

**THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED,
BANGKOK BRANCH**

FINANCIAL STATEMENTS

31 DECEMBER 2017

Independent Auditor's Report

To the Board of Directors of The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch.

My opinion

In my opinion, the financial statements of The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch (the Branch) present fairly, in all material respects, the financial position of the Branch as at 31 December 2017, and its financial performance and its cash flows for the year then ended in accordance with Thai Financial Reporting Standards (TFRSs).

What I have audited

The Branch's financial statements comprise:

- the statement of financial position as at 31 December 2017;
- the statement of comprehensive income for the year then ended;
- the statement of changes in head office and other branches of the same juristic person for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements which include a summary of significant accounting policies.

Basis for opinion

I conducted my audit in accordance with Thai Standards on Auditing (TSAs). My responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of my report. I am independent of the Branch in accordance with the Federation of Accounting Professions under the Royal Patronage of his Majesty the King's Code of Ethics for Professional Accountants together with the ethical requirements that are relevant to my audit of the financial statements, and I have fulfilled my other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Responsibilities of the management for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with TFRSs, and for such internal control as the management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Branch's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Branch or to cease operations, or has no realistic alternative but to do so.

Management is responsible for overseeing the Branch's financial reporting process.



Auditor's responsibilities for the audit of the financial statements

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

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

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

I communicate with management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

PricewaterhouseCoopers ABAS Ltd.

A blue handwritten signature, likely of the auditor, Unakorn Phruithithada.

Unakorn Phruithithada

Certified Public Accountant (Thailand) No. 3257

Bangkok


14 February 2018

The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch

Statement of Financial Position

As at 31 December 2017

	Notes	2017 Thousand Baht	2016 Thousand Baht
Assets			
Cash		70,054	28,703
Interbank and money market items, net	6, 22	49,427,330	35,951,415
Derivative assets	7	27,071,516	37,712,630
Investments, net	8	69,866,633	84,709,316
Loans to customers and accrued interest receivables, net	9		
Loans to customers		66,697,951	66,264,783
Accrued interest receivables		189,525	150,163
Total loans to customers and accrued interest receivables		66,887,476	66,414,946
<u>Less</u> Deferred revenue		(14,872)	(10,267)
<u>Less</u> Allowance for doubtful accounts	9.4, 10	(1,086,105)	(1,090,088)
Total loans to customers and accrued interest receivables, net	9.1	65,786,499	65,314,591
Customer's liabilities under acceptance		412	-
Leasehold improvements and equipment, net		22,406	25,789
Intangible asset, net		75	186
Leasehold right for land and buildings, net	11	130,929	145,284
Deferred tax assets, net	12	84,121	164,822
Other assets, net	13	2,847,872	1,110,242
Total assets		215,307,847	225,162,978


Neeranuch Upaphattavanij

Chief Financial Officer
Thailand Branch


Tan Swee Beng Kelvin

Chief Executive Officer
Thailand Branch

The accompanying notes are an integral part of the financial statements.

The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch
Statement of Financial Position (Cont'd)
As at 31 December 2017

		2017	2016
		Thousand	Thousand
	Notes	Baht	Baht
Liabilities and accounts with head office and other branches abroad of the same juristic person			
Liabilities			
Deposits	15	116,340,346	105,690,931
Interbank and money market items	16, 22	9,855,669	25,524,852
Liabilities payable on demand		2,342,485	2,844,002
Derivative liabilities	7	29,357,132	37,480,656
Debt issued and borrowings	17	9,817,691	9,088,650
Bank's liabilities under acceptance		412	-
Employee benefit obligations	18	238,281	225,073
Provisions	19	105,648	152,348
Other liabilities	20	3,875,069	8,867,823
Total liabilities		171,932,733	189,874,335
Accounts with head office and other branches of the same juristic person			
Net funds brought in to maintain assets under the Act	5	20,100,000	20,100,000
Net balance of inter-office accounts with head office and other branches of the same juristic person	22	19,126,269	9,651,832
Other components of accounts with head office and other branches of the same juristic person		85,309	49,145
Retained earnings		4,063,536	5,487,666
Total accounts with head office and other branches of the same juristic person		43,375,114	35,288,643
Total liabilities and accounts with head office and other branches of the same juristic person		215,307,847	225,162,978

The accompanying notes are an integral part of the financial statements.

The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch
Statement of Comprehensive Income
For the year ended 31 December 2017

		2017	2016
		Thousand	Thousand
	Notes	Baht	Baht
Interest income	22, 26	3,603,262	4,019,318
Interest expense	22, 27	1,516,751	1,688,053
Net interest income		2,086,511	2,331,265
Fees and service income		908,358	994,600
Fees and service expenses		198,543	175,570
Net fees and service income	22, 28	709,815	819,030
Net gain on trading and foreign exchange transactions	29	1,767,689	2,195,252
Other operating income	22	822	13,617
Total operating income		4,564,837	5,359,164
Other operating expenses			
Employee expenses	23, 31	1,214,488	1,159,059
Premises and equipment expenses		343,888	351,328
Taxes and duties		73,610	69,803
Other expenses	22, 32	537,169	521,313
Total other operating expenses		2,169,155	2,101,503
Bad debts, doubtful accounts expense and impairment loss	30	547	(9,306)
Operating profit before income tax expense		2,395,135	3,266,967
Income tax expense	33	501,165	654,221
Net profit		1,893,970	2,612,746
Other comprehensive income			
Items that will be reclassified subsequently to profit or loss			
Gains (losses) on remeasurement of available-for-sale investments		47,758	(146,244)
Other reserves		(7,780)	4,417
Income taxes relating to items that will be reclassified to profit or loss	33	(9,552)	29,249
Items that will not be reclassified subsequently to profit or loss			
Actuarial gains (losses)	18	7,172	(3,773)
Income taxes on items that will not be reclassified to profit or loss	33	(1,434)	755
Other comprehensive income (losses) for the year, net of income tax		36,164	(115,596)
Total comprehensive income for the year		1,930,134	2,497,150

The accompanying notes are an integral part of the financial statements.

The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch
Statement of Changes in Head Office and Other Branches of the Same Juristic Person
For the year ended 31 December 2017

	Net funds brought in to maintain assets under the Act Thousand Baht	Net balance of inter-office accounts with head office and other branches of the same juristic person Thousand Baht	Other components of accounts with head office and other branches of the same juristic person		Retained earnings Thousand Baht	Total Thousand Baht
			Gains (losses) on remeasurement of available-for-sale investments Thousand Baht	Other reserves Thousand Baht		
Balance at 1 January 2016	20,100,000	14,185,571	112,803	51,938	2,874,920	37,325,232
Comprehensive income for the year						
Net profit	-	-	-	-	2,612,746	2,612,746
Other comprehensive income						
Losses on remeasurement of available-for-sale investments, net of income tax	-	-	(116,995)	-	-	(116,995)
Actuarial losses, net of income tax	-	-	-	(3,018)	-	(3,018)
Others, net of income tax	-	-	-	4,417	-	4,417
Total other comprehensive income	-	-	(116,995)	1,399	-	(115,596)
Total comprehensive income for the year	-	-	(116,995)	1,399	2,612,746	2,497,150
Movement in balance of inter-office accounts with head office and other branches of the same juristic person	-	(4,533,739)	-	-	-	(4,533,739)
Balance at 31 December 2016	<u>20,100,000</u>	<u>9,651,832</u>	<u>(4,192)</u>	<u>53,337</u>	<u>5,487,666</u>	<u>35,288,643</u>
Balance at 1 January 2017	20,100,000	9,651,832	(4,192)	53,337	5,487,666	35,288,643
Comprehensive income for the year						
Net profit	-	-	-	-	1,893,970	1,893,970
Other comprehensive income						
Gains on remeasurement of available-for-sale investments, net of income tax	-	-	38,206	-	-	38,206
Actuarial gain, net of income tax	-	-	-	5,738	-	5,738
Others, net of income tax	-	-	-	(7,780)	-	(7,780)
Total other comprehensive income	-	-	38,206	(2,042)	-	36,164
Total comprehensive income for the year	-	-	38,206	(2,042)	1,893,970	1,930,134
Movement in balance of inter-office accounts with head office and other branches of the same juristic person	-	9,474,437	-	-	-	9,474,437
Profit remittance to head office	-	-	-	-	(3,318,100)	(3,318,100)
Balance at 31 December 2017	<u>20,100,000</u>	<u>19,126,269</u>	<u>34,014</u>	<u>51,295</u>	<u>4,063,536</u>	<u>43,375,114</u>

The accompanying notes are an integral part of the financial statements.

The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch
Statement of Cash Flows
For the year ended 31 December 2017

	2017	2016
	Thousand	Thousand
	Baht	Baht
Cash flows from operating activities		
Operating profit before income tax expenses	2,395,135	3,266,967
Adjustments to reconcile profit from operations before income tax expense to cash received (paid) from operating activities		
Depreciation and amortisation	25,501	25,859
Bad debt, doubtful accounts expense and impairment loss	547	(9,306)
Unrealised losses (gains) on revaluation of trading investment	(392,207)	841,893
Gains on disposal of equipment	-	(45)
Unrealised losses (gains) on change in foreign exchange	(777,904)	100,614
Unrealised losses on derivative assets and liabilities	2,517,590	267,931
Provisions for contingent liabilities	(118)	-
Increase in other reserves	(145)	7,632
Net interest income	(2,086,511)	(2,331,265)
Proceeds from interest income	3,580,031	4,069,780
Interest paid	(1,524,299)	(1,707,391)
Income tax paid	(807,334)	(755,938)
Net profit from operations before change in operating assets and liabilities	2,930,286	3,776,731
Decrease (increase) in operating assets		
Interbank and money market items	(13,480,424)	11,377,738
Trading investment	(3,645,315)	714,866
Loans to customers	(1,038,242)	5,337,916
Other assets	(1,760,041)	675,919
Increase (decrease) in operating liabilities		
Deposits	11,707,237	(24,906,371)
Interbank and money market items	(15,667,537)	10,889,053
Liabilities payable on demand	(501,517)	653,106
Debt issued and borrowings	729,041	(7,070,521)
Employee benefit obligations	20,380	24,652
Provisions	(46,582)	(20,214)
Other liabilities	(4,617,333)	187,499
Net cash (used in) provided by operating activities	(25,370,047)	1,640,374

The accompanying notes are an integral part of the financial statements.

The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch
Statement of Cash Flows (Cont'd)
For the year ended 31 December 2017

	2017	2016
	Thousand	Thousand
	Baht	Baht
Cash flows from investing activities		
Decrease in available-for-sale investments	18,927,962	2,926,907
Purchases of equipment	(7,653)	(4,888)
Proceeds from sales of equipment	-	45
	<u>18,920,309</u>	<u>2,922,064</u>
Net cash provided by investing activities		
Cash flows from financing activities		
Profit remittance to head office	(3,318,100)	-
Increase (decrease) in net balance of inter-office accounts with head office and other branches of the same juristic person	<u>9,809,189</u>	<u>(4,584,117)</u>
Net cash provided by (used in) financing activities	<u>6,491,089</u>	<u>(4,584,117)</u>
Net increase (decrease) in cash and cash equivalents	41,351	(21,679)
Cash and cash equivalents at the beginning of the year	<u>28,703</u>	<u>50,382</u>
Cash and cash equivalents at the end of the year	<u><u>70,054</u></u>	<u><u>28,703</u></u>

The accompanying notes are an integral part of the financial statements.

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1 General information

The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch (“the Branch”) has its registered office at 968 Rama IV Road, Silom, Bangrak, Bangkok 10500.

The head office of the Branch is The Hongkong and Shanghai Banking Corporation Limited (“the Head Office”), which is incorporated in the Hong Kong Special Administrative Region of the People’s Republic of China, with limited liability.

The principal activities of the Branch are to provide a wide range of banking services to corporate customers.

The Branch’s financial statements have been approved for issue by the Branch’s management on 14 February 2018.

2 Significant accounting policies

The principal accounting policies applied in the preparation of the Branch financial statements are set out below:

2.1 Basis of preparation

The financial statements are prepared in accordance with Thai financial reporting standards (“TFRS”) under the Accounting Act B.E. 2543, being those Thai financial reporting standards issued under the Accounting Professions Act B.E. 2547. The primary financial statements are prepared in the full format as required by the Notification of the Bank of Thailand (“BoT”), no. Sor Nor Sor 21/2558 Re: The preparation and announcement of the Financial Statements of Commercial Bank and Holding Parent Company of Financial Group dated 4 December 2015.

The Branch’s financial statements have been prepared under the historical cost convention, except as disclosed in the accounting policies below.

The preparation of financial statements in conformity with Thai generally accepted accounting principles requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Branch’s accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 4, Fair value of financial instruments.

An English version of the financial statements have been prepared from the statutory financial statements that are in the Thai language. In the event of a conflict or a difference in interpretation between the two languages, the Thai language statutory financial statements shall prevail.

2 Significant accounting policies (Cont'd)

2.2 Revised financial reporting standards and related interpretations

2.2.1 Revised financial reporting standards and interpretations are effective on 1 January 2017 which are relevant and have a significant impact to the Branch.

TAS 1 (revised 2016)	Presentation of financial statements
TAS 19 (revised 2016)	Employee benefits

TAS 1 (revised 2016), the amendments provide clarifications on a number of issues, including:

- Materiality - an entity should not aggregate or disaggregate information in a manner that obscures useful information. Where items are material, sufficient information must be provided to explain the impact on the financial position or performance.
- Disaggregation and subtotals - line items specified in TAS 1 may need to be disaggregated where this is relevant to an understanding of the entity's financial position or performance. There is also new guidance on the use of subtotals.
- Notes - confirmation that the notes do not need to be presented in a particular order.
- OCI arising from investments accounted for under the equity method - the share of OCI arising from equity-accounted investments is grouped based on whether the items will or will not subsequently be reclassified to profit or loss. Each group should then be presented as a single line item in the statement of other comprehensive income.

TAS 19 (revised 2016), the amendments clarify that when determining the discount rate for post-employment benefit obligations, it is the currency that the liabilities are denominated in that is important and not the country where they arise.

2.2.2 Revised financial reporting standards are effective for annual period beginning on or after 1 January 2018, which have significant changes are relevant to the Branch. The Branch has not yet adopted these revised standards

TAS 7 (revised 2017)	Statement of cash Flows
TAS 12 (revised 2017)	Income taxes

TAS 7 (revised 2017), the amendments require additional disclosure of changes in liabilities arising from financing activities. This includes changes arising from cash and non-cash.

TAS 12 (revised 2017), the amendments clarify the accounting for deferred tax where an asset is measured at fair value and that fair value is below the asset's tax base. Specifically, the amendments confirm that:

- A temporary difference exists whenever the carrying amount of an asset is less than its tax base at the end of the reporting period.
- An entity can assume that it will recover an amount higher than the carrying amount of an asset to estimate its future taxable profit.
- Where the tax law restricts the source of taxable profits against which particular types of deferred tax assets can be recovered, the recoverability of the deferred tax assets can only be assessed in combination with other deferred tax assets of the same type.
- Tax deductions resulting from the reversal of deferred tax assets are excluded from the estimated future taxable profits.

The management assessed and considered that the above revised standards will not have a material impact on the Branch.

2 Significant accounting policies (Cont'd)

2.3 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of the Branch are measured using the currency of the primary economic environment in which the entity operates ('the functional currency') as Thai Baht.

(b) Transactions and balances

Transactions in foreign currencies are translated to the functional currency at the dates of the transactions or the date of remeasurement. Gains and losses on settlement of foreign currency or translation of monetary assets and liabilities are recognised in profit or loss.

When a gain or loss on a non-monetary item is recognised in other comprehensive income, any exchange component of that gain or loss is recognised in other comprehensive income. Conversely, when a gain or loss on a non-monetary item is recognised in profit and loss, any exchange component of that gain or loss is recognised in profit and loss.

2.4 Cash

Cash consists of cash on hand according to the BOT's notification.

2.5 Investments

Investments in debt securities and equity securities

Debt securities and marketable equity securities that the Branch intends to hold for a short period of time in order to take advantage of anticipated changes in the underlying market value are classified as being held-for-trading investments and stated at fair value. Gains or losses on remeasuring investments are recognised in profit or loss.

Debt securities that the Branch has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are stated at amortised cost, less any impairment losses. The difference between the acquisition cost and redemption value of such debt securities is amortised using the effective interest rate method over the period to maturity.

Debt securities and marketable equity securities, other than those securities held for trading or intended to be held to maturity, are classified as available-for-sale investments. Available-for-sale investments are, subsequent to initial recognition, stated at fair value, and changes therein, other than impairment losses and foreign currency differences on available-for-sale monetary items, are recognised directly in the accounts with head office and other branches of the same juristic person. Impairment losses and foreign exchange differences are recognised in profit or loss. When these investments are derecognised, the cumulative gain or loss previously recognised directly in the accounts with head office and other branches of the same juristic person is recognised in profit or loss. Where these investments are interest-bearing, interest calculated using the effective interest method is recognised in profit or loss.

Equity securities which are not marketable are stated at cost less impairment loss.

2 Significant accounting policies (Cont'd)

2.5 Investments (Cont'd)

The fair value of the financial instruments classified as held-for-trading and available-for-sale is determined as the quoted bid price at the reporting date.

Investment recognition

The Branch recognised and eliminated such items in these financial statements using the settlement date method.

Disposal of investments

On disposal of an investment, the difference between net disposal proceeds and the carrying amount together with the associated cumulative gain or loss that was reported in the accounts with head office and other branches of the same juristic person is recognised in profit or loss.

If the Branch disposes of part of its holding of a particular investment, the carrying amount of the part sold is determined using the weighted average method applied to the carrying value of the total holding of the investment.

2.6 Loan to customers

Loan to customers represent loans originated by the Branch, which are not intended to be sold in the short term and have not been classified as held for trading. Loans are recognised when cash is advanced to borrowers. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment losses.

2.7 Allowance for doubtful accounts

The Branch provides an allowance for doubtful accounts equal to the estimated losses that may be incurred in the collection of all receivables. The estimated losses are calculated by discounting expected future cash flows (inclusive of the value of security) using a discount rate, which includes a premium for uncertainty of the cash flows.

The BoT has guidelines for establishing a minimum level of allowance for doubtful accounts, which is primarily determined by applying specified percentages to the different classifications of financing in conjunction with the consideration of collateral valuation. Financing classifications are based principally on the period that a financing is past due. The Branch has set up, at a minimum, the allowance for doubtful accounts according to the BoT regulations.

With reference to the BoT's directive, the Branch has classified its loan portfolios into six categories, primarily based on the overdue period. For loans classified as pass and special-mention, the calculation of allowances for doubtful accounts is based on the regulatory minimum percentage requirement, taking into consideration the collateral value, where the collateral type and date of the latest appraisal are qualifying factors. For loans classified as sub-standard, doubtful and doubtful of loss, the allowance on these accounts will be set at 100 percent of the difference between the outstanding book value of the debt and the present value of future cashflows expected to be received or the expected proceeds from the disposal of collateral, in accordance with BoT criteria.

The allowance for doubtful accounts established during the year is charged as an expense in profit or loss.

Bad debts written off or recovered are recorded as charges or credit, respectively, to the allowance for doubtful accounts.

2 Significant accounting policies (Cont'd)

2.8 Restructured loans

The Branch classified restructured loans as performing when there is appropriate evidence that the restructured terms can be met. At a minimum, restructured terms involving periodic repayments must be met without exception for a three-payment period before a restructured loan can be reclassified.

2.9 Leasehold improvements and equipment

All other leasehold improvements and equipment are stated at historical cost less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Branch and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to profit or loss during the financial period in which they are incurred.

Gains or losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within 'other (losses)/gains - net' in profit or loss.

2.10 Leasehold right for land and buildings

Leasehold right for land and buildings is stated at cost less accumulated amortisation and accumulated impairment losses. The amortisation is charged to profit or loss on a straight-line basis over the lease period of 28 years.

2.11 Impairment

Assets that have an indefinite useful life, for example goodwill, are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the assets exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows. Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2 Significant accounting policies (Cont'd)

2.12 Current and deferred income taxes

The tax expense for the period comprises current and deferred tax. Tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income Accounts with head office and other branches of the same juristic person. In this case the tax is also recognised in other comprehensive income or Accounts with head office and other branches of the same juristic person, respectively.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of reporting period in the countries where the Branch operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised, using the liability method, on temporary differences arising from differences between the tax base of assets and liabilities and their carrying amounts in the financial statements.

However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

2 Significant accounting policies (Cont'd)

2.13 Financial instruments

Derivatives

Derivative financial instruments are used to manage exposure to interest and foreign exchange rates and arising from operational, financing and investment activities. Derivative financial instruments that do not qualify for hedge accounting are accounted for as trading instruments.

Derivatives are recognised initially at fair value from the date a derivative contract is entered into (trade date) and are subsequently remeasured at their fair value. The gain or loss on remeasurement is recognised immediately in profit or loss. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss on remeasurement depends on the nature of the item being hedged.

All derivatives are carried as assets when fair value is positive as "Derivatives assets" and as liabilities when fair value is negative as "Derivatives liabilities" in the statements of financial position.

The Branch designated derivatives as either: (1) hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge) or (2) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction (cash flow hedge). Hedge accounting is applied for derivatives designated as fair value or cash flow hedges, provided certain criteria are met.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualified as fair value hedges are recorded in the profit or loss, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used shall be amortised to the profit or loss over the period to maturity.

Cash flow hedge

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

Amounts accumulated in other comprehensive income are recycled through profit or loss in the periods in which the hedged item will affect profit or loss.

Discontinuing hedge accounting

Hedge accounting is discontinued prospectively when the hedging instrument expires or is sold, or no longer qualifies for hedge accounting. Any cumulative gain or loss on the hedging instrument existing in accounts with head office and other branches of the same juristic person is retained in accounts with head office and other branches of the same juristic person and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in accounts with head office and other branches of the same juristic person is recognised in profit or loss immediately.

2 Significant accounting policies (Cont'd)

2.14 Employee benefits

Post-employment benefits

The Branch operates a number of employee benefit plans as follows:

Defined contribution plan

A defined contribution plan is a post-employment benefit plan where the Branch pays fixed contributions into a separate entity (provident fund) and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution plans are recognised as an employee benefit expense in profit or loss in the periods during which services are rendered by employees.

Defined benefit plans

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Branch's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior years; that benefit is discounted to determine its present value. The discount rate is the yield at the reporting date on government bonds that have maturity dates approximating the terms of the Branch's obligations and that are denominated in the same currency in which the benefits are expected to be paid. The calculation is performed by an actuary using the projected unit credit method.

Actuarial gains and losses that arise are recognised in other comprehensive income.

Equity compensation plan

Where shares of HSBC Holdings Plc., the ultimate parent company of the Head Office, are awarded to an employee of the Branch, the cost of shares awarded is amortised over the vesting period from the date the shares are awarded.

For share options, the compensation expense to be spread over the vesting period is determined by reference to the fair value of the options on grant date, and the impact of any non-market vesting conditions such as option lapses. The compensation expense is recognised on a straight-line basis over the vesting period. Where the Branch is not charged for this by Head Office, the corresponding amount is credited to "other reserves" in accounts with head office and other branches of the same juristic person.

Short-term employee benefits

Short-term employee benefit obligations 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 if the Branch 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.

2 Significant accounting policies (Cont'd)

2.15 Share-based payment

The Branch enters into equity-settled share-based payment arrangements with its employees as compensation for services provided by employees. The cost of equity-settled 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 'Other Comprehensive Income'.

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

HSBC Holdings is the grantor of its equity instruments for all share awards across the group. The credit to 'Other reserves' over the vesting period on expensing an award represents the effective capital contribution from HSBC Holdings. To the extent the group will be, or has been, required to fund a share-based payment arrangement, this capital contribution is reduced and the fair value of shares expected to be released to employees is recorded within 'Other liabilities'.

2.16 Provisions

Provisions are recognised if, as a result of a past event, the Branch has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

2.17 Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognised in interest income and interest expense in profit or loss using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Branch 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 Branch that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

2.18 Non-interest income and expenses

Fees and commission income are recognised in profit or loss when the services are rendered.

Non-interest expenses are recognised on an accrual basis.

2.19 Offsetting

Financial assets and liabilities are offset and the net amount is reported in the statements of financial position when the Branch has a legal, enforceable right to set off the recognised amounts and the transactions are intended to be settled on a net basis.

3 Financial risk management

The Branch has following risks from financial instruments:

3.1 Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in a financial loss to the Branch. The Branch has adopted a policy of dealing with credit worthy counterparts and obtaining sufficient collateral or other security, where appropriate, as a means of mitigating the risk of financial losses from defaults.

In respect of recognised financial assets, the carrying amount of the assets recorded in the statements of financial position, net of allowance for doubtful accounts, represents the Branch's exposure to credit loss.

The Branch's exposure to credit loss in case of non-performance by a counterparty to the financial instruments is represented by the contractual notional amount of those instruments.

Credit risk also arises from the possibility that a counterparty to off-financial reporting financial instruments will not adhere to the terms of the contract with the Branch when settlement becomes due.

Off-financial reporting financial instruments classified by type and at regulatory credit equivalent values as at 31 December 2017 and 2016 were as follows:

	2017	2016
	Million Baht	Million Baht
Forward exchange contracts	15,108	16,970
Forward interest rate contracts	15,469	17,991
Equity options	18	28
Total	30,595	34,989

3.2 Market risk

Market risk is the risk that changes in market prices, such as interest rates, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's/issuer's credit standing) will affect the Branch's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

The Branch faces three major types of market risk namely interest rate risk, foreign exchange rate risk and equity price risk.

3 Financial risk management (Cont'd)

3.2 Market risk (Cont'd)

(a) Interest rate risk

Interest rate risk arises from the potential for a change in interest rates which may have an adverse effect on the value of the Branch's financial instruments or Branch's earnings or cost of funds, both in the current reporting period and future years. Interest rate risk arises from the structure and characteristic of the Branch's assets, liabilities and accounts with head office and other branches of the same juristic person, and from the mismatch in repricing dates of its assets and liabilities. The Branch mitigates this risk by using derivative financial instruments, principally interest rate swaps, to manage its exposure to fluctuations in interest rates on specific financial instruments.

As at 31 December 2017, significant financial assets and liabilities classified by type of interest rate were as follows:

	2017			
	Floating interest rate Million Baht	Fixed interest rate Million Baht	Non - interest bearing Million Baht	Total Million Baht
Financial assets				
Cash	-	-	70	70
Interbank and money market items, net	890	45,744	2,793	49,427
Investments, net	106	46,290	23,471	69,867
Loans to customers ⁽¹⁾	33,538	32,903	431	66,872
Other assets	2,519	-	329	2,848
Total financial assets	37,053	124,937	27,094	189,084
Financial liabilities				
Deposits	87,562	15,512	13,266	116,340
Interbank and money market items	4,385	1,110	4,361	9,856
Liabilities payable on demand	-	-	2,342	2,342
Debt issued and borrowings	9,818	-	-	9,818
Other liabilities	1,638	-	2,237	3,875
Total financial liabilities	103,403	16,622	22,206	142,231
Avals to bill and guarantee on loan	-	-	589	589
Letters of credit	-	-	2,113	2,113
Other contingencies	-	-	107,871	107,871

Effect of derivatives held for risk management refer to the notional amount in the notes 7.1.

⁽¹⁾ Loans to customers and accrued interest receivable net of deferred revenue

3 Financial risk management (Cont'd)

3.2 Market risk (Cont'd)

(a) Interest rate risk (Cont'd)

As at 31 December 2016, significant financial assets and liabilities classified by type of interest rate were as follows:

	2016			
	Floating interest rate Million Baht	Fixed interest rate Million Baht	Non - interest bearing Million Baht	Total Million Baht
Financial assets				
Cash	-	-	29	29
Interbank and money market items, net	1,632	31,521	2,798	35,951
Investments, net	6	43,548	41,155	84,709
Loans to customers ⁽¹⁾	41,048	25,027	330	66,405
Other assets	716	-	394	1,110
Total financial assets	43,402	100,096	44,706	188,204
Financial liabilities				
Deposits	78,329	13,026	14,336	105,691
Interbank and money market items	4,966	15,190	5,369	25,525
Liabilities payable on demand	-	-	2,844	2,844
Debt issued and borrowings	8,989	100	-	9,089
Other liabilities	6,756	-	2,112	8,868
Total financial liabilities	99,040	28,316	24,661	152,017
Avals to bill and guarantee on loan	-	-	674	674
Letters of credit	-	-	946	946
Other contingencies	-	-	117,061	117,061

Effect of derivatives held for risk management refer to the notional amount in the notes 7.1.

⁽¹⁾ Loans to customers and accrued interest receivable net of deferred revenue

3 Financial risk management (Cont'd)

3.2 Market risk (Cont'd)

(a) Interest rate risk (Cont'd)

Details of the Branch's interest rate risk based on the period to the earlier of the contractual repricing date or maturity at 31 December 2017 were as follows:

	2017						
	Less than 3 months Million Baht	3 months to 1 year Million Baht	1 to 5 years Million Baht	Over 5 years Million Baht	Non- interest bearing Million Baht	Total Million Baht	Average interest rate (% per annum)
Financial assets							
Cash	-	-	-	-	70	70	-
Interbank and money market items, net	46,553	81	-	-	2,793	49,427	1.54
Investments, net	15,890	22,733	14,747	16,497	-	69,867	1.82
Loans to customers and accrued interest receivable, net of deferred revenue	54,508	8,976	1,842	1,357	189	66,872	2.44
Other assets	2,519	-	-	-	329	2,848	1.02
Total financial assets	119,470	31,790	16,589	17,854	3,381	189,084	
Financial liabilities							
Deposits	100,193	2,881	-	-	13,266	116,340	0.72
Interbank and money market items	5,495	-	-	-	4,361	9,856	2.25
Liabilities payable on demand	-	-	-	-	2,342	2,342	-
Debt issued and borrowings	7,288	2,530	-	-	-	9,818	3.35
Other liabilities	1,638	-	-	-	2,237	3,875	1.31
Total financial liabilities	114,614	5,411	-	-	22,206	142,231	
Effect of derivatives held for risk management	42,283	(45,810)	(4,894)	8,421	425,877	425,877	
Avals to bill and guarantee on loan	-	-	-	-	589	589	
Letters of credit	-	-	-	-	2,113	2,113	
Other contingencies	-	-	-	-	107,871	107,871	

3 Financial risk management (Cont'd)

3.2 Market risk (Cont'd)

(a) Interest rate risk (Cont'd)

Details of the Branch's interest rate risk based on the period to the earlier of the contractual repricing date or maturity at 31 December 2016 were as follows:

	2016					Total Million Baht	Average interest rate (% per annum)
	Less than 3 months Million Baht	3 months to 1 year Million Baht	1 to 5 years Million Baht	Over 5 years Million Baht	Non- interest bearing Million Baht		
Financial assets							
Cash	-	-	-	-	29	29	-
Interbank and money market items, net	33,001	152	-	-	2,798	35,951	1.64
Investments, net	18,656	39,647	14,978	11,428	-	84,709	1.94
Loans to customers and accrued interest receivable, net of deferred revenue	53,698	8,697	3,498	362	150	66,405	2.45
Other assets	716	-	-	-	394	1,110	1.04
Total financial assets	106,071	48,496	18,476	11,790	3,371	188,204	
Financial liabilities							
Deposits	90,443	912	-	-	14,336	105,691	0.75
Interbank and money market items	20,156	-	-	-	5,369	25,525	2.13
Liabilities payable on demand	-	-	-	-	2,844	2,844	-
Debt issued and borrowings	6,616	2,473	-	-	-	9,089	2.93
Other liabilities	6,756	-	-	-	2,112	8,868	0.78
Total financial liabilities	123,971	3,385	-	-	24,661	152,017	
Effect of derivatives held for risk management	31,277	(37,469)	33	6,159	421,148	421,148	
Avals to bill and guarantee on loan	-	-	-	-	674	674	
Letters of credit	-	-	-	-	946	946	
Other contingencies	-	-	-	-	117,061	117,061	

The Branch manages interest rate risk by means of an appropriate structuring of holdings in assets and liabilities with different repricing dates, taking into account the direction of market interest rates, in order to generate a suitable yield while maintaining risk at acceptable levels.

(b) Foreign exchange risk

Foreign exchange rate risk is the risk that occurs from changes in foreign exchange rates which may affect the value of the Branch's financial instruments or may cause volatility in the Branch's earnings or cost of funds. Tools adopted for managing foreign exchange rate risk are for instance, limited open positions and Value at Risk ("VaR").

As at 31 December 2017 and 2016, the Branch has net open position assets (liabilities) denominated in the various currencies as follows;

	2017 Million Baht	2016 Million Baht
Net foreign currency exposure*		
US Dollar	(4,790)	(5,045)
Euro	2,110	1,642
Yen	(33)	(250)
Pound	962	(33)
Singapore Dollar	(157)	(3,731)
Others	43	(13)

* No non-performing loans amounting in foreign currency exposure at 31 December 2017 and 2016.

3 Financial risk management (Cont'd)

3.2 Market risk (Cont'd)

(c) Equity price risk

Equity price risk is any risk arising from changes in the price of equities or common stock that may cause volatility in the Branch's earnings or fluctuations in the value of the Branch's financial assets. The Branch manages its equity price risk by close monitoring of market situations to provide information for management.

3.3 Liquidity risk

Liquidity risk is the risk that the Branch either does not have sufficient financial resources available to meet the obligations as they fall due, or can only access these financial resources at excessive cost.

The objective of the Branch's liquidity and funding management framework is to ensure that all foreseeable funding commitments can be met when due. Therefore, the Branch is required to maintain strong liquidity positions and to manage the liquidity profiles of assets, liabilities and commitments with the objective of ensuring that cash flows are balanced appropriately and that all anticipated obligations can be met when due.

The Branch monitors its liquidity risk and maintains a level of cash and cash equivalents deemed adequate by management to finance the Branch's operations and to mitigate the effects of fluctuations in cash flows.

The Branch manages its liquidity position under the Bank of Thailand's guideline on Liquidity Coverage Ratio and other applicable regulations. The Treasury Department is accountable for managing the Branch's liquidity position by providing short-term and long-term funding sources as well as investing in highly liquid assets in both domestic and foreign currencies. The Branch also ensures that its liquidity position is suitable and sufficient for the current and foreseeable market conditions. The Assets and Liabilities Management Committee supervises management of liquidity risk.

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3 Financial risk management (Cont'd)

3.3 Liquidity risk (Cont'd)

A maturity analysis of financial assets and liabilities as at 31 December 2017 and 2016 was as follows:

	2017						Total Million Baht
	At call Million Baht	Less than 3 months Million Baht	3 months to 1 year Million Baht	1 to 5 years Million Baht	Over 5 years Million Baht	No maturity Million Baht	
Financial assets							
Cash	-	-	-	-	-	70	70
Interbank and money market items, net	3,326	46,020	81	-	-	-	49,427
Derivative assets	87	2,259	3,720	11,208	9,798	-	27,072
Investments, net	-	15,890	22,733	14,747	16,497	-	69,867
Loans to customers and accrued interest receivable, net	-	34,807	8,976	16,787	5,216	-	65,786
Other assets	-	2,519	-	-	-	329	2,848
Total financial assets	3,413	101,495	35,510	42,742	31,511	399	215,070
Financial liabilities							
Deposits	100,828	12,631	2,881	-	-	-	116,340
Interbank and money market items	8,746	1,110	-	-	-	-	9,856
Liabilities payable on demand	2,342	-	-	-	-	-	2,342
Derivative liabilities	297	2,171	4,094	10,755	12,040	-	29,357
Debt issued and borrowings	-	248	-	6,035	3,535	-	9,818
Other liabilities	-	1,638	-	-	-	2,237	3,875
Total financial liabilities	112,213	17,798	6,975	16,790	15,575	2,237	171,588
Liquidity gap, net	(108,800)	83,697	28,535	25,952	15,936	(1,838)	43,482
	2016						Total Million Baht
	At call Million Baht	Less than 3 months Million Baht	3 months to 1 year Million Baht	1 to 5 years Million Baht	Over 5 years Million Baht	No maturity Million Baht	
Financial assets							
Cash	-	-	-	-	-	29	29
Interbank and money market items, net	3,288	32,511	152	-	-	-	35,951
Derivative assets	158	3,570	6,554	16,593	10,838	-	37,713
Investments, net	-	18,656	39,647	14,978	11,428	-	84,709
Loans to customers and accrued interest receivable, net	-	34,941	4,788	21,221	4,365	-	65,315
Other assets	-	716	-	-	-	394	1,110
Total financial assets	3,446	90,394	51,141	52,792	26,631	423	224,827
Financial liabilities							
Deposits	92,665	12,114	912	-	-	-	105,691
Interbank and money market items	10,335	15,190	-	-	-	-	25,525
Liabilities payable on demand	2,844	-	-	-	-	-	2,844
Derivative liabilities	157	3,240	7,586	15,636	10,862	-	37,481
Debt issued and borrowings	-	-	99	5,287	3,703	-	9,089
Other liabilities	-	6,756	-	-	-	2,112	8,868
Total financial liabilities	106,001	37,300	8,597	20,923	14,565	2,112	189,498
Liquidity gap, net	(102,555)	53,094	42,544	31,869	12,066	(1,689)	35,329

4 Fair value of financial instruments

Fair values hierarchy

Fair values of financial assets and liabilities are determined according to the following hierarchy:

- Level 1 - valuation technique using quoted market price: financial instruments with quoted prices for identical instruments in active markets that the Branch can access at the measurement date.
- Level 2 - valuation technique using observable inputs: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
- Level 3 - valuation technique with significant unobservable inputs: financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk-taker. For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, the Branch will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable.

For fair values determined using valuation models, the control framework may include, as applicable, development or validation by independent support functions of (i) the logic within valuation models; (ii) the inputs to those models; (iii) any adjustments required outside the valuation models; and (iv) where possible, model outputs. Valuation models are subject to a process of due diligence and calibration before becoming operational and are calibrated against external market data on an ongoing basis.

Fair value adjustments

Fair value adjustments are adopted when the Branch considers that there are additional factors that would be considered relevant by a market participant that are not incorporated within the valuation model. The Branch classifies fair value adjustments as either 'risk-related' or 'model-related'. The majority of these adjustments relate to Global Banking and Markets.

Risk-related adjustments

Bid-offer

IFRS 13 requires use of the price within the bid-offer spread that is most representative of fair value. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the extent to which bid-offer costs would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of, or unwinding the position.

Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, there exists a range of possible values that the financial instrument or market parameter may assume and an adjustment may be necessary to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model.

Credit valuation adjustment

The credit valuation adjustment is an adjustment to the valuation of over-the-counter ("OTC") derivative contracts to reflect within fair value the possibility that the counterparty may default and the Branch may not receive the full market value of the transactions.

4 Fair value of financial instruments (Cont'd)

Fair value adjustments (Cont'd)

Debit valuation adjustment

The debit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the Branch may default, and that the Branch may not pay full market value of the transactions.

Funding fair value adjustment

The funding fair value adjustment is calculated by applying future market funding spreads to the expected future funding exposure of any uncollateralised component of the OTC derivative portfolio. This includes the uncollateralised component of collateralised derivatives in addition to derivatives that are fully uncollateralised. The expected future funding exposure is calculated by a simulation methodology, where available. The expected future funding exposure is adjusted for events that may terminate the exposure such as the default of the Branch or the counterparty. The funding fair value adjustment and debit valuation adjustment are calculated independently.

Model-related adjustments

Model limitation

Models used for portfolio valuation purposes may be based upon a simplifying set of assumptions that do not capture all material market characteristics. Additionally, markets evolve, and models that were adequate in the past may require development to capture all material market characteristics in current market conditions. In these circumstances, model limitation adjustments are adopted. As model development progresses, model limitations are addressed within the valuation models and a model limitation adjustment is no longer needed.

Inception profit (Day 1 profit or loss reserves)

Inception profit adjustments are adopted when the fair value estimated by a valuation model is based on one or more significant unobservable inputs.

Credit valuation adjustment/debit valuation adjustment methodology

The Group calculates a separate credit valuation adjustment ("CVA") and debit valuation adjustment ("DVA") for each Group legal entity, and within each entity for each counterparty to which the entity has exposure. The Branch calculates the CVA by applying the probability of default ("PD") of the counterparty conditional on the non-default of the Branch, to the expected positive exposure of the Branch to the counterparty, and multiplying the result by the loss expected in the event of default. Conversely, the Branch calculates the DVA by applying the PD of the Branch, conditional on the non-default of the counterparty, to the expected positive exposure of the counterparty to the Branch, and multiplying by the loss expected in the event of default. Both calculations are performed over the life of the potential exposure.

For most products, the Branch uses a simulation methodology to calculate the expected positive exposure to a counterparty. This incorporates a range of potential exposures across the portfolio of transactions with the counterparty over the life of portfolio. The simulation methodology includes credit mitigants such as counterparty netting agreements and collateral agreements with the counterparty.

For certain types of exotic derivatives where the products are not currently supported by the simulation, or for derivative exposures in smaller trading locations where the simulation tool is not yet available, the Branch adopts alternative methodologies.

The methodologies do not, in general, account for 'wrong-way risk'. Wrong-way risk arises when the underlying value of the derivative prior to any CVA is positively correlated to the probability of default of the counterparty. When there is significant wrong-way risk, a trade-specific approach is applied to reflect the wrong-way risk within the valuation.

4 Fair value of financial instruments (Cont'd)

4.1 Fair values of financial instruments carried at fair value

The following table presents the Branch's financial assets and liabilities carried at fair value by fair value hierarchy at 31 December 2017.

	2017			
	Level 1 Million Baht	Level 2 Million Baht	Level 3 Million Baht	Total Million Baht
Financial assets				
Financial assets at fair value through profit or loss				
Trading investments	15,604	10,365	-	25,969
Derivatives	13	26,921	138	27,072
Available-for-sale financial assets				
Debt securities	3,191	40,707	-	43,898
Total financial assets	<u>18,808</u>	<u>77,993</u>	<u>138</u>	<u>96,939</u>
Financial liabilities				
Financial liabilities at fair value through profit or loss				
Debt issued and borrowings	-	9,490	328	9,818
Derivatives	14	29,337	6	29,357
Total financial liabilities	<u>14</u>	<u>38,827</u>	<u>334</u>	<u>39,175</u>

Transfers between Level 1 and Level 2 fair values during the year 2017 can be summarised as follows:

	Assets	
	Trading investment Million Baht	Available-for- sale financial assets Million Baht
At 31 December 2017		
Transfers from Level 1 to Level 2	3	202
Transfers from Level 2 to Level 1	-	6

4 Fair value of financial instruments (Cont'd)

4.1 Fair values of financial instruments carried at fair value (Cont'd)

The following table presents the Branch's financial assets and liabilities carried at fair value by fair value hierarchy at 31 December 2016.

	2016			
	Level 1 Million Baht	Level 2 Million Baht	Level 3 Million Baht	Total Million Baht
Financial assets				
Financial assets at fair value through profit or loss				
Trading investments	9,789	12,142	-	21,931
Derivatives	21	37,684	8	37,713
Available-for-sale financial assets				
Debt securities	11,992	50,786	-	62,778
Total financial assets	<u>21,802</u>	<u>100,612</u>	<u>8</u>	<u>122,422</u>
Financial liabilities				
Financial liabilities at fair value through profit or loss				
Debt issued and borrowings	-	8,763	326	9,089
Derivatives	14	37,467	-	37,481
Total financial liabilities	<u>14</u>	<u>46,230</u>	<u>326</u>	<u>46,570</u>

Transfers between Level 1 and Level 2 fair values during the year 2016 can be summarised as follows:

	Assets	
	Trading investment Million Baht	Available-for- sale financial assets Million Baht
At 31 December 2016		
Transfers from Level 1 to Level 2	147	-
Transfers from Level 2 to Level 1	2	3,502

4 Fair value of financial instruments (Cont'd)

4.1 Fair values of financial instruments carried at fair value (Cont'd)

Fair value valuation of financial instruments carried at fair value

Financial investments

The fair values of financial investments are stated according to the Branch's accounting policies mentioned in note 2.

Derivatives

OTC (i.e. non-exchange traded) derivatives are valued using valuation models. Valuation models calculate the present value of expected future cash flows, based upon 'no-arbitrage' principles. For many vanilla derivative products, such as interest rate swaps and European options, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some differences in market practice. Inputs to valuation models are determined from observable market data wherever possible, including prices available from exchanges and third parties such as dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices via model calibration procedures or estimated from historical data or other sources. Examples of inputs that may be unobservable include volatility surfaces, in whole or in part, for less commonly traded option products, and correlations between market factors such as foreign exchange rates, interest rates and equity prices.

Derivative products valued using valuation techniques with significant unobservable inputs included certain types of correlation products, such as foreign exchange basket options, equity basket options, foreign exchange interest rate hybrid transactions and long-dated option transactions. Examples of the latter are equity options, interest rate and foreign exchange options.

Structured notes

The fair value of structured notes valued using a valuation technique with significant unobservable inputs is derived from the fair value of the underlying debt security and the fair value of the embedded derivative is determined as described in the above paragraph on derivatives.

Level 3 structured notes principally comprise equity-linked notes which are issued by the Branch and provide the counterparty with a return that is linked to the performance of certain equity securities and other portfolios. The notes are classified as Level 3 due to the unobservability of parameters such as long-dated equity volatilities and correlations between equity prices, between equity prices and interest rates and between interest rates and foreign exchange rates.

4 Fair value of financial instruments (Cont'd)

4.1 Fair values of financial instruments carried at fair value (Cont'd)

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy

The following table presents the movement between opening and closing balance of Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs for the year ended 31 December 2017.

	Derivatives assets Million Baht	Derivatives liabilities Million Baht	Trading liabilities at fair value through profit or loss Million Baht
At 1 January 2017	8	-	326
Gains and losses recognised in profit or loss	(8)	6	4
Settlements	8	-	(2)
Transfers in	130	-	-
At 31 December 2017	138	6	328
Unrealised losses for the period included in profit or loss for assets/liabilities held at 31 December 2017	8	6	1

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

It should be noted that there is no significantly effect of changes in significant unobservable assumptions to reasonably possible alternatives.

4 Fair value of financial instruments (Cont'd)

4.1 Fair values of financial instruments carried at fair value (Cont'd)

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy (Cont'd)

The following table presents the movement between opening and closing balance of Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs for the year ended 31 December 2016.

	Derivatives assets Million Baht	Trading liabilities at fair value through profit or loss Million Baht
At 1 January 2016	17	618
Gains and losses recognised in profit or loss	(10)	(3)
Settlements	1	(7)
Transfers out	-	(282)
At 31 December 2016	8	326
Unrealised gains or losses for the period included in profit or loss for assets/liabilities held at 31 December 2016	(9)	1

Transfers out of Level 3 derivative assets principally certain model inputs become observable.

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

The following table shows the sensitivity of Level 3 fair values to reasonably possible alternative assumptions:

	Reflected in profit or loss Favorable change Million Baht	Unfavorable change Million Baht
Other derivatives	1	(1)
At 31 December 2016	1	(1)

Favourable and unfavourable changes are determined on the basis of sensitivity analysis. The sensitivity analysis aims to measure a range of fair values consistent with the application of a 95% confidence interval. Methodologies take account of the nature of the valuation technique employed, as well as the availability and reliability of observable proxy and historical data. When the available data is not amenable to statistical analysis, the quantification of uncertainty is judgemental, but remains guided by the 95% confidence interval.

When the fair value of a financial instrument is affected by more than one unobservable assumption, the above table reflects the most favourable or the most unfavourable change from varying the assumptions individually.

4 Fair value of financial instruments (Cont'd)

4.1 Fair values of financial instruments carried at fair value (Cont'd)

Key unobservable inputs to Level 3 financial instruments

The table below lists key unobservable inputs to Level 3 financial instruments and provides the range of those inputs as at 31 December 2017. The core range of inputs is the estimated range within which 90% of the inputs fall. A further description of the categories of key unobservable inputs is given as follows:

Quantitative information about the significant unobservable inputs used in Level 3 fair value measurements

	Fair value		Valuation technique	Key unobservable inputs	Full range of inputs		Core range of inputs	
	Assets	Liabilities			Lower	Higher	Lower	Higher
	Million Baht	Million Baht						
Other derivatives								
Interest rate derivatives	138	6	Price - Market comparable approach	IR Basis	2.2%	2.5%	2.2%	2.5%
Structure notes								
Equity link notes	-	328	Model - Option model	IR Correlation	87.9%	99.0%	87.9%	99.0%
At 31 December 2017	<u>138</u>	<u>334</u>						

4 Fair value of financial instruments (Cont'd)

4.1 Fair values of financial instruments carried at fair value (Cont'd)

Key unobservable inputs to Level 3 financial instruments (Cont'd)

The table below lists key unobservable inputs to Level 3 financial instruments and provides the range of those inputs as at 31 December 2016. The core range of inputs is the estimated range within which 90% of the inputs fall. A further description of the categories of key unobservable inputs is given as follows:

Quantitative information about the significant unobservable inputs used in Level 3 fair value measurements

	Fair value		Valuation technique	Key unobservable inputs	Full range of inputs		Core range of inputs	
	Assets	Liabilities			Lower	Higher	Lower	Higher
	Million Baht	Million Baht						
Other derivatives								
Interest rate derivatives	8	-	Model - Discounted cash flows	IR basis	2.4%	2.6%	2.4%	2.6%
Structure notes								
Equity link notes	-	326	Model - Option model	Equity correlation	89.4%	99.6%	89.4%	99.6%
At 31 December 2016	<u>8</u>	<u>326</u>						

4 Fair value of financial instruments (Cont'd)

4.1 Fair values of financial instruments carried at fair value (Cont'd)

Volatility

Volatility is a measure of the anticipated future variability of a market price. Volatility tends to increase in stressed market conditions, and decrease in calmer market conditions. Volatility is an important input in the pricing of options. In general, the higher the volatility, the more expensive the option will be. This reflects both the higher probability of an increased return from the option and the potentially higher costs that the Branch may incur in hedging the risks associated with the option. If option prices become more expensive, this will increase the value of the Branch's long option positions (i.e. the positions in which the Branch has purchased options), while the Branch's short option positions (i.e. the positions in which the Branch has sold options) will suffer losses.

Volatility varies by underlying reference market price, and by strike and maturity of the option. Volatility also varies over time. As a result, it is difficult to make general statements regarding volatility levels. For example, while it is generally the case that foreign exchange volatilities are lower than equity volatilities, there may be examples in particular currency pairs or for particular equities where this is not the case.

Certain volatilities, typically those of a longer-dated nature, are unobservable. The unobservable volatility is then estimated from observable data. For example, longer-dated volatilities may be extrapolated from shorter-dated volatilities. The range of unobservable volatilities quoted in the above table reflects the wide variation in volatility inputs by reference market price. For example, foreign exchange volatilities for a pegged currency may be very low, whereas for non-managed currencies the foreign exchange volatility may be higher. As a further example, volatilities for deep-in-the-money or deep-out-of-the-money equity options may be significantly higher than at-the-money options. The core range is significantly narrower than the full range because these examples with extreme volatilities occur relatively rarely within the Branch portfolio.

Correlation

Correlation is a measure of the inter-relationship between two market prices and is expressed as a number between minus one and plus one. A positive correlation implies that the two market prices tend to move in the same direction, with a correlation of one implying that they always move in the same direction. A negative correlation implies that the two market prices tend to move in opposite directions, with a correlation of minus one implying that the two market prices always move in opposite directions. Correlation is used to value more complex instruments where the payout is dependent upon more than one market price. For example, an equity basket option has a payout that is dependent upon the performance of a basket of single stocks, and the correlation between the price movements of those stocks will be an input to the valuation. This is referred to as equity-equity correlation. There is a wide range of instruments for which correlation is an input, and consequently a wide range of both same-asset correlations (e.g. equity-equity correlation) and cross-asset correlations (e.g. foreign exchange rate-interest rate correlation) used. In general, the range of same-asset correlations will be narrower than the range of cross-asset correlations.

Correlation may be unobservable. Unobservable correlations may be estimated based upon a range of evidence, including consensus pricing services, the Branch trade prices, proxy correlations and examination of historical price relationships.

The range of unobservable correlations quoted in the table reflects the wide variation in correlation inputs by market price pair. For any single unobservable correlation, the uncertainty in the correlation determination is likely to be less than the range quoted above.

4 Fair value of financial instruments (Cont'd)

4.2 Fair values of financial instruments not carried at fair value

The following table presents the Branch's financial assets and liabilities not carried at fair value by fair value hierarchy at 31 December 2017.

	2017			
	Level 1 Million Baht	Level 2 Million Baht	Level 3 Million Baht	Total Million Baht
Financial assets				
Cash	70	-	-	70
Interbank and money market items, net	-	49,427	-	49,427
Loans to customers and accrued interest receivables	-	-	66,758	66,758
Total financial assets	70	49,427	66,758	116,255
Financial liabilities				
Deposits	-	116,340	-	116,340
Interbank and money market items	-	9,856	-	9,856
Total financial liabilities	-	126,196	-	126,196

The following table presents the Branch's financial assets and liabilities not carried at fair value by fair value hierarchy at 31 December 2016.

	2016			
	Level 1 Million Baht	Level 2 Million Baht	Level 3 Million Baht	Total Million Baht
Financial assets				
Cash	29	-	-	29
Interbank and money market items, net	-	35,951	-	35,951
Loans to customers and accrued interest receivables	-	-	66,202	66,202
Total financial assets	29	35,951	66,202	102,182
Financial liabilities				
Deposits	-	105,691	-	105,691
Interbank and money market items	-	25,525	-	25,525
Total financial liabilities	-	131,216	-	131,216

4 Fair value of financial instruments (Cont'd)

4.2 Fair values of financial instruments not carried at fair value (Cont'd)

Fair value valuation of financial instruments not carried at fair value

Other financial instruments not carried at fair value are typically short-term in nature and reprice to current market rates frequently. Accordingly, their carrying amount is a reasonable approximation of fair value. This includes cash and balances at central banks, interbank and money market items (assets and liabilities), all of which are measured at amortised cost.

Loans and advances to customers

The fair value of loans to customers are considered to be materially consistent with the carrying value as the majority of loans are at the market variable rate of interest and allowance for doubtful accounts for certain non-performing loans are considered to materially reflect the credit risk inherent in the portfolio at the statement of financial position date.

Floating rate loans to customers that reprice frequently and have no significant change in credit risk, fair value approximates its carrying value at the reporting date. The fair value of fixed rate loans to customers that reprice within one year of the reporting date approximates the carrying value at the reporting date. The fair value of other fixed interest loans to customers is estimated using discounted cash flow analysis and using interest rates currently being offered for loans to customers with similar credit quality.

Deposits

Fair value of deposit repayable on demand and its carrying amount of deposit repricing within one year are approximated by their carrying value at the reporting date. The fair value of other fixed interest deposits is estimated using discounted cash flows, applying current rates being offered for deposits of similar remaining maturity.

5 Maintenance of capital fund

The Branch maintains its capital funds in accordance with Section 32 of the Financial Institution Business Act, B.E. 2551 by maintaining its capital fund as a proportion of risk assets in accordance with the criteria, methodologies, and conditions prescribed by the Bank of Thailand as at 31 December 2017 and 2016, can be summarised as follows:

	2017	2016
	Million Baht	Million Baht
Assets maintained under Section 32	21,175	21,990
Sum of net capital for maintenance of assets under Section 32 and net balance of inter-office accounts		
Net fund brought in to maintenance assets under Section 32	20,100	20,100
Net balance of inter-office accounts which the branch is the debtor (the creditor) to the head office and other branches of the same juristic person, the parent company and subsidiaries of the head office	19,240	10,136
Total	39,340	30,236
Regulatory Capital (in million Baht)	20,100	20,100
Regulatory Capital after deducting capital add-on from Single Lending Limit (in million Baht)	19,653	19,828
Capital Adequacy Ratio (%)	18.18	18.70
Capital Adequacy Ratio after deducting capital add-on from Single Lending Limit (%)	17.78	18.44

5 Maintenance of capital fund (Cont'd)

As at 31 December 2017 and 2016, the Branch has applied the Standardised Approach ("SA") for credit risk and operational risk and the Combined Approach between Standardised Approach and Internal Model for market risk as approved by the Bank of Thailand and in accordance with the Bank of Thailand notification.

As at 31 December 2017 and 2016, the Branch met the minimum Capital Adequacy Ratio requirements set down by the Bank of Thailand, which is in compliance with the Basel III for Capital Adequacy Ratio at minimum of 8.5% plus capital conservation buffer of 2.5%. The conservation buffer are being phased in: starting at 0.625% on 1 January 2016 and increasing a further 0.625% each year in order to reach 2.5% on 1 January 2019.

In accordance with the Bank of Thailand Notification No. Sor Nor Sor 4/2556 dated 2 May 2013, Re: "The Public Disclosure of Capital Maintenance for Commercial Banks", the Branch intends to disclose Capital Maintenance information as at 31 December 2017 and 2016 within 4 months after the year end date as indicated in the notification through the Branch's website www.hsbc.co.th.

6 Interbank and money market items, net (assets)

	2017			2016		
	At call Million Baht	Term Million Baht	Total Million Baht	At call Million Baht	Term Million Baht	Total Million Baht
Domestic						
The Bank of Thailand and Financial Institutions						
Development Fund	565	2,031	2,596	2,457	3,055	5,512
Commercial banks	552	39,430	39,982	382	28,622	29,004
Specialised financial institutions	-	4,300	4,300	-	-	-
Other financial institutions	380	-	380	-	589	589
<u>Add</u> Accrued interest receivable	-	15	15	-	10	10
<u>Less</u> Deferred revenue	-	(1)	(1)	-	(1)	(1)
Allowance for doubtful accounts	(4)	-	(4)	-	-	-
Total domestic	1,493	45,775	47,268	2,839	32,275	35,114
Foreign						
US Dollar	1,407	231	1,638	421	389	810
Euro	355	-	355	-	-	-
Other currencies	71	96	167	28	-	28
<u>Less</u> Deferred revenue	-	(1)	(1)	-	(1)	(1)
Total foreign	1,833	326	2,159	449	388	837
Total domestic and foreign	3,326	46,101	49,427	3,288	32,663	35,951

7 Derivatives

7.1 Derivatives held for trading

As at 31 December 2017 and 2016, fair value and notional amount of derivatives classified by type of risks are as follows:

Type of risk	2017				
	Fair value		Notional amount		
	Assets Million Baht	Liabilities Million Baht	Up to 1 year Million Baht	Over 1 year Million Baht	Total Million Baht
Exchange rate	10,178	11,880	465,658	228,659	694,317
Interest rate	16,655	17,149	403,160	992,196	1,395,356
Others					
- Equities	4	-	-	174	174
- Bond	235	328	3,950	9,185	13,135
Total	27,072	29,357	872,768	1,230,214	2,102,982

Type of risk	2016				
	Fair value		Notional amount		
	Assets Million Baht	Liabilities Million Baht	Up to 1 year Million Baht	Over 1 year Million Baht	Total Million Baht
Exchange rate	19,425	19,940	486,447	281,164	767,611
Interest rate	17,848	17,265	570,030	1,146,886	1,716,916
Others					
- Equities	6	-	104	192	296
- Bond	434	276	1,750	5,450	7,200
Total	37,713	37,481	1,058,331	1,433,692	2,492,023

As at 31 December 2017 and 2016, proportions of the notional amount of derivative transactions, classified by counterparties, consisted of:

	2017 %	2016 %
Counterparty		
Financial institutions	57	53
Related parties	35	40
Third parties	8	7
Total	100	100

7.2 Derivatives held for fair value hedge

During 2017, the Branch has entered into the interest rate swap contracts for fair value hedge of its loans to customers with residual maturity over one year. As at 31 December 2017, the fair value and notional amount of derivatives held for fair value hedging, classified by type of risk, consisted of:

	Assets Million Baht	Liabilities Million Baht	Notional amount Million Baht
Interest rate	3	-	1,000
Total	3	-	1,000

8 Investments, net

8.1 Classification of investment in securities

As at 31 December 2017 and 2016, the Branch classified investment types, as follows:

	2017	2016
	Fair value	Fair value
	Million Baht	Million Baht
Trading investments		
Government and state enterprise securities	25,242	21,445
Private debt instruments	727	486
Total	25,969	21,931
Available-for-sale investments		
Government and state enterprise securities	43,898	62,778
Total	43,898	62,778
Total investments, net	69,867	84,709

As at 31 December 2017, investments classified as available-for-sale with market values of Baht 21,175 million, Baht 15,646 million and nil (2016: Baht 21,990 million, Baht 12,052 million and Baht 14,493 million) were maintained as capital fund under the Bank of Thailand's regulation, pledged with the Bank of Thailand for intraday liquidity facilities and securities requirement for settlement and collateralised to other parties under repurchase agreements, respectively.

8.2 Gain (loss) on remeasurement of available-for-sale investments as follows:

	2017	2016
	Fair value	Fair value
	Million Baht	Million Baht
Gain on investments		
Debt securities	42	24
Loss on investments		
Debt securities	-	(29)
Total	42	(5)
<u>Less</u> Deferred tax	(8)	1
Net	34	(4)

9 Loans to customers and accrued interest receivables, net

9.1 Classified by type of loans

	2017	2016
	Million Baht	Million Baht
Overdrafts	498	2,138
Loans	59,797	57,916
Bills	6,403	6,211
<u>Less</u> Deferred revenue	<u>(15)</u>	<u>(10)</u>
Total loans to customers net from deferred revenue	66,683	66,255
<u>Add</u> Accrued interest receivables	<u>189</u>	<u>150</u>
Total loans to customers net from deferred revenue add accrued interest receivables	66,872	66,405
<u>Less</u> Allowance for doubtful accounts		
- BoT's minimum requirement - individual approach	(780)	(764)
- Allowance in excess	<u>(306)</u>	<u>(326)</u>
Total loans to customers and accrued interest receivables, net	<u>65,786</u>	<u>65,315</u>

9.2 Classified by currencies and residencies of debtors

	2017			2016		
	Domestic	Foreign	Total	Domestic	Foreign	Total
	Million	Million	Million	Million	Million	Million
	Baht	Baht	Baht	Baht	Baht	Baht
Baht	42,587	-	42,587	43,609	-	43,609
US Dollar	19,088	1,856	20,944	18,335	2,135	20,470
Other currencies	1,837	1,315	3,152	1,261	915	2,176
Total*	<u>63,512</u>	<u>3,171</u>	<u>66,683</u>	<u>63,205</u>	<u>3,050</u>	<u>66,255</u>

* Loans to customers net of deferred revenue

9 Loans to customers and accrued interest receivables, net (Cont'd)

9.3 Classified by type of business and loan classification

	2017			Total Million Baht
	Pass Million Baht	Special mention Million Baht	Doubtful of loss Million Baht	
Agriculture and mining	1,064	-	-	1,064
Industrial and commercial	35,806	82	211	36,099
Property and construction	1,566	-	-	1,566
Infrastructure and service	26,456	-	-	26,456
Home mortgages	325	-	-	325
Others	1,173	-	-	1,173
Total*	66,390	82	211	66,683

* Loans to customers net of deferred revenue

	2016			Total Million Baht
	Pass Million Baht	Doubtful of loss Million Baht		
Agriculture and mining	1,442	-		1,442
Industrial and commercial	40,051	218		40,269
Property and construction	1,804	-		1,804
Infrastructure and service	21,727	-		21,727
Home mortgages	347	-		347
Others	666	-		666
Total*	66,037	218		66,255

* Loans to customers net of deferred revenue

9.4 Classified by grade

	2017			Allowance for doubtful accounts Million Baht
	Loans to customers and accrued interest receivables Million Baht	Net amount to set up allowance for doubtful accounts Million Baht	Rate used to set up allowance for doubtful accounts (%)	
Allowance as per BoT's minimum requirement				
- Pass	66,579	63,345	1	640
- Special mention	82	82	2	2
- Doubtful of loss	211	138	100	138
Total	66,872	63,565		780
Allowance in excess				306
Total *				1,086

* Loans to customers net of deferred revenue included accrued interest receivables

9 Loans to customers and accrued interest receivables, net (Cont'd)

9.4 Classified by grade (Cont'd)

	2016		
	Loans to customers and accrued interest receivables Million Baht	Net amount to set up allowance for doubtful accounts Million Baht	Rate used to set up allowance for doubtful accounts (%)
Allowance as per BoT's minimum requirement			
- Pass	66,187	60,607	1
- Doubtful of loss	218	151	100
Total	66,405	60,758	
Allowance in excess			
Total *			1,090

* Loans to customers net of deferred revenue included accrued interest receivables

9.5 Non-performing loans

As at 31 December 2017 and 2016 the Branch had non-performing loans gross ("NPLs Gross") (including financial institutions) based on the BoT notification as follows:

	2017	2016
NPLs, gross (<i>in million Baht</i>)	211	218
Loans used for NPLs ratio calculation ⁽¹⁾ (<i>in million Baht</i>)	113,326	99,008
Percentage of total loans ⁽²⁾	0.19	0.22

⁽¹⁾ Total loans used for NPLs ratio calculation are loans to customers as presented in the statement of financial position and loans to financial institutions as included in inter-bank and money market items.

⁽²⁾ The ratio of NPLs Gross to total loans before allowance for doubtful accounts of non-performing loans.

As at 31 December 2017 and 2016 the Branch had non-performing loans net ("NPLs Net") (including financial institutions) based on the BoT notification as follows:

	2017	2016
NPLs, net (<i>in million Baht</i>)	49	57
Loans used for NPLs ratio calculation ⁽¹⁾ (<i>in million Baht</i>)	113,164	98,846
Percentage of total loans ⁽²⁾	0.04	0.06

⁽¹⁾ Total loans used for NPLs, net ratio calculation are loans to customers as presented in the statements of financial position and loans to financial institutions as included in inter-bank and money market items after allowance for doubtful accounts of non-performing loans.

⁽²⁾ The ratio of NPLs, net to total loans after allowance for doubtful accounts of non-performing loans.

As at 31 December 2017, allowance for doubtful accounts of Baht 162 million (2016: Baht 162 million) have been provided against the Branch's non-performing loans being those classified as substandard, doubtful and doubtful of loss.

10 Allowance for doubtful accounts

Movements in the allowance for doubtful accounts for loans to customers during the year ended 31 December 2017 and 2016 consisted of:

	2017					
	Pass Million Baht	Special mention Million Baht	Substandard Million Baht	Doubtful Million Baht	Doubtful of loss Million Baht	Total Million Baht
Beginning balance	928	-	-	-	162	1,090
Doubtful accounts charge	(6)	2	-	-	-	(4)
Ending balance	922	2	-	-	162	1,086

	2016					
	Pass Million Baht	Special mention Million Baht	Substandard Million Baht	Doubtful Million Baht	Doubtful of loss Million Baht	Total Million Baht
Beginning balance	875	8	-	-	207	1,090
Doubtful accounts charge	53	(8)	-	-	(44)	1
Recovery	-	-	-	-	(1)	(1)
Ending balance	928	-	-	-	162	1,090

11 Leasehold right for land and buildings, net

	2017 Million Baht	2016 Million Baht
Cost	909	909
<u>Less</u> Accumulated amortisation	(509)	(495)
<u>Less</u> Loss on impairment	(269)	(269)
Total	131	145

12 Deferred tax assets, net

Deferred tax assets and liabilities determined after netting off are included in the statements of financial position as follows:

	2017 Million Baht	2016 Million Baht
Deferred tax asset to be recovered within 12 months	63	51
Deferred tax asset to be recovered after more than 12 months	143	160
Deferred tax liability to be settled within 12 months	(87)	(1)
Deferred tax liability to be settled after more than 12 months	(35)	(45)
Deferred tax asset, net	84	165

12 Deferred tax assets, net (Cont'd)

Movements in deferred tax assets and liabilities during the year ended 31 December 2017 were as follows:

	At 1 January 2017 Million Baht	(Charged)/ credited to		At 31 December 2017 Million Baht
		Profit or loss (Note 33) Million Baht	Other comprehensive income Million Baht	
Deferred tax assets				
Investments	41	(40)	(1)	-
Allowance for doubtful accounts and provision for contingent liabilities	10	-	-	10
Provision for impairment	36	(3)	-	33
Others	124	41	(2)	163
Total	211	(2)	(3)	206
Deferred tax liabilities				
Investments	-	39	8	47
Borrowings and financial instruments	45	(10)	-	35
Others	1	39	-	40
Total	46	68	8	122
Net	165	(70)	(11)	84

Movements in deferred tax assets and liabilities during the year ended 31 December 2016 were as follows:

	At 1 January 2016 Million Baht	(Charged)/ credited to		At 31 December 2016 Million Baht
		Profit or loss (Note 33) Million Baht	Other comprehensive income Million Baht	
Deferred tax assets				
Investments	-	40	1	41
Allowance for doubtful accounts and provision for contingent liabilities	11	(1)	-	10
Provision for impairment	39	(3)	-	36
Others	127	(4)	1	124
Total	177	32	2	211
Deferred tax liabilities				
Investments	157	(129)	(28)	-
Borrowings and financial instruments	-	45	-	45
Others	-	1	-	1
Total	157	(83)	(28)	46
Net	20	115	30	165

13 Other assets, net

	2017 Million Baht	2016 Million Baht
Accrued income receivable	250	317
Margins	2,519	746
Others	79	47
Total	2,848	1,110

14 Classified assets

As at 31 December 2017 and 2016, assets of the Branch were categorised by quality in compliance with the BoT regulations, taking into account analyses of each loan and appraisal of the financial standing of each borrower, as follows:

	2017			
	Investments	Interbank	Loans to	
	Million Baht	and money	customers	
		market	and accrued	
		Million Baht	interest	
			receivables	Total
			Million Baht	Million Baht
Pass	69,867	46,613	66,579	183,059
Special mention	-	42	82	124
Doubtful of loss	-	-	211	211
Total	69,867	46,655	66,872	183,394

	2016			
	Investments	Interbank	Loans to	
	Million Baht	and money	customers	
		market	and accrued	
		Million Baht	interest	
			receivables	Total
			Million Baht	Million Baht
Pass	84,709	32,763	66,187	183,659
Doubtful of loss	-	-	218	218
Total	84,709	32,763	66,405	183,877

Investments are stated at fair value. As at 31 December 2017, investments classified as doubtful of loss according to the BoT's definition represented unrealised loss on revaluation of Baht 142 million (2016: Baht 410 million).

15 Deposits

15.1 Classified by type of deposits

	2017 Million Baht	2016 Million Baht
Current	32,997	29,237
Saving	67,831	63,428
Term		
- Less than 6 months	15,352	12,905
- More than 6 months but less than 1 year	160	121
Total	116,340	105,691

15.2 Classified by currencies and residencies of depositors:

	2017			2016		
	Domestic Million Baht	Foreign Million Baht	Total Million Baht	Domestic Million Baht	Foreign Million Baht	Total Million Baht
Baht	88,843	1,202	90,045	77,706	1,365	79,071
US Dollar	25,146	516	25,662	21,346	853	22,199
Other currencies	615	18	633	4,421	-	4,421
Total	114,604	1,736	116,340	103,473	2,218	105,691

16 Interbank and money market items (liabilities)

	2017			2016		
	At call Million Baht	Term Million Baht	Total Million Baht	At call Million Baht	Term Million Baht	Total Million Baht
Domestic						
Commercial banks	1	50	51	3	8,300	8,303
Specialised financial institutions	-	-	-	-	6,200	6,200
Finance, securities and credit foncier companies	2,645	-	2,645	3,181	-	3,181
Other financial institutions	1,448	1,060	2,508	1,246	690	1,936
Total domestic	4,094	1,110	5,204	4,430	15,190	19,620
Foreign						
Baht	4,626	-	4,626	5,779	-	5,779
Other currencies	26	-	26	126	-	126
Total foreign	4,652	-	4,652	5,905	-	5,905
Total domestic and foreign	8,746	1,110	9,856	10,335	15,190	25,525

17 Debt issued and borrowings

	2017 Million Baht	2016 Million Baht
Bills of exchange	-	100
Floating rate notes	9,818	8,989
Total	9,818	9,089

As at 31 December 2017, all borrowings were in Thai Baht with interest rates between 0.31% - 1.84% per annum (2016: 1.08% - 1.83% per annum).

18 Employee benefit obligations

Statement of financial position obligations for

	2017 Million Baht	2016 Million Baht
Post employment benefits		
- Legal severance payment plan and gratuity plan	238	225

	2017 Million Baht	2016 Million Baht
Year ended 31 December		
Statement of comprehensive income:		
Recognised in profit or loss		
Post employment benefits		
- Legal severance payment plan and gratuity plan	27	25
Recognised in other comprehensive income		
Actuarial (gains) losses recognised during the year	(7)	4
Total	20	29

The Branch operates the following unfunded defined benefit plans for eligible employees in Thailand in accordance with the requirements of the Thai Labour Protection Act B.E. 2541 (1998) to provide retirement benefits to employees based on pensionable remuneration and length of service.

Legal severance payment plan

Under this plan, employees are entitled to legal severance payment benefits ranging from 30 days to 300 days of final salary upon retirement or involuntary separation before retirement.

Gratuity plan

Under this plan, employees are entitled to one month final salary for every five years of completed service upon retirement.

18 Employee benefit obligations (Cont'd)

The statement of financial position obligations were determined as follows:

	2017 Million Baht	2016 Million Baht
Present value of unfunded obligations	238	225
Statement of financial position obligations	238	225

Movement in the present value of the defined benefit obligations:

	2017 Million Baht	2016 Million Baht
At 1 January	225	197
Expense recognised in profit or loss		
Current service costs	20	19
Interest cost on obligation	7	6
Benefits paid during the year	(7)	(1)
Actuarial (gains) losses in other comprehensive income	(7)	4
At 31 December	238	225

The expense is recognised in profit or loss:

	2017 Million Baht	2016 Million Baht
Other operating expenses		
- Employee expenses	27	25
Total	27	25

Actuarial losses recognised in other comprehensive income, net of deferred tax.

	2017 Million Baht	2016 Million Baht
At 1 January	50	47
Recognised during the year	(5)	3
At 31 December	45	50

Principal actuarial assumptions at the reporting date:

	2017 (%)	2016 (%)
Discount rate	2.6	3.0
Future average salary increases	3	3 - 12
Retirement mortality rate retirement	Thai Mortality Ordinary Table 2017	Thai Mortality Ordinary Table 2008

18 Employee benefit obligations (Cont'd)

As at 31 December 2017 and 2016, the impact on defined benefit obligations of key assumption changes are summarised as follows:

	2017 Million Baht	2016 Million Baht
Discount rate		
1.0% decrease	17	18
1.0% increase	(15)	(16)
Expected rate of salary increase		
1.0% decrease	(15)	(16)
1.0% increase	17	18
Turnover rate		
10% decrease in likelihood of turnover	6	8
10% increase in likelihood of turnover	(6)	(7)

Maturity analysis of benefits expected to be paid

	2017 Million Baht	2016 Million Baht
Benefits expected to be paid within 12 months	4	8
Benefits expected to be paid between 1 and 2 years	20	8
Benefits expected to be paid between 2 and 5 years	70	80
Benefits expected to be paid in more than 5 years	192	157

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions the same method as when calculating the pension liability recognised within the statement of financial position.

19 Provisions

	2017 Million Baht	2016 Million Baht
At 1 January	152	173
Provision used/ released	(46)	(21)
At 31 December	106	152

The above consists of the restructuring provision relating to disposal of retail portfolio and also includes provision for contingent liabilities.

20 Other liabilities

	2017 Million Baht	2016 Million Baht
Accrued interest expense	40	48
Accrued expenses	473	492
Income tax payable	200	576
Marginal deposit	1,638	6,761
Others	1,524	991
Total	3,875	8,868

21 Commitments and contingent liabilities

	2017			2016		
	Baht Million Baht	Foreign currency Million Baht	Total Million Baht	Baht Million Baht	Foreign currency Million Baht	Total Million Baht
Guarantees of loans	1	588	589	1	673	674
Other guarantees	24,382	14,082	38,464	19,785	12,465	32,250
Liabilities under unmaturing import bills	-	2,011	2,011	-	1,302	1,302
Letters of credit	10	2,103	2,113	-	946	946
Unused credit lines of overdrafts and credit facilities	53,134	14,262	67,396	63,420	20,089	83,509
Total	77,527	33,046	110,573	83,206	35,475	118,681

The Branch received a claim in respect of default on sale and purchase agreement, bills torts, return of property, and guarantee amount totaling Baht 463 million against the Branch. On 28 June 2017, the Supreme Court judgment has been rendered in favour of the Branch by dismissing the customer's complaint. Since this judgment has been final, therefore, as at 31 December 2017, the Branch's contingent liability due to this litigation has no longer existed.

Moreover, the Branch also has received claims in respect of allegation of misconduct to transfer fund and closure account without comply with account mandate of totalling Baht 369 million against the Branch. No provision has been made in the financial statements as the Branch's management does not currently expect that the Branch will incur significant loss from this lawsuit.

Long-term lease commitments

Type of lease agreement	Remaining period	2017 Million Baht
Building and service lease agreements	1 January 2018 - 30 June 2019	3
Vehicle lease agreements	1 January 2018 - 31 October 2020	14
Equipment lease agreement	1 January 2018 - 31 March 2022	22
		39
Type of lease agreement	Remaining period	2016 Million Baht
Building and service lease agreements	1 January 2017 - 30 June 2019	16
Vehicle lease agreements	1 January 2017 - 24 February 2019	6
Equipment lease agreement	1 January 2017 - 31 August 2021	20
		42

22 Related parties

For the purposes of these financial statements, parties are considered to be related to the Branch if the Branch has the ability, directly or indirectly, to control or joint control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Branch and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

Relationships with significant key management personnel and related parties were as follows:

Name of entities/Personnel	Country of incorporation	Nature of relationships
Key management personnel	Thailand	Persons having authority and responsibility for planning, directing and controlling the activities of the Branch, directly or indirectly including any directs (whether executive or otherwise) of the Branch. The Branch's key management personnel consisted of: <ul style="list-style-type: none"> - Chief Executive Officer - Chief Financial Officer - Chief Operating Officer - Chief Risk Officer - Head of Global Market - Head of Global Banking - Head of Commercial Banking - Head of Regulatory Compliance - Head of Financial Crime Compliance - Head of Legal - Head of Communications - Head of Human Resources
HSBC Holdings Plc.	England	Ultimate parent company of the Head Office
The Hongkong and Shanghai Banking Corporation Limited (HBAP)	Hong Kong	Head Office and other branches
Other HSBC Group entities		
HSBC Bank Plc.	England	HSBC Holdings Plc's subsidiary
HSBC Bank USA, N.A.	United States	HSBC Holdings Plc's subsidiary
HSBC Private Banking Holdings (Suisse) S.A.	Switzerland	HSBC Holdings Plc's subsidiary
HSBC Bank Canada	Canada	HSBC Holdings Plc's subsidiary
HSBC Bank Bermuda Limited	Bermuda	HSBC Holdings Plc's subsidiary
HSBC Bank Australia Limited	Australia	HBAP's subsidiary
HSBC Bank Malaysia Berhad	Malaysia	HBAP's subsidiary
HSBC Bank (Taiwan) Limited	Taiwan	HBAP's subsidiary
Hang Seng Bank Limited	Hong Kong	HBAP's subsidiary

22 Related parties (Cont'd)

The pricing policies for particular types of transactions are explained further below:

Transactions	Pricing policies
Interest	Based on market rate
Services	Contractually agreed price
Derivatives	Based on market price

Significant transactions for the year ended 31 December 2017 and 2016 with the related parties were as follows:

	2017 Million Baht	2016 Million Baht
HBAP		
Interest income on inter-office lending	15	16
Fee and commission income	64	63
Interest expense on inter-office borrowing	176	94
Fee and commission expenses	56	37
Other income	-	9
Head office expenses	488	473
Other expenses	19	27
Other HSBC Group entities		
Interest income	1	1
Fee and commission income	70	70
Interest expense	1	1
Fee and commission expenses	35	28
Other income	1	4
Other expenses	57	47

Significant balances with related parties as at 31 December 2017 and 2016 consisted of:

	2017 Million Baht	2016 Million Baht
Interbank and money market items (assets)		
HSBC Group entities		
HSBC Bank Plc.	1,749	12
HSBC Bank USA, N.A.	60	184
HSBC Bank Bermuda Limited	-	22
HSBC Bank Australia Limited	8	3
HSBC Bank Canada	2	1
Others	4	1
Total	1,823	223
Interbank and money market items (liabilities)		
HSBC Group entities		
HSBC Bank Plc.	307	187
HSBC Bank USA, N.A.	32	93
HSBC Bank Australia Limited	9	46
HSBC Bank (Taiwan) Limited	-	281
Hang Seng Bank Limited	73	89
HSBC Bank Malaysia Berhad	14	73
HSBC Private Banking Holdings (Suisse) S.A.	21	18
Others	153	132
Total	609	919

22 Related parties (Cont'd)

Significant balances with related parties as at 31 December 2017 and 2016 consisted of: (Cont'd)

	2017 Million Baht	2016 Million Baht
Net balance of inter-office accounts with head office and other branches of the same juristic person		
HBAP		
Nostro accounts	(16)	(37)
Vostro accounts	474	1,168
Lending	-	(6,629)
Borrowings	18,203	14,669
Accrued interest receivables	-	(13)
Accrued interest expenses	10	1
Accrued expenses	471	494
Other receivables	(28)	(1)
Other payables	12	-
Total	19,126	9,652

The Branch enters into certain treasury transactions, including swap, foreign exchange, and option contracts, with other HSBC Group entities for hedging purposes.

Significant agreements with related parties

(a) Service agreement

The Branch entered into a services agreement with the Head Office relating to the provision of certain management and other services to the Branch by the Head Office. The fees payable by the Branch to the Head Office under the services agreement are based on an allocation of relevant actual costs.

(b) Outsourcing services

The Branch entered into service agreements with related parties for certain banking operation, financial processing activities and information technology support.

23 Benefits paid to directors and executives

The Branch has no special benefits given to the directors and executives beyond the general benefits provided such as directors' remuneration, executives' salary and bonus (if any) included ESOP warrants.

	2017 Million Baht	2016 Million Baht
Short-term employee benefits	150	155
Post-employment benefits	6	8
Share-based payment	20	14
Total	176	177

24 Share-based payments

Income statement charge

	2017 Million Baht	2016 Million Baht
Equity-settled share-based payments		
Restricted share awards	(1)	21
ShareMatch	1	1
Total	-	22

HSBC Share Awards

Award	Policy	Purpose
Restricted share awards (including annual incentive awards delivered in shares) and Group Performance Shares Plan ('GPSP')	<ul style="list-style-type: none"> An assessment of performance over the relevant period ending on 31 December is used to determine the amount of the award to be granted. Deferred awards generally require employees to remain in employment over the vesting period and are not subject to performance conditions after the grant date. Deferred share awards generally vest over a period of three years and GPSP awards vest after five years. Vested shares may be subject to a retention requirement (restriction) post-vesting. GPSP awards are retained until cessation of employment. Awards granted from 2010 onwards are subject to a malus provision prior to vesting. Awards granted to Material Risk Takers from 2015 onwards are subject to clawback post vesting. 	<ul style="list-style-type: none"> To drive and reward performance consistent with strategy and align to shareholder interests. Deferral provides an incentive for a longer term commitment and the ability to apply malus.
International Employee Share Purchase Plan ('ShareMatch')	<ul style="list-style-type: none"> Shares are purchased in the market each quarter up to a maximum value of £250 or the equivalent in local currency. Matching awards are added at a ratio of one free share for every three purchased. Matching awards vest subject to continued employment and the retention of the purchased shares for a maximum period of two years and nine months. 	<ul style="list-style-type: none"> To align the interests of all employees with the creation of shareholder value.

Calculation of fair values

The fair value of a share award is based on the share price at the date of the grant.

Movement on HSBC share awards

	2017 Number	2016 Number
Outstanding at 1 January	166,873	161,116
Additions during the year	49,491	104,147
Released during the year	(94,549)	(91,688)
Forfeited during the year	(2,852)	(6,702)
Outstanding at 31 December	118,963	166,873
Weighted average fair value of awards granted (Baht)	262.15	276.75

25 The financial position and results of operations classified by domestic and foreign business

The Branch does not present the financial position and results of operations classified by domestic and foreign business in the financial statements since the Branch is engaged in only one domestic business in Thailand.

26 Interest income

	2017 Million Baht	2016 Million Baht
Interbank and money market items	778	908
Investments and trading transactions	500	663
Investments in debt securities	763	949
Loans	1,562	1,499
Total interest income	3,603	4,019

27 Interest expense

	2017 Million Baht	2016 Million Baht
Deposits	366	475
Interbank and money market items	378	332
Contribution to Deposit Protection Agency	455	472
Borrowings	318	409
Total interest expense	1,517	1,688

28 Net fees and service income

	2017 Million Baht	2016 Million Baht
Fees and service income		
- Acceptances, aval and guarantees	118	115
- Remittances	280	288
- Underwriting, management and consulting	36	193
- Custody	368	322
- Others	106	77
Total	908	995
Fees and service expenses		
- Remittances	53	50
- Others	145	126
Total	198	176
Net	710	819

29 Net gain on trading and foreign exchange transactions

	2017	2016
	Million Baht	Million Baht
Gain on trading and foreign exchange transactions		
- Foreign currencies and foreign currency related derivatives	1,953	1,249
- Interest rate related derivatives	(860)	1,224
- Debt instruments	674	(278)
Total	1,767	2,195
Gain on hedging transactions	1	-
Total	1,768	2,195

30 Bad debts, doubtful accounts expense and impairment loss

	2017	2016
	Million Baht	Million Baht
Provision for doubtful accounts (Reversal)		
- Transactions between interbank and money markets	4	(10)
- Loans to customers	(4)	1
Total	-	(9)

31 Employee expenses

	2017	2016
	Million Baht	Million Baht
Wages, salaries and bonus	996	956
Post-employment benefits - defined benefit plans	27	25
Post-employment benefits - defined contribution plans	56	52
Others	135	126
Total	1,214	1,159

The Branch has established contributory provident funds for their employees. Memberships of the funds are on a voluntary basis. Contributions are made monthly by the employees at rates ranging from 3% to 15% of their basic salaries and by the Branch at 10% of the employees' basic salaries. The provident funds are registered with the Ministry of Finance as juristic entities and are managed by licensed Fund Managers, therefore, they are not included in the statements of financial position.

32 Other expenses

	2017	2016
	Million Baht	Million Baht
Expenses allocated from Head Office	274	266
Others	263	255
Total	537	521

33 Income tax expense

Income tax expense recognised in profit or loss

	Note	2017 Million Baht	2016 Million Baht
Current tax expense			
Current year		404	779
Under (over) provided in prior year		27	(10)
		<u>431</u>	<u>769</u>
Deferred tax expense			
Movements in temporary differences	12	70	(115)
Total income tax expense		<u>501</u>	<u>654</u>

Income tax expense recognised in other comprehensive income

	2017			2016		
	Before tax Million Baht	Tax benefit Million Baht	Net of tax Million Baht	Before tax Million Baht	Tax (expense) benefit Million Baht	Net of tax Million Baht
Available-for-sale investments	47	(9)	38	(146)	29	(117)
Defined benefit plans actuarial losses	7	(2)	5	(4)	1	(3)
Total	<u>54</u>	<u>(11)</u>	<u>43</u>	<u>(150)</u>	<u>30</u>	<u>(120)</u>

Reconciliation of effective tax rate

	2017		2016	
	Rate (%)	Million Baht	Rate (%)	Million Baht
Profit before income tax expense		2,395		3,267
Income tax using the Thai corporation tax rate	20.0	479	20.0	653
Expenses not deductible for tax purposes	0.3	6	0.3	11
Adjustment from temporary difference	(0.5)	(11)	-	-
Under (over) provided in prior year	1.1	27	(0.3)	(10)
Total	<u>20.9</u>	<u>501</u>	<u>20.0</u>	<u>654</u>

Income tax reduction

According to Revenue Code Amendment Act (No. 42) B.E. 2559 dated 3 March 2016 grants a reduction in the prescribed standard rate at corporate tax in the revenue code from 30% to 20% starting from the accounting period of 2016.

The Branch has applied the reduced tax rate of 20% in measuring deferred tax assets and liabilities as at 31 December 2017 and 2016 in accordance with the clarification issued by the FAP in 2012.