

**HSBC Bank Plc -
Tel Aviv Branch**

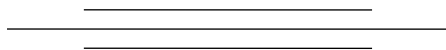
**Financial Statements
As at December 31, 2019**

RESTRICTED

Financial Statements as at December 31, 2019

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AUDITORS' REPORT

To the Head Office of
HSBC BANK PLC - TEL AVIV BRANCH

We have audited the accompanying balance sheets of HSBC Bank Plc - Tel Aviv Branch (the "Branch") as of December 31, 2019 and 2018 and the related statement of profit and loss, statement of other comprehensive income and the changes in reserves and Head Office Account for each of the three years in the period ended December 31, 2019. These financial statements are the responsibility of the Branch's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in Israel, including standards prescribed by the auditors Regulations (Manner of Auditor's Performance) – 1973, and auditing standards which application in auditing banking corporations was enforced by the Supervisor of Banks in Israel. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Branch's Management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Branch as of December 31, 2019 and 2018, the results of operations and the changes in reserves and Head Office Account for each of the three years in the period ended December 31, 2019 in accordance with International Financial Reporting Standards (hereinafter - IFRS) after taking into account the directives and guidelines of the Supervisor of Banks and leniencies granted by it.

Tel-Aviv, Israel
March 31, 2020

Kesselman & Kesselman
Certified Public Accountants (Isr.)
A member firm of PricewaterhouseCoopers International Limited

Balance Sheets

	Note	December 31	
		2019	2018
		(Audited)	
		NIS thousands	
Assets			
Cash and deposits with banks		4,775,200	6,037,849
Securities		710,772	27,958
Loans to customers		2,148,483	2,082,369
Loan impairment charges and other credit risk provisions		(33,159)	(29,889)
Credit to the public, net		<u>2,115,324</u>	<u>2,052,480</u>
Building and equipment		4,223	4,628
Assets from derivative instruments	8b	150,813	140,976
Other assets	4	<u>54,545</u>	<u>32,785</u>
Total assets		<u>7,810,877</u>	<u>8,296,676</u>
Liabilities, Reserves and Head Office Account			
Deposits from the public		6,468,827	7,136,663
Deposits from banks		450,896	335,500
Liabilities from derivative instruments	8b	171,208	148,826
Other liabilities	5	<u>92,382</u>	<u>104,986</u>
Total liabilities		<u>7,183,313</u>	<u>7,725,975</u>
Accumulated other comprehensive income (loss)		199	(56)
Capital Reserve from allocation of Head Office costs and Share-based plans	9	46,333	46,070
Accumulated profits		<u>581,032</u>	<u>524,687</u>
		<u>627,564</u>	<u>570,701</u>
Total liabilities, Reserves and Head Office Account		<u>7,810,877</u>	<u>8,296,676</u>



Michael Israel
Chief Executive Officer

Alon Jannai
Head of Finance



Yehuda Purian
Chief Accountant

Date of approval of the Financial Statements: March 31, 2020.

The accompanying notes are an integral part of the Financial Statements.

Statements of Profit and Loss

	Note	For the year ended December 31		
		2019	2018	2017
		(Audited)		
NIS thousands				
Interest income		146,871	118,769	70,694
Interest expenses		74,502	58,321	28,647
Interest income, net		72,369	60,448	42,047
Loan impairment charges and other Credit risk Provisions, net		(5,489)	(19,304)	(3,097)
Interest income, net, after loan impairment charges and other credit risk provisions		66,880	41,144	38,950
Non-interest income				
Fee income		68,690	131,214	131,480
Non-interest financing income		34,449	44,913	27,528
Other income		8,335	7,742	13,290
Total non-interest income		111,474	183,869	172,298
Operating and other expenses:				
Salaries and related expenses	6	63,828	68,765	65,913
Maintenance and depreciation of building and equipment		6,894	7,843	7,417
Other expenses	7	23,290	20,328	21,987
Inter-group costs recoveries		(2,122)	(2,223)	(3,008)
Total operating and other expenses		91,890	94,713	92,309
Operating profit before taxes		86,464	130,300	118,939
Tax expense	10	30,119	43,324	41,195
Net profit for the period		56,345	86,976	77,744

The accompanying notes are an integral part of the Financial Statements.

Statements of Other Comprehensive Income

	For the year ended December 31		
	2019	2018	2017
	(Audited)		
	NIS thousands		
Net profit for the period	56,345	86,976	77,744
Fair value through other comprehensive income (loss), net after taxes	255	(73)	(34)
Total comprehensive income for the year	<u>56,600</u>	<u>86,903</u>	<u>77,710</u>

The accompanying notes are an integral part of the Financial Statements

Statements of Changes in Reserves and Head Office Account

	Loan from Head Office NIS thousands	Capital reserve from allocation of Head Office costs and share- based plans NIS thousands	Accumulated other comprehensive Income (loss) NIS thousands	Accumulated profits NIS thousands	Total NIS thousands
Balance as at					
December 31, 2016	8,026	45,937	51	376,522	430,536
Changes during 2017:					
Profit for the year	-	-	-	77,744	77,744
Net other comprehensive loss	-	-	(34)	-	(34)
Transactions with Head Office	(8,026)	(731)	-	-	(8,757)
Balance as at					
December 31, 2017	-	45,206	17	454,266	499,489
Changes in accounting policy – IFRS 9 impact	-	-	-	(16,555)	(16,555)
	-	45,206	17	437,711	482,934
Changes during 2018:					
Profit for the year	-	-	-	86,976	86,976
Net other comprehensive income	-	-	(73)	-	(73)
Transactions with Head Office	-	864	-	-	864
Balance as at					
December 31, 2018	-	46,070	(56)	524,687	570,701
Changes during 2019:					
Profit for the year	-	-	-	56,345	56,345
Net other comprehensive income	-	-	255	-	255
Transactions with Head Office	-	263	-	-	263
Balance as at					
December 31, 2019	-	46,333	199	581,032	627,564

The accompanying notes are an integral part of the Financial Statements.

Notes to the Financial Statements as at December 31, 2019 (Audited)

Note 1 - General

1. HSBC Bank Plc operates in Tel Aviv as a Branch of HSBC Bank Plc, a UK bank (hereinafter "the Branch").
2. The Branch in Tel Aviv was incorporated as a foreign entity in Israel and commenced operations at the beginning of March 2001.

Note 2 - Principal Accounting Policies

A. General

1. Since January 1, 2005, the Branch prepares its financial statements in accordance with International Financial Reporting Standards as adopted by the Group (hereafter - "IFRS"). For the years ended in December 31, 2019, 2018 and 2017, the effects on the Branch's net profit of the differences between generally accepted accounting principles prescribed in IFRS and those prescribed in the directives and guidelines of the Supervisor of Banks in Israel were immaterial, other than those reported in Note 3.
The financial statements are presented in accordance with International Financial Reporting Standards (hereinafter - IFRS) after taking into account the directives and guidelines of the Supervisor of Banks in Israel and leniencies granted by him.
2. The financial statements are presented on a nominal basis. This is in accordance with the leniencies granted to the Branch by the Supervisor of Banks in Israel. In addition, statements of cash flows are not presented in these financial statements.

B. Foreign currency and linkage

1. Monetary assets and liabilities in foreign currency or linked thereto, are included in the financial statement, according to the exchange rate in the Group's international treasury systems as at the balance sheet date.
2. Transactions in foreign currency are translated to market exchange rates prevailing at the end of the related business days.
3. Foreign currency differences arising on retranslation are recognized in the statements of Profit and Loss.

C. Use of estimates and assumptions

The preparation of financial information requires the use of estimates and assumptions about future conditions. The use of available information and the application of judgment are inherent in the formation of estimates. Actual results in the future may differ from those reported as a result of the use of estimates and assumptions about future conditions.

Notes to the Financial Statements as at December 31, 2019 (Audited)

Note 2 - Principal Accounting Policies (cont'd)**D. Valuation of financial instruments**

All financial instruments are initially recognised at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, if there is a difference between the transaction price and the fair value of financial instruments whose fair value is based on a quoted price in an active market or a valuation technique that uses only data from observable markets, the Branch recognises the difference as a trading gain or loss at inception (a 'day 1 gain or loss'). In all other cases, the entire day 1 gain or loss is deferred and recognised in the income statement over the life of the transaction either until the transaction matures or is closed out or the valuation inputs become observable.

The fair value of financial instruments is generally measured on an individual basis. However, in cases where the Branch manages a group of financial assets and liabilities according to its net market or credit risk exposure, the fair value of the group of financial instruments is measured on a net basis but the underlying financial assets and liabilities are presented separately in the financial statements, unless they satisfy the IFRS offsetting criteria.

E. Financial instruments measured at amortised cost

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

The Branch may commit to underwriting loans on fixed contractual terms for specified periods of time. When the loan arising from the lending commitment is expected to be held for sale, the commitment to lend is recorded as a derivative. When the Branch intends to hold the loan, the loan commitment is included in the impairment calculations set out below.

F. Financial assets measured at fair value through other comprehensive income

Financial assets held for a business model that is achieved by both collecting contractual cash flows and selling and which contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest are measured at fair value through other comprehensive income ('FVOCI'). They are recognised on the trade date when the Branch enters into contractual arrangements to purchase and are normally derecognised when they are either sold or redeemed.

They are subsequently remeasured at fair value and changes therein (except for those relating to impairment, interest income and foreign currency exchange gains and losses) are recognised in other comprehensive income until the assets are sold. Upon disposal, the cumulative gains or losses in other comprehensive income are recognised in the income statement as 'Gains less losses from financial instruments'. Financial assets measured at FVOCI are included in the impairment calculations set out below and impairment is recognised in profit or loss.

Notes to the Financial Statements as at December 31, 2019 (Audited)

Note 2 - Principal Accounting Policies (cont'd)**G. Financial instruments designated at fair value through profit or loss**

Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss (FVPL). A gain or loss on a debt investment that is subsequently measured at FVPL is recognised in profit or loss and presented net within other gains (losses) in the period in which it arises.

H. Impairment of amortised cost

Expected credit losses are recognised for loans to customers, other financial assets held at amortised cost and certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is required for expected credit losses (ECL) resulting from default events that are possible within the next 12 months, or less, where the remaining life is less than 12 months,

('12-month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in 'stage 3'.

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

Notes to the Financial Statements as at December 31, 2019 (Audited)

Note 2 - Principal Accounting Policies (cont'd)**I . Accounting policy applied prior to 1 January 2018 -****Loans to customers**

1. Loans to customers include loans and advances originated by the Branch, and are not classified either as held for sale or designated at fair value. Loans and advances are recognized when cash is advanced to borrowers. They are derecognized when either borrowers repay their obligations or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortized cost using the effective interest method, less impairment losses. Where loans and advances are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment for the hedged risk only.

Loan impairment

It is the Branch's policy to recognize losses for impaired loans promptly where there is objective evidence that impairment of a loan or portfolio of loans has occurred.

There are two basic methods of calculating impairment losses, those calculated on individual loans and those losses assessed on a collective basis. Losses expected as a result of future events, no matter how likely, are not recognized.

a) Individually assessed loans

Impairment losses on individually assessed accounts are determined by an evaluation of the exposures on a case-by-case basis. This procedure is applied to all accounts that are considered individually significant.

An impairment loss is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in profit or loss and reflected in a provision for loss against receivables. Interest income on the impaired asset is recognized using the interest rate that was used to discount the future cash flows for the purpose of measuring the impairment loss.

The specific provision for doubtful debts is prepared on the basis of a prudent assessment of management regarding the losses inherent in the credit portfolio, including in off-balance sheet items. In its assessment management takes into account, inter alia, the risks relating to the financial strength of the borrowers, on the basis of information in its possession with respect to their financial situation, their business activity, their fulfillment of their liabilities and an assessment of the value of the security received from them.

b) Collectively assessed loans and advances

Impairment losses are calculated on a collective basis in two circumstances:

- For homogeneous groups of loans which is not considered individually significant.
- Where loans have been individually assessed and no evidence of loss has been identified.

Notes to the Financial Statements as at December 31, 2019 (Audited)

Note 2 - Principal Accounting Policies (cont'd)**I. Accounting policy applied prior to 1 January 2018 - (Con't)**

These loans are grouped together on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss. This loss covers loans that are impaired at the balance sheet date but which will not be individually identified as such until sometime in the future.

In assessing collective impairment the Branch uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

No provision for collective impairment losses exists as of December 31, 2017.

c) **Reversal of impairment**

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognized, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognized in the income statement.

2. Loans to customers – held for sale

Loans and advances to customers also include syndicated loans arrangements where the Branch is providing the undrawn facility and the subsequent drawn balance and is entitled to sell to other institutions part or all of this commitment/drawn balance. Those loans that the entity intends to sell are classified as held for sale and the commitment to lend is recorded as a derivative. On drawdown, the loan is measured at fair value. The loan is included in the balance sheet as "Loans to customers". Subsequent changes in fair value are recognized in the statement of profit and loss.

3. Trading assets

Treasury bills, debt securities and short positions in securities which have been acquired or incurred principally for the purpose of selling or repurchasing in the near term or they form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking are classified as held-for-trading. These financial assets are recognized on the trade date, when the Branch enters into contractual arrangements with counterparties to purchase or sell the financial instruments, and are normally derecognized when sold. Measurement is initially at fair value, with transaction costs taken to the statement of profit and loss. Subsequently, their fair values are remeasured, and all gains and losses from changes therein are recognized in the statement of profit and loss in "Non Interest financing income (expense)" as they arise.

Notes to the Financial Statements as at December 31, 2019 (Audited)

Note 2 - Principal Accounting Policies (cont'd)**4. Financial investments**

Treasury bills and debt securities intended to be held on a continuing basis, are classified as available for sale.

They are recognized on the trade date when the Branch enters into contractual arrangements to purchase those instruments, and are normally derecognized when either the securities are sold or redeemed.

Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value, and changes therein are recognized in other comprehensive income until the assets are either sold or become impaired. When available-for-sale financial assets are sold, cumulative gains or losses previously recognized in other comprehensive income are recognized in the income statement as 'Non-interest financing income'.

Interest income is recognized over a debt security's expected life. Premiums and/or discounts arising on the purchase of dated debt securities are included in the interest recognized.

J. Determination of fair value

All financial instruments are recognized initially at fair value. The fair value of a financial instrument on initial recognition is normally the transaction price, i.e. the fair value of the consideration given or received. In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Branch recognizes a trading gain or loss on inception of the financial instrument. When unobservable market data have a significant impact on the valuation of financial instruments, the entire initial difference in fair value indicated by the valuation model from the transaction price is not recognized immediately in the statement of profit and loss but is recognized over the life of the transaction on an appropriate basis, or when the inputs become observable, or the transaction matures or is closed out, or when the Branch enters into an offsetting transaction.

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

Fair values of financial instruments may be determined in whole or in part using valuation techniques based on assumptions that are not supported by prices from current market transactions or observable market data, where current prices or observable market data are not available.

Notes to the Financial Statements as at December 31, 2019 (Audited)

Note 2 - Principal Accounting Policies (cont'd)

Factors such as bid-offer spread, credit profile and model uncertainty are taken into account, as appropriate, when fair values are calculated using valuation techniques. Valuation techniques incorporate assumptions that other market participants would use in their valuations, including assumptions about interest rate yield curves, exchange rates, volatilities, and prepayment and default rates.

The amount of change during the period, and cumulatively, in the fair value of loans and advances that is attributable to changes in their credit spread is determined as the amount of change in fair value that is not attributable to changes in market conditions that give rise to market risk.

K. Derivatives and hedge accounting

Derivatives are recognized initially, and are subsequently re-measured, at fair value. Fair values are obtained from quoted market prices in active markets, or by using valuation techniques, including recent market transactions, where an active market does not exist. Valuation techniques include discounted cash flow models and option pricing models as appropriate. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative.

In the normal course of business, the fair value of a derivative on initial recognition is considered to be the transaction price (i.e. the fair value of the consideration given or received). However, in certain circumstances the fair value of an instrument will be evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets, including interest rate yield curves, option volatilities and currency rates.

Hedge accounting

The Branch elected to exercise the accounting policy choice in IFRS9 to remain with IAS 39 hedge accounting.

It is the Branch's policy to document, at the inception of a hedging relationship, the relationship between the hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking the hedge. Such policies also require documentation of the assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair value of hedged items attributable to the hedged risks.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the statement of profit and loss, together with changes in the fair value of the asset or liability or group thereof that are attributable to the hedged risk.

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

Notes to the Financial Statements as at December 31, 2019 (Audited)

Note 2 - Principal Accounting Policies (cont'd)**Hedge effectiveness testing**

To qualify for hedge accounting, IAS 39 requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness). Actual effectiveness (retrospective effectiveness) must also be demonstrated on an ongoing basis. The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed.

For fair value hedge relationships, the Branch utilizes the regression analysis as effectiveness testing methodology.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in achieving offsetting changes in fair value attributable to the hedge risk during the period for which the hedge is designated. For actual effectiveness, the changes in fair value must offset each other in the range of 80 percent to 125 percent for the hedge to be deemed effective.

Hedge ineffectiveness is recognized in the statement of profit and loss in Non Interest financing income (expense).

L. Building and equipment

1. Owned assets

Items of property, plant and equipment are stated at cost less accumulated depreciation (see 2 below) and impairment losses (see 3 below).

2. Depreciation

Depreciation is recognized in profit and loss on a straight-line basis over the estimated useful lives of each part of fixed asset, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset.

3. Building and equipment is subject to review for impairment if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

Notes to the Financial Statements as at December 31, 2019 (Audited)

Note 2 - Principal Accounting Policies (cont'd)**M. employee benefits**

1. Severance Pay

Adequate provisions for severance pay cover the obligations of the Branch for severance pay to its employees. Payments to defined contribution plans where the Branch's obligations under the plans are equivalent to a defined contribution plan are charged as an expense as the employees render service.

2. Defined contribution plans

The Branch has a number of post-employment contribution plans. The plans are usually financed by deposits with insurance companies or with funds placed with local provident and pension funds, and they are classified as defined contribution plans.

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and has no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognized as an expense in the profit and loss and account in the periods during which related services are rendered by employees.

N. Recognition of income and expenses

- Income and expenses are recorded on an accrual basis.
- Derivative financial instruments – see 2K above.
- Loan syndication fees are recognized as revenue when the syndication is completed.

O. Commissions

The Branch earns commission income from a diverse range of services provided to its customers. Commissions are accounted for as follows:

- If the income is an integral part of the effective interest rate of a financial instrument, it is recognized as an adjustment to the effective interest rate and recorded in "Interest income".
- Several referral fees in accordance with SLA agreements are recorded in the Branch's books upon receipt of information from other HSBC entities regarding payments receivable, and not on an accrual basis.
- Income earned on the execution of syndicated transactions is recognized as revenue when the syndication is completed.
- Income earned from the provision of services is recognized as revenue as the services are provided.

Notes to the Financial Statements as at December 31, 2019 (Audited)

Note 2 - Principal Accounting Policies (cont'd)**P. Taxes on income**

Income tax on the profit or loss for the year comprises current tax and deferred tax. Current tax and deferred tax are recognized in the statement of profit and loss except to the extent that it relates to items recognized directly in equity. The related current and deferred taxation for such items is recorded directly in equity as well.

Current taxes - Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantively enacted by the balance sheet date, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities are offset when the Branch intends to settle on a net basis and the legal right to offset exists.

Deferred taxes – Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognized for all taxable temporary differences.

Deferred tax assets are recognized to the extent it is probable that future taxable profit will be available against which deductible temporary differences can be utilized.

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

Value Added Tax - The Branch is deemed a “Financial Institution” under the Value Added Tax Law (VAT). As such, it is subject to VAT on its profit and salaries. VAT levied on salaries paid by “financial institutions” is included in the Statement of Profit and Loss in the item “Salaries and related expenses”.

Q. Share-Based Payments

The Branch enters into equity-settled share-based payment arrangements with its employees as compensation for services provided by employees. Equity-settled share-based payment arrangements entitle employees to receive equity instruments of HSBC.

The vesting period for these schemes may commence before the grant date if the employees have started to render services in respect of the award before the grant date. Expenses are recognized when the employee starts to render service to which the award relates.

Cancellations result from the failure to meet a non-vesting condition during the vesting period, are treated as an acceleration of vesting recognized immediately in the income statement. Failure to meet a vesting condition by the employee is not treated as a cancellation, and the amount of expense recognized for the award is adjusted to reflect the number of awards expected to vest.

Notes to the Financial Statements as at December 31, 2019 (Audited)

Note 2 - Principal Accounting Policies (cont'd)Share plans

Discretionary awards of shares granted under HSBC share plans align the interests of employees with those of shareholders and are designated to defer variable pay. Vesting of awards is generally subject to continued employment with HSBC and is generally staggered over three years.

When an inducement is awarded to an employee on commencement of employment with the Branch and the employee must complete a specified period of service before the inducement vests, the expense is amortized over the period to vesting.

The value of the benefit of awards granted is charged to the statement of profit and loss, and concurrently to Capital reserve from transactions with Head office in respect of share-based plans, according to the vesting period.

Recharge arrangement exists with Head Office accordingly, the Branch records a liability against the capital reserve from transactions with Head office in respect of share-based plans.

This is measured at fair value at the date of grant. As the transaction is on the equity level, the Branch includes the difference between the fair value and the consideration from the transaction in its Capital Reserve.

R. Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided or upon the actual absence of the employee when the benefit is not accumulated.

A liability is recognized for the amount expected to be paid under short-term cash bonus based on management discretion.

The employee benefits are classified as short-term benefits or as other long-term benefits according to the time the liability is due to be settled.

S. Provisions

A provision is recognized 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.

A provision for claims is recognized if, as a result of a past event, the Branch has a present legal or constructive obligation and it is more likely than not that an outflow of economic benefits will be required to settle the obligation and the amount of obligation can be estimated reliably. When the value of time is material, the provision is measured at its present value.

Notes to the Financial Statements as at December 31, 2019 (Audited)

Note 2 - Principal Accounting Policies (cont'd)**T. New Standards and amendments**

Standards and amendments issued by the IASB and adopted by the Branch:

IFRS 16 'Leases'

On 1 January 2019, the Branch adopted the IFRS 16 standard using retrospective approach. The cumulative effect of initially applying the standard was recognised as an adjustment to the opening balance of retained earnings at that date. Comparatives were not restated. The Branch decided not to implement the IFRS 16 for its car leases due to the immaterial amount. The adoption of the standard increased assets by NIS 17 in million and increased financial liabilities by the same amount with no effect on net assets or retained earnings.

On adoption of IFRS 16, the Branch recognised lease liabilities in relation to leases that had previously been classified as 'operating leases' in accordance with IAS 17 'Leases'. These liabilities were recognised in 'other liabilities' and measured at the present value of the remaining lease payments, discounted at the lessee's incremental borrowing rate at 1 January 2019. The associated right of use ('ROU') assets were recognised in 'other assets' and measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments or provisions for onerous leases recognised on the balance sheet at 31 December 2018. In addition, the following practical expedients permitted by the standard were applied:

- reliance was placed on previous assessments on whether leases were onerous;
- operating leases with a remaining lease term of less than 12 months at 1 January 2019 were treated as short-term leases; and
- initial direct costs were not included in the measurement of ROU assets for leases previously accounted for as operating leases.

Note 3 - Compliance with Directives of the Supervisor of Banks

The Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted by the HSBC Group.

Following the implementation of IFRS 9 on January 1, 2018 and in accordance to lenience received from the Supervisor of Banks in Israel the impairment provision according to IFRS 9 supersedes the supplementary loan loss provision according to directives of the Supervisor of Banks. The supplementary loan loss provision as of December 31, 2017 was in the amount of NIS 11,431 thousands and the loan impairment charges and other credit risk provisions according to IFRS 9 as of January 1 2018 was in the amount of NIS 25,157 thousands.

Notes to the Financial Statements as at December 31, 2019 (Audited)**Note 4 - Other Assets****Composition:**

	December 31	
	2019	2018
	NIS thousands	
Prepaid expenses	55	224
Income receivable	977	1,013
Inter-company balances - receivable	7,260	14,054
Deferred taxation	15,091	17,136
Tax advance payments, net	16,313	-
Right Of Use asset, see note 2T	14,509	-
Other debtors and debit balances	340	358
	<u>54,545</u>	<u>32,785</u>

Note 5 - Other Liabilities**Composition:**

	December 31	
	2019	2018
	NIS thousands	
Provisions for salaries and related expenses	16,636	19,497
Commissions received in advance	10,833	13,401
Accrued expenses	1,145	2,488
Inter-company balances – payable	9,775	10,705
Acceptances and endorsements	23,174	16,280
Credit risk provision – IFRS 9 related	13,210	19,925
Tax provision net of tax advances	-	19,394
Lease Liability, see note 2T	15,725	-
Other	1,884	3,296
	<u>92,382</u>	<u>104,986</u>

Notes to the Financial Statements as at December 31, 2019 (Audited)**Note 6 - Salaries and Related Expenses****Composition:**

	For the year ended December 31		
	2019	2018	2017
	NIS thousands		
Salaries	40,675	45,608	43,616
Severance pay, provident funds, pensions and vacation pay	9,188	9,250	9,022
National insurance and salary taxes	10,444	9,871	9,949
Other related expenses	3,521	4,036	3,326
	<u>63,828</u>	<u>68,765</u>	<u>65,913</u>

Note 7 - Other Expenses**Composition:**

	For the year ended December 31		
	2019	2018	2017
	NIS thousands		
Marketing and advertising	389	515	605
Communications	1,895	2,312	2,601
Computer services	6,482	6,477	6,086
Office expenses	426	391	448
Insurance expenses	298	157	265
Professional services	7,389	5,846	7,579
Training	705	584	338
Operating commissions	1,231	1,067	925
Travel & entertainment	1,446	1,396	1,793
Other	3,029	1,583	1,347
	<u>23,290</u>	<u>20,328</u>	<u>21,987</u>

Notes to the Financial Statements as at December 31, 2019 (Audited)

Note 8 - Contingent Liabilities, Commitments and Liens

A. Contractual commitments and guarantees

	December 31	
	2019	2018
	NIS thousands	
Credit Guarantees & Documentary credits	3,110,515	3,228,340
Unutilized committed credit facilities	566,923	982,391

B. Derivative financial instruments

	December 31, 2019			December 31, 2018		
	Stated	Fair value		Stated	Fair value	
	Amount	Assets	Liabilities	Amount	Assets	Liabilities
	NIS thousands			NIS thousands		
Interest Rate contracts -						
Hedging contracts	43,000	-	1,700	105,980	-	1,360
Trading contracts	5,863,326	56,756	62,529	1,143,077	33,673	39,385
Total Interest Rate contracts	5,906,326	56,756	64,229	1,249,057	33,673	40,745
Currency contracts						
Spot, Forward, Swap	18,400,554	84,834	97,756	10,714,680	94,289	95,067
Options - Purchased	1,682,864	9,223	-	1,549,128	13,014	-
Written	1,682,864	-	9,223	1,549,128	-	13,014
Total currency contracts	21,766,283	94,057	106,979	13,812,936	107,303	108,081
Total	27,672,609	150,813	171,208	15,061,993	140,976	148,826

C. Bonds pledged to the Tel Aviv Stock Exchange and Clearing House

The Branch is a member of the Tel Aviv Stock Exchange and Clearing House. In accordance with Clearing House directives, and in order to guarantee transactions under the Branch's responsibility, the Branch pledged bond and cash accounts.

As at December 31, 2019 there were no pledged bonds. The balance of the pledged bonds as at December 31, 2018 totaled NIS 11,446 thousand. The balance of the pledged cash account as at December 31, 2019 totaled NIS 20,070 thousand (at December 31, 2018 totaled NIS 3,565 thousand).

On March 10th, 2019 the Bank executed a pledge agreement in favour of the Bank of Israel. The pledge was granted in order to secure credit & settlement lines granted by Bank of Israel from time to time (including Participation in The ZAHAV Settlement System). The pledge includes a first ranking pledge over the Branch accounts in Bank of Israel and at the Tel Aviv Stock Exchange Clearing House Ltd.

Note 9 - Share-Based Payments

Share plans and annual bonus in shares:

Restricted share awards of HSBC Holdings are allocated to eligible employees of the Branch. The awards are vested within periods of one and five years from date of grant (mainly one to three years). The value of the benefit derived from the above shares to employees is calculated according to their fair value, based on the share price at the grant date.

The value of awards granted is charged to the statement of profit and loss, and concurrently to capital reserve from transactions with Head Office in respect of Share-Based Plans.

When recharge arrangement exists with Head Office, the Branch records a liability against the capital reserve from transactions with Head office in respect of Share-Based Plans.

Note 10 – Taxes on income

In December 2016, the Law for the Amendment of the Income Tax Ordinance (No. 234) was published, enacting a reduction of Corporate Tax rate to 24% as of January 1st, 2017 and to 23% as of January 1st, 2018 onwards.

According to Value Added Tax Order (Tax Rate of Non-Profits and Financial Institutions) - 1992, VAT is imposed on Financial Institutions' profits. The VAT rate is 17%.

Given the Corporate Tax and VAT rates, the effective tax rate (i.e. Corporate Tax and VAT) of the Branch is as follows: 2017 - 35.04%, 2018 and thereafter - 34.19%.

Tax assessments are final through the year ended December 31, 2015 (inclusive).

Note 11 – Subsequent events

Impact of the Coronavirus epidemic

Following the December 2019 outbreak of Coronavirus (COVID-19) in China and after its spread into a large number of other countries, economic activity has suffered in many regions of the world, including in Israel. Among other things, the epidemic disrupted supply chains, suppressed the volume of global transportation activity, prompted the Israeli and other governments worldwide to put in place restrictions on movement and employment, and resulted in a drop in the values of financial assets and commodities on global markets. As a consequence, after the reported period, including due to Coronavirus, the credit risk of some customers of the Branch has increased.

Management of the Branch estimates, based on the information available to it as of the date of approval of the financial statements, that the current events and persistence of declines on markets in Israeli and further afield may have material impact on the business results of the Branch's customers in the short term, which may elevate credit risk, the provision for loan impairment and other credit risk provisions. As factors such as the extent of continued spread or containment of the virus may impact results, as of the date of this report, management is unable to estimate the size of the impact on the Branch's business activity and operating results.