

c. to attend all Board meetings whenever required by the Board and accordingly, update the Board members on any Shariah matters pertaining to the Bank;

d. to endorse Shariah policies and procedures of the Bank and to ensure that the contents are Shariah compliant;

e. to approve the product structures and transactions which are being managed, executed and entered into by the Bank;

f. to endorse and validate the following documentations:

   i. the terms and conditions contained in the forms, contracts, agreements or other legal documentations used in executing the transactions; and

   ii. the product manuals, marketing advertisements, sales illustrations and brochures used to describe the products;

g. to perform an oversight role on Shariah matters related to the institution's business operations and activities through regular Shariah review reports and Shariah audit observations and where appropriate, to propose corrective measures.

h. to provide necessary assistance on Shariah matters to the Bank's related parties such as its legal counsel, compliance department and auditors to ensure compliance with the Shariah principles;

i. to provide written Shariah opinions if the Bank makes a reference to the Shariah Advisory Council of BNM for further deliberation or in the event the Bank submits an application to BNM/Securities Commission for approval on any new product / transaction.

j. to ratify the list of approved matters prepared by the Shariah Department that the operations and business activities of the Bank are in compliance with the Shariah principles;

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### SHARIAH COMMITTEE (Cont'd)

#### Responsibilities (Cont'd)

k. to provide Shariah compliant endorsement in the annual financial statements of the Bank, supported by the Annual Shariah Committee Report; and

l. if the Shariah Committee has a reasonable ground to believe that the Bank is involved in non Shariah compliant activities, the Shariah Committee shall inform the Board and to advise, propose or rectify as necessary to ensure its conformity to Shariah requirements. In cases where Shariah non-compliant activities are not effectively or adequately addressed or no rectification measures are made by the Bank, the Shariah Committee shall inform BNM of the fact.

m. to provide consultation to the Audit Committee in the course of the Audit Committee determining the deliverables of the Shariah audit function.

#### Written or Circulating Resolution

Any resolution in writing, signed or assented to by all the members of the Shariah Committee shall be as valid and effectual as if it had been passed at a meeting of the Shariah Committee duly called and constituted and may consist of several documents in the like form each signed by one or more of such members.

#### Restrictions

The Shariah Committee member shall not have any relationship that could interfere or be reasonably perceived to interfere with the exercise of independent judgment, with the following persons:

a. an immediate family member such as spouse, children or siblings who are, or who were during the last financial year, employed by the Bank or any of its related companies as a senior executive officer (CEO) or non-independent board members; and

b. a substantial shareholder or a partner in (with a stake of 5% or more) or an executive officer of, or a director of any for-profit business organisation to which the Bank or any of its subsidiaries made or from which the Bank or any of its subsidiaries received, significant payments in the current or immediate past financial year.

The Shariah Committee member shall not be:

a. an employee of the Bank or any of its related companies for the current or the last financial year; and

b. currently serving another Islamic financial institution as a Shariah Committee member.

## BOARD RESPONSIBILITY AND OVERSIGHT (Cont'd)

### SHARIAH COMMITTEE (Cont'd)

#### Recommendations

Where, in the course of meeting its objectives and performing its obligations, the Shariah Committee discovers an issue of concern or for which there is scope for improvement, it shall make recommendations to the Board of Directors on actions needed to address the issue or to make improvements.

The Shariah Committee shall from time to time review these Terms of Reference (but at a minimum, once a year) and its own effectiveness and recommend to the Board of Directors any necessary changes.

#### Law and Guidelines

The provisions of these Terms of Reference must be read together with all applicable laws and guidelines including all relevant laws, regulations, as well as guidelines, circulars and directives issued by Bank Negara Malaysia and other relevant authorities, the Bank's Memorandum and Articles of Association and policies & manuals which the Bank must adhere to by virtue of being a member of the HSBC Group of companies.

In the event of any conflict between these Terms of Reference and such laws and guidelines, the provisions of such laws and guidelines must prevail.

## MANAGEMENT REPORTS

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

- Minutes of the Board Committees
- Business progress report
- Financial Performance Report
- Rolling/Annual Operating Plan
- Market Risk Limits
- Risk Appetite Statement
- Internal Capital Adequacy Assessment Process
- Advance Internal Ratings –Based Approach (IRBA) Implementation Plan
- HSBC Global Standards and Risk and Control Framework
- Risk Management Reports on Asset Quality
- Credit Advances Reports
- Scenario Stress Testing and Reverse Stress Testing Results
- Credit Transactions and Exposures to Connected Parties Report
- Anti Money Laundering and Counter Terrorist Financing Reports
- Organisational Effectiveness Update Report
- Resolvability and Resolution Plan
- People and Structure Strategy
- Human Resource Update
- Comparative analysis of competitor banks and competitor performance report

## INTERNAL AUDIT AND INTERNAL CONTROL ACTIVITIES

It is the responsibility of management at all levels to ensure that effective internal controls are in place for all the operations for which they are responsible. Primary controls within the internal control environment are provided by established and documented procedures, secondary controls by managerial and executive supervision. Internal Audit provides tertiary control through independent inspection.

Systems and procedures are in place to identify, control and report on all major risks including credit, volatility in the market prices of financial papers, liquidity, operational errors, breaches of law or regulations, unauthorized activities, or frauds. These are monitored by the Operational Risk and Internal Control Committee, the Risk Committee, the Asset and Liability Management Committee (ALCO), the Executive Committee (EXCO), the Audit Committee, the Risk Management Committee and the Board of Directors.

Responsibilities for financial performance against plans and for capital expenditure, credit exposures and market risk exposures are delegated within limits to line management. Functional management in HSBC Group Head Office has been given responsibility to set policies, procedures and standards in the areas of finance; legal and regulatory compliance; internal audit; human resources; credit; market risk; operational risk; computer systems and operations; property management; and for selected global product lines. The Bank operates within these policies, procedures and standards set by the HSBC Group Head Office functions.

The Bank’s internal audit function monitors compliance with policies and standards and the effectiveness of internal control structures across the whole Bank in conjunction with other HSBC Group Internal Audit units. The work of the operational risk assurance and audit functions is focused on areas of greatest risk to the Bank on a risk-based approach. The Head of Internal Audit reports functionally to the Audit Committee and administratively to the Chief Executive Officer of HSBC Bank Malaysia Berhad.

The Audit Committee has also reviewed the annual internal audit plan to ensure adequate scope and comprehensive coverage on the audit activities, effectiveness of the audit process, adequate resource deployment for the year and satisfactory performance of the Bank’s Internal Audit Unit. The Committee has reviewed the internal audit reports, audit recommendations made and management’s response to these recommendations. Where appropriate, the Committee has directed actions to be taken by the Bank’s management team to rectify any deficiencies identified by internal audit and improve the system of internal controls based on the internal auditors’ recommendations for improvements.

## RATING BY EXTERNAL RATING AGENCIES

Details of the Bank's ratings are as follows:

| **Rating Agency** | **Date** | **Rating Classification** | **Ratings Received** |
|---|---|---|---|
| RAM Ratings Services Berhad | September 2012 | - Long term | AAA |
| | | - Short term | P1 |
| | | - Outlook | Stable |
| | | - Multi-currency Sukuk Programme | AAA |

## DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2012

The directors have pleasure in presenting their report together with the audited financial statements of HSBC Amanah Malaysia Berhad ("the Bank") for the year ended 31 December 2012.

### Principal Activities

The principal activities of the Bank are Islamic banking business and related financial services.

There have been no significant changes in these activities during the year.

### Results

| | **RM'000** |
|---|---|
| Profit before taxation | **165,171** |
| Taxation | **(31,931)** |
| Profit after taxation | **133,240** |

### Dividend

The directors do not recommend any dividend payment in respect of the current financial year.

### Reserves and Provisions

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

### Other statutory information

Before the financial statements of the Bank were finalised, the directors took reasonable steps to ascertain that:

i) all known bad debts have been written off and adequate provision made for doubtful debts, and
ii) any current assets which were unlikely to be realised in the ordinary course of business have been written down to an amount which they might be expected so to realise.

At the date of this report, the directors are not aware of any circumstances:

i) that would render the amount written off for bad debts, or the amount of the provision for doubtful debts, in the financial statements of the Bank inadequate to any substantial extent.
ii) that would render the value attributed to the current assets in the financial statements of the Bank misleading, or
iii) which have arisen which render adherence to the existing methods of valuation of assets or liabilities of the Bank misleading or inappropriate, or
iv) not otherwise dealt with in this report or the financial statements, that would render any amount stated in the financial statements of the Bank misleading.

**Other statutory information (Cont'd)**

At the date of this report, there does not exist:

i) any charge on the assets of the Bank that has arisen since the end of the financial year and which secures the liabilities of any other person, or

ii) any contingent liability in respect of the Bank that has arisen since the end of the financial year other than in the ordinary course of business.

No contingent liability or other liability of the Bank has become enforceable, or is likely to become enforceable within the period of twelve months after the end of the financial year which, in the opinion of the directors, will or may affect the ability of the Bank to meet its obligations as and when they fall due.

In the opinion of the directors, the financial performance of the Bank for the financial year ended 31 December 2012 has not been substantially affected by any item, transaction, or event of a material and unusual nature, nor has any such item, transaction or event occurred in the interval between the end of that financial year and the date of this report.

**Business Strategy during the year**

Malaysia's GDP growth for 2012 continues to be spurred by robust domestic and private consumption, effectively mitigating against negative spillovers from weaknesses in the external environment. The government's efforts through the Economic Transformation Programme (ETP) and the Government Transformation Programme (GTP) have contributed to sustainable economic growth within the country. The Malaysian financial services industry in particular, despite facing both macroeconomic pressures and regulatory changes, still recorded strong growth in both financing and deposits. It is against this backdrop and the intensified competition from existing and new competitors alike that the Bank delivered an outstanding performance, achieving the highest profit before tax in history as it continues to remain strong in cost discipline, relationship-banking, product innovation and global distribution capabilities.

RAM Ratings Services Berhad has reaffirmed the Bank's AAA/P1 ratings, reflecting the Bank's robust asset quality and strong financial standing. The Bank maintained its market leader position in various segments and won numerous awards in 2012. Amongst the awards won are:

1. Best Sukuk House 2012 - Euromoney
2. Most Innovative Deal (Axiata RMB Sukuk) - Euromoney
3. Best Islamic Finance Bank in South East Asia - Alpha South East Asia
4. Best Project Financing (Tanjung Bin Energy USD2.1 Billion Senior Financing) - Asia Money.
5. Best Islamic Finance Deal (Axiata RMB Sukuk) - Finance Asia
6. Project Bond of the Year (Tanjung Bin Energy MYR 3.29 Billion Sukuk) - PFI Awards
7. Best Sovereign Sukuk (Government of Malaysia US2 Billion Dual Tranche Global Sukuk) – The Asset Triple A Asian Awards
8. Islamic Deal of the Year - (Government of Malaysia US2 Billion Dual Tranche Global Sukuk) – The Asset Triple A Asian Awards
9. Best Islamic Deal Malaysia - (Government of Malaysia US2 Billion Dual Tranche Global Sukuk) – The Asset Triple A Asian Awards
10. Best International Islamic Bank– Euromoney
11. Outstanding Contribution to Islamic Finance Award - (Government of Malaysia Wakala Global Sukuk Berhad) – Euromoney

**Business Strategy during the year (Cont'd)**

The Retail Banking and Wealth Management segment has seen significant additions in the range and diversity of wealth and asset management products and services offered during the year. The launch of the HSBC Fund Navigator, an online unit trust fund analytical tool to aid customers in making informed investment decisions is the first amongst retail banks in Malaysia, and a testament of the Bank's commitment to develop products and solutions in response to market trends and in support of our customers' personal and business needs.

The Bank's Global Market's segment continues to take advantage of its debt capital market (DCM) leadership and expertise to secure key deals. The Bank also focused on driving incremental growth in the foreign exchange flow business amongst its corporate clientele as well as strategically positioning itself so as to be able to capture additional value in the form of other related trades from its larger DCM deals.

On the Corporate platform, increased efforts were made to deepen existing relationships and deliver more value. Global Trade and Receivables Finance focused on key sectors and clients in bilateral trade flows within countries in East Asia with promising results during the year.

With the opening of 11 branches during the year, the Bank now has the widest branch and delivery network amongst foreign Islamic banks in Malaysia, with 26 branches and 25 standalone automatic-teller machines (ATMs). The Bank is a member of the Malaysian Electronic Payment System (MEPS), a shared ATM network of local banks with more than 10,000 ATMs nationwide and HOUSe, a shared ATM network connecting 4 locally incorporated foreign banks in Malaysia.

The Bank's investment in the community is primarily focused on education and the environment because we believe they provide the fundamental building blocks for the development of the society. The Bank endeavours to contribute towards changing people's lives and the environment they live in for the better, and encourages active participation from our colleagues in all corporate sustainability initiatives. The Bank's approach to sustainability is about managing its business successfully, profitably and for the long term.

**Outlook For 2013**

With the continually evolving regulatory environment and slower economic activity predicted in major global economies, both growth and margins are expected to be under pressure, with the overall outlook for the local banking sector appearing challenging. Nevertheless, growth in the local financial and insurance sectors in 2013 is still expected to remain resilient, supported by the continued expansion in domestic demand and private sector activities.

The focus in 2013 will remain on growing the Premier and Advance propositions. The Bank intends to increase its current share of high quality assets via the relationship-based approach, by increasing value added offerings, building on cross referrals and cross selling of various banking products (with special emphasis on wealth management services) to the Bank's existing customers. The Bank will also capitalise on the HSBC Group's international connectivity for cross border trade initiatives, and will engage with relevant Government bodies for early identification of inbound investments. As liquidity conditions in the domestic financial markets is expected to remain favourable for further expansion of sukuk-market activity, the Bank will play on its Debt Capital Market leadership and expertise to secure more key deals.

The Bank is currently guided by both HSBC Group's global standards and local regulatory requirements in Risk and Compliance and will continue to improve the effectiveness and efficiency of its business model in 2013 under the backdrop of these standards and requirements. At the same time, the Bank will focus on delivering quality customer service and offer needs based banking products and business solutions, while deepening relationships with valued clients and customers.

**Directors' Report (Cont'd)**

## Directors and their Interests in Shares

The names of the directors of the Bank in office since the last report and at the date of this report are:

- Louisa Cheang Wai Wan
- Mukhtar Malik Hussain
- Mohamed Rafe bin Mohamed Haneef
- Mohamed Ross bin Mohd Din
- Azlan bin Abdullah
- Mohamed Ashraf bin Mohamed Iqbal
- Lee Choo Hock

In accordance with Articles 72 and 73 of the Articles of Association, Mukhtar Malik Hussain and Azlan bin Abdullah shall retire from the Board at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-election.

According to the register of directors' shareholdings maintained by the Bank in accordance with Section 134 of the Companies Act, 1965, the directors holding office at year end (including the spouses or children of the Directors) who have beneficial interests in the shares of related corporations are as follows:

| | | Number of Shares | | |
|---|---|---|---|---|
| Name<br>**HSBC Holdings plc**<br>**Ordinary Shares** | Balance at<br>1.1.2012 | Bought | Sold | Balance at<br>31.12.2011 |
| Mukhtar Malik Hussain | 388,720 | 352,599 | - | 741,319 |

| | | Number of Shares | | |
|---|---|---|---|---|
| Name<br>**HSBC Holdings plc**<br>**HSBC Share Plan** | Balance at<br>1.1.2012 | Shares Issued Including Dividend | Shares Vested/ Forfeited | Balance at<br>31.12.2012 |
| Mukhtar Malik Hussain | 863,983 | 134,719 | 711,711 | 286,991 |

| | | Number of Shares | | |
|---|---|---|---|---|
| Name<br>**Options over HSBC Holdings plc shares** | Balance at<br>1.1.2012 | Bought | Sold | Balance at<br>31.12.2012 |
| Mukhtar Malik Hussain | 4,016 | - | 4,016 | - |
| Mohamed Ross bin Mohd Din | 3,443 | - | - | 3,443 |

None of the other directors holding office at 31 December 2012 had any interest in the ordinary shares and options of the Bank and of its related corporations during the financial year.

**Directors' Report (Cont'd)**

## Directors' Benefits

Since the end of the previous financial year, no Director of the Bank has received or become entitled to receive any benefit (other than a benefit included in the aggregate amount of emoluments received or due and receivable by Directors as shown in the financial statements or the fixed salary of a full-time employee of the Bank or of a related company) by reason of a contract made by the Bank or a related corporation with the Director or with a firm of which the Director is a member, or with a company in which the Director has a substantial financial interest.

Neither at the end of the financial year, nor at any time during that year, did there subsist any arrangements to which the Bank is a party whereby Directors might acquire benefits by means of the acquisition of shares in, or debentures of, the Bank or any other body corporate, except for:

i Directors who were granted the option to subscribe for shares in the ultimate holding company, HSBC Holdings plc, under Executive/Savings-Related Share Option Schemes at prices and terms as determined by the schemes, and

ii Directors who were conditionally awarded shares of the ultimate holding company, HSBC Holdings plc, under its Restricted Share Plan/HSBC Share Plan.

## Immediate and Ultimate Holding Company

The Directors regard HSBC Bank Malaysia Berhad, a company incorporated in Malaysia, and HSBC Holdings plc, a company incorporated in England, as the immediate and ultimate holding companies of the Bank respectively.

**Shariah Committee**

The business activities of the Bank are subject to Shariah compliance and conformation by the Shariah Committee consisting of five (5) members appointed by the Board for two (2) years terms.

All Shariah Committee members are expected to participate and engage actively in deliberating on Shariah issues put before them. Without limiting the generality of the Shariah Committee's objectives as stipulated by the Bank's Shariah Governance Policy (to be read together with the Bank Negara Malaysia's Shariah Governance Framework as well as the Bank's Shariah Committee Terms of Reference) the Shariah Committee shall have the following responsibilities, authorities and discretion:

a. to make decisions on Shariah matters in an independent and objective manner without undue influence or duress and to be responsible and accountable for its Shariah decisions, opinions and views;

b. to advise the Board and provide input on Shariah matters and to help the Bank to comply with the Shariah principles at all times;

c. to attend all Board meetings whenever required by the Board and accordingly, update the Board members on any Shariah matters pertaining to the Bank;

d. to endorse Shariah policies and procedures of the Bank and to ensure that the contents are Shariah compliant;

e. to approve the product structures and transactions which are being managed, executed and entered into by the Bank;

f. to endorse and validate the following documentations:

    i. the terms and conditions contained in the forms, contracts, agreements or other legal documentations used in executing the transactions; and

    ii. the product manuals, marketing advertisements, sales illustrations and brochures used to describe the products;

g. to perform an oversight role on Shariah matters related to the institution's business operations and activities through regular Shariah review reports and Shariah audit observations and where appropriate, to propose corrective measures.

h. to provide necessary assistance on Shariah matters to the Bank's related parties such as its legal counsel, compliance department and auditors to ensure compliance with the Shariah principles;

i. to provide written Shariah opinions if the Bank makes a reference to the Shariah Advisory Council of BNM for further deliberation or in the event the Bank submits an application to BNM/Securities Commission for approval on any new product/transaction.

j. to ratify the list of approved matters prepared by the Shariah Department that the operations and business activities of the Bank are in compliance with the Shariah principles;

k. to provide Shariah compliant endorsement in the annual financial statements of the Bank, supported by the Annual Shariah Committee Report; and

**Shariah Committee (Cont'd)**

l. if the Shariah Committee has a reasonable ground to believe that the Bank is involved in non Shariah compliant activities, the Shariah Committee shall inform the Board and to advise, propose or rectify as necessary to ensure its conformity to Shariah requirements. In cases where Shariah non-compliant activities are not effectively or adequately addressed or no rectification measures are made by the Bank, the Shariah Committee shall inform BNM of the fact;

m. to provide consultation to the Audit Committee in the course of the Audit Committee determining the deliverables of the Shariah audit function.

**Directors' Report (Cont'd)**

**Auditors**

The auditors, Messrs. KPMG, have indicated their willingness to accept re-appointment.

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

.............................................Director
**MUKHTAR MALIK HUSSAIN**

.............................................Director
**MOHAMED RAFE BIN MOHAMED HANEEF**

Kuala Lumpur, Malaysia
20 February 2013

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

## DIRECTORS' STATEMENT

In the opinion of the directors:

We, Mukhtar Malik Hussain and Mohamed Rafe bin Mohamed Haneef, being two of the directors of HSBC Amanah Malaysia Berhad, do hereby state on behalf of the directors that, in our opinion, the financial statements set out on pages 47 to 119 are drawn up in accordance with the provisions of the Companies Act, 1965 and Malaysian Financial Reporting Standards, International Financial Reporting Standards and the requirements of the Companies Act, 1965 in Malaysia so as to give a true and fair view of the financial position of the Bank as at 31 December 2012 and of the financial performance and cash flows of the Bank for the year then ended.

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

..................................................Director
**MUKHTAR MALIK HUSSAIN**

..................................................Director
**MOHAMED RAFE BIN MOHAMED HANEEF**

Kuala Lumpur, Malaysia
20 February 2013

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

## STATUTORY DECLARATION

I, Saw Say Pin, being the officer primarily responsible for the financial management of HSBC Amanah Malaysia Berhad, do solemnly and sincerely declare that, to the best of my knowledge and belief, the financial statements set out on pages 47 to 119 are correct, and I make this solemn declaration conscientiously believing the same to be true, and by virtue of the provisions of the Statutory Declarations Act, 1960.

Subscribed and solemnly declared by the abovenamed in Kuala Lumpur, Malaysia on 20 February 2013

.................................................................
SAW SAY PIN

BEFORE ME:

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

PESURUHJAYA SUMPAH
No. W 633
MURALITHERAN
ART PILLAI
MALAYSIA

Tkt. 20, AmBank Building
No. 55, Jalan Raja Chulan
50200 Kuala Lumpur

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

## SHARIAH COMMITTEE'S REPORT

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

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

Assalamu 'Alaikum Warahmatullahi Wabarakatuh

In carrying out the roles and responsibilities as Shariah Committee of HSBC Amanah Malaysia Berhad as prescribed in the Shariah Governance Framework for Islamic Financial Institutions issued by Bank Negara Malaysia, the HSBC Amanah Shariah Governance Policy as well as the HSBC Amanah Shariah Committee's Terms of Reference, we hereby submit the following report for the financial year ended 31 December 2012:

1. We have conducted eleven (11) meetings for the whole year of 2012 and reviewed the principles and the contracts relating to the transactions and applications introduced by HSBC Amanah Malaysia Berhad during the financial year ended 31 December 2012 to ensure conformity with Shariah requirements.

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

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

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

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

On that note, we, being the members of the Shariah Committee of HSBC Amanah Malaysia Berhad, do hereby confirm that in our opinion:-

a) the contracts, transactions, dealings entered into by HSBC Amanah Malaysia Berhad during the financial year ended 31 December 2012 have been reviewed by us and are in compliance with Shariah rules and principles; and

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

c) all earnings that have been realized from sources or by means prohibited by the Shariah principles have been considered for disposal to charitable causes.

**SHARIAH COMMITTEE'S REPORT (Cont'd)**

We, the members of the Shariah Committee of HSBC Amanah Malaysia Berhad, do hereby confirm that, to our view, the operations of HSBC Amanah Malaysia Berhad for the financial year ended 31 December 2012 have been conducted in conformity with the Shariah principles.

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

Wassalamu 'Alaikum Warahmatullahi Wabarakatuh

Chairman of the Shariah Committee ……………………………
Assoc. Prof. Dr. Younes Soualhi

Member of the Shariah Committee ……………………………
Khairul Anuar Ahmad

Member of the Shariah Committee ……………………………
Dr. Yusuf Saleem Ghulam Nabi

Member of the Shariah Committee ……………………………
Prof. Dr. Obiyathulla Ismath Bacha

Member of the Shariah Committee ……………………………
Prof. Dr. Abdul Rahim Abdul Rahman

Kuala Lumpur, Malaysia
20 February 2013

KPMG (Firm No. AF 0758)
Chartered Accountants
Level 10, KPMG Tower
8, First Avenue, Bandar Utama
47800 Petaling Jaya
Selangor Darul Ehsan, Malaysia

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

## INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF HSBC AMANAH MALAYSIA BERHAD

### Report on the Financial Statements

We have audited the financial statements of HSBC Amanah Malaysia Berhad, which comprise the statement of financial position as at 31 December 2012, and the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages 47 to 119.

Directors' Responsibility for the Financial Statements

The Directors of the Bank are responsible for the preparation and fair presentation of financial statements so as to give a true and fair view in accordance with Malaysian Financial Reporting Standards, International Financial Reporting Standards and the requirements of the Companies Act, 1965 in Malaysia. The Directors are also responsible for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with approved standards on auditing in Malaysia. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including the assessment of risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Bank's preparation of the financial statements that give a true and fair view 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as of 31 December 2012 and of its financial performance and cash flows for the year then ended in accordance with Malaysian Financial Reporting Standards, International Financial Reporting Standards and the requirements of the Companies Act, 1965 in Malaysia.

KPMG

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



**Report on Other Legal and Regulatory Requirements**

In accordance with the requirements of the Companies Act, 1965 in Malaysia, we also report that in our opinion the accounting and other records and the registers required by the Act to be kept by the Bank have been properly kept in accordance with the provisions of the Act.

**Other Matters**

This report is made solely to the member of the Bank, as a body, in accordance with Section 174 of the Companies Act, 1965 in Malaysia and for no other purpose. We do not assume responsibility to any other person for the content of this report.

**KPMG**
Firm Number: AF 0758
Chartered Accountants

Foong Mun Kong
Approval Number: 2613/12/14(J)
Chartered Accountant

20 February 2013

Petaling Jaya

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

**STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2012**

| | *Note* | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and short-term funds | *6* | **1,650,386** | 1,536,792 | 1,508,998 |
| Financial Assets Held-for-Trading | *7* | **182,509** | 216,716 | 148,006 |
| Financial Investments Available-for-Sale | *8* | **1,265,283** | 422,086 | 330,665 |
| Financing and advances | *9* | **8,483,879** | 7,785,150 | 4,801,903 |
| Other assets | *11* | **151,220** | 204,466 | 56,586 |
| Statutory deposits with Bank Negara Malaysia | *12* | **343,561** | 228,562 | 34,729 |
| Equipment | *13* | **27,839** | 18,926 | 16,425 |
| Intangible assets | *14* | **29** | 461 | 1,499 |
| Deferred tax assets | *15* | **41,473** | 29,674 | 36,866 |
| Total Assets | | **12,146,179** | 10,442,833 | 6,935,677 |
| **Liabilities** | | | | |
| Deposits from customers | *16* | **8,639,809** | 5,662,496 | 3,930,560 |
| Deposits and placements from banks and other financial institutions | *17* | **1,763,316** | 3,740,525 | 2,084,599 |
| Bills and acceptances payable | | **15,426** | 7,600 | 5,531 |
| Other liabilities | *18* | **184,541** | 99,296 | 88,790 |
| Provision for taxation and zakat | *19* | **3,307** | 31,248 | 26,061 |
| Multi-Currency Sukuk Programme | *20* | **500,000** | - | - |
| Total Liabilities | | **11,106,399** | 9,541,165 | 6,135,541 |
| **Shareholder's Equity** | | | | |
| Share capital | *21* | **50,000** | 50,000 | 50,000 |
| Reserves | *22* | **989,780** | 851,668 | 750,136 |
| Total Shareholder's Equity | | **1,039,780** | 901,668 | 800,136 |
| Total Liabilities and Shareholder's Equity | | **12,146,179** | 10,442,833 | 6,935,677 |
| Commitments and Contingencies | *34* | **7,668,612** | 5,343,157 | 1,675,614 |

*The financial statements were approved for issue by the Board of Directors on 20 February 2013.*

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

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

## STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2012

| | *Note* | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 |
|---|---|---|---|
| Income derived from investment of depositors' funds and others | *23* | **623,650** | 450,475 |
| Income derived from investment of shareholder's funds | *24* | **136,241** | 90,864 |
| Impairment losses on financing | *25* | **(142,010)** | (96,405) |
| Total distributable income | | **617,881** | 444,934 |
| Income attributable to depositors | *26* | **(244,965)** | (154,050) |
| Total net income | | **372,916** | 290,884 |
| Personnel expenses | *27* | **(35,864)** | (26,452) |
| Other overheads and expenditures | *28* | **(171,881)** | (137,142) |
| Profit before taxation | | **165,171** | 127,290 |
| Taxation | *29* | **(31,931)** | (26,402) |
| **Profit for the year** | | **133,240** | 100,888 |
| Other comprehensive income | | | |
| Fair value reserve | | | |
| Change in fair value | | **514** | 379 |
| Income tax relating to components of other comprehensive income | | **(128)** | (95) |
| Other comprehensive income for the year, net of tax | | **386** | 284 |
| **Total comprehensive income for the year** | | **133,626** | 101,172 |
| Profit attributable to the owner of the Bank | | **133,240** | 100,888 |
| Total comprehensive income attributable to the owner of the Bank | | **133,626** | 101,172 |
| Basic earnings per RM0.50 ordinary share | *30* | **133.2 sen** | 100.9 sen |

*The financial statements were approved for issue by the Board of Directors on 20 February 2013.*

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

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

**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2012**

| | *Non-distributable* | | | | | | *Distributable* | |
|---|---|---|---|---|---|---|---|---|
| | *Share capital* | *Share premium* | *Statutory reserve* | *Available-for-sale reserve* | *Capital contribution reserve* | *Profit equalisation reserve* | *Retained profits* | *Total* |
| | **RM'000** | **RM'000** | **RM'000** | **RM'000** | **RM'000** | **RM'000** | **RM'000** | **RM'000** |
| **2011** | | | | | | | | |
| Balance as at 1 January 2011, FRS | 50,000 | 610,000 | 50,000 | (136) | 335 | - | 74,652 | 784,851 |
| Effect of convergence to MFRS | - | - | - | - | - | - | 15,285 | 15,285 |
| Balance as at 1 January 2011, MFRS | 50,000 | 610,000 | 50,000 | (136) | 335 | - | 89,937 | 800,136 |
| **Total comprehensive income for the year** | | | | | | | | |
| Net profit for the year | - | - | - | - | - | - | 100,888 | 100,888 |
| **Other comprehensive income, net of income tax** | | | | | | | | |
| Fair value reserve: | | | | | | | | |
| Net change in fair value | - | - | - | 284 | - | - | - | 284 |
| Total other comprehensive income | - | - | - | 284 | - | - | - | 284 |
| Total comprehensive income for the year | - | - | - | 284 | - | - | 100,888 | 101,172 |
| **Transactions with ultimate holding company, recorded directly in equity** | | | | | | | | |
| Share based payment transactions | - | - | - | - | 360 | - | - | 360 |
| Balance as at 31 December 2011 | 50,000 | 610,000 | 50,000 | 148 | 695 | - | 190,825 | 901,668 |
| | | | | | | | | |
| **2012** | | | | | | | | |
| Balance as at 1 January 2012, FRS | **50,000** | **610,000** | **50,000** | **148** | **695** | **-** | **153,216** | **864,059** |
| Effect of convergence to MFRS | **-** | **-** | **-** | **-** | **-** | **-** | **37,609** | **37,609** |
| Balance as at 1 January 2012, MFRS | **50,000** | **610,000** | **50,000** | **148** | **695** | **-** | **190,825** | **901,668** |
| **Total comprehensive income for the year** | | | | | | | | |
| Net profit for the year | **-** | **-** | **-** | **-** | **-** | **-** | **133,240** | **133,240** |
| **Other comprehensive income, net of income tax** | | | | | | | | |
| Fair value reserve: | | | | | | | | |
| Net change in fair value | **-** | **-** | **-** | **386** | **-** | **-** | **-** | **386** |
| Total other comprehensive income | **-** | **-** | **-** | **386** | **-** | **-** | **-** | **386** |
| Total comprehensive income for the year | **-** | **-** | **-** | **386** | **-** | **-** | **133,240** | **133,626** |
| **Transactions with ultimate holding company, recorded directly in equity** | | | | | | | | |
| Share based payment transactions | **-** | **-** | **-** | **-** | **466** | **-** | **-** | **466** |
| **Other transactions, recorded directly in equity** | | | | | | | | |
| Reclassification from other liabilities to equity | **-** | **-** | **-** | **-** | **-** | **5,360** | **-** | **5,360** |
| Reclassification to retained earnings | **-** | **-** | **-** | **-** | **-** | **(5,360)** | **5,360** | **-** |
| Deferred tax adjustment | **-** | **-** | **-** | **-** | **-** | **-** | **(1,340)** | **(1,340)** |
| Balance as at 31 December 2012 | **50,000** | **610,000** | **50,000** | **534** | **1,161** | **-** | **328,085** | **1,039,780** |

*The financial statements were approved for issue by the Board of Directors on 20 February 2013.*

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

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

## STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2012

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 |
|---|---|---|
| **Cash Flows from Operating Activities** | | |
| Profit before taxation | **165,171** | 127,290 |
| Adjustments for : | | |
| Equipment written off | **1** | 51 |
| Share based payment transactions | **466** | 360 |
| Net transfer of property and equipment from parent company | **(144)** | (527) |
| Depreciation of equipment | **7,910** | 5,616 |
| Amortisation of intangible assets | **450** | 233 |
| Reversal of capitalised charges | **-** | 810 |
| Net gain on disposal of equipment | **-** | (2) |
| Operating profit before changes in operating assets and liabilities | **173,854** | 133,831 |
| (Increase)/ Decrease in operating assets | | |
| Financial Assets Held-for-Trading | **34,207** | (68,710) |
| Financing and advances | **(698,061)** | (2,983,247) |
| Other assets | **59,438** | (147,880) |
| Statutory deposits with Bank Negara Malaysia | **(114,999)** | (193,833) |
| Increase/ (Decrease) in operating liabilities | | |
| Deposits from customers | **2,977,313** | 1,731,936 |
| Deposits and placements from banks and other financial institutions | **(1,977,209)** | 1,655,926 |
| Bills and acceptances payable | **7,826** | 2,069 |
| Other liabilities | **90,605** | 10,506 |
| Net cash generated from operating activities | **552,974** | 140,598 |
| Taxation paid | **(80,000)** | (14,018) |
| Utilisation of zakat provision | **-** | (100) |
| Net cash generated from operating activities | **472,974** | 126,480 |
| **Cash Flows from Investing Activities** | | |
| Purchase of equipment | **(16,680)** | (7,641) |
| Purchase of intangible assets | **(18)** | (5) |
| Proceeds from disposal of equipment | **-** | 2 |
| Financial Investments Available-for-Sale | **(842,682)** | (91,042) |
| Net cash used in investing activities | **(859,380)** | (98,686) |
| **Cash Flows from Financing Activity** | | |
| Issuance of Multi-Currency Sukuk | **500,000** | - |
| Net cash generated from financing activity | **500,000** | - |
| **Net increase in Cash and Cash Equivalents** | **113,594** | 27,794 |
| **Cash and Cash Equivalents at beginning of the year** | **1,536,792** | 1,508,998 |
| **Cash and Cash Equivalents at end of the year** | **1,650,386** | 1,536,792 |
| **Analysis of Cash and Cash Equivalents** | | |
| Cash and short-term funds | **1,650,386** | 1,536,792 |

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

## 1 General Information

HSBC Amanah Malaysia Berhad ("the Bank") incorporated on 26 February 2008, is a licensed Islamic Bank under the Islamic Banking Act, 1983. The registered office of the Bank is at No. 2, Leboh Ampang, 50100 Kuala Lumpur.

The principal activities of the Bank are Islamic banking and related financial services.

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

## 2 Basis of Preparation

### *(a) Statement of compliance*

The financial statements of the Bank have been prepared in accordance with the requirements of Malaysian Financial Reporting Standards ("MFRS"), International Financial Reporting Standards ("IFRSs") and the Companies Act, 1965 in Malaysia and Shariah requirements.

The Bank has adopted the Malaysian Financial Reporting Standards ("MFRS") framework issued by the Malaysian Accounting Standards Board ("MASB") with effect from 1 January 2012. The MFRS framework was introduced in order to fully converge Malaysia's existing Financial Reporting Standards ("FRS") framework with the International Financial Reporting Standards ("IFRS") framework issued by the International Accounting Standards Board. Whilst all FRSs issued under the previous FRS framework were equivalent to the MFRSs issued under the MFRS framework, there are some differences in relation to the transitional provisions and effective dates contained in certain MFRSs.

This is the Bank's first annual financial statements covered by the MFRS framework and MFRS 1, First-time Adoption of Malaysian Financial Reporting Standards has been applied. The MFRS did not result in any material financial impact to the Bank other than the financial impact arising from the change in accounting policy on i) the impairment of collectively assessed financing and advances, ii) the fair valuation of structured deposits and iii) the recognition of securities pledged on Islamic repurchase agreements, as the accounting policies previously adopted under the FRS framework were already in line with the requirements of the MFRS framework. The changes in these accounting policies are described in Note 2(e) Change in Accounting Policy. The financial impacts on transition to MFRSs are disclosed in Note 42. Other accounting treatment changes resulting from new/revised Bank Negara Malaysia's ("BNM") guidelines are also described in Note 2(e).

The Bank has early adopted the amendments to MFRS 101, Presentation of Items of other Comprehensive Income (Amendments to MFRS 101) which is originally effective for annual reports beginning on or after 1 July 2012. The early adoption of this amendment to MFRS 101 has no impact on the financial statements other than the presentation format of the statement of profit or loss and other comprehensive income.

**2 Basis of Preparation (Cont'd)**

***(a) Statement of compliance (Cont'd)***

The following are accounting standards, amendments and interpretations of the MFRS framework that have been issued by the MASB but have not been adopted by the Bank as they are not yet effective to the Bank:

Effective for annual periods commencing on or after 1 January 2013

- MFRS 10, Consolidated Financial Statements
- MFRS 11, Joint Arrangements
- MFRS 12, Disclosure of Interest in Other Entities
- MFRS 13, Fair Value Measurement
- MFRS 119, Employee Benefits (IAS 19 as amended by IASB in June 2011)
- MFRS 127, Consolidated and Separate Financial Statements (IAS 27 as amended by IASB in December 2003)
- MFRS 128, Investments in Associates and Joint Ventures (IAS 28 as amended by IASB in May 2011
- Amendments to MFRS 1, First-time Adoption of Malaysian Financial Reporting Standards (Government Loans)
- Amendments to MFRS 1, First-time Adoption of Malaysian Financial Reporting Standards (Annual Improvements 2009-2011 Cycle: Repeated Application of MFRS 1 and Borrowing Cost)
- Amendments to MFRS 7, Disclosures-Offsetting Financial Assets and Financial Liabilities
- Amendments to MFRS 10, MFRS 11 and MFRS 12, Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance
- Amendments to MFRS 101, Presentation of Financial Statements (Annual Improvements 2009-2011 Cycle: Clarification of the Requirements for Comparative Information)
- Amendments to MFRS 116, Property, Plant and Equipment (Annual Improvements 2009-2011 Cycle: Classification of Servicing Equipment)
- Amendments to MFRS 132, Financial Instruments: Presentation (Annual Improvements 2009-2011 Cycle: Tax effect of distribution to holders of equity instruments)
- Amendments to MFRS 134, Interim Financial Reporting (Annual Improvements 2009-2011 Cycle: Interim Financial Reporting and Segment Information for Total Assets and Liabilities)
- IC Interpretation 20, Stripping Costs in the Production Phase of a Surface Mine

Effective for annual periods commencing on or after 1 January 2014

- Amendments to MFRS 132, Financial Instruments: Presentation (Offsetting Financial Assets and Financial Liabilities)

Effective for annual periods commencing on or after 1 January 2015

- MFRS 9, Financial Instruments (IFRS 9 issued by IASB in November 2009)
- MFRS 9, Financial Instruments (IFRS 9 issued by IASB in October 2010)
- Amendment to MFRS 7, Financial Instruments: Disclosures – Mandatory date of MFRS 9 and Transition Disclosures.

The Bank plans to apply the abovementioned accounting standards, amendments and interpretations from the annual period beginning 1 January 2013 except for Amendments to MFRS 132 (Offsetting Financial Assets and Financial Liabilities) that would apply for the annual period beginning on or after 1 January 2014 and MFRS 9 (2009 & 2010) and Amendment to MFRS 7 (Financial Instruments: Disclosures – Mandatory date of MFRS 9 and Transition Disclosures) that would apply for the annual period beginning on or after 1 January 2015.

IC Interpretation 20 is not expected to have any impact on the financial statements of the Bank as it is not relevant to the operations of the Bank. The initial application of the other standards, amendments and interpretations is not expected to have any material financial impact to the current and prior periods financial statements of the Bank upon their first adoption, except for those discussed below:-

***MFRS 9, Financial Instruments***

MFRS 9 replaces the guidance in MFRS 139: Financial Instruments, Recognition and Measurement on the classification and measurement of financial assets. Upon adoption of MFRS 9, financial assets will be measured at either fair value or amortised cost. The adoption of MFRS 9 will result in a change in accounting policy.

**2 Basis of Preparation (Cont'd)**

***(b) Basis of measurement***

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

- Trading assets and liabilities
- Financial investments
- Equipment
- Derivatives and Hedge Accounting

***(c) Functional and presentation currency***

The financial statements are presented in Ringgit Malaysia (RM), which is the Bank's functional currency. All financial information presented in RM has been rounded to the nearest thousand, unless otherwise stated.

***(d) Use of estimates and judgements***

The preparation of the financial statements in conformity with MFRSs requires management to make estimates and assumptions about future conditions. The use of available information and the application of 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 financing and advances and the valuation of financial instruments (see Note 5). There are no other significant areas of estimation uncertainty and critical judgements in applying accounting policies that have significant effect on the amounts recognised in the financial statements other than those disclosed above

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

***(e) Change in accounting policies***

***(i) Impairment of collectively assessed financing and advances***
Prior to the transition to MFRS 139, the Bank had maintained its collective impairment provision at 1.5% of total outstanding financing, net of individual impairment provision, in line with BNM's transitional provisions under its Guidelines on Classification and Impairment Provisions for Loans/Financing. Upon the transition to MFRS 139 on 1 January 2012, these transitional provisions were removed and the Bank has applied the requirements of MFRS 139 in the determination of collective impairment provision, of which the full revised accounting policy is described in Note 3(l).

This change in accounting policy has been accounted for retrospectively and has resulted in a decrease in the collective allowance for impairment charged in the income statement and a writeback of collective allowance to the opening retained profits and opening collective allowance in the statements of financial position. A summary of the financial impact of the change in accounting policy on the financial statements of the Bank is reflected in Note 42.

***(ii) Fair valuation of structured deposits***
Prior to the transition to MFRS 139, derivatives embedded in structured deposits were bifurcated and marked to market separately from the deposits portion. After the transition to MFRS 139, the entire structured deposits are classified as "trading liabilities" and fair valued on a totality basis, as this is allowed under MFRS 139. This change in accounting policy has been accounted for retrospectively and a summary of the financial impact on the financial statements of the Bank is reflected in Note 42.

**2 Basis of Preparation (Cont'd)**

***(e) Change in accounting policies (Cont'd)***

***(iii) Contracts under Islamic Sell and Buyback Agreements ("SBBA")***

Prior to its convergence to the MFRS framework, the BNM Guidelines on Financial Reporting for Islamic Banking Institutions requires securities sold in a SBBA to be derecognised from the financial statements and the buy-back commitment to be recognised as an off balance sheet liability. However, BNM recently issued a revised Guidance Note on SBBA that allows financial institutions to account for SBBA as per the approved accounting standards by the Malaysian Accounting Standards Board. With this, the securities sold via SBBA will no longer be derecognised from the financial statements and the buy-back commitment is now recognised as an on balance sheet liability. This change in accounting policy has been accounted for retrospectively and a summary of the financial impact on the financial statements of the Bank is reflected in Note 42.

***(iv)Profit Equalisation Reserves (PER)***

PER refers to the amount appropriated out of total gross income in order to maintain an acceptable level of return to depositors as stipulated by BNM's "The Framework of Rate of Return". PER is a provision shared by both the depositors and the Bank.

During the financial year, as stipulated by BNM's "Guidelines on Profit Equalisation Reserve", effective 1 January 2012, PER has been segregated into the portion belonging to the depositors and the Bank based on the contractual profit sharing ratio. The portion belonging to the depositors continues to be recognised as other liabilities but the portion belonging to the Bank has been transferred to retained earnings.

**3 Significant Accounting Policies**

The accounting policies set out below have been applied consistently to the periods presented in these financial statements and have been applied consistently by the Bank.

***(a) Foreign Currency Transactions***

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting period are retranslated to the functional currency at the exchange rate at that date.

Non-monetary assets and liabilities denominated in foreign currencies are not retranslated at the end of the reporting date except for those that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined.

Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments or a financial instrument designated as a hedge of currency risk, which are recognised in other comprehensive income.

***(b) Revenue***

Revenue comprises gross finance income, fee and commission income, net trading income, investment income and other operating income.

***(c) Recognition of Financing Income and Financing Expenses***

Financing income and attributable profits on deposits and borrowings are recognised on an accrual basis applying the effective profit rate method in accordance with the principles of Shariah. Financing expense and income attributable on deposits and borrowings are amortised using the effective profit rate method in accordance with the principles of Shariah.

The effective profit rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability, or where appropriate, a shorter period, to the net carrying amount of the financial asset or liability. When calculating the effective profit rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but not future credit losses.

The calculation includes all amounts paid or received by the Bank that are an integral part of the effective profit rate of a financial instrument, including transaction costs and all other premiums or discounts.

**3 Significant Accounting Policies (Cont'd)**

***(d) Recognition of Fees and Commission, Net Trading Income and Other Operating Income***

Fee income is earned from a diverse range of services the Bank provides to their customers. Fee income is accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the significant act has been completed;
- income earned from the provision of services is recognised as revenue as the services are provided; and
- income which forms an integral part of the effective profit rate of a financial instrument is recognised as an adjustment to the effective profit rate and recorded in 'financing income' (see Note 3c).

Other fees and commission expense relates mainly to transaction and service fees, which are expensed as the services are rendered.

Dividend income from equity securities is recognised when the right to receive payment is established, which in the case of quoted securities is the ex-dividend date.

Net trading income comprises gains and losses from changes in the fair value of financial assets and financial liabilities held-for-trading, together with the related profit income and attributable profit on financial liabilities.

***(e) Income tax expense***

Income tax expense comprises current and deferred tax. Income tax expense is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in other comprehensive income or equity, in which case it is recognized in the same statement in which the related item appears.

Current tax is the tax expected to be payable on the taxable income for the year, calculated using tax rates enacted or substantively enacted by the balance sheet date, and any adjustment to tax payable in respect of previous years. The Bank provides for potential current tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities. Current tax assets and liabilities are offset when the Bank intends to settle on a net basis and the legal right to offset exists.

Deferred tax is recognised using the tax rates expected to apply in the periods in which the assets will be realized or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, by the balance sheet date. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when the Bank has a legal right to offset.

Deferred tax relating to share-based payment transactions is recognised directly in equity to the extent that the amount of the estimated future tax deduction exceeds the amount of the related cumulative remuneration expense. Deferred tax relating to fair value re-measurements of available-for-sale investments which are charged or credited directly to other comprehensive income, is also charged or credited to other comprehensive income and is subsequently recognised in the statement of comprehensive income when the deferred fair value gain or loss is recognised in the statement of comprehensive income.

**3 Significant Accounting Policies (Cont'd)**

***(f) Financial instruments***

***i) Initial recognition and measurement***

The Bank initially recognises financing and advances, deposits, debt securities issued and subordinated liabilities on the date at which they are originated. Regular way purchases and sales of financial assets are recognised on the trade date at which the Bank commits to purchase or sell the asset. All other financial assets and liabilities (including assets and liabilities designated at fair value through statement of comprehensive income) are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for a financial instrument not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

***ii) Classification***

The Bank classifies its financial assets into one of the following categories:
- financing and advances (See Note 3k)
- held to maturity (See Note 3j(i))
- available-for-sale (See Note 3j(ii)); or
- at fair value through statement of comprehensive income and within the category as held for trading (see Note 3i):

The Bank classifies its financial liabilities, other than financial guarantees, as measured at amortised cost or fair value through statement of comprehensive income. (See accounting policies in Notes 3(i), 3(s), 3(t)).

***iii) Derecognition***

Financial assets
The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the rights to receive the contractual cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred, or in which the Bank neither transfers not retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in such transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognized in other comprehensive income is recognized in profit or loss.

The Bank enters into transactions whereby it transfers assets recognised on its statements of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised. Transfers of assets with retention of all or substantially all risks and rewards include, repurchase transactions.

In transactions in which the Bank neither retains, nor transfers substantially all the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to the changes in the value of the transferred asset.

Financial liabilities
The Bank derecognises a financial liability when its contractual obligations are discharged, cancelled, or expired.

**3 Significant Accounting Policies (Cont'd)**

***(f) Financial instruments (Cont'd)***

***iv) Offsetting***

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position when the Bank has a legal right to offset the amounts and intends either to settle them on a net basis, or realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under the MFRSs, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

***v) Amortised cost measurement***

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

***vi) Fair value measurement***

All financial instruments are recognised initially at fair value. 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 profit rate yield curves, option volatilities and currency rates. When such evidence exists, the Bank recognises a trading gain or loss on inception of the financial instrument, being the difference between the transaction price and the fair value. When unobservable market data have a significant impact on the valuation of financial instruments, the entire initial difference in fair value indicated by the valuation model from the transaction price is not recognised immediately in statement of comprehensive income but 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.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. When independent prices are not available, fair values are determined by using valuation techniques which refer to observable market data. These include comparison with similar instruments where market prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. Fair values of financial instruments may be determined in whole or in part using valuation techniques based on assumptions that are not supported by prices from current market transactions or observable market data, where current prices or observable market data are not available.

Valuation techniques incorporate assumptions about factors that other market participants would use in their valuations, including profit rate yield curves, exchange rates, volatilities, and prepayment and default rates. If there are additional factors that are not incorporated within the valuation model but would be considered by market participants, further fair value adjustments are applied to model calculated fair values. These fair value adjustments include adjustments for bid-offer spread, model uncertainty, credit risk and model limitation. Where a financial instrument has a quoted price in an active market and it is part of a portfolio, the fair value of the portfolio is calculated as the product of the number of units and quoted price and no block discounts are made.

If the fair value of a financial asset measured at fair value becomes negative, the financial instrument is recorded as a financial liability until the fair value becomes positive, at which time the financial instrument is recorded as a financial asset.

**3 Significant Accounting Policies (Cont'd)**

***(f) Financial instruments (Cont'd)***

***vi) Fair value measurement (Cont'd)***

The fair values of financial liabilities are measured using quoted market prices where available, or using valuation techniques. These fair values include market participants' assessments of the appropriate credit spread to apply to the Bank's liabilities. The amount of change during the period, and cumulatively, in the fair value of designated financial liabilities and financing and advances that is attributable to changes in their credit spread is determined as the amount of change in the fair value that is not attributable to changes in market conditions that give rise to market risk.

***vii) Identification of impairment***

At each reporting date the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is (are) impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

The criteria used by the Bank to help determine whether there is objective evidence of impairment of such an asset include:
- known cash flow difficulties experienced by the customer;
- an overdue contractual payment of principal or profit or both that is in arrears for more than 90 days;
- breach of financing covenants or conditions;
- the probability that the customer will enter bankruptcy or other distressed financial reorganisation, based on conditions existing at the reporting date; and
- a significant downgrading in credit rating by an external credit rating agency - not in itself evidence of impairment, but to be considered in conjunction with other information.

The Bank takes a prudent approach, through its criteria for assessing whether objective evidence of impairment exists, to interpretation of the term 'objective evidence' and to quantifying impairment allowance requirements. However, it also allows circumstances in which, in the absence of other indicators of impairment, exposures designated as past due will not normally be regarded as impaired, including:
- individually assessed financing fewer than 90 days past due;
- financing fully secured by cash collateral; and
- short-term trade facilities technically overdue, for instance through documentation delay, but where there is no concern over the creditworthiness of the customer/ counterparty.

***(g) Cash and cash equivalents***

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash at hand and bank balances, and short term deposits and placements with banks maturing within one month that is readily convertible to known amounts of cash and which are subject to insignificant risk of change in value.

***(h) Contracts under Islamic Sell and Buyback Agreements***

Securities purchased under resale agreements are securities which the Bank had purchased with a commitment to resell at future date. The commitment to resell the securities is reflected as an asset on the statement of financial position.

Conversely, obligation on securities sold under repurchase agreements are securities which the Bank had sold from its portfolio, with a commitment to repurchase at future dates. Such financing transactions and the obligation to repurchase the securities are reflected as a liability on the statement of financial position.

**3 Significant Accounting Policies (Cont'd)**

***(i) Trading assets and trading liabilities***

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

***(j) Financial investments***

Treasury bills, debt securities and equity securities intended to be held on a continuing basis, other than those designated at fair value, are classified as available for sale or held to maturity. 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.

***i Held-to-maturity***

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank positively intends, and is able, to hold to maturity. These investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective profit rate method, less any impairment losses.

***ii Available-for-sale***

Available-for-sale investments are non derivative financial assets that are not classified as held-for-trading or held-to-maturity investments; and are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income in 'Net unrealised gain/loss from revaluation of financial assets held-for-trading and other financial assets' until the financial assets are either sold or become impaired. When available-for-sale financial assets are sold, cumulative gains or losses previously recognised in other comprehensive income are recognised in statement of comprehensive income as 'Net gains/loss from sale of financial assets held-for-trading and other financial instruments'.

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 stated at cost.

For financing converted into debt or equity instruments classified as available-for-sale, these instruments are measured at fair value. The difference between the net book value of the restructured financing (outstanding amount of financing net of individual impairment provision) and the fair value of the debt or equity instruments will be a gain or loss from the conversion scheme.

- Where the net book value of the restructured financing is higher than the fair value of the debt or equity instruments, the loss shall be recognised in the statement of comprehensive income in the current reporting period.
- Where the fair value of the debt or equity instruments is higher than the net book value of the restructured financing, the gain from the conversion exercise is transferred to the "impairment loss" account, which would be netted off from the "Financial investments available-for-sale" account in the statement of financial position.

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

**3 Significant Accounting Policies (Cont'd)**

***(j) Financial investments (Cont'd)***

***ii Available-for-sale (Cont'd)***

An assessment is made at each reporting date as to 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 the statement of comprehensive income, is removed from other comprehensive income and recognised in the statement of comprehensive income.

Impairment losses for available-for-sale debt securities are recognised within 'Financing 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 'Impairment losses on available-for-sale financial investments' in the statement of comprehensive income. The impairment methodologies for available-for-sale financial assets are set out in more detail below:

- For 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 reorganisation, or the disappearance of an active market for the debt security because of financial difficulties relating to the issuer. These types of specific event and other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment of a debt security.
- For 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 objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the period in which the fair value of the asset has been below its original cost at initial recognition.

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 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 decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the statement of comprehensive income, the impairment loss is reversed through the statement of comprehensive income to the extent of the increase in fair value;
- 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 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, to the extent that further cumulative impairment losses have been incurred in relation to the acquisition cost of the equity security.

**3 Significant Accounting Policies (Cont'd)**

***(k) Financing and Advances***

Financing and advances include financing and advances originated from the Bank, which are not intended to be sold in the short term and have not been classified as held for trading or designated at fair value. Financing and advances are recognised when cash is advanced to customers. They are derecognised when either the customer repays its obligations, or the advances are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective profit rate method, less any impairment losses.

***(l) Impairment of financing and advances***

The Bank's allowance for impaired loans/financing are in conformity with FRS 139 and Bank Negara Malaysia's "Guidelines on Classification and Impairment Provisions for Loans/Financing" issued on 1 January 2012. Accounts are classified as impaired when principal or profit or both are past due for more than ninety (90) days, or once there is objective evidence that the customer's account is impaired, whichever is sooner. Where repayments are scheduled on intervals of 3 months or longer, the financing is classified as impaired as soon as a default occurs, unless it does not exhibit any weakness that would render it classified according to the Bank's credit risk grading framework.

Individual impairment provisions are made for impaired debts and financing which have been individually reviewed and specifically identified as impaired.

Impaired financing are measured at their estimated recoverable amount based on the discounted cash flow methodology. Individual impairment allowances are provided if the recoverable amount (present value of estimated future cash flows discounted at original effective profit rate) is lower than the net book value of the financing (outstanding amount of financing and advances, net of individual impairment allowance). The expected cash flows are based on projections of liquidation proceeds, realisation of assets or estimates of future operating cash flows.

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss may be reversed to the extent it is now excessive by reducing the loan impairment allowance account. The amount of any reversal is recognised in the statement of comprehensive income.

***Impairment of collectively assessed loans, advances and financing***

Prior to the transition to MFRS 139, the Bank had maintained its collective impairment provision at 1.5% of total outstanding loans, net of individual impairment provision, in line with BNM's transitional provisions under its Guidelines on Classification and Impairment Provisions for Loans/Financing. Upon the transition to MFRS 139 on 1 January 2012, these transitional provisions were removed and the Bank has applied the requirements of MFRS 139 in the determination of collective impairment provision, of which the revised accounting policy is described below.

This change in accounting policy has been accounted for retrospectively and has resulted in a decrease in the collective allowance for impairment charged in the income statement and a writeback of collective allowance to the opening retained profits and opening collective allowance in the statement of financial position. A summary of the financial impact of the change in accounting policy on the financial statements of the Bank is reflected in Note 42.

Impairment is assessed on a collective basis in two circumstances:
- to cover losses which have been incurred but not yet been identified on financing subject to individual assessment; and
- for homogeneous groups of financing that are not considered individually significant.

Losses incurred but not yet identified on individually significant financing and advances

Individually assessed financing for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective impairment. These credit risk characteristics may include type of products offered, industry sector, credit characteristics or other relevant factors. As soon as information becomes available which identifies losses on individual financing within the group, those financing are removed from the group and assessed on an individual basis for impairment.

**3 Significant Accounting Policies (Cont'd)**

***(l) Impairment of financing and advances (Cont'd)***

The collective impairment allowance is determined after taking into account:

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

<u>Homogeneous groups of financing and advances</u>
Statistical methods are used to determine impairment losses on a collective basis for homogeneous groups of financing that are not considered individually significant, because individual financing assessment is impracticable. Losses in these groups of financing are recorded on an individual basis only when individual financing are written off, at which point they are removed from the group. Two alternative methods are used to calculate allowances on a collective basis:

When appropriate empirical information is available, roll rate methodology is applied. This methodology employs statistical analyses of historical data and experience of delinquency and default to estimate the amount of financing that will eventually be written off as a result of the events occurring before the balance sheet date which the Bank is not able to identify on an individual financing basis, and that can be reliably estimated. Under this methodology, financing are grouped into ranges according to the number of days past due and statistical analysis is used to estimate the likelihood that financing in each range will progress through the various stages of delinquency, and ultimately prove irrecoverable. In addition to the delinquency groupings, financing are segmented according to their credit characteristics as described above. Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss.

When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll rate methodology, a basic formulaic approach based on historical loss rate experience is adopted.

In normal circumstances, historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio, though sometimes it provides less relevant information about the inherent loss in a given portfolio at the balance sheet date, for example, when there have been changes in economic, regulatory or behavioural conditions which result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models. In these circumstances, the risk factors are taken into account by adjusting the impairment allowances derived solely from historical loss experience.

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

Financing (and related allowances) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised financing, when the proceeds from the realisation of security have been received.

**3 Significant Accounting Policies (Cont'd)**

***(m) Impairment of other assets***

The carrying amounts of other assets (except for deferred tax asset, assets arising from employee benefits and non-current assets (or disposal groups) classified as held for sale) are reviewed at the end of each reporting period to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets (known as cash-generating unit).

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit.

An impairment loss is recognised if the carrying amount of an asset or its related cash-generating unit exceeds its estimated recoverable amount.

Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated to reduce the carrying amount of the other assets in the cash-generating unit (or a group of cash-generating units) on a pro rata basis.

Impairment losses recognised in prior periods are assessed at the end of each reporting period for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount since the last impairment loss was recognised. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. Reversals of impairment losses are credited to profit or loss in the financial year in which the reversals are recognised.

***(n) Equipment***

Equipment, fixtures and fittings are stated at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is calculated on a straight-line basis to write off the assets over their useful lives as follows: -

| | |
|---|---|
| Office equipment, fixtures and fittings | 5 to 10 years |
| Computer equipment | 3 to 5 years |
| Motor vehicles | 5 years |

Additions to equipment costing RM1,000 and under are fully depreciated in the year of purchase; for those assets costing more than RM1,000, depreciation is provided at the above rates.

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

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

***(o) Operating Leases***

Leases, where the the Bank does not assume substantially all the risks and rewards of ownership, are classified as operating leases and the leased assets are not recognised in the statement of financial position of the Bank. Rentals payable under operating leases are accounted for on a straight line basis over the periods of the leases unless another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed and are recognised in profit or loss under "General administrative expenses."

Lease incentives received are recognised in profit or loss as an integral part of the total lease expense, over the term of the lease. Contingent rentals are charged to profit or loss in the reporting period in which they are incurred.

**3 Significant Accounting Policies (Cont'd)**

***(p) Intangible Assets***

Intangible assets represent computer software and are stated at cost less accumulated amortisation and any accumulated impairment losses. Amortisation of intangible assets is calculated to write off the cost of the intangible assets on a straight line basis over the expected useful lives of 3 to 5 years. Intangible assets are subject to an impairment review if there are events or changes which indicate that the carrying amount may not be recoverable.

***(q) Bills and Acceptances Payable***

Bills and acceptances payable represent the Bank's own bills and acceptances rediscounted and outstanding in the market.

***(r) Provisions***

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation, which had arisen as a result of past events, and for which a reliable estimate can made of the amount of the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognised as finance cost.

***(s) Financial guarantees***

Liabilities under financial guarantee contracts are recorded initially at their fair value, which is generally the fee received or receivable. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations.

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

***(t) Debt securities issued, subordinated liabilities and deposits by customers and banks***

Financial liabilities are recognised when the Bank enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at fair value, which is normally the consideration received, net of directly attributable transaction costs incurred. Subsequent measurement of financial liabilities, other than those measured at fair value through profit or loss and financial guarantees, is at amortised cost, using the effective profit method to amortise the difference between proceeds received, net of directly attributable transaction costs incurred, and the redemption amount over the expected life of the instrument.

The medium term note (Sukuk) issued by the Bank during the year, is carried at amortised cost, with profit payable recognised on an accruals basis.

**3 Significant Accounting Policies (Cont'd)**

***(u) Derivatives and Hedge Accounting***

Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values of exchange traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models.

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

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

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

**Hedge accounting**

At the inception of a hedging relationship, the Bank documents the relationship between the hedging instruments and the hedged items, its risk management objective and its strategy for undertaking the hedge. The Bank 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. Profit on designated qualifying hedges is included in 'Net finance income'.

***i) Fair value hedge***

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the 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 to statement of comprehensive income based on a recalculated effective profit rate over the residual period to maturity, unless the hedged item has been derecognised, in which case, it is released to statement of comprehensive income immediately.

**3 Significant Accounting Policies (Cont'd)**

***(u) Derivatives and Hedge Accounting(Cont'd)***

***ii) Cash flow hedge***

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

The accumulated gains and losses recognised in other comprehensive income are reclassified to statement of comprehensive income in the periods in which the hedged item will affect the statement of comprehensive income. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously recognised in other comprehensive income are removed from equity and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss recognised in other comprehensive income at that time remains in equity until the forecast transaction is eventually recognised in the statement of comprehensive income. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in other comprehensive income is immediately reclassified to the statement of comprehensive income.

***(v) Profit Equalisation Reserves (PER)***

PER refers to the amount appropriated out of the total Islamic Banking gross income in order to maintain an acceptable level of return to Mudharabah depositors as stipulated by Bank Negara Malaysia's "The Framework of Rate of Return". PER is a provision shared by both the depositors and the Bank, and is deducted from the total gross income.

***(w) Employee Benefits***

***i Short term employee benefits***

Short term employee benefit obligations in respect of salaries, annual bonuses, paid annual leave and sick leave are measured on an undiscounted basis and are expensed as the related service is provided.

A liability is recognised for the amount expected to be paid under short term cash bonus or profit-sharing plans if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

***ii Defined contribution plan***

As required by law, companies in Malaysia make contributions to the Employees Provident Fund (EPF). Such contributions are recognised as an expense in the statement of comprehensive income as incurred.

## 3 Significant Accounting Policies (Cont'd)

### *(x) Share based payments*

The Bank enters into equity-settled share based payment arrangements with its employees as compensation for services provided by employees. Equity-settled share based payment arrangements entitle employees to receive equity instruments of the ultimate holding company, HSBC Holdings plc.

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

Fair value is determined by using appropriate valuation models, taking into account the terms and conditions upon which the equity instruments were granted. Vesting conditions include service conditions and performance conditions; any other features of a share-based payment arrangement are non-vesting conditions. Market performance conditions and non-vesting conditions are taken into account when estimating the fair value of equity instruments at the date of grant, so that an award is treated as vesting irrespective of whether the market performance condition or non-vesting condition is satisfied, provided all other vesting conditions are satisfied.

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

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

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

### *(y) Earnings per share*

The Bank presents basic earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to the ordinary shareholder of the Bank by the weighted average number of shares outstanding during the period.

**3 Significant Accounting Policies (Cont'd)**

***(z) Assets under management***

The Bank had entered into a Restricted Profit Sharing Investment Account ("RPSIA") arrangement with its Parent company, HSBC Bank Malaysia Berhad (HBMY) to invest in certain identified financing assets ("underlying assets" or "RPSIA financing") of the Bank.

The RPSIA arrangement is a contract based on the Mudharabah principle between the Bank and HBMY to finance a financing where HBMY (as the investor) solely provides capital, whilst the assets are managed by the Bank (as the agent). The profit of the underlying assets is shared based on pre-agreed ratios, whilst risk on the financing is borne by HBMY.

Arising from the RPSIA arrangement, the underlying assets are derecognised by the Bank as substantially all the risks and rewards have been effectively transferred and borne by HBMY. Hence, the underlying assets and the allowances for impairment arising thereon, if any, are recognised and accounted by HBMY instead. The recognition and derecognition treatment is in accordance to Note 3 (e) on Financial Instruments.

The RPSIA financing, nevertheless, will continue to be administered and managed by HBMS. Therefore, the Bank will record these exposures as assets under management.

As at 31 December 2012, the assets under management in respect of the RPSIA financing are as below. The exposures and the corresponding risk weighted amount will be reported in HBMY financial statements:

| | 31 Dec 2012<br>RM'000 |
|---|---|
| Term financing | 632,121 |
| Less: Individual allowance for impaired financing: | - |
| Total net financing and advances | 632,121 |

| | Credit Principal amount<br>RM'000 | Credit equivalent amount<br>RM'000 | Risk weighted amount<br>RM'000 |
|---|---|---|---|
| Commitments and Contingencies | - | - | - |

| | Principal<br>RM'000 | Risk weighted<br>RM'000 |
|---|---|---|
| Total RWA for Credit Risk | 632,121 | 632,121 |

## 4 Financial risk management

### a) Introduction and overview

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

- credit risk
- liquidity risk
- market risks (includes foreign exchange, profit rate and equity/commodity price risk)
- operational risks

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

**Risk management framework**

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

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

The Risk Management Committee is entrusted with the responsibility to oversee senior management's activities in managing credit, market, liquidity, operational, legal and other risks and to ensure that the risk management process is in place and functioning. In addition, a separate internal Risk Committee was set up in 2009 in line with the Group's Risk Governance Structure to oversee and ensure that risk issues across all businesses are appropriately managed, and that adequate controls exist. The Bank's holding company also has an internal Operational Risk and Internal Control Committee to oversee and manage operational risk and ensure that adequate controls are maintained over operational processes in HSBC Bank Malaysia Berhad and the Bank.

### b) Credit risk management

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

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

**4 Financial risk management (Cont'd)**

**b) Credit risk management (Cont'd)**

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

- risk concentration and exposures to industry sectors;
- large customer group exposures;
- large impaired accounts and impairment allowances; and
- rescheduled and restructured financing.

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

**Impairment assessment**

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

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

**Past due but not impaired financing and investment debt securities**

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

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

## 4 Financial risk management (Cont'd)

### b) Credit risk management (Cont'd)

**Financing with renegotiated terms**

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

**Write-off of financing and advances**

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

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

- under the residential and real estate business; house financing over residential and financed properties;
- under certain Islamic specialised financing and leasing transactions (such as vehicle financing) where physical assets form the principal source of facility repayment, physical collateral is typically taken;
- in the commercial and industrial sectors, charges over business assets such as premises, stock and debtors;
- facilities provided to small and medium enterprises are commonly granted against guarantees by their owners/directors;
- guarantees from third parties can arise where facilities are extended without the benefit of any alternative form of security, e.g. where the Bank issues a bid or performance sukuk in favour of a non-customer at the request of another bank.
- under the institutional sector, certain trading facilities are supported by charges over financial instruments such as cash, debt securities and equities.
- financial collateral in the form of marketable securities is used in much of the over-the-counter (OTC) derivatives activities and in the Bank's securities financing business (securities financing and borrowing or repos and reverse repos). Netting is extensively used and is a prominent feature of market standard documentation.

The Bank does not disclose the fair value of collateral held as security or other credit enhancements on financing and advances past due but not impaired, or on individually assessed financing and advances, as it is not practicable to do so.

The estimated fair value of collateral and other security enhancements held against impaired financing as at 31 December 2012 amounted to RM64.9 million (31 December 2011 : RM28.1 million).

Collateral especially properties are made available for sale in an orderly fashion, with the proceeds used to reduce or pay the outstanding financing amount. If excess funds arise after the outstanding financing has been paid, they are made available either to pay other secured financiers with lower priority or are returned to the customer. The Bank does not generally occupy repossessed properties for its business use.

The Bank monitors concentration of credit risk by sector and geographical location. The analysis of concentration of credit risk from financing and advances to customers is shown in Note 9 (vi) and 9 (viii). The analysis of concentration of credit risk from financing and advances to banks and investment securities is shown in note 4 b(ii).

## 4 Financial risk management (Cont'd)

### b) Credit risk management (Cont'd)

#### Financial assets held-for-trading

The Bank holds financial assets held-for-trading of RM182.5 million. An analysis of the credit quality of the maximum credit exposure, based on the rating agency Standard & Poor's, is as disclosed in Note 7 to the financial statements.

#### Settlement risk

Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt of cash, securities or equities. Daily settlement limits are established for counterparties to cover the aggregate of the Bank's transactions with each one on any single day. Settlement risk on many transactions, particularly those involving securities and equities, is substantially mitigated by settling through assured payment systems or on a delivery-versus-payment basis.

## 4 Financial risk management (Cont'd)

### b) Credit risk management (Cont'd)

#### i) Exposure to credit risk

| | 2012 | | |
|---|---|---|---|
| | **Financing and advances to customers RM'000** | **Financing and advances to banks* RM'000** | **Investment Securities ** RM'000** |
| Carrying amount | **8,483,879** | **1,650,386** | **1,265,283** |
| **Assets at amortised cost** | | | |
| Individually impaired: | | | |
| Gross amount | **129,418** | **-** | **-** |
| Allowance for impairment | **(30,379)** | **-** | **-** |
| Carrying amount | **99,039** | **-** | **-** |
| Past due but not impaired: | | | |
| Carrying amount | **531,532** | **-** | **-** |
| *Past due comprises:* | | | |
| *up to 29 days* | **369,174** | **-** | **-** |
| *30 - 59 days* | **81,630** | **-** | **-** |
| *60 - 89 days* | **80,728** | **-** | **-** |
| | **531,532** | **-** | **-** |
| Neither past due nor impaired: | | | |
| Strong | **4,834,901** | **1,650,386** | **-** |
| Medium -good | **1,562,509** | **-** | **-** |
| Medium-satisfactory | **1,491,596** | **-** | **-** |
| Substandard | **109,155** | **-** | **-** |
| Carrying amount | **7,998,161** | **1,650,386** | **-** |
| *of which includes accounts with renegotiated terms* | - | - | - |
| Collective allowance for impairment | **(144,853)** | **-** | **-** |
| Carrying amount-amortised cost | **8,483,879** | **1,650,386** | **-** |
| **Available-for-sale (AFS)** | | | |
| Neither past due nor impaired: | | | |
| Strong | **-** | **-** | **1,265,283** |
| Carrying amount | **-** | **-** | **1,265,283** |
| *of which includes accounts with renegotiated terms* | - | - | - |
| Carrying amount-fair value | **-** | **-** | **1,265,283** |

In addition to the above, the Bank had entered into financing commitments of RM4,176.4 million. The Bank had also issued financial guarantee contracts for which the maximum amount payable by the Bank, assuming all guarantees are called on, is RM764.6 million.

* Consists of cash and short term funds and deposits and placements with banks and other financial institutions and securities purchased under resale agreements.

** Excludes equity securities.

## 4 Financial risk management (Cont'd)

### b) Credit risk management (Cont'd)

#### i) Exposure to credit risk

| | 2011 | | |
|---|---|---|---|
| | **Financing and advances to customers RM'000** | **Financing and advances to banks* RM'000** | **Investment Securities** RM'000** |
| Carrying amount | 7,785,150 | 1,536,792 | 422,086 |
| **Assets at amortised cost** | | | |
| Individually impaired: | | | |
| Gross amount | 125,688 | - | - |
| Allowance for impairment | (32,981) | - | - |
| Carrying amount | 92,707 | - | - |
| Past due but not impaired: | | | |
| Carrying amount | 341,446 | - | - |
| *Past due comprises:* | | | |
| *up to 29 days* | 243,078 | - | - |
| *30 - 59 days* | 56,211 | - | - |
| *60 - 89 days* | 42,157 | - | - |
| | 341,446 | - | - |
| Neither past due nor impaired: | | | |
| Strong | 3,911,811 | 1,536,792 | - |
| Medium -good | 2,291,674 | - | - |
| Medium-satisfactory | 1,241,415 | - | - |
| Substandard | 11,282 | - | - |
| Carrying amount | 7,456,182 | 1,536,792 | - |
| *of which includes accounts with renegotiated terms* | *30,862* | - | - |
| Collective allowance for impairment | (105,185) | - | - |
| Carrying amount-amortised cost | 7,785,150 | 1,536,792 | - |
| **Available-for-sale (AFS)** | | | |
| Neither past due nor impaired: | | | |
| Strong | - | - | 422,086 |
| Medium-satisfactory | - | - | - |
| Carrying amount | - | - | 422,086 |
| *of which includes accounts with renegotiated terms* | - | - | - |
| Carrying amount-fair value | - | - | 422,086 |

In addition to the above, the Bank had entered into financing commitments of RM3,359.2 million. The Bank had also issued financial guarantee contracts for which the maximum amount payable by the Bank, assuming all guarantees are called on, is RM589.8 million.

* Consists of cash and short term funds and deposits and placements with banks and other financial institutions and securities purchased under resale agreements.

** Excludes equity securities.

**4 Financial risk management (Cont'd)**

**b) Credit risk management (Cont'd)**

**i) Exposure to credit risk**

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

| Credit quality of the Bank's debt securities and other bills | External Credit Rating* |
|---|---|
| Strong | A- and above |
| Medium-good | BBB+ and BBB- |
| Medium-satisfactory | BB+ to B+ and unrated |
| Sub-standard | B and below |
| Impaired | Impaired |

* External ratings have been aligned to the five quality classifications. The ratings of Standard and Poor's are cited, with those of other agencies being treated equivalently.

| Credit quality of the Bank's corporate financing | Internal Credit Rating |
|---|---|
| Strong | CRR1 - CRR2 |
| Medium-good | CRR3 |
| Medium-satisfactory | CRR4 - CRR5 |
| Sub-standard | CRR6 - CRR8 |
| Impaired | CRR9 - CRR10 |

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

**ii) Concentration by sector and by location#**

| | **31 Dec 2012** | | **31 Dec 2011** | |
|---|---|---|---|---|
| | **Financing and advances to banks* RM'000** | **Investment Securities** RM'000** | **Financing and advances to banks* RM'000** | **Investment Securities** RM'000** |
| Carrying amount | **1,650,386** | **1,265,283** | 1,536,792 | 422,086 |
| **By Sector** | | | | |
| Finance, insurance and business services | **1,650,386** | **48,631** | 1,536,792 | 25,004 |
| Others | **-** | **1,216,652** | - | 397,082 |
| | **1,650,386** | **1,265,283** | 1,536,792 | 422,086 |
| **By geographical location** | | | | |
| Within Malaysia | **1,579,492** | **1,265,283** | 1,497,246 | 422,086 |
| Outside Malaysia | **70,894** | **-** | 39,546 | - |
| | **1,650,386** | **1,265,283** | 1,536,792 | 422,086 |

* Consists of cash and short term funds, deposits and placements with banks and other financial institutions and securities purchased under resale agreements.

** Excludes equity securities

# Concentration by sector and location for financing and advances is disclosed under Note 9vi and 9viii to the financial statements.

## 4 Financial risk management (Cont'd)

### c) Liquidity and funding management

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

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

Current accounts and savings deposits payable on demand or at short notice form a significant part of the HSBC's funding, and the Bank places considerable importance on maintaining their stability. For deposits, stability depends upon preserving depositor confidence in the Bank's capital strength and liquidity, and on competitive and transparent pricing. In aggregate, the Bank is a net liquidity provider to the interbank market, placing significantly more funds with other banks than it borrows.

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

The Bank's liquidity and funding management process includes:

- projecting cash flows and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet advances to core funding ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises while minimising adverse long-term implications for the business.
- stress testing and scenario analysis are important tools in HSBC's liquidity management framework. This will also include an assessment of asset liquidity under various stress scenerios.
- manage the maturities and diversify secured and unsecured funding liabilities across markets, products and counterparties.
- maintain liabilities of appropriate term relative to asset base.

## 4 Financial risk management (Cont'd)

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

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

| RM'000 | On Demand | Due within 3 months | Due between 3 months to 12 months | Due between 1 and 5 years | Due after 5 years |
|---|---|---|---|---|---|
| **As at 31 Dec 2012** | | | | | |
| Deposits by customers | **3,193,551** | **4,352,814** | **1,113,413** | **633,561** | **-** |
| Deposits and placements from banks and other financial institutions | **9,775** | **101,066** | **1,659,359** | **20,493** | **-** |
| Bills and acceptances payable | **15,426** | **-** | **-** | **-** | **-** |
| Multi-Currency Sukuk Programme | **-** | **-** | **-** | **589,063** | **-** |
| Other liabilities | **106,700** | **36,524** | **-** | **-** | **-** |
| | **3,325,452** | **4,490,404** | **2,772,772** | **1,243,117** | **-** |
| Financing and other credit-related commitments | **2,190,094** | **395,046** | **1,995,067** | **557,385** | **-** |
| Financial guarantees and similar contracts | **680,927** | **17,387** | **16,765** | **49,538** | **-** |
| | **6,196,473** | **4,902,837** | **4,784,604** | **1,850,040** | **-** |

| RM'000 | On Demand | Due within 3 months | Due between 3 months to 12 months | Due between 1 and 5 years | Due after 5 years |
|---|---|---|---|---|---|
| **As at 31 Dec 2011 (Restated)** | | | | | |
| Deposits by customers | 1,882,306 | 3,050,222 | 756,263 | 16,679 | - |
| Deposits and placements from banks and other financial institutions | 3,964 | 1,018,080 | 2,520,792 | 197,688 | - |
| Bills and acceptances payable | 7,600 | - | - | - | - |
| Other liabilities | 97,027 | 20,023 | - | - | - |
| | 1,990,897 | 4,088,325 | 3,277,055 | 214,367 | - |
| Financing and other credit-related commitments | 2,338,386 | 536,199 | 2,007,150 | 251,778 | - |
| Financial guarantees and similar contracts | 451,223 | 12,501 | 46,881 | 79,183 | - |
| | 4,780,506 | 4,637,025 | 5,331,086 | 545,328 | - |

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

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

**4 Financial risk management (Cont'd)**

**d) Market risk management**

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

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

The Bank separates exposures to market risk into either trading or non-trading portfolios. Trading portfolios include those positions arising from market making, proprietary position taking and other marked-to-market positions so designated. Non-trading portfolios primarily arise from the profit rate management of the Bank’s retail and commercial banking assets and liabilities, and financial investments available-for-sale.

The management of market risk is principally undertaken using risk limit mandates approved by HSBC’s Regional Global Wholesale Market Risk Management (WMR), an independent unit which develops HSBC Group’s market risk management policies and measurement techniques. Market risks which arise on each product are transferred to either the Global Markets or to a separate book managed under the supervision of ALCO. The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to manage such risks professionally. Limits are set for portfolios, products and risk types, with market liquidity being the principal factor in determining the level of limits set. The Group has an independent market risk control function that is responsible for measuring market risk exposures in accordance with the policies defined by WMR. Positions are monitored daily and excesses against the prescribed limits are reported immediately to local senior management and WMR. The nature of the hedging and risk mitigation strategies corresponds to the market instruments available. These strategies range from the use of traditional market instruments, such as profit rate swaps, to more sophisticated hedging strategies to address a combination of risk factors arising at portfolio level.

Market risk in the trading portfolio is monitored and controlled at both portfolio and position levels using a complementary set of techniques such as value at risk and present value of a basis point, together with stress and sensitivity testing and concentration limits. Other controls to contain trading portfolio market risk at an acceptable level include rigorous new product approval procedures and a list of permissible instruments to be traded.

*Value at risk ('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. The VAR models used by the Bank are based predominantly on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates such as profitt rates and foreign exchange rates. The models also incorporate the effect of option features on the underlying exposures. The historical simulation models used by the Bank incorporate the following features:

- potential market movements are calculated with reference to data from the past two years;
- historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, profit rates, equity prices and the associated volatilities; and
- VAR is calculated to a 99 per cent confidence level and for a one-day holding period. The nature of the VAR models means that an increase in observed market volatility will lead to an increase in VAR without any changes in the underlying positions. The Bank routinely validates the accuracy of its VAR models by back-testing the actual daily profit and loss results, adjusted to remove non-modelled items such as fees and commissions, against the corresponding VAR numbers. Statistically, the Bank would expect to see losses in excess of VAR only 1 per cent of the time over a one-year period. The actual number of excesses over this period can therefore be used to gauge how well the models are performing.

## 4 Financial risk management (Cont'd)

### d) Market risk management (Cont'd)

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

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

| RM'000 | At 31 Dec 2012 | Average | Maximum | Minimum |
|---|---|---|---|---|
| Foreign currentcy risk | **22** | **59** | **414** | **5** |
| Profit rate risk | **96** | **138** | **251** | **90** |
| Credit spread risk | **-** | **-** | **-** | **-** |
| Overall | **87** | **352** | **999** | **87** |

| RM'000 | At 31 Dec 2011 | Average | Maximum | Minimum |
|---|---|---|---|---|
| Foreign currentcy risk | 46 | 64 | 236 | 5 |
| Profit rate risk | 233 | 263 | 664 | 104 |
| Credit spread risk | - | 8 | 154 | - |
| Overall | 237 | 268 | 712 | 108 |

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

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

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

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

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

## 4 Financial risk management (Cont'd)

### d) Market risk management (Cont'd)

**Exposure to profit rate risk - non-trading portfolio**

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

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

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

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

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

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

**ii) Sensitivity of projected net finance income**

| **Change in projected net finance income in next 12 months arising from a shift in profit rates of :** | **31 Dec 2012 RM'000** | **31 Dec 2011 RM'000** |
|---|---|---|
| + 100 basis points parallel increase | **16,102** | 6,286 |
| - 100 basis points parallel increase | **(15,440)** | (6,868) |
| | | |
| + 25 basis poimts at the beginning of each quarter | **7,737** | 4,488 |
| + 25 basis points at the beginning of each quarter | **(7,721)** | (4,764) |

Sensitivity of reported reserves in "Other Comprehensive Income" to profit rate movements are monitored on a monthly basis by assessing the expected reduction in valuation of available-for-sale portfolios due to parallel movements of plus or minus 100 basis points in all yield curves.

## 4 Financial risk management (Cont'd)

### d) Market risk management (Cont'd)

**Exposure to profit rate risk - non-trading portfolio (Cont'd)**

**iii) Sensitivity of reported reserves in "Other Comprehensive Income" to profit rate movements**

| **Change in projected net finance income in next 12 months arising from a shift in profit rates of :** | **31 Dec 2012 RM'000** | **31 Dec 2011 RM'000** |
|---|---|---|
| + 100 basis points parallel increase | **(37,191)** | (4,981) |
| - 100 basis points parallel increase | **37,191** | 4,981 |

**Foreign Exchange Risk**

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

**Specific Issuer Risk**

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

**Equity Risk**

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

**4 Financial risk management (Cont'd)**

**e) Operational risk management**

Operational risk is the risk of loss arising from fraud, unauthorised activities, error, omission, inefficiency, systems failure or external events, including legal risk. It is inherent to every business organisation and covers a wide spectrum of issues.

The Bank manages this risk through a control-based environment in which processes are documented, authorisation is independent and transactions are reconciled and monitored. This is supported by an independent programme of periodic reviews undertaken by the Internal Audit function, and by monitoring external operational risk events, which ensure that the Bank stays in line with best practice and takes account of lessons learned from publicised operational failures within the financial services industry.

The Bank adheres to the HSBC Global standard on operational risk. This standard explains how HSBC manages operational risk by identifying, assessing, monitoring, controlling and mitigating the risk, rectifying operational risk events and implementing any additional procedures required for compliance with local statutory requirements. The standard covers the following :

- operational risk management responsibility is assigned at senior management level within the business operation;
- information systems are used to record the identification and assessment of operational risks and generate appropriate, regular management reporting;
- operational risks are identified by assessments covering operational risks facing each business and risk inherent in processes, activities and products. Risk assessment incorporates a regular review of identified risks to monitor significant changes;
- operational risk loss data is collected and reported to senior management. Aggregate operational risk losses are recorded and details of incidents above a materiality threshold are reported to the Operational Risk and Internal Control Committee. The items are also reported to the internal Risk Committee, the Board level Risk Management Committee, the Audit Committee and as well as Regional Head of Operational Risk Management Asia Pacific; and
- risk mitigation, including insurance, is considered where this is cost-effective.

The Bank maintains and tests contingency facilities to support operations in the event of disasters. Additional reviews and tests are conducted in the event that the Bank is affected by a business disruption event to incorporate lessons learned in the operational recovery from those circumstances.

**f) Capital management**

The Bank's lead regulator, Bank Negara Malaysia ("BNM") sets and monitors capital requirements for the Bank. With effect from 2008, the Bank is required to comply with the provisions of the Basel II framework in respect of regulatory capital and Basic Indicator Approach for Operational Risk. The Bank adopts the Standardised approach for Credit and Market Risk in its trading portfolios. Please refer to Note 33 of the financial statements for the Bank's regulatory capital position under Basel II at the reporting date.
The Bank's regulatory capital is analysed in two tiers:

- Tier 1 capital, which includes ordinary share capital, share premium, retained earnings, statutory reserves and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.
- Tier 2 capital, which includes collective impairment allowances (excluding collective impairment allowances attributable to financing classified as impaired).

## 5 Use of estimates and judgements

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

The accounting policies that are deemed critical to the Bank's results and financial position, in terms of the materiality of the items to which the policy is applied, and which involve a high degree of judgement including the use of assumptions and estimation, are discussed below.

### i) Impairment of financing and advances

The Bank's accounting policy for losses arising from the impairment of customer financing and advances is described in Note 3l to the financial statements. Financing impairment allowances represent management's best estimate of losses incurred in the financing portfolios at the reporting date.

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

### ii) Valuation of financial instruments

The Bank's accounting policy for determining the fair value of financial instruments is described in Note 3f (vi) to the financial statements. The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The majority of valuation techniques employ only observable market data, and so the reliability of the fair value measurement is high. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable. Valuation techniques that rely to a greater extent on unobservable inputs require a higher level of management judgement to calculate a fair value than those based wholly on observable inputs.

Valuation techniques used to calculate fair values include comparisons with similar financial instruments for which market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. Valuation techniques incorporate assumptions that other market participants would use in their valuations, including assumptions about profit rate yield curves, exchange rates, volatilities, and prepayment and default rates. When valuing instruments by reference to comparable instruments, management takes into account the maturity, structure and rating of the

The main assumptions and estimates which management considers when applying a model with valuation techniques are:

- the likelihood and expected timing of future cash flows on the instrument. These cash flows are usually governed by the terms of the instrument, although management judgement may be required when the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt. Future cash flows may be sensitive to changes in market rates;
- selecting an appropriate discount rate for the instrument. Management bases the determination of this rate on its assessment of what a market participant would regard as the appropriate spread of the rate for the instrument over the appropriate risk-free rate; and
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

When applying a model with unobservable inputs, estimates are made to reflect uncertainties in fair values resulting from a lack of market data inputs, for example, as a result of illiquidity in the market. For these instruments, the fair value measurement is less reliable. Inputs into valuations based on unobservable data are inherently uncertain because there is little or no current market data available from which to determine the level at which an arm's length transaction would occur under normal business conditions. However, in most cases there is some market data available on which to base a determination of fair value, for example historical data, and the fair values of most financial instruments will be based on some market observable inputs even where the unobservable inputs are significant.

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 an identical instrument.
• Level 2 : Valuation techniques based on observable inputs, either directly, (ie as prices) or indirectly (derived from prices). This category includes instruments valued using: quoted prices for identical or similar instruments in markets that are considered less 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 includes 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.

## 5 Use of estimates and judgements (Cont'd)

### ii) Valuation of financial instruments (Cont'd)

The tables below analyses financial instruments measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value measurement is categorised.

| | Level 1 RM'000 | Level 2 RM'000 | Level 3 RM'000 | Total RM'000 |
|---|---|---|---|---|
| **2012** | | | | |
| Financial Assets Held-for-Trading (Note 7) | **-** | **182,509** | **-** | **182,509** |
| Financial Investments Available-for-Sale* (Note 8) | **1,241,652** | **23,631** | **-** | **1,265,283** |
| Derivative financial assets (Note 11) | **-** | **19,200** | **32** | **19,232** |
| | **1,241,652** | **225,340** | **32** | **1,467,024** |
| Trading liabilities** | **-** | **940,741** | **245,177** | **1,185,918** |
| Derivative financial liabilities (Note 18) | **1** | **40,793** | **2,490** | **43,284** |
| | **1** | **981,534** | **247,667** | **1,229,202** |
| **2011 (Restated)** | | | | |
| Financial Assets Held-for-Trading (Note 7) | 216,716 | - | - | 216,716 |
| Financial Investments Available-for-Sale* (Note 8) | 422,086 | - | - | 422,086 |
| Derivative financial assets (Note 11) | - | 20,178 | 273 | 20,451 |
| | 638,802 | 20,178 | 273 | 659,253 |
| Trading liabilities** | - | 154,188 | 42,914 | 197,102 |
| Derivative financial liabilities (Note 18) | - | 6,794 | - | 6,794 |
| | - | 160,982 | 42,914 | 203,896 |

** Excludes equity securities which are carried at cost due to the lack of quoted prices in an active market or /and the fair values of the investments cannot be reliably measured.*

*** Trading liabilities consist of structured deposits, negotiable instruments of deposits classified as trading, net short position in securities and settlement accounts classified as held for trading. Structured deposits and negotiable instruments of deposits form part of the balance reported under Note 16 (Deposits from customers) while short position in securities and settlement accounts classified as held for trading form part of the balance reported under Note 18 (Other Liabilities).*

The following tables show the reconciliation from the beginning balances to the ending balances for fair value measurements in Level 3 of the fair value hierarchy:

| | 2012 Derivative financial assets RM'000 | 2012 Derivative financial liabilities RM'000 | 2012 Trading liabilities RM'000 | 2011 Derivative financial assets RM'000 | 2011 Derivative financial liabilities RM'000 | 2011 Trading liabilities RM'000 |
|---|---|---|---|---|---|---|
| Balance at 1 January | **273** | **-** | **42,914** | 5,054 | - | 45,646 |
| Total gains or losses in profit or loss | **(241)** ^ | **2,490** ^ | **(1,127)** # | (954) ^ | - | (3,535) # |
| Issues | **-** | **-** | **45,548** | - | - | - |
| Settlements | **-** | **-** | **157,842** | - | - | 25,418 |
| Transfer out of Level 3 | **-** | **-** | **-** | (3,827) | - | (24,615) |
| Balance at 31 December | **32** | **2,490** | **245,177** | 273 | - | 42,914 |

Total gains or losses included in profit or loss for the financial year in the above tables are presented in the statement of comprehensive income as follows:

| | 2012 Derivative financial assets RM'000 | 2012 Derivative financial liabilities RM'000 | 2012 Trading liabilities RM'000 | 2011 Derivative financial assets RM'000 | 2011 Derivative financial liabilities RM'000 | 2011 Trading liabilities RM'000 |
|---|---|---|---|---|---|---|
| Total gains or losses included in profit or loss for the year ended: | | | | | | |
| - Net trading income | **-** | **-** | **-** | (645) ^ | - | (508) # |
| Total gains or losses for the year ended included in profit or loss for assets and liabilities held at the end of the year: | | | | | | |
| - Net trading income | **(241)** ^ | **2,490** ^ | **(1,127)** # | (309) ^ | - | (3,027) # |

^ Denotes losses in profit or loss
# Denotes gains in profit or loss

## 6 Cash and Short-Term Funds

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Cash and balances with banks and other financial institutions | **150,386** | 113,412 | 28,217 |
| Money at call and interbank placements | | | |
| maturing within one month | **1,500,000** | 1,423,380 | 1,480,781 |
| | **1,650,386** | 1,536,792 | 1,508,998 |

## 7 Financial Assets Held-for-Trading

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| **At fair value** | | | |
| Money market instruments: | | | |
| Malaysian Government Islamic bonds | **-** | 216,716 | 58,552 |
| Malaysian Government treasury bills | **182,509** | - | 64,360 |
| Unquoted securities: | | | |
| Private debt securities | **-** | - | 25,094 |
| | **182,509** | 216,716 | 148,006 |

Credit quality of financial assets held-for-trading based on the ratings of Standard & Poor's on the counterparty :-

| | | | |
|---|---|---|---|
| Money market instruments: | | | |
| Malaysian Government treasury bills | | | |
| *AA+ to AA-* | **182,509** | - | 64,360 |
| Malaysian Government Islamic bonds | | | |
| *AA+ to AA-* | **-** | 216,716 | 58,552 |
| Unquoted securities: | | | |
| Private debt securities | | | |
| Unrated | **-** | - | 25,094 |
| | **182,509** | 216,716 | 148,006 |

All the financial assets held-for-trading held, as disclosed above, are not pledged to any counterparties.

## 8 Financial Investments Available-for-Sale

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| **At fair value** | | | |
| Money market instruments: | | | |
| Malaysian Government Islamic bonds | **1,216,651** | 397,082 | 296,161 |
| Negotiable instruments of deposit | **25,001** | 25,004 | 30,002 |
| Bankers' acceptances and Islamic accepted bills | **23,631** | - | 4,502 |
| | **1,265,283** | 422,086 | 330,665 |

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

| | | | |
|---|---|---|---|
| Maturing within one year | **303,905** | 206,016 | 34,504 |
| More than one year to three years | **331,801** | 216,070 | 296,161 |
| More than three years to five years | **145,412** | - | - |
| Over five years | **484,165** | - | - |
| | **1,265,283** | 422,086 | 330,665 |

## 9 Financing And Advances

### (i) By type

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Cash line | **62,737** | 49,753 | 14,502 |
| Term financing | | | |
| House financing | **2,096,318** | 1,272,351 | 460,173 |
| Hire purchase receivables | **296,641** | 258,634 | 176,381 |
| Lease receivables | **3,219** | 129 | 187 |
| Other term financing | **4,712,263** | 4,629,180 | 3,134,643 |
| Trust receipts | **49,217** | 25,137 | 704 |
| Claims on customers under acceptance credits | **864,548** | 1,247,279 | 905,611 |
| Staff financing | **41,073** | 20,378 | 9,332 |
| Credit/ charge cards | **442,771** | 365,947 | 261,517 |
| Revolving credit | **211,621** | 168,726 | - |
| | **8,780,408** | 8,037,514 | 4,963,050 |
| Less: Unearned income | **(121,297)** | (114,198) | (66,727) |
| | **8,659,111** | 7,923,316 | 4,896,323 |
| Less: Allowance for impaired financing: | | | |
| - Collective allowances for impairment | **(144,853)** | (105,185) | (78,844) |
| - Individual allowances for impairment | **(30,379)** | (32,981) | (15,576) |
| Total net financing and advances | **8,483,879** | 7,785,150 | 4,801,903 |

### (ii) By contract

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Bai Bithaman Ajil *(deferred payment sale)* | **386,505** | 496,370 | 762,967 |
| Ijarah *(lease)* | **2,777** | 123 | 173 |
| Ijarah Thumma Al-Bai (AITAB) *(hire purchase)* | **269,517** | 234,425 | 161,735 |
| Murabahah *(cost-plus)* | **3,044,272** | 2,853,393 | 1,557,703 |
| Musharakah (*profit and loss sharing)* | **3,255,938** | 1,707,395 | 552,958 |
| Bai Al-Inah *(sell and buy back)* | **878,477** | 1,573,752 | 1,234,198 |
| Bai Al-Dayn *(sale of debt)* | **259,995** | 292,850 | 267,797 |
| Ujrah *(fee-based)* | **561,630** | 765,008 | 358,786 |
| Qard (*benevolent financing* ) | **-** | - | 6 |
| | **8,659,111** | 7,923,316 | 4,896,323 |

### (iii) By type of customer

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Domestic non-bank financial institutions | **-** | - | 78 |
| Domestic business enterprises | | | |
| Small medium enterprises | **1,712,652** | 1,864,749 | 1,081,261 |
| Others | **2,418,532** | 2,402,235 | 1,571,024 |
| Government and statutory bodies | **20,193** | 25,086 | 25,443 |
| Individuals | **4,037,832** | 3,217,167 | 1,969,341 |
| Other domestic entities | **1,648** | 2,934 | 3,614 |
| Foreign entities | **468,254** | 411,145 | 245,562 |
| | **8,659,111** | 7,923,316 | 4,896,323 |

**9 Financing And Advances (Cont'd)**

**(iv) By profit rate sensitivity**

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Fixed rate | | | |
| House financing | **10,327** | 14,812 | 21,518 |
| Hire purchase receivables | **269,517** | 234,425 | 161,735 |
| Other financing | **2,360,678** | 3,269,277 | 2,865,037 |
| Variable rate | | | |
| House financing | **2,668,365** | 1,309,663 | 448,763 |
| Other financing | **3,350,224** | 3,095,139 | 1,399,270 |
| | **8,659,111** | 7,923,316 | 4,896,323 |

**(v) By maturity structure**

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Maturing within one year | **3,769,152** | 4,069,410 | 2,631,068 |
| More than one year to three years | **626,054** | 674,185 | 639,036 |
| More than three years to five years | **765,104** | 1,173,785 | 935,955 |
| Over five years | **3,498,801** | 2,005,936 | 690,264 |
| | **8,659,111** | 7,923,316 | 4,896,323 |

**(vi) By sector**

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Agriculture, hunting, forestry & fishing | **542,637** | 495,346 | 97,788 |
| Mining and quarrying | **151,227** | 158,056 | 138,144 |
| Manufacturing | **1,253,426** | 1,636,587 | 1,176,026 |
| Electricity, gas and water | **100,845** | 82,353 | 15,253 |
| Construction | **255,241** | 270,145 | 90,738 |
| Real estate | **529,295** | 394,054 | 323,738 |
| Wholesale & retail trade, restaurants & hotels | **614,146** | 431,776 | 275,405 |
| Transport, storage and communication | **284,958** | 409,556 | 234,077 |
| Finance, takaful and business services | **229,244** | 183,116 | 237,033 |
| Household - Retail | **4,356,938** | 3,360,543 | 2,000,719 |
| Others | **341,154** | 501,784 | 307,402 |
| | **8,659,111** | 7,923,316 | 4,896,323 |

**(vii) By purpose**

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Purchase of landed property: | | | |
| - Residential | **1,966,090** | 1,254,170 | 455,611 |
| - Non-residential | **74,027** | 63,002 | 25,469 |
| Purchase of securities | **-** | - | 1,019 |
| Purchase of transport vehicles | **1,487** | 1,578 | 1,464 |
| Purchase of fixed assets excluding land & building | **49,562** | 57,469 | 76,779 |
| Consumption credit | **2,387,506** | 2,102,850 | 1,541,544 |
| Construction | **255,241** | 256,840 | 80,790 |
| Working capital | **3,754,209** | 3,891,707 | 2,470,559 |
| Other purpose | **170,989** | 295,700 | 243,088 |
| | **8,659,111** | 7,923,316 | 4,896,323 |

**9 Financing And Advances (Cont'd)**

**(viii) By geographical distribution**

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Northern Region | **1,642,810** | 1,498,872 | 1,016,661 |
| Southern Region | **1,321,642** | 1,138,794 | 535,768 |
| Central Region | **5,082,757** | 4,441,080 | 2,895,418 |
| Eastern Region | **611,902** | 844,570 | 448,476 |
| | **8,659,111** | 7,923,316 | 4,896,323 |

The Northern region consists of the states of Perlis, Kedah, Penang, Perak, Pahang, Kelantan and Terengganu.
The Southern region consists of the states of Johor, Malacca and Negeri Sembilan.
The Central region consists of the states of Selangor and the Federal Territory of Kuala Lumpur.
The Eastern region consists of the states of Sabah, Sarawak and the Federal Territory of Labuan.
Concentration by location for financing and advances is based on the location of the customer.

**10 Impaired Financing**

**(i) Movements in impaired financing and advances**

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 |
|---|---|---|
| At beginning of year | **125,688** | 70,810 |
| Classified as impaired during the year | **230,701** | 169,700 |
| Reclassified as performing | **(23,715)** | (492) |
| Amount recovered | **(65,354)** | (40,326) |
| Amount written off | **(116,486)** | (83,291) |
| Other movements | **(21,416)** | 9,287 |
| At end of year | **129,418** | 125,688 |
| Less: Individual allowance for impairment | **(30,379)** | (32,981) |
| Collective allowance for impairment (impaired portion) | **(57,126)** | (43,962) |
| Net impaired financing and advances | **41,913** | 48,745 |

**(ii) Movements in allowance for impaired financing**

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 |
|---|---|---|
| **Collective allowance for impairment** | | |
| At beginning of year | **105,185** | 70,655 |
| - effect of convergence to MFRS | **-** | 8,189 |
| At beginning of year, MFRS | **105,185** | 78,844 |
| Made during the year | **159,920** | 104,685 |
| Amount released | **(6,644)** | (5,435) |
| Amount written off | **(110,956)** | (72,533) |
| Discount unwind | **18** | (376) |
| Other movement | **(2,670)** | - |
| At end of year | **144,853** | 105,185 |

## 10 Impaired Financing (Cont'd)

### (ii) Movements in allowance for impaired financing (Cont'd)

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 |
|---|---|---|
| **Individual allowance for impairment** | | |
| At beginning of year | **69,269** | 41,858 |
| - effect of convergence to MFRS | **(36,288)** | (26,282) |
| At beginning of year, MFRS | **32,981** | 15,576 |
| Made during the year | **32,088** | 13,397 |
| Amount recovered | **(18,053)** | (2,488) |
| Amount written off | **(1,370)** | (3,097) |
| Other movement | **(14,684)** | 9,287 |
| Discount unwind | **(583)** | 306 |
| At end of year | **30,379** | 32,981 |

### (iii) By contract

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Bai Bithaman Ajil *(deferred payment sale)* | **597** | 779 | 2,149 |
| Ijarah Thumma Al-Bai (AITAB) *(hire purchase)* | **9,251** | 4,552 | 2,545 |
| Murabahah *(cost-plus)* | **10,073** | 7,420 | 4,521 |
| Musharakah (*profit and loss sharing)* | **39,454** | 19,385 | 1,859 |
| Bai Al-Inah *(sell and buy back)* | **54,397** | 83,315 | 51,608 |
| Ujrah *(fee-based)* | **15,646** | 10,237 | 8,128 |
| | **129,418** | 125,688 | 70,810 |

### (iv) By sector

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Agriculture, hunting, forestry & fishing | **84** | - | - |
| Manufacturing | **7,594** | 9,068 | 2,929 |
| Wholesale & retail trade, restaurants & hotels | **6,913** | 4,281 | 5,246 |
| Transport, storage and communication | **829** | - | 80 |
| Finance, takaful and business services | **420** | - | 685 |
| Household - Retail | **113,578** | 112,339 | 61,870 |
| | **129,418** | 125,688 | 70,810 |

### (v) By purpose

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Purchase of landed property: | | | |
| - Residential | **45,439** | 19,032 | 2,218 |
| - Non-residential | **108** | 111 | 111 |
| Purchase of transport vehicles | **60** | - | - |
| Consumption credit | **68,079** | 93,304 | 59,652 |
| Working capital | **15,046** | 12,910 | 8,829 |
| Other purpose | **686** | 331 | - |
| | **129,418** | 125,688 | 70,810 |

## 10 Impaired Financing (Cont'd)

### (vi) By geographical distribution

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Northern Region | **36,631** | 32,022 | 19,219 |
| Southern Region | **30,106** | 23,057 | 12,865 |
| Central Region | **57,037** | 64,135 | 31,681 |
| Eastern Region | **5,644** | 6,474 | 7,045 |
| | **129,418** | 125,688 | 70,810 |

## 11 Other Assets

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Derivative financial assets (Note 34) | **19,232** | 20,451 | 8,706 |
| Income receivable | **16,387** | 6,691 | 4,128 |
| Amount due from holding company/ related companies | **96,723** | 161,007 | 30,604 |
| Other receivables, deposits and prepayments | **18,878** | 16,317 | 13,148 |
| | **151,220** | 204,466 | 56,586 |

## 12 Statutory deposits with Bank Negara Malaysia

The non-profit bearing statutory deposits are maintained with Bank Negara Malaysia in compliance with Section 26(2)c and 26(3) of the Central Bank of Malaysia Act 2009, the amounts of which are determined at set percentages of total eligible liabilities.

## 13 Equipment

| 2012 | *Office equipment, fixtures and fittings* | *Computer equipment* | *Motor vehicles* | *Total* |
|---|---|---|---|---|
| | **RM'000** | **RM'000** | **RM'000** | **RM'000** |
| **Cost** | | | | |
| Balance as at 1 January 2012 | **17,603** | **11,433** | **221** | **29,257** |
| Additions | **11,024** | **5,656** | **-** | **16,680** |
| Disposals | **-** | **-** | **-** | **-** |
| Written off | **(3)** | **-** | **-** | **(3)** |
| Net transfers (to)/from parent company | **-** | **143** | **-** | **143** |
| Balance as at 31 December 2012 | **28,624** | **17,232** | **221** | **46,077** |
| **Accumulated depreciation** | | | | |
| Balance as at 1 January 2012 | **6,871** | **3,423** | **37** | **10,331** |
| Charge for the year | **5,148** | **2,718** | **44** | **7,910** |
| Disposals | **-** | **-** | **-** | **-** |
| Written off | **(2)** | **-** | **-** | **(2)** |
| Net transfers to/ (from) parent company | **-** | **(1)** | **-** | **(1)** |
| Balance as at 31 December 2012 | **12,017** | **6,140** | **81** | **18,238** |
| **Net book value as at 31 December 2012** | **16,607** | **11,092** | **140** | **27,839** |

| 2011 | *Office equipment, fixtures and fittings* | *Computer equipment* | *Motor vehicles* | *Total* |
|---|---|---|---|---|
| | **RM'000** | **RM'000** | **RM'000** | **RM'000** |
| **Cost** | | | | |
| Balance as at 1 January 2011 | 14,692 | 7,024 | - | 21,716 |
| Additions | 3,517 | 3,903 | 221 | 7,641 |
| Disposals | - | - | - | - |
| Written off | (612) | - | - | (612) |
| Net transfers from parent company | 6 | 506 | - | 512 |
| Balance as at 31 December 2011 | 17,603 | 11,433 | 221 | 29,257 |
| **Accumulated depreciation** | | | | |
| Balance as at 1 January 2011 | 3,518 | 1,773 | - | 5,291 |
| Charge for the year | 3,913 | 1,666 | 37 | 5,616 |
| Disposals | - | - | - | - |
| Written off | (561) | - | - | (561) |
| Net transfers to/(from) parent company | 1 | (16) | - | (15) |
| Balance as at 31 December 2011 | 6,871 | 3,423 | 37 | 10,331 |
| **Net book value as at 31 December 2011** | 10,732 | 8,010 | 184 | 18,926 |

## 14 Intangible assets

| **2012** | *Computer software* **RM'000** |
|---|---|
| **Cost** | |
| Balance as at 1 January 2012 | **5,074** |
| Additions | **18** |
| Balance as at 31 December 2012 | **5,092** |
| **Accumulated depreciation** | |
| Balance as at 1 January 2012 | **4,613** |
| Charge for the year | **450** |
| Balance as at 31 December 2012 | **5,063** |
| **Net book value as at 31 December 2012** | **29** |

| **2011** | *Computer software* **RM'000** |
|---|---|
| **Cost** | |
| Balance as at 1 January 2011 | 5,879 |
| Additions | 5 |
| Reversal of capitalised charges to income statement | (810) |
| Balance as at 31 December 2011 | 5,074 |
| **Accumulated depreciation** | |
| Balance as at 1 January 2011 | 4,380 |
| Charge for the year | 233 |
| Balance as at 31 December 2011 | 4,613 |
| **Net book value as at 31 December 2011** | 461 |

## 15 Deferred tax assets

The amounts, prior to offsetting are summarised as follows:

| | **31 Dec 2012** | 31 Dec 2011 | 1 Jan 2011 |
|---|---|---|---|
| | **RM'000** | RM'000 | RM'000 |
| Deferred tax assets | **44,483** | 31,738 | 38,594 |
| Deferred tax liabilities | **(3,010)** | (2,064) | (1,728) |
| | **41,473** | 29,674 | 36,866 |

Deferred tax assets and liabilities are offset where there is a legally enforceable right to set-off current tax assets against current tax liabilities.

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

| | **31 Dec 2012** | 31 Dec 2011 | 1 Jan 2011 |
|---|---|---|---|
| | **RM'000** | RM'000 | RM'000 |
| Equipment | | | |
| - Capital allowances | **(2,793)** | (2,000) | (1,728) |
| Available-for-sale reserve | **(178)** | (49) | 46 |
| Allowances | | | |
| - Collective impairment allowance | **35,094** | 25,133 | 33,922 |
| - Others | **9,389** | 6,605 | 4,623 |
| Lease receivables | **(39)** | (15) | 3 |
| | **41,473** | 29,674 | 36,866 |

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

| **2012** | *As at 1 Jan 2012* **RM'000** | *Transfer to parent via statement of financial position* **RM'000** | *Transfer of PER to retained earnings* **RM'000** | *Recognised in income statement* **RM'000** | *Recognised in other comprehensive income* **RM'000** | *As at 31 Dec 2012* **RM'000** |
|---|---|---|---|---|---|---|
| Equipment | | | | | | |
| - Capital allowances | **(2,000)** | **-** | **-** | **(793)** | **-** | **(2,793)** |
| Available-for-sale reserve | **(49)** | **-** | **-** | **-** | **(129)** | **(178)** |
| Allowances | | | | | | |
| - Collective impairment allowance | **25,133** | **(668)** | **-** | **10,629** | **-** | **35,094** |
| - Others | **6,605** | **-** | **(1,340)** | **4,124** | **-** | **9,389** |
| Lease receivables | **(15)** | **-** | **-** | **(24)** | **-** | **(39)** |
| | **29,674** | **(668)** | **(1,340)** | **13,936** | **(129)** | **41,473** |

| **2011** | *As at 1 Jan 2011* RM'000 | *Transfer to parent via statement of financial position* RM'000 | *Transfer of PER to retained earnings* RM'000 | *Recognised in income statement* RM'000 | *Recognised in other comprehensive income* RM'000 | *As at 31 Dec 2011* RM'000 |
|---|---|---|---|---|---|---|
| Equipment | | | | | | |
| - Capital allowances | (1,728) | - | - | (272) | - | (2,000) |
| Available-for-sale reserve | 46 | - | - | - | (95) | (49) |
| Allowances | | | | | | |
| - Collective impairment allowance | 33,922 | - | - | (8,789) | - | 25,133 |
| - Others | 4,623 | - | - | 1,982 | - | 6,605 |
| Lease receivables | 3 | - | - | (18) | - | (15) |
| | 36,866 | - | - | (7,097) | (95) | 29,674 |

## 16 Deposits From Customers

### (i) By type of deposit

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Non-Mudharabah Fund | | | |
| Demand deposits | **797,894** | 673,829 | 513,731 |
| Savings deposits | **942,872** | 822,480 | 655,350 |
| Fixed return investment deposits | **5,446,258** | 3,780,189 | 705,179 |
| Islamic repurchase agreements | **223,467** | 192,401 | 147,534 |
| Negotiable instruments of deposits | **80,434** | 15,400 | - |
| Others | **1,148,884** | 178,197 | - |
| | **8,639,809** | 5,662,496 | 2,021,794 |
| Mudharabah Fund | | | |
| General investment deposits | **-** | - | 1,778,568 |
| Others | **-** | - | 130,198 |
| | **8,639,809** | 5,662,496 | 3,930,560 |

The maturity structure of term deposits and negotiable instruments of deposits is as follows:

| | RM'000 | RM'000 | RM'000 |
|---|---|---|---|
| Due within six months | **4,697,623** | 3,217,397 | 2,165,113 |
| More than six months to one year | **709,464** | 548,110 | 295,281 |
| More than one year to three years | **58,711** | 30,082 | 18,736 |
| More than three years to five years | **60,894** | - | 4,617 |
| | **5,526,692** | 3,795,589 | 2,483,747 |

### (ii) By type of customer

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Government and statutory bodies | **86,997** | 86,624 | 134,519 |
| Business enterprises | **2,053,853** | 1,883,294 | 1,719,526 |
| Individuals | **5,252,261** | 3,070,475 | 1,700,485 |
| Others | **1,246,698** | 622,103 | 376,030 |
| | **8,639,809** | 5,662,496 | 3,930,560 |

## 17 Deposits and Placements from Banks and Other Financial Institutions

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Mudharabah Fund | | | |
| Licensed banks | **1,753,541** | 3,261,118 | 1,493,087 |
| Bank Negara Malaysia | **9,775** | 48,405 | - |
| Other financial institutions | **-** | 431,002 | 591,512 |
| | **1,763,316** | 3,740,525 | 2,084,599 |

## 18 Other Liabilities

| | Note | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|---|
| Derivative financial liabilities | | **43,284** | 6,794 | - |
| Profit payable | | **41,915** | 16,503 | 12,550 |
| Amounts due to holding company/ related companies | | **33,776** | 17,743 | 33,533 |
| Profit equalisation reserve | (a) | **1,340** | 6,700 | 6,700 |
| Other creditors and accruals | (b) | **64,226** | 51,556 | 36,007 |
| | | **184,541** | 99,296 | 88,790 |

(a) Movement in profit equalisation reserve is as follows:

| | | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|---|
| At beginning of financial year | | **6,700** | 6,700 | 6,700 |
| Transfer to retained profits | 2e(iv) | **(5,360)** | - | - |
| At end of year | | **1,340** | 6,700 | 6,700 |

(b) Other creditors and accruals

Included in other creditors and accruals is excess compensation balance and profit earned from inadvertent financing of Shariah non-compliant activities. The contribution was distributed to the Non-Governmental Organisations approved by the Shariah Committee during the financial year.

| **Source and use of charity funds** | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| **Source of charity funds** | | | |
| At beginning of year | **-** | - | - |
| Excess compensation account | **70** | - | - |
| Income from inadvertent Shariah non-compliant activities | **32** | - | - |
| **Use of charity funds** | | | |
| Contribution to non-profit organisations | **(70)** | - | - |
| At end of year | **32** | - | - |

## 19 Provision for taxation and zakat

| | **31 Dec 2012** | 31 Dec 2011 | 1 Jan 2011 |
|---|---|---|---|
| | **RM'000** | RM'000 | RM'000 |
| Taxation | **3,307** | 31,248 | 25,961 |
| Zakat | **-** | - | 100 |
| | **3,307** | 31,248 | 26,061 |

## 20 Multi-Currency Sukuk Programme ("MCSP")

| | **31 Dec 2012** | 31 Dec 2011 | 1 Jan 2011 |
|---|---|---|---|
| | **RM'000** | RM'000 | RM'000 |
| Multi-Currency Sukuk Programme | **500,000** | - | - |

During the year, the Bank issued a RM500 million 5-year medium term note (Sukuk) under its RM3 billion Multi-Currency Sukuk Programme (“MCSP”). The Sukuk's maturity date is 28 September 2017 and bears a distribution rate of 3.75% per annum payable semi-annually in arrears. The Sukuk issued under the MCSP is carried at amortised cost, with profit payable recognised on an accrual basis.

## 21 Share Capital

| | **31 Dec 2012** | 31 Dec 2011 | 1 Jan 2011 |
|---|---|---|---|
| | **RM'000** | RM'000 | RM'000 |
| **Authorised:** | | | |
| 600 million ordinary shares of RM0.50 each | **300,000** | 300,000 | 300,000 |
| **Issued and fully paid:** | | | |
| 100 million ordinary shares of RM0.50 each | | | |
| At beginning and end of financial year | **50,000** | 50,000 | 50,000 |

## 22 Reserves

| | **31 Dec 2012** | 31 Dec 2011 | 1 Jan 2011 |
|---|---|---|---|
| | **RM'000** | RM'000 | RM'000 |
| Non-distributable | | | |
| Share premium | **610,000** | 610,000 | 610,000 |
| Statutory reserve | **50,000** | 50,000 | 50,000 |
| Available-for-sale reserve | **534** | 148 | (136) |
| Capital Contribution reserve | **1,161** | 695 | 335 |
| | **661,695** | 660,843 | 660,199 |
| Distributable | | | |
| Retained profits | **328,085** | 190,825 | 89,937 |
| | **989,780** | 851,668 | 750,136 |

The statutory reserve is maintained in compliance with Section 15 (1) of the Islamic Banking Act, 1983 and is not distributable as cash dividends.

## 23 Income Derived from Investment of Depositors' Funds and Others

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 |
|---|---|---|
| Income derived from investment of: | | |
| (i) general investment deposits | **439,599** | 321,530 |
| (ii) specific investment deposits | **96,201** | 52,969 |
| (iii) other deposits | **87,850** | 75,976 |
| | **623,650** | 450,475 |

(i) Income derived from investment of general investment deposits

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 |
|---|---|---|
| Finance income and hibah: | | |
| Financing and advances | | |
| - Profit earned other than recoveries from impaired financing | **386,292** | 288,693 |
| - Recoveries from impaired financing | **442** | - |
| Financial investments available-for-sale | **11,516** | 296 |
| Money at call and deposit with financial institutions | **41,349** | 32,453 |
| | **439,599** | 321,442 |
| Other operating income | | |
| Net gains from sale of financial assets held-for-trading and other financial instruments | **-** | 69 |
| Net profit earned from financial assets held-for-trading | **-** | 19 |
| | **-** | 88 |
| | **439,599** | 321,530 |

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

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 |
|---|---|---|
| (ii) Income derived from investment of specific investment deposits | | |
| Finance income and hibah: | | |
| Financing and advances | | |
| - Profit earned other than recoveries from impaired financing | **30,353** | 21,971 |
| Financial investments available-for-sale | **10,427** | 10,104 |
| | **40,780** | 32,075 |
| Other operating income | | |
| Fees and commission | **3,080** | 2,977 |
| Net gains from dealing in foreign currency | **16,234** | 9,746 |
| Net gain/(loss) from sale of financial assets held-for-trading and other financial instruments | **49,600** | (301) |
| Net gains from trading in derivatives | **3,275** | 8,908 |
| Net profit (paid)/earned from financial assets held-for-trading and other financial instruments | **(14,726)** | 54 |
| Net unrealised loss from revaluation of financial assets held-for-trading | **(2,042)** | (490) |
| | **55,421** | 20,894 |
| | **96,201** | 52,969 |

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

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 |
|---|---|---|
| Guarantee fees | **1,217** | 423 |
| Service charges and fees | **1,109** | 1,931 |
| Credit facilities | **393** | 609 |

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 |
|---|---|---|
| (iii) Income derived from investment of other deposits | | |
| Finance income and hibah: | | |
| Financing and advances | | |
| - Profit earned other than recoveries from impaired financing | **77,198** | 68,217 |
| - Recoveries from impaired financing | **88** | - |
| Financial investments available-for-sale | **2,301** | 70 |
| Money at call and deposit with financial institutions | **8,263** | 7,669 |
| | **87,850** | 75,956 |
| Other operating income | | |
| Net gains from sale of financial assets held-for-trading and other financial instruments | **-** | 16 |
| Net profit earned from financial assets held-for-trading | **-** | 4 |
| | **-** | 20 |
| | **87,850** | 75,976 |

## 24 Income Derived from Investment of Shareholder's Funds

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 |
|---|---|---|
| Finance income and hibah: | | |
| Financing and advances | | |
| - Profit earned other than recoveries from impaired financing | **46,583** | 39,712 |
| - Recoveries from impaired financing | **53** | - |
| Financial investments available-for-sale | **1,389** | 41 |
| Money at call and deposit with financial institutions | **4,986** | 4,464 |
| | **53,011** | 44,217 |
| Other operating income | | |
| Fees and commission | **76,882** | 44,326 |
| Net gains from sale of financial assets held-for-trading and other financial instruments | **-** | 10 |
| Net profit earned from financial assets held-for-trading | **-** | 3 |
| Shared-service fees from holding company | **6,093** | 2,082 |
| Net gain on disposal of equipment | **-** | 2 |
| Other income | **255** | 224 |
| | **83,230** | 46,647 |
| | **136,241** | 90,864 |

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

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 |
|---|---|---|
| Service charges and fees | **21,027** | 15,604 |
| Cards | **24,728** | 14,489 |
| Agency fees | **16,675** | 7,058 |

## 25 Impairment Losses on Financing

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 |
|---|---|---|
| Impairment charges on financing: | | |
| (a) Individual impairment | | |
| - Provided | **32,088** | 13,397 |
| - Written back | **(18,053)** | (2,488) |
| (b) Collective impairment | | |
| - Provided | **159,920** | 104,685 |
| - Written back | **(6,644)** | (5,435) |
| Impaired financing | | |
| - Recovered | **(26,312)** | (21,416) |
| - Written off | **1,011** | 7,662 |
| | **142,010** | 96,405 |

## 26 Income Attributable to Depositors

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 |
|---|---|---|
| Deposits from customers | | |
| - Mudharabah Fund | **-** | 35,308 |
| - Non-Mudharabah Fund | **177,714** | 62,912 |
| Deposits and placements of banks and other financial institutions | | |
| - Mudharabah Fund | **61,597** | 55,447 |
| Others | **5,654** | 383 |
| | **244,965** | 154,050 |

## 27 Personnel Expenses

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 |
|---|---|---|
| Salaries, allowances and bonuses | **28,148** | 21,010 |
| Employees Provident Fund contributions | **4,419** | 3,396 |
| Other staff related costs | **3,297** | 2,046 |
| | **35,864** | 26,452 |

## 28 Other Overheads and Expenditures

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 |
|---|---|---|
| Promotion and marketing related expenses | | |
| Advertising and promotion | **9,915** | 7,636 |
| Marketing | **6,167** | 2,755 |
| | **16,082** | 10,391 |
| Establishment related expenses | | |
| Depreciation of equipment | **7,910** | 5,616 |
| Amortisation of intangible assets | **450** | 233 |
| Information technology costs | **1,183** | 767 |
| Hire of Equipment | **54** | 71 |
| Rental of premises | **7,329** | 5,074 |
| Equipment written off | **1** | 51 |
| Others | **3,049** | 1,917 |
| | **19,976** | 13,729 |
| General administrative expenses | | |
| Shared-service fees to immediate holding company | **105,917** | 97,327 |
| Auditors' remuneration | | |
| Audit fees | | |
| KPMG Malaysia | **110** | 100 |
| Non-audit services | | |
| KPMG Malaysia | **130** | 90 |
| Professional fees | **1,807** | 1,444 |
| Others | **27,859** | 14,061 |
| | **135,823** | 113,022 |
| | **171,881** | 137,142 |

## 29 Taxation

| | **31 Dec 2012** | 31 Dec 2011 |
|---|---|---|
| | **RM'000** | RM'000 |
| Malaysian income tax | | |
| - Current year | **49,474** | 31,704 |
| - In respect of changes in tax treatment for collective allowance for impairment | **-** | (12,557) |
| - Prior year | **(3,607)** | 158 |
| Total current tax recognised in profit or loss | **45,867** | 19,305 |
| Deferred tax: | | |
| Origination and reversal of temporary differences | | |
| - Current year | **(13,936)** | (10,377) |
| - In respect of changes in tax treatment for collective allowance for impairment | **-** | 19,430 |
| - Prior year | **-** | (1,956) |
| Total deferred tax recognised in profit or loss | **(13,936)** | 7,097 |
| Total income tax expense | **31,931** | 26,402 |

A numerical reconciliation between tax expense and the accounting profit multiplied by the applicable tax rate is as follows:

| | **RM'000** | RM'000 |
|---|---|---|
| Profit before taxation and zakat | **165,171** | 127,290 |
| Taxation at Malaysian tax rate of 25% (2011 : 25%) | **41,293** | 31,823 |
| Non-deductible expenses | **1,811** | 955 |
| Tax exempt income | **(7,566)** | (4,578) |
| (Over)/Under provision in respect of prior years | **(3,607)** | (1,798) |
| Tax expense | **31,931** | 26,402 |

## 30 Earnings per share

The earnings per ordinary share have been calculated based on profit for the year and 100,000,000 number of ordinary shares of RM0.50 each in issue during the financial year.

## 31 Significant related party transactions and balances

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

a. the Bank has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial or operational decisions, or vice versa, or
b. the Bank and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

The related parties of the Bank comprise: -

i the Bank's immediate, penultimate and ultimate holding companies (hereinafter collectively referred to as "parent companies"),
ii subsidiary and associated companies of the Bank's parent companies,
iii key management personnel who are defined as those person having authority and responsibility for planning, directing and controlling the activities of the Bank, being the members of the Board of Directors of HSBC Amanah Malaysia Berhad, and
iv the close family members of key management personnel.

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

| | **31 Dec 2012** | | 31 Dec 2011 | |
|---|---|---|---|---|
| | ***Parent companies*** **RM'000** | ***Other related companies*** **RM'000** | *Parent companies* RM'000 | *Other related companies* RM'000 |
| Income | | | | |
| Fees and commission | **7,421** | **15,346** | 707 | 5,531 |
| Other income | **6,093** | **-** | 2,082 | - |
| | **13,514** | **15,346** | 2,789 | 5,531 |
| Expenditure | | | | |
| Profit attributable to intercompany deposits | **59,340** | **2,628** | 52,288 | 4,347 |
| Fees and commission | **32** | **87** | 2 | 29 |
| Operating expenses | **105,917** | **12,887** | 97,327 | 9,522 |
| | **165,289** | **15,602** | 149,617 | 13,898 |
| Amount due from | | | | |
| Current account balances | **1,990** | **68,904** | - | 39,546 |
| Other assets | **94,567** | **2,156** | 160,913 | 94 |
| | **96,557** | **71,060** | 160,913 | 39,640 |
| Amount due to | | | | |
| Intercompany deposits | **1,653,541** | **125,185** | 3,261,118 | 533,681 |
| Current account balances | **16,081** | **-** | 5,353 | - |
| Other liabilities | **2,918** | **14,777** | 3,057 | 5,827 |
| | **1,672,540** | **139,962** | 3,269,528 | 539,508 |

All transactions between the Bank and its related parties are made in the ordinary course of business and on substantially the same terms, including profit rates, as for comparable to transactions with a third party.

Total financing due by key management personnel of the Bank as at 31 December 2012 is RM17,606 (2011: RM63,240).

## 31 Significant Related Party Transactions and Balances (Cont'd)

(b) Key Management Personnel Compensation

The remuneration of the key management personnel, being the members of the Board of Directors and Shariah Committee of the Bank charged to the income statements during the financial year are as follows: -

The directors' shareholdings in the shares of the ultimate holding company, HSBC Holdings plc, are shown in the Directors' Report.

**2012**

| RM'000 | Salaries and bonuses | Other remuneration and employee benefits | Benefits-in-kind | Fees | Total |
|---|---|---|---|---|---|
| **Directors** | | | | | |
| **Executive Director** | | | | | |
| Mohamed Rafe Bin Mohamed Haneef (CEO) | **1,875** | **172** | **35** | **-** | **2,082** |
| **Non Executive Directors** | | | | | |
| Louisa Cheang | **-** | **-** | **-** | **-** | **-** |
| Mukhtar Malik Hussain | **-** | **-** | **-** | **-** | **-** |
| Mohamed Ross bin Mohd Din | **-** | **-** | **-** | **90** | **90** |
| Azlan bin Abdullah | **-** | **-** | **-** | **81** | **81** |
| Mohamed Ashraf Bin Mohamed Iqbal | **-** | **-** | **-** | **82** | **82** |
| Lee Choo Hock | **-** | **-** | **-** | **91** | **91** |
| | **1,875** | **172** | **35** | **344** | **2,426** |
| Shariah Committee | **-** | **-** | **-** | **248** | **248** |
| | **1,875** | **172** | **35** | **592** | **2,674** |

**2011**

| RM'000 | Salaries and bonuses | Other remuneration and employee benefits | Benefits-in-kind | Fees | Total |
|---|---|---|---|---|---|
| **Directors** | | | | | |
| **Executive Director** | | | | | |
| Mohamed Rafe Bin Mohamed Haneef (CEO) | 1,141 | 172 | 7 | - | 1,320 |
| **Non Executive Directors** | | | | | |
| Mukhtar Malik Hussain | - | - | - | - | - |
| Mohamed Ross bin Mohd Din | - | - | - | 82 | 82 |
| Azlan bin Abdullah | - | - | - | 80 | 80 |
| Mohamed Ashraf Bin Mohamed Iqbal | - | - | - | 77 | 77 |
| Lee Choo Hock | - | - | - | 88 | 88 |
| Mohd Razlan Bin Mohamed^ | - | - | - | 52 | 52 |
| | 1,141 | 172 | 7 | 379 | 1,699 |
| Shariah Committee | - | - | - | 204 | 204 |
| | 1,141 | 172 | 7 | 583 | 1,903 |

^ resigned 6 August 2011

## 32 Credit exposure to connected parties

The credit exposures of the Bank to connected parties, as defined by Bank Negara Malaysia's Guidelines on Credit Transactions and Exposures with Connected Parties' are as follows:

| | **31 Dec 2012** | 31 Dec 2011 |
|---|---|---|
| Aggregate value of outstanding credit exposures to connected parties (RM'000) | **130,602** | 165,813 |
| As a percentage of total credit exposures | **1.25%** | 1.80% |
| Aggregate value of outstanding credit exposures to connected parties which is non-performing or in default (RM'000) | **-** | - |
| As a percentage of total credit exposures | **-** | - |

## 33 Capital Adequacy

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 Restated |
|---|---|---|
| **Tier 1 capital** | | |
| Paid-up ordinary share capital | **50,000** | 50,000 |
| Share premium | **610,000** | 610,000 |
| Retained profits | **328,085** | 190,825 |
| Statutory reserve | **50,000** | 50,000 |
| | **1,038,085** | 900,825 |
| Deferred tax adjustments | **(41,651)** | (29,723) |
| Total Tier 1 capital | **996,434** | 871,102 |
| **Tier 2 capital** | | |
| Collective impairment allowance (unimpaired portion) | **87,727** | 61,223 |
| Total Tier 2 capital | **87,727** | 61,223 |
| **Capital base** | **1,084,161** | 932,325 |
| **Core capital ratio** | **10.8%** | 10.6% |
| **Risk-weighted capital ratio** | **11.8%** | 11.3% |

*The capital ratios have been computed in accordance with the Capital Adequacy Framework for Islamic Banks (CAFIB).*

Breakdown of risk-weighted assets ("RWA") in the various categories of risk weighted:

| | **31 Dec 2012** | | 31 Dec 2011 | |
|---|---|---|---|---|
| | **Principal RM'000** | **Risk-weighted RM'000** | Principal RM'000 | Risk-weighted RM'000 |
| Total RWA for credit risk | **14,058,135** | **8,397,856** | 11,629,129 | 7,546,956 |
| Total RWA for market risk | **-** | **72,469** | - | 100,942 |
| Total RWA for operational risk | **-** | **746,473** | - | 580,027 |
| | **14,058,135** | **9,216,798** | 11,629,129 | 8,227,925 |

## 34 Commitments and Contingencies

The table below shows the contracts or underlying principal amounts, positive fair value of derivative contracts, credit equivalent amounts and risk weighted amounts of unmatured off-balance sheet transactions as at balance sheet date. The underlying principal amounts indicate the volume of business outstanding and do not represent amounts at risk.

| **31 Dec 2012** | **Principal amount RM'000** | **Positive fair value of derivative contracts RM'000** | **Credit equivalent amount * RM'000** | **Risk weighted amount * RM'000** |
|---|---|---|---|---|
| Direct credit substitutes | **683,648** | **-** | **683,648** | **635,259** |
| Transaction-related contingent items | **674,205** | **-** | **337,103** | **261,801** |
| Short-term self-liquidating trade- related contingencies | **17,107** | **-** | **3,421** | **2,634** |
| Irrevocable commitments to extend credit | | | | |
| - Maturity not exceeding one year | **1,645,059** | **-** | **329,012** | **302,734** |
| - Maturity exceeding one year | **123,684** | **-** | **61,842** | **59,511** |
| Unutilised credit card lines | **1,032,666** | **-** | **206,533** | **154,900** |
| Equity related contracts | | | | |
| - Less than one year | **743,859** | **604** | **45,235** | **22,349** |
| - One year to less than five years | **520,972** | **5,214** | **46,974** | **18,989** |
| Profit rate related contracts | | | | |
| - Less than one year | **10,000** | **39** | **64** | **32** |
| - One year to less than five years | **1,479,461** | **9,241** | **51,784** | **29,087** |
| - Over five years | **550,000** | **2,206** | **29,706** | **22,169** |
| Foreign exchange related contracts | | | | |
| - Less than one year | **96,181** | **497** | **1,942** | **1,287** |
| - Over five years | **91,770** | **1,431** | **11,526** | **9,002** |
| | **7,668,612** | **19,232** | **1,808,790** | **1,519,754** |
| | | **Note 11** | | |

| **31 Dec 2011** | Principal amount RM'000 | Positive fair value of derivative contracts RM'000 | Credit equivalent amount * RM'000 | Risk weighted amount * RM'000 |
|---|---|---|---|---|
| Direct credit substitutes | 461,660 | - | 461,660 | 404,287 |
| Transaction-related contingent items | 531,060 | - | 265,530 | 257,691 |
| Short-term self-liquidating trade- related contingencies | 32,928 | - | 6,586 | 4,745 |
| Irrevocable commitments to extend credit | | | | |
| - Maturity not exceeding one year | 1,314,320 | - | 262,864 | 246,185 |
| - Maturity exceeding one year | 133,435 | - | 26,687 | 26,251 |
| Unutilised credit card lines | 885,773 | - | 177,155 | 132,866 |
| Equity related contracts | | | | |
| - Less than one year | - | - | - | - |
| - One year to less than five years | 206,474 | 5,192 | 21,710 | 5,138 |
| Profit rate related contracts | | | | |
| - One year to less than five years | 1,551,362 | 13,568 | 73,052 | 41,410 |
| - Over five years | - | - | - | - |
| Foreign exchange related contracts | | | | |
| - Less than one year | 226,145 | 1,691 | 5,783 | 4,003 |
| | 5,343,157 | 20,451 | 1,301,027 | 1,122,576 |
| | | Note 11 | | |

**34 Commitments and Contingencies (Cont'd)**

| 1 Jan 2011 | Principal amount RM'000 | Positive fair value of derivative contracts RM'000 | Credit equivalent amount * RM'000 | Risk weighted amount * RM'000 |
|---|---|---|---|---|
| Direct credit substitutes | 90,224 | - | 90,224 | 80,828 |
| Transaction-related contingent items | 22,347 | - | 11,174 | 9,800 |
| Short-term self-liquidating trade-related contingencies | 14,427 | - | 2,885 | 1,406 |
| Irrevocable commitments to extend credit | | | | |
| - Maturity not exceeding one year | 766,956 | - | - | - |
| - Maturity exceeding one year | 81,217 | - | 40,609 | 31,995 |
| Unutilised credit card lines | 581,158 | - | 116,232 | 87,174 |
| Equity related contracts | | | | |
| - Less than one year | 13,177 | 4,642 | 5,439 | 1,087 |
| - One year to less than five years | 106,108 | 4,064 | 15,028 | 3,006 |
| | 1,675,614 | 8,706 | 281,591 | 215,296 |
| | | Note 11 | | |

* The credit equivalent and risk weighted amounts are computed using credit conversion factors and risk weighting rules as per Bank Negara Malaysia guidelines. The credit conversion factors and risk weighting rules were based on Basel II Capital Adequacy Framework for Islamic Banks, "CAFIB".

## 35 Profit Rate Risk

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

| | Non-trading book | | | | | | | | Effective |
|---|---|---|---|---|---|---|---|---|---|
| **31 Dec 2012** | **Up to 1 month RM'000** | **>1 - 3 months RM'000** | **>3 - 12 months RM'000** | **1 - 5 years RM'000** | **Over 5 years RM'000** | **Non-profit sensitive RM'000** | **Trading book RM'000** | **Total RM'000** | **profit rate %** |
| **ASSETS** | | | | | | | | | |
| Cash and short-term funds | 1,500,000 | - | - | - | - | 150,386 | - | 1,650,386 | 3.02 |
| Financial assets held-for-trading | - | - | - | - | - | - | 182,509 | 182,509 | 2.96 |
| Financial investments available-for-sale | 23,631 | 75,062 | 205,212 | 477,212 | 484,166 | - | - | 1,265,283 | 3.01 |
| Financing and advances | | | | | | | | | |
| - performing | 6,315,087 | 341,391 | 266,409 | 1,244,264 | 106,685 | 168,130 | - | 8,441,966 | 6.38 |
| - impaired * | - | - | - | - | - | 41,913 | - | 41,913 | - |
| Others | - | - | - | - | - | 539,555 | 24,567 | 564,122 | - |
| **Total Assets** | 7,838,718 | 416,453 | 471,621 | 1,721,476 | 590,851 | 899,984 | 207,076 | 12,146,179 | |
| **LIABILITIES AND SHAREHOLDERS' FUNDS** | | | | | | | | | |
| Deposits from customers | 4,550,442 | 1,174,978 | 1,086,522 | 39,171 | - | 639,812 | 1,148,884 | 8,639,809 | 2.67 |
| Deposits and placements from banks and other financial institutions | 101,066 | - | 1,632,591 | 19,884 | - | 9,775 | - | 1,763,316 | 2.12 |
| Bills and acceptances payable | - | - | - | - | - | 15,426 | - | 15,426 | - |
| Multi-Currency Sukuk Programme | - | - | - | 500,000 | - | - | - | 500,000 | 3.75 |
| Others | - | - | - | - | - | 138,285 | 49,563 | 187,848 | - |
| **Total Liabilities** | 4,651,508 | 1,174,978 | 2,719,113 | 559,055 | - | 803,298 | 1,198,447 | 11,106,399 | |
| Shareholder's Equity | - | - | - | - | - | 1,039,780 | - | 1,039,780 | |
| **Total Liabilities and Shareholders' Equity** | 4,651,508 | 1,174,978 | 2,719,113 | 559,055 | - | 1,843,078 | 1,198,447 | 12,146,179 | |
| On-balance sheet profit sensitivity gap | 3,187,210 | (758,525) | (2,247,492) | 1,162,421 | 590,851 | (943,094) | (991,371) | - | |
| Off-balance sheet profit sensitivity gap | | | | | | | | | |
| - Profit rate swaps | 33,285 | (139,222) | 67,762 | 38,175 | - | - | - | - | |
| **Total profit sensitivity gap** | 3,220,495 | (897,747) | (2,179,730) | 1,200,596 | 590,851 | (943,094) | (991,371) | - | |

* This is arrived at after deducting the individual allowance from impaired financing.

## 35 Profit rate risk (Cont'd)

| 31 Dec 2011 | Non-trading book: Up to 1 month RM'000 | >1 - 3 months RM'000 | >3 - 12 months RM'000 | 1 - 5 years RM'000 | Over 5 years RM'000 | Non-profit sensitive RM'000 | Trading book RM'000 | Total RM'000 | Effective profit rate % |
|---|---|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | | | |
| Cash and short term funds | 1,436,103 | - | - | - | - | 100,689 | - | 1,536,792 | 2.92 |
| Financial assets held-for-trading | - | - | - | - | - | - | 216,716 | 216,716 | 3.19 |
| Financial investments available-for-sale | - | 25,009 | 181,007 | 216,070 | - | - | - | 422,086 | 3.12 |
| Financing and advances | | | | | | | | | |
| - performing | 5,091,195 | 352,609 | 234,522 | 1,689,629 | 209,914 | 158,536 | - | 7,736,405 | 7.17 |
| - impaired * | - | - | - | - | - | 48,745 | - | 48,745 | - |
| Others | - | - | - | - | - | 455,318 | 26,771 | 482,089 | - |
| **Total Assets** | 6,527,298 | 377,618 | 415,529 | 1,905,699 | 209,914 | 763,288 | 243,487 | 10,442,833 | |
| **LIABILITIES AND SHAREHOLDERS' FUNDS** | | | | | | | | | |
| Deposits from customers | 3,240,553 | 1,032,454 | 737,997 | 14,682 | - | 458,613 | 178,197 | 5,662,496 | 2.40 |
| Deposits and placements from banks and other financial institutions | 701,280 | 316,800 | 2,520,793 | 197,688 | - | 3,964 | - | 3,740,525 | 2.09 |
| Bills and acceptances payable | - | - | - | - | - | 7,600 | - | 7,600 | - |
| Others | - | - | - | - | - | 122,883 | 7,661 | 130,544 | - |
| **Total Liabilities** | 3,941,833 | 1,349,254 | 3,258,790 | 212,370 | - | 593,060 | 185,858 | 9,541,165 | |
| Shareholder's Equity | - | - | - | - | - | 901,668 | - | 901,668 | |
| **Total Liabilities and Shareholders' Equity** | 3,941,833 | 1,349,254 | 3,258,790 | 212,370 | - | 1,494,728 | 185,858 | 10,442,833 | |
| On-balance sheet profit sensitivity gap | 2,585,465 | (971,636) | (2,843,261) | 1,693,329 | 209,914 | (731,440) | 57,629 | - | |
| Off-balance sheet profit sensitivity gap | 49,190 | (139,222) | 56,482 | 33,550 | - | - | - | - | |
| **Total profit sensitivity gap** | 2,634,655 | (1,110,858) | (2,786,779) | 1,726,879 | 209,914 | (731,440) | 57,629 | - | |

* This is arrived at after deducting the individual allowance from impaired financing.

## 36 Collateral

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

| | 31 Dec 2012 | 31 Dec 2011 |
|---|---|---|
| **Carrying amount of assets pledged as collateral** | **RM'000** | RM'000 |
| - Collateral pledged for repurchase agreements | **223,467** | 192,401 |

## 37 Fair values of financial assets and liabilities

The following table summarises the fair values of the financial assets and liabilities carried on the balance sheet as at 31 December.

| | | 31 Dec 2012 Carrying amount RM'000 | 31 Dec 2012 Fair Value RM'000 | 31 Dec 2011 Carrying amount RM'000 Restated | 31 Dec 2011 Fair Value RM'000 Restated |
|---|---|---|---|---|---|
| **Financial Assets** | | | | | |
| Cash and short-term funds | | **1,650,386** | **1,650,386** | 1,536,792 | 1,536,792 |
| Securities held for trading | | **182,509** | **182,509** | 216,716 | 216,716 |
| Securities available for sale | | **1,265,283** | **1,265,282** | 422,086 | 422,086 |
| Financing and advances | | **8,483,879** | **8,477,300** | 7,785,150 | 7,780,262 |
| **Financial Liabilities** | | | | | |
| Deposits from customers | | **8,639,809** | **8,609,264** | 5,662,496 | 5,633,443 |
| Deposits and placements from banks and other financial institutions | | **1,763,316** | **1,733,598** | 3,740,525 | 3,670,857 |
| Bills and acceptances payable | | **15,426** | **15,426** | 7,600 | 7,600 |
| Multi-Currency Sukuk Programme | Note 20 | **500,000** | **502,169** | - | - |

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

**Cash and short-term funds**
**Bills and acceptances payable**

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

**Financing and advances**

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

**Deposits from customers**
**Deposits and placements of banks and other financial institutions**

Deposits, placements and obligations which mature or reprice after six months are grouped by residual maturity. Fair value is estimated using discounted cash flows, applying either market rates, where applicable, or current rates offered for deposits of similar remaining maturities.

**Multi-Currency Sukuk Programme**

The fair value of subordinated bonds are estimated based on discounted cash flows using rates currently offered for debt instruments of similar remaining maturities and credit grading.

## 38 Lease commitments

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

| Year | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 |
|---|---|---|
| Less than one year | **6,793** | 2,870 |
| Between one and five years | **5,183** | 651 |
| | **11,976** | 3,521 |

## 39 Capital commitments

| | 31 Dec 2012 RM'000 | 31 Dec 2011 RM'000 |
|---|---|---|
| Capital expenditure: | | |
| - Authorised and contracted for | **3,489** | 1,387 |
| - Authorised but not contracted for | **359** | 733 |
| | **3,848** | 2,120 |

## 40 Equity-based compensation

The Bank participated in the Savings-Related Share Option Schemes operated by the HSBC Group for the acquisition of HSBC Holdings plc shares.

*a) Savings-Related Share Option Schemes*

The Savings-Related Share Option Schemes are all-employee share plans under which eligible HSBC employees are granted options to acquire HSBC Holdings ordinary shares. Employees may make monthly contributions up to £250 over a period of one, three or five years which may be used to exercise the options; alternatively the employee may elect to have the savings repaid in cash. The options are exercisable within three months following the first anniversary of the commencement of a one-year savings contract or within six months following either the third or the fifth anniversary of the commencement of three-year or five-year savings contracts. The exercise price is set at a discount of up to 20 per cent of the market value of the ordinary shares at the date of grant. The cost of the awards is amortised over the vesting period.

Movements in the number of share options held by employees are as follows:

| Year | **31 Dec 2012 Number ('000)** | **Weighted average exercise price £** | 31 Dec 2011 Number ('000) | Weighted average exercise price £ |
|---|---|---|---|---|
| Outstanding at 1 January | **34** | **5.35** | 39 | 4.79 |
| Granted in the year | **17** | **4.46** | 14 | 5.10 |
| Exercised in the year | **(12)** | **4.31** | (3) | 5.80 |
| Lapsed in the year | **(3)** | **4.82** | (16) | 3.73 |
| Outstanding at 31 December | **36** | **5.32** | 34 | 5.35 |
| Options vested at 31 December | **12** | | 3 | |

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 |
|---|---|---|
| Compensation cost recognised during the year | **409** | 360 |

*b) Restricted Share Plan*

The HSBC Holdings Restricted Share Plan is intended to align the interests of executives with those of shareholders by linking executive awards to the creation of superior shareholder value. This is achieved by focusing on predetermined targets. The cost of the conditional awards is recognised through an annual charge based on the likely level of vesting of shares, apportioned over the period of service to which the award relates.

| | **31 Dec 2012 Number ('000)** | 31 Dec 2011 Number ('000) |
|---|---|---|
| Outstanding at 1 January | **11** | - |
| Additions during the year | **7** | 11 |
| Released in the year | **(5)** | - |
| Outstanding at 31 December | **13** | 11 |

| | **31 Dec 2012 RM'000** | 31 Dec 2011 RM'000 |
|---|---|---|
| Compensation cost recognised during the year | **372** | 248 |

The weighted average purchase price for all shares purchased by HSBC for awards under the Restricted Share Plan is £6.14 (2011: £6.50). The closing price of the HSBC share at 31 December 2012 was £6.47 (2011: £4.91). The weighted average remaining vesting period as at 31 December 2012 was 2.38 years (2011: 3.00 years).

**41 Shariah Advisors**

In line with Bank Negara Malaysia's "Shariah Governance Framework for Islamic Financial Institutions", the following Shariah scholars were appointed:

1) Dr. Younes Soualhi, Associate Professor in International Islamic University Malaysia (IIUM). He holds a Bachelor, Master and PhD in Usul al-Fiqh from the Emir Abdul Qadir University for Islamic Sciences in in Algeria, IIUM and University of Malaya respectively. He also holds a diploma in Islamic Banking and Insurance from the Institute of Islamic Banking and Insurance in London, U.K.

2) Khairul Anuar bin Ahmad, lecturer with Selangor International Islamic University College. He holds a Bachelor and Master of Shariah from University of Malaya.

3) Dr. Muhammad Yusuf Saleem Ghulam Nabi, lecturer with International IIUM. He holds a Bachelor of Law (LLB), Master of Comparatuve Laws and PhD in Law from IIUM.

4) Prof. Dr. Obiyathulla Ismath Bacha, Head of Finance and Accounting and Head of Graduate Studies in International Centre for Education in Islamic Finance. He holds a Bachelor of Social Science, Master of Business Administration, Master of Arts (Economics) and Doctor of Business Adminstration specialising in Finance from Boston University.

5) Prof. Dr. Abdul Rahim Abdul Rahman, Professor of Accounting in IIUM. He holds a Bachelor in Finance and Accounting from University of East London, and Master in Accounting and Management Sciences and PhD in Accounting for Islamic Institutions from University of Southampton, United Kingdom.

**42 Explanation of transition to MFRSs**

In preparing its opening MFRS statement of financial position, the Bank has adjusted amounts reported previously in financial statements prepared in accordance with the previous FRSs. An explanation of how the transtition from previous FRSs to the new MFRSs has affected the Bank's financial position is set out in the following table and notes that accompany these tables.

**(i) Reconciliation of financial position**

| | *Note* | FRSs RM'000 | Effect of transition to MFRSs 31 Dec 2011 RM'000 | MFRSs RM'000 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and short-term funds | | 1,536,792 | - | 1,536,792 |
| Financial Assets Held-for-Trading | | 216,716 | - | 216,716 |
| Financial Investments Available-for-Sale | | 422,086 | - | 422,086 |
| Financing and advances | 42(iv)(a) | 7,546,346 | 238,804 | 7,785,150 |
| Other assets | 42(iv)(b) | 212,308 | (7,842) | 204,466 |
| Statutory deposits with Bank Negara Malaysia | | 228,562 | - | 228,562 |
| Equipment | | 18,926 | - | 18,926 |
| Intangible assets | | 461 | - | 461 |
| Deferred tax assets | 42(iv)(c) | 15,182 | 14,492 | 29,674 |
| Total Assets | | 10,197,379 | 245,454 | 10,442,833 |
| **Liabilities** | | | | |
| Deposits from customers | 42(iv)(b) | 5,476,252 | 186,244 | 5,662,496 |
| Deposits and placements from banks and other financial institutions | | 3,740,525 | - | 3,740,525 |
| Bills and acceptances payable | | 7,600 | - | 7,600 |
| Other liabilities | 42(iv)(b) | 102,105 | (2,809) | 99,296 |
| Provision for taxation | 42(iv)(c) | 6,838 | 24,410 | 31,248 |
| Total Liabilities | | 9,333,320 | 207,845 | 9,541,165 |
| **Shareholder's Equity** | | | | |
| Share capital | | 50,000 | - | 50,000 |
| Reserves | 42(iv)(d) | 814,059 | 37,609 | 851,668 |
| Total Shareholder's Equity | | 864,059 | 37,609 | 901,668 |
| Total Liabilities and Shareholder's Equity | | 10,197,379 | 245,454 | 10,442,833 |
| Commitments and Contingencies | 42(iv)(a) | 5,535,558 | (192,401) | 5,343,157 |

## 42 Explanation of transition to MFRSs (Cont'd)

### (i) Reconciliation of financial position (Cont'd)

| | Note | FRSs RM'000 | Effect of transition to MFRSs 1 Jan 2011 RM'000 | MFRSs RM'000 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and short-term funds | | 1,508,998 | - | 1,508,998 |
| Financial Assets Held-for-Trading | | 148,006 | - | 148,006 |
| Financial Investments Available-for-Sale | | 330,665 | - | 330,665 |
| Financing and advances | 42(iv)(a) | 4,636,276 | 165,627 | 4,801,903 |
| Other assets | 42(iv)(b) | 59,035 | (2,449) | 56,586 |
| Statutory deposits with Bank Negara Malaysia | | 34,729 | - | 34,729 |
| Equipment | | 16,425 | - | 16,425 |
| Intangible assets | | 1,499 | - | 1,499 |
| Deferred tax assets | 42(iv)(c) | 18,002 | 18,864 | 36,866 |
| Total Assets | | 6,753,635 | 182,042 | 6,935,677 |
| **Liabilities** | | | | |
| Deposits from customers | 42(iv)(b) | 3,782,536 | 148,024 | 3,930,560 |
| Deposits and placements from banks and other financial institutions | | 2,084,599 | - | 2,084,599 |
| Bills and acceptances payable | | 5,531 | - | 5,531 |
| Other liabilities | 42(iv)(b) | 91,670 | (2,880) | 88,790 |
| Provision for taxation | 42(iv)(c) | 4,448 | 21,613 | 26,061 |
| Total Liabilities | | 5,968,784 | 166,757 | 6,135,541 |
| **Shareholder's Equity** | | | | |
| Share capital | | 50,000 | - | 50,000 |
| Reserves | 42(iv)(d) | 734,851 | 15,285 | 750,136 |
| Total Shareholder's Equity | | 784,851 | 15,285 | 800,136 |
| Total Liabilities and Shareholder's Equity | | 6,753,635 | 182,042 | 6,935,677 |
| Commitments and Contingencies | 42(iv)(a) | 1,823,148 | (147,534) | 1,675,614 |

## 42 Explanation of transition to MFRSs (Cont'd)

### (ii) Reconciliation of profit or loss and other comprehensive income

| | *Note* | **FRSs** RM'000 | **Effect of transition to MFRSs year ended 31 Dec 2011** RM'000 | **MFRSs** RM'000 |
|---|---|---|---|---|
| Income derived from investment of depositors' funds and others | 42(iv)(e) | 455,721 | (5,246) | 450,475 |
| Income derived from investment of shareholder's funds | 42(iv)(e) | 89,499 | 1,365 | 90,864 |
| Impairment losses on financing | 42(iv)(f) | (124,337) | 27,932 | (96,405) |
| Total distributable income | | 420,883 | 24,051 | 444,934 |
| Income attributable to depositors | 42(iv)(g) | (159,492) | 5,442 | (154,050) |
| Total net income | | 261,391 | 29,493 | 290,884 |
| Personnel expenses | | (26,452) | - | (26,452) |
| Other overheads and expenditures | | (137,142) | - | (137,142) |
| Profit before taxation | | 97,797 | 29,493 | 127,290 |
| Taxation | 42(iv)(h) | (19,233) | (7,169) | (26,402) |
| **Profit for the year** | | 78,564 | 22,324 | 100,888 |
| **Other comprehensive income** | | | | |
| **Items that may be reclassified subsequently to profit or loss** | | | | |
| Fair value reserve | | | | |
| Change in fair value | | 379 | - | 379 |
| Income tax relating to components of other comprehensive income | | (95) | - | (95) |
| Other comprehensive income for the period, net of tax | | 284 | - | 284 |
| **Total comprehensive income for the period** | | 78,848 | 22,324 | 101,172 |
| Profit attributable to the owner of the Bank | | 78,564 | | 100,888 |
| Total comprehensive income attributable to owner of the Bank | | 78,848 | | 101,172 |
| Basic earnings per RM0.50 ordinary share | | 78.6 sen | | 100.9 sen |

**42 Explanation of transition to MFRSs (Cont'd)**

**(iii) Reconciliation of Statement of Cash Flows**

| | *Note* | FRSs RM'000 | Effect of transition to MFRSs 31 Dec 2011 RM'000 | MFRSs RM'000 |
|---|---|---|---|---|
| **Cash Flows from Operating Activities** | | | | |
| Profit before taxation | | 97,797 | 29,493 | 127,290 |
| Adjustments for : | | | | |
| Equipment written off | | 51 | - | 51 |
| Reversal of capitalised charges | | 810 | - | 810 |
| Share based payment transactions | | 360 | - | 360 |
| Net transfer from parent company | | (527) | - | (527) |
| Depreciation of equipment | | 5,616 | - | 5,616 |
| Amortisation of intangible assets | | 233 | - | 233 |
| Net gain on disposal of equipment | | (2) | - | (2) |
| Operating profit before changes in operating assets and liabilities | | 104,338 | 29,493 | 133,831 |
| (Increase)/ Decrease in operating assets | | | | |
| Financial assets held-for-trading | | (68,710) | - | (68,710) |
| Financing and advances | | (2,910,070) | (73,177) | (2,983,247) |
| Other assets | | (153,273) | 5,393 | (147,880) |
| Statutory deposits with Bank Negara Malaysia | | (193,833) | - | (193,833) |
| Increase/ (Decrease) in operating liabilities | | | | |
| Deposits from customers | | 1,693,716 | 38,220 | 1,731,936 |
| Deposits and placements from banks and other financial institutions | | 1,655,926 | - | 1,655,926 |
| Bills and acceptances payable | | 2,069 | - | 2,069 |
| Other liabilities | | 10,435 | 71 | 10,506 |
| Net cash generated from operating activities before income tax | | 140,598 | - | 140,598 |
| Taxation paid | | (14,018) | - | (14,018) |
| Utilisation of zakat provision | | (100) | - | (100) |
| Net cash generated from operating activities | | 126,480 | - | 126,480 |
| **Cash Flows from Investing Activities** | | | | |
| Purchase of equipment | | (7,641) | - | (7,641) |
| Purchase of intangible assets | | (5) | - | (5) |
| Proceeds from disposal of equipment | | 2 | - | 2 |
| Financial investments available-for-sale | | (91,042) | - | (91,042) |
| Net cash (used in)/ generated from investing activities | | (98,686) | - | (98,686) |
| **Net decrease in Cash and Cash Equivalents** | | 27,794 | - | 27,794 |
| **Cash and Cash Equivalents at beginning of the year** | | 1,508,998 | - | 1,508,998 |
| **Cash and Cash Equivalents at end of the year** | | 1,536,792 | - | 1,536,792 |
| **Analysis of Cash and Cash Equivalents** | | | | |
| Cash and short-term funds | | 1,536,792 | - | 1,536,792 |

The comparative statement of cash flows have been restated for the effects of the change in accounting policies as disclosed in Note 2e Changes in Accounting Policies. However, the differences between the statement of cash flows presented under the MFRSs and the statement of cash flows presented under FRSs are not material.

**42 Explanation of transition to MFRSs (Cont'd)**

**(iv) Explanation of transition to MFRSs**

**Notes to reconciliation of statement of financial position**

| | Note | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| **(a) Financing and advances** | | | |
| Decrease/(Increase) in collective impairment ("CIP") | 9(ii) | 10,115 | (8,189) |
| Decrease in individual impairment ("IIP") | 9(ii) | 36,288 | 26,282 |
| *Adjustment to increase retained earnings* | 42(iv)(d) | 46,403 | 18,093 |
| Islamic repurchase agreements | | 192,401 | 147,534 |
| | | 238,804 | 165,627 |

In the previous years, collective impairment provisions were based on a percentage (1.5%) of the total outstanding financing portfolio net of individual impairment provisions to cover future potential losses from the financing and advances portfolio. Upon transition to MFRSs, the Bank adopted a MFRS compliant CIP model where collective impairment provisions are set aside to cover financing losses incurred but the financing has not been individually identified as impaired at reporting date. Additionally, impairment provisions for homogeneous groups of financing that are not considered individually significant are now computed under appropriate CIP models instead of being individually assessed. The accounting policy for collective impairment of financing and advances after the transition to MFRSs is disclosed in Note 2e(i).

Please refer to Note 2(e)(iii) for the change in accounting policy on disclosure on Islamic repurchase agreements.

**(b) Other assets, other liabilities and deposits from customers**

| | Note | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| **Other assets:** | | | |
| Decrease in derivative financial assets | 15 | (7,842) | (2,449) |
| **Other liabilities:** | | | |
| Decrease in derivative financial liabilities | 18 | 2,809 | 2,880 |
| **Deposit from customers:** | | | |
| Decrease/(Increase) in structured deposits | 16(i) | 6,157 | (490) |
| *Adjustment to increase retained earnings* | 42(iv)(d) | 1,124 | (59) |
| | | | |
| **Deposit from customers:** | | | |
| - Islamic repurchase agreements | 42(iv)(a) | 192,401 | 147,534 |
| - (Decrease)/Increase in structured deposits | | (6,157) | 490 |
| *Adjustment to increase deposits from customers* | | 186,244 | 148,024 |

In the previous years, structured deposits were measured at amortised cost using the effective profit method. Upon transition to MFRSs, structured deposits are classified as "trading liabilities" and measured at fair value. The accounting policy for the fair value measurement of structured deposits is as disclosed in Note 3(f)(vi).

## 42 Explanation of transition to MFRSs (Cont'd)

### (iv) Explanation of transition to MFRSs

**Notes to reconciliation of statement of financial position**

| | Note | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| **(c) Deferred tax assets and provision for taxation** | | | |
| **Deferred tax assets** | | | |
| Increase in deferred tax assets on collective impairment allowance | | 14,492 | 18,864 |
| **Provision for taxation** | | | |
| (Decrease)/Increase in provision for tax liability upon fair valuation of structured deposits | | (281) | 15 |
| Increase in provision for tax liability upon decrease in CIP and IIP | | (24,129) | (21,628) |
| | | (24,410) | (21,613) |
| *Adjustment to decrease retained earnings* | 42(iv)(d) | (9,918) | (2,749) |

The (increase)/decrease in collective impairment provision resulted in (lower)/higher deferred tax assets recognised.
The increase in regulatory reserve provision resulted in higher deferred tax assets recognised.
Provision for tax liability increased upon positive fair valuation of structured deposits and decrease in CIP and IIP.

**(d) Retained earnings**

| | Note | 31 Dec 2011 RM'000 | 1 Jan 2011 RM'000 |
|---|---|---|---|
| Financing and advances | 42(iv)(a) | 46,403 | 18,093 |
| Other assets, other liabilities and deposits from customers | 42(iv)(b) | 1,124 | (59) |
| Deferred tax assets and provision for taxation | 42(iv)(c) | (9,918) | (2,749) |
| *Adjustment to increase retained earnings* | | 37,609 | 15,285 |

| | 31 Dec 2011 RM'000 |
|---|---|
| **(e) Total income derived from investment of funds** | |
| Adjustment to: | |
| - Income derived from investment of depositors funds and others | (5,246) |
| - Income derived from investment of shareholder's funds | 1,365 |
| | (3,881) |
| Of which: | |
| Increase in finance income and hibah | 377 |
| Decrease in other income | (4,258) |
| *Adjustment to decrease profit or loss* | (3,881) |
| **(f) Impairment losses on financing** | |
| Adjustment to collective impairment ("CIP") | (54,605) |
| Adjustment to individual impairment ("IIP") | 82,537 |
| *Adjustment to increase profit or loss* | 27,932 |
| **(g) Income attributable to depositors** | |
| Effect of fair valuation of derivative financial liabilties | 5,442 |
| *Adjustment to increase profit or loss* | 5,442 |
| **(h) Taxation** | |
| Effect of fair valuation of structured deposits | (296) |
| Decrease in impairment provisions | (2,501) |
| Deferred taxation on increase in CIP | (4,372) |
| *Adjustment to decrease profit or loss* | (7,169) |

**42 Explanation of transition to MFRSs (Cont'd)**

**(iv) Explanation of transition to MFRSs (Cont'd)**

**Notes to reconciliation of statement of financial position (Cont'd)**

**(g) Capital Adequacy**

The adjustments to the financial statements of the Bank as a result of the transition to the MFRS framework and the changes in accounting policies, as discussed above, also had consequential effects on the comparative capital adequacy ratios. These are summarised below:

| | 31 Dec 2011 | |
|---|---|---|
| | FRS | MFRS |
| Tier 1 Capital (RM'000) | 862,538 | 871,102 |
| Capital Base (RM'000) | 977,838 | 932,325 |
| | | |
| Tier 1 Capital Ratio % | 10.5% | 10.6% |
| Risk Weighted Capital Ratio % | 11.9% | 11.3% |

| | 31 Dec 2010 | |
|---|---|---|
| | FRS | MFRS |
| Tier 1 Capital (RM'000) | 782,605 | 763,117 |
| Capital Base (RM'000) | 852,197 | 810,029 |
| | | |
| Tier 1 Capital Ratio % | 16.1% | 15.7% |
| Risk Weighted Capital Ratio % | 17.5% | 16.6% |