Connecting customers to opportunities for 150 years

HSBC Holdings plc
Strategic Report 2014

HSBC

Overview

Strategic objectives

Business model

Strategic priorities

Outcomes

Directors

Supplementary information

The *Strategic Report 2014* forms part of the *Annual Report and Accounts 2014* for HSBC Holdings plc and is not the Group's statutory accounts. It does not contain the Report of the Directors and it does not contain sufficient information to allow as full an understanding of the results and state of affairs of the Group and of its policies and arrangements concerning Directors' remuneration as would be provided by the full *Annual Report and Accounts 2014*.

Additional information, including commentary on 2013 compared with 2012, may be found in the Form 20-F filed with the US Securities and Exchange Commission ('SEC') and available on www.hsbc.com and www.sec.gov.

Certain defined terms

Unless the context requires otherwise, 'HSBC Holdings' means HSBC Holdings plc and 'HSBC', the 'Group', 'we', 'us' and 'our' refer to HSBC Holdings together with its subsidiaries. Within this document the Hong Kong Special Administrative Region of the People's Republic of China is referred to as 'Hong Kong'. When used in the terms 'shareholders' equity' and 'total shareholders' equity', 'shareholders' means holders of HSBC Holdings ordinary shares and those preference shares and capital securities issued by HSBC Holdings classified as equity. The abbreviations 'US$m' and 'US$bn' represent millions and billions (thousands of millions) of US dollars, respectively.

We use the US dollar as our presentation currency because the US dollar and currencies linked to it form the major currency bloc in which we transact and fund our business. Unless otherwise stated, the information presented in this document has been prepared in accordance with IFRSs.

Who we are

HSBC is one of the largest banking and financial services organisations in the world.

Customers:
51m

Served by:
266,000
employees (257,600 FTE)

Through four global businesses:
- Retail Banking and Wealth Management
- Commercial Banking
- Global Banking and Markets
- Global Private Banking

Located in:
73
countries and territories

Across five geographical regions:
- Europe
- Asia
- Middle East and North Africa
- North America
- Latin America

Offices:
Over 6,100

Global headquarters:
- London

Market capitalisation:
US$182bn

Listed on stock exchanges in:
- London
- Hong Kong
- New York
- Paris
- Bermuda

Shareholders:
216,000 in 127
countries and territories

Our purpose

Our purpose is to be where the growth is, connecting customers to opportunities, enabling businesses to thrive and economies to prosper, and ultimately helping people to fulfil their hopes and realise their ambitions.

Our strategic priorities

We aim to be the world's leading and most respected international bank. We will achieve this by focusing on the needs of our customers and the societies we serve, thereby delivering long-term sustainable value to all our stakeholders.

In 2013, we announced a set of three interconnected and equally weighted priorities for 2014 to 2016 to help us deliver our strategy:

- grow the business and dividends;
- implement Global Standards; and
- streamline processes and procedures.

Each priority is complementary and underpinned by initiatives being undertaken within our day-to-day business. Together they create value for our customers and shareholders, and contribute to the long-term sustainability of HSBC.

How we measure performance

We track our progress in implementing our strategy with a range of financial and non-financial measures or key performance indicators. From 2015, we have revised our targets to better reflect the changing regulatory and operating environment.

Highlights of 2014 are shown on page 3.
For further information on our new targets see page 32.

Rewarding performance

The remuneration of all staff within the Group, including executive Directors, is based on the achievement of financial and non-financial objectives. These objectives, which are aligned with the Group's strategy, are detailed in individuals' annual scorecards. To be considered for a variable pay award, an individual must have fully complied with HSBC Values.

For further information on HSBC Values, see page 10.

Cautionary statement regarding forward-looking statements

The *Strategic Report 2014* contains certain forward-looking statements with respect to HSBC's financial condition, results of operations, capital position and business.

Statements that are not historical facts, including statements about HSBC's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential' and 'reasonably possible', variations of these words and similar expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made. HSBC makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statements.

Written and/or oral forward-looking statements may also be made in the periodic reports to the US Securities and Exchange Commission, summary financial statements to shareholders, proxy statements, offering circulars and prospectuses, press releases and other written materials, and in oral statements made by HSBC's Directors, officers or employees to third parties, including financial analysts.

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward-looking statement. These include, but are not limited to:

- changes in general economic conditions in the markets in which we operate, such as continuing or deepening recessions and fluctuations in employment beyond those factored into consensus forecasts; changes in foreign exchange rates and interest rates; volatility in equity markets; lack of liquidity in wholesale funding markets; illiquidity and downward price pressure in national real estate markets; adverse changes in central banks' policies with respect to the provision of liquidity support to financial markets; heightened market concerns over sovereign creditworthiness in over-indebted countries; adverse changes in the funding status of public or private defined benefit pensions; and consumer perception as to the continuing availability of credit and price competition in the market segments we serve;
- changes in government policy and regulation, including the monetary, interest rate and other policies of central banks and other regulatory authorities; initiatives to change the size, scope of activities and interconnectedness of financial institutions in connection with the implementation of stricter regulation of financial institutions in key markets worldwide; revised capital and liquidity benchmarks which could serve to deleverage bank balance sheets and lower returns available from the current business model and portfolio mix; imposition of levies or taxes designed to change business mix and risk appetite; the practices, pricing or responsibilities of financial institutions serving their consumer markets; expropriation, nationalisation, confiscation of assets and changes in legislation relating to foreign ownership; changes in bankruptcy legislation in the principal markets in which we operate and the consequences thereof; general changes in government policy that may significantly influence investor decisions; extraordinary government actions as a result of current market turmoil; other unfavourable political or diplomatic developments producing social instability or legal uncertainty which in turn may affect demand for our products and services; the costs, effects and outcomes of product regulatory reviews, actions or litigation, including any additional compliance requirements; and the effects of competition in the markets where we operate including increased competition from non-bank financial services companies, including securities firms; and
- factors specific to HSBC, including discretionary RWA growth and our success in adequately identifying the risks we face, such as the incidence of loan losses or delinquency, and managing those risks (through account management, hedging and other techniques). Effective risk management depends on, among other things, our ability through stress testing and other techniques to prepare for events that cannot be captured by the statistical models it uses; and our success in addressing operational, legal and regulatory, and litigation challenges, notably compliance with the DPA.

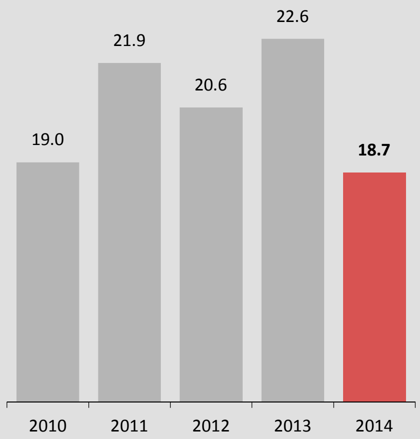
Highlights

- Profit before tax was down 17% to US$18.7bn on a reported basis. Adjusted profit before tax, excluding the effect of significant items and currency translation, was broadly unchanged at US$22.8bn.
- Reinforced HSBC's capital strength. Our CRD IV transitional common equity tier 1 ratio was 10.9% compared with 10.8% at the end of 2013.
- Dividends to shareholders increased to US$9.6bn as capital strength created capacity for organic growth and allowed us to increase the dividends paid.

Profit before taxation
(reported basis)

US$18.7bn

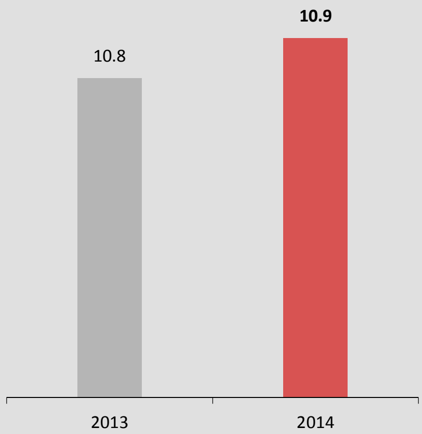
£11.3bn
HK$145bn



Capital strength
(CRD IV common equity tier 1 ratio transitional)[1]

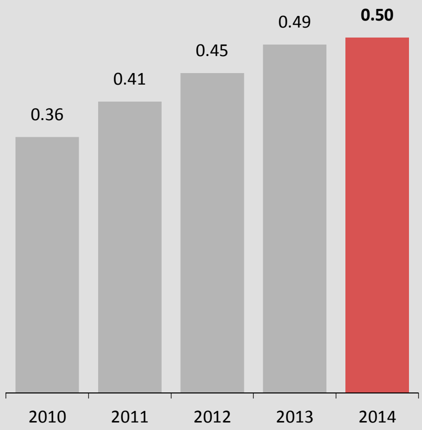
10.9%

At 31 December



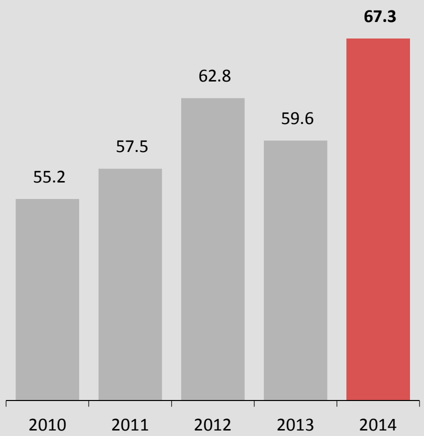
Dividends per ordinary share
(in respect of year)[2]

US$0.50



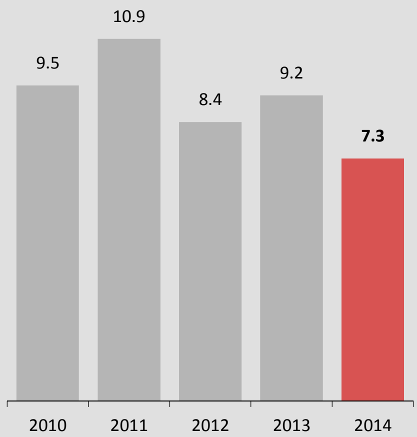
Cost efficiency ratio
(reported basis)[3]

67.3%



Return on average ordinary shareholders' equity[4]

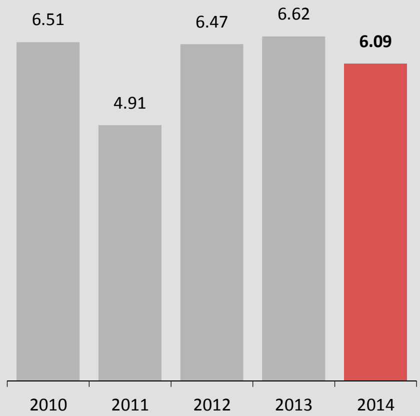
7.3%



Share price
(at 31 December)

£6.09

HK$74.00
US$47.23 American Depositary Share



For a description of the difference between reported and adjusted performance, see page 40 of the Annual Report and Accounts 2014.

For footnotes, see page 39.

Group Chairman's Statement

HSBC's performance in 2014 reflected another year of consolidation in the reshaping and strengthening of the Group against a backdrop of geopolitical and economic headwinds, many of which could not have been foreseen at the outset of the year.

As economic activity in much of the world failed to reach the levels required to rebuild sustainable consumer confidence and prompt renewed investment expenditure, governments most impacted expanded their stimulus measures and the major central banks maintained interest rates at their unprecedented low levels. Concerns over deflationary trends, particularly in the eurozone, grew. Although China delivered growth which comfortably surpassed all other major economies, expectations of slower growth in the future weighed heavily on market sentiment and contributed to significant commodity price falls and further curtailment of global investment spending.

Unsurprisingly in this environment, revenue growth opportunities were strongest in our Asian businesses, with expansion in lending and debt capital financing. Cost progression continued globally in large part to implement regulatory change and enhance risk controls, notably around financial system integrity and conduct. Streamlining initiatives could only partly offset this cost expansion. Further customer redress costs and regulatory penalties around past failings reinforced the Board's continuing commitment to prioritise whatever further investment in systems and controls is necessary to mitigate future repetition.

It is clear now that societal, regulatory and public policy expectations of our industry are changing its long-term cost structure. Technological advancements around data analytics, including 'big data', are providing much more sophisticated tools to enhance our capabilities to protect the financial system from bad actors. Also, as more and more customers choose to transact online and through mobile devices, we are making the necessary investment to protect ourselves and our customers from cyber threats. Building the required analytical capabilities entails considerable investment in systems and in maintaining customer data which is accurate and up to date. Reconfiguring customer and transactional data to the digital age is no small endeavour given legacy systems and a multiplicity of historical data standards globally. The benefits, however, of enhanced customer due diligence capabilities and greater systems security essentially go to the core of our systemic role and allow us to be more proactive in fulfilling that role as a key gatekeeper to the financial system.

As our industry reshapes in response to public policy and regulatory directives, we now need to demonstrate, through clarity of our business model, the value to society of our scale and diversification. We must never forget that investors have choices where to invest and individuals have choices where to make their careers. Thus it is essential that we can demonstrate a positive contribution to the societies we serve in order to bolster the business friendly environment that all agree is essential for economic growth and prosperity.

For 150 years HSBC has been following trade and investment flows to serve customers as they fulfil their financial ambitions. In a world which has moved from being interconnected to being interdependent, our business model is increasingly relevant to companies of all sizes and to individuals whose financial future is linked to economic activity in multiple countries.

This can be seen most markedly in our Commercial Banking business, which delivered a record year buoyed by the expansion of supply chain management solutions and increasing cross-border payment flows. Our network coverage of the countries which originate more than 85% of the world's payment activity drives this key element of our business model. On the investment side, throughout our network we saw corporate flows continuing to target the higher growth emerging markets. At the same time, growth in outward investment from mainland China accelerated as its major companies sought diversification and access to both skill bases and markets. These trends played to HSBC's scale and presence in the key financial centres, allowing us to support customers with debt and equity financing solutions, offering tailored liquidity and transactional banking support and providing risk management solutions primarily against our clients' interest rate and foreign exchange exposures. Success was evidenced by growing recognition in industry awards, the most important of which are referred to in the Group Chief Executive's Review. Finally, our Retail Banking and Wealth Management business continued its journey to build a sustainable customer focused business model, completing the removal of formulaic links between product sales and performance-related pay of our staff, and expanding our digital and mobile offerings.

Performance in 2014

Profit before tax of US$18.7bn on a reported basis was US$3.9bn or 17% lower than that achieved in 2013. This primarily reflected lower business disposal and reclassification gains and the negative effect, on both revenue and costs, of significant items including fines, settlements, UK customer redress and associated provisions. On the adjusted basis that is one of the key metrics used to assess current year management and business performance, profit before tax was US$22.8bn, broadly in line with 2013 on a comparable basis.

Earnings per share were US$0.69, against US$0.84 in 2013. The Group's capital position remained strong with the transitional common equity tier 1 ratio standing at 10.9% at the end of the year, compared with 10.8% 12 months earlier, and our end point ratio at 11.1% compared with 10.9%. Based on this capital strength and the Group's capital generating capabilities, the Board approved a fourth interim dividend in respect of 2014 of US$0.20 per share, taking the total dividends in respect of the year to US$0.50 per share (US$9.6bn, US$0.4bn higher than in respect of 2013).

Taking into account this financial performance, together with the further progress made in reshaping the Group, responding to regulatory change and implementing Global Standards, the Board considered executive management to have made good progress during 2014 towards strengthening HSBC's long-term competitive position.

The Group Chief Executive's Review analyses in detail the important benchmarks and highlights of 2014.

Regulatory landscape becomes clearer but still much to do

A great deal of progress was made during 2014 to finalise the framework under which globally systemic banks like HSBC will be required to operate when it is fully implemented. This clarity is essential if we are to be able to position our global businesses to meet the return expectations of those who invest in us within an acceptable risk appetite.

In particular, major progress was made in addressing the challenge of 'too big to fail', largely through finalising proposals to augment existing loss absorbing capacity with 'bail-inable' debt and through greater definition of how resolution frameworks would operate in practice. In both cases, this involved the critical issue of how to address cross-border implications and home and host country regulatory responsibilities.

There is, however, still much to complete. The regulatory reform agenda for 2015 is very full with pending public policy decisions, regulatory consultations and impact studies in areas of far reaching influence to the structure of our industry. These include the conclusion of structural separation deliberations in Europe, further work on so called 'shadow banking' including identifying non-bank systemically important institutions, addressing the resolution framework for central counterparties, finalising the calibration of the leverage ratio, calibrating the quantum of total loss absorbing capacity to be raised and settling the disposition of that capacity within global groups.

Restoration of trust in our industry remains a significant challenge as further misdeeds are uncovered but it is a challenge we must meet successfully.

In addition, further work will be undertaken on utilising standardised risk weights to overcome regulatory loss of confidence in internally modelled capital measures and a 'fundamental review of the trading book' is also underway within the regulatory community to look again at capital support for this activity. These measures, which in aggregate are designed to make the industry structurally more stable, will take the next five or so years to implement, an indication of the scale of the transformation to be completed.

During 2014, the UK government also confirmed the permanence of the UK bank levy. This was introduced in 2010, in part to address the burden borne by taxpayers from failures during the global financial crisis; in 2014, the cost to HSBC of the levy was US$1.1bn, an increase of US$0.2bn over 2013. 58% of the levy we pay does not relate to our UK banking activity.

Rebuilding trust

Restoration of trust in our industry remains a significant challenge as further misdeeds are uncovered but it is a challenge we must meet successfully. We owe this not just to society but to our staff to ensure they can be rightly proud of the organisation to which they have committed their careers. When commentators extrapolate instances of control failure or individual misconduct to question the culture of the firm it strikes painfully at the heart of our identity.

Swiss Private Bank

The recent disclosures around unacceptable historical practices and behaviour within the Swiss Private Bank remind us of how much there still is to do and how far society's expectations have changed in terms of banks' responsibilities. They are also a reminder of the need for constant vigilance over the effectiveness of our controls and the imperative to embed a robust and ethical compliance culture.

We deeply regret and apologise for the conduct and compliance failures highlighted which were in contravention of our own policies as well as expectations of us.

In response to, and in parallel with, the tax investigations prompted by the data theft more than eight years ago, we have been completely overhauling our private banking business, putting the entire customer base through enhanced due diligence and tax transparency filters. Our Swiss Private Bank customer base and the countries we serve are now both about one-third of the size they were in 2007. In addition, HSBC is already working to implement the OECD's Common Reporting Standard and other measures to foster greater transparency. We cannot change the past. But, looking to the future, we can and must reinforce controls and provide demonstrable evidence of their effectiveness. This forms part of our commitment to Global Standards, to ensure that we will never knowingly do business with counterparties seeking to evade taxes or use the financial system to commit financial crime.

Banking standards

More broadly, following the publication in 2013 of the Parliamentary Commission on Banking Standards, considerable progress has been made in giving effect to its recommendations. The Financial Services (Banking Reform) Act of 2013 provided greater clarity on the accountabilities and responsibilities of management and the Board. We welcome the appointment of Dame Colette Bowe to lead the Banking Standards Review Council and have committed to support her fully in its work. The current Fair and Effective Markets

Review being conducted by the Bank of England, Her Majesty's Treasury and the Financial Conduct Authority is an extremely timely and important exercise to re-establish the integrity of wholesale financial markets.

In terms of our own governance of these areas, the Conduct & Values Committee of the Board that we created at the beginning of 2014 to focus on behavioural issues has established itself firmly as the central support to the Board in these important areas.

Board changes

Since we reported at the interim stage we have taken further steps to augment the skills and experience within the Board and to address succession to key roles.

On 1 January 2015, Phillip Ameen joined the Board and the Group Audit Committee as an independent non-executive Director. Phil was formerly Vice President, Comptroller and Principal Accounting Officer of General Electric Corp. He brings with him extensive financial and accounting experience gained in one of the world's leading international companies as well as a depth of technical knowledge from his long service in the accounting standard setting world. As a serving Director on HSBC's US businesses he also brings further detailed insight to Group Board discussions and enhances the strong links that already exist between the Group Board and its major subsidiaries.

Sir Simon Robertson had previously indicated his intention to retire from the Board at the upcoming AGM. I am delighted to report that Simon has agreed to stay on for at least a further year as Deputy Chairman. He has been a considerable support to me and to Stuart Gulliver, in addition to his role leading the non-executives, and we are all delighted that we shall continue to benefit from his wisdom and experience.

150th anniversary

2015 marks the 150th anniversary of our founding back in Hong Kong and Shanghai as a small regional bank focused on trade and investment. All of us within HSBC owe a huge debt of gratitude and respect to our forebears who charted the course that has taken HSBC to one of the most important institutions serving the financial needs of this interdependent world.

Outlook

It is impossible not to reflect on the very broad range of uncertainties and challenges to be addressed in 2015 and beyond, most of which are outside our control, particularly against a backdrop of patchy economic recovery and limited policy ammunition. Unexpected outcomes arising from current geopolitical tensions, eurozone membership uncertainties, political changes, currency and commodity price realignments, interest rate moves and the effectiveness of central banks' unconventional policies, to name but a few, all could materially affect economic conditions and confidence around investment and consumption decisions. One economic uncertainty stands out for a major financial institution headquartered in the UK, that of continuing UK membership of the EU. Today, we publish a major research study which concludes that working to complete the Single Market in services and reforming the EU to make it more competitive are far less risky than going it alone, given the importance of EU markets to British trade.

There are also many underlying positive trends that shape our thinking about the coming year. We are very encouraged by the trends in outward investment from China, the potential for further liberalisation and internationalisation of the renminbi and the reshaping of the Chinese economy from export dependence to domestic consumption. We are positive on the opportunities that will arise from Capital Markets Union within Europe and the declared focus of the incoming Commission on growth and jobs. The strength of the US economy and the benefits of lower oil prices should be positive drivers of growth. There is much to be gained from successful negotiation of the Transatlantic Trade and Investment Partnership and the Trans-Pacific Partnership. Current attention on funding infrastructure investment globally is potentially of huge significance.

Finally, on behalf of the Board, I want again to express our thanks and gratitude to our 266,000 colleagues around the world who worked determinedly in 2014 to build an HSBC fit for the next 150 years.

D J Flint
Group Chairman

23 February 2015

Group Chief Executive's Review

2014 was a challenging year in which we continued to work hard to improve business performance while managing the impact of a higher operating cost environment.

Profits disappointed, although a tough fourth quarter masked some of the progress made over the preceding three quarters. Many of the challenging aspects of the fourth quarter results were common to the industry as a whole. In spite of this, there were a number of encouraging signs, particularly in Commercial Banking, Payments & Cash Management and renminbi products and services. We were also able to continue to grow the dividend.

Reported profit before tax in 2014 was US$18.7bn, US$3.9bn lower than in the previous year. This reflected lower gains from disposals and reclassifications, and the negative effect of other significant items, including fines, settlements, UK customer redress and associated provisions, totalling US$3.7bn.

Adjusted profit before tax, which excludes the year-on-year effects of currency translation differences and significant items, was US$22.8bn, broadly unchanged on 2013.

Asia continued to provide a strong contribution to Group profits. Middle East and North Africa reported a record profit before tax in 2014. Together, Asia and MENA generated more than 70% of adjusted Group profit before tax.

Commercial Banking also delivered a record reported profit, which is evidence of the successful execution of our strategy. Revenue in CMB continued to grow, notably in our two home markets of Hong Kong and the UK.

Global Banking and Markets performed relatively well for the first three quarters of the year, but, like much of the rest of the industry, suffered a poor fourth quarter. Revenue was lower in 2014, particularly in our Markets businesses, but all other client-facing businesses delivered year-on-year growth.

Revenue was also lower in Retail Banking and Wealth Management, due primarily to the continuing repositioning of the business. However, in our Global Asset Management business we continued our strategy of strengthening collaboration across our global businesses, which helped to attract net new money of US$29bn.

Global Private Banking continues to undergo a comprehensive overhaul which was accelerated from 2011. As part of this overhaul, we are implementing tough financial crime, regulatory compliance and tax transparency measures. In order to achieve our desired business model and informed by our six filters process, we have also sold a number of businesses and customer portfolios, including assets in Japan, Panama and Luxembourg. The number of customer accounts in our Swiss Private Bank is now nearly 70% lower than at its peak. We continued to remodel the Private Bank in 2014, which included the sale of a customer portfolio in Switzerland to LGT Bank. One consequence of this remodelling was a reduction in revenue. We have also grown the parts of the business that fit our new model, attracting US$14bn of net new money in 2014, mostly through clients of Global Banking & Markets and Commercial Banking.

Loan impairment charges were lower, reflecting the current economic environment and the changes we have made to our portfolio since 2011.

Operating expenses were higher due to increased regulatory and compliance costs, inflationary pressures and investment in strategic initiatives to support growth, primarily in Commercial Banking in Asia and Europe. Significant items, which include restructuring costs, were also higher than last year.

We agreed settlements in respect of inquiries by the UK Financial Conduct Authority and the US Commodity Futures Trading Commission into the foreign exchange market in 2014. HSBC was badly let down by a few individuals whose actions do not reflect the vast majority of employees who uphold the values and standards expected of the bank. This matter is now rightly in the hands of the Serious Fraud Office.

Our balance sheet remained strong, with a ratio of customer advances to customer accounts of 72%. Excluding the effects of currency translation, customer loans and advances grew by US$28bn during 2014.

The common equity tier 1 ratio on a transitional basis was 10.9% and on a CRD IV end point basis was 11.1% at 31 December 2014.

Connecting customers to opportunities

2015 is HSBC's 150th anniversary. Founded in Hong Kong in 1865 to finance local and international trade, the bank expanded rapidly to capture the increasing flow of commerce between Asia, Europe and North America. Our ability to connect customers across the world remains central to the bank's strategy today and in 2014 we continued to develop and grow the product areas that rely on international connectivity.

Our market-leading Global Trade and Receivables Finance business remains strong and we were voted best global trade finance bank and best trade finance bank in MENA in the *Global Trade Review* 'Leaders In Trade' Awards.

In Payments and Cash Management, we increased customer mandates and improved client coverage. We were recognised as the best global cash management bank for the third successive year in the 2014 *Euromoney* Cash Management Survey.

Our share of the capital financing market continued to improve and we were ranked number one for debt capital markets in our home markets of the UK and Hong Kong, and number one for Equity Capital Markets in Hong Kong by *Dealogic*. HSBC was also named global bond house of the year, global derivatives house of the year and Asian bond house of the year in the *International Financing Review* Awards 2014.

We consolidated our leadership of the rapidly growing renminbi market in 2014. According to SWIFT, the renminbi is now the fifth most widely used payment currency in the world, up from 13th just two years ago. We increased revenue from renminbi products and retained our ranking as number one issuer of offshore renminbi bonds worldwide over the last twelve months. HSBC was also recognised as the best overall provider for products and services in Asiamoney's Offshore Renminbi Services Survey in 2014, and renminbi house of the year in the 2014 Asia Risk Awards.

Operating a global business

It is already clear that the regulatory costs of operating a global business model have increased since we announced our strategy for HSBC in 2011.

As the Group Chairman's Statement explains, the regulatory environment continues to evolve.

Our commitment to be the world's leading international bank means that improving our regulatory and compliance abilities and implementing Global Standards must remain priorities for HSBC. Our Compliance staff headcount has more than doubled since 2011 and there is more work still to do to strengthen the Group's compliance capability.

At the same time, the level of capital that we hold has increased by over 60% since before the financial crisis. Specifically, we have further strengthened our capital levels in response to increasing capital requirements from the UK Prudential Regulation Authority.

Whilst we expected an increase in the amount of capital we were required to hold when setting targets for the Group in 2011, we could not have foreseen the full extent of the additional costs and capital commitment that would subsequently be asked of us. The pace of change has been exceptional. As a consequence, some of the targets that we set for the Group in 2011 are no longer realistic.

In recognition of that fact, we have set new medium-term targets that better reflect the ongoing operating environment.

We are setting a revised return on equity target of more than 10%. This target is modelled using a common equity tier 1 capital ratio on a CRD IV end point basis in the range of 12% to 13%.

Our cost target will be to grow our revenue faster than costs ('positive jaws') on an adjusted basis.

We are also restating our commitment to grow the dividend. To be clear, the progression of dividends should be consistent with the growth of the overall profitability of the Group and is predicated on our ability to meet regulatory capital requirements in a timely manner.

These targets offer a realistic reflection of the capabilities of HSBC in the prevailing operating environment.

Our employees

I am grateful for the hard work, dedication and professionalism of all of our employees in 2014.

Extensive work was required to prepare HSBC for stress tests in a number of jurisdictions throughout the year, the results of which confirmed the capital strength of the Group. HSBC will face additional stress testing in 2015.

We all have to work continuously to make sure that the Group remains compliant with anti-money laundering and sanctions legislation and this effort continued in 2014.

Management and staff across the Group continued to work very closely with the Monitor to deliver our commitments under the terms of our December 2012 settlement agreements with the US authorities and the UK Financial Conduct Authority. We have now received the second annual report from the Monitor. Whilst it confirmed that we continue to comply with the obligations we undertook in the Deferred Prosecution Agreement with the US Department of Justice, as we expected we still have substantial work to do.

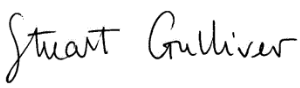
Summary and outlook

The business remains in a good position structurally to capitalise on broader market trends and the macroeconomic backdrop remains favourable, notwithstanding the continuing low interest rate environment. There are still a number of historical issues left to resolve and we will make further progress on these in 2015. We will also continue the work we started in 2011 to simplify the Group to make it easier to manage and control.

Our 2014 results show a business powered by our continued strength in Hong Kong, with significant additional contributions from the rest of Asia and the Middle East and North Africa. The continuing success of Commercial Banking and the resilience of our differentiated Global Banking & Markets business illustrate the effectiveness of our strategy to bridge global trade and capital flows. Retail Banking & Wealth Management remains a work in progress, but we took considerable further steps to de-risk the business in 2014. Global Private Banking continues to attract net new money from clients in our other global businesses. We maintain a sharp focus on generating net savings to offset increased costs arising from inflation, and the cost of implementing global standards.

Our early 2015 performance has been satisfactory.

We continue to focus on the execution of our strategy and on delivering value to shareholders.



S T Gulliver
Group Chief Executive
23 February 2015

Strategic objectives

Value creation and long-term sustainability

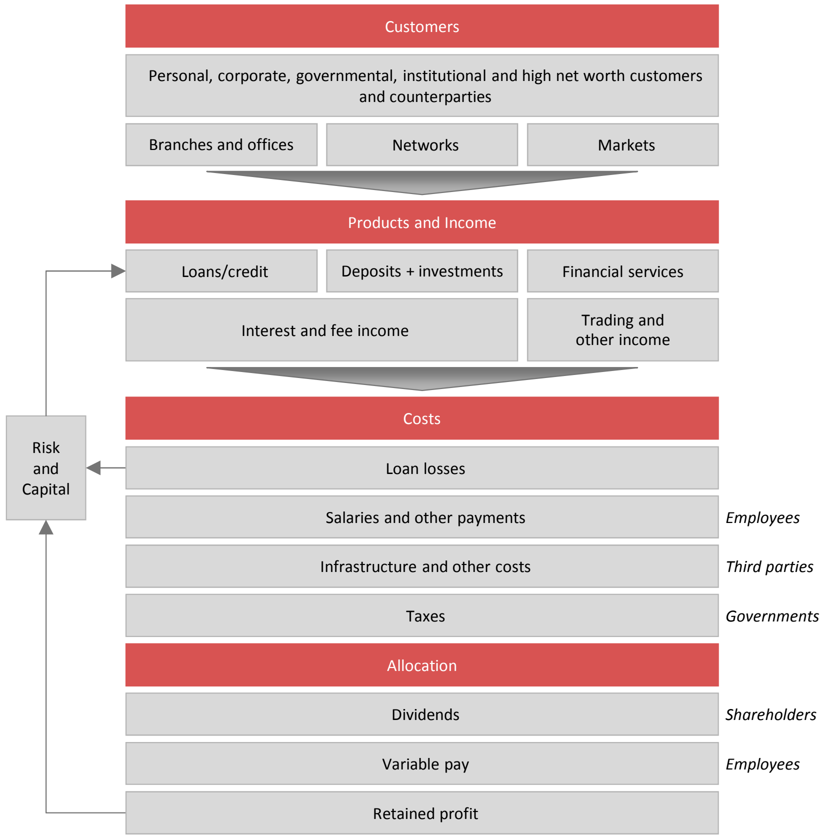
We continue to follow the vision for HSBC we first outlined in 2011 along with the clear strategy that will help us achieve it. Our strategy guides where and how we seek to compete. We constantly assess our progress against this strategy and provide regular updates to stakeholders.

Through our principal activities – making payments, holding savings, enabling trade, providing finance and managing risks – we play a central role in society and in the economic system. Our target is to build and maintain a business which is sustainable in the long term.

How we create value

Banks, and the individuals within them, play a crucial role in the economic and social system, creating value for many parties in different ways.

Value creation



We provide a facility for customers to securely and conveniently deposit their savings. We allow funds to flow from savers and investors to borrowers, either directly or through the capital markets. The borrowers use these loans or other forms of credit to buy goods or invest in businesses. By these means, we help the economy to convert savings which may be individually short-term into financing which is, in aggregate, longer term. We bring together investors and people looking for investment funding. We develop new financial products. We also facilitate personal and commercial transactions by acting as payment agent both within countries and internationally. Through these activities, we take on risks which we then manage and reflect in our prices.

Our direct lending includes residential and commercial mortgages and overdrafts, and term loan facilities. We finance importers and exporters engaged in international trade and provide advances to companies secured on amounts owed to them by their customers.

We also offer additional financial products and services including broking, asset management, financial advisory services, life insurance, corporate finance, securities services and alternative investments. We make markets in financial assets so that investors have confidence in efficient pricing and the availability of buyers and sellers. We provide these products for clients ranging from governments to large and mid-market corporates, small and medium-sized enterprises, high net worth individuals and retail customers. We help customers raise financing from external investors in debt and equity capital markets. We create liquidity and price transparency in these securities allowing investors to buy and sell them on the secondary market. We exchange national currencies, helping international trade.

We offer products that help a wide range of customers to manage their risks and exposures through, for example, life insurance and pension products for retail customers and receivables finance or documentary trade instruments for companies. Corporate customers also ask us to help with managing the financial risks arising in their businesses by employing our expertise and market access.

An important way of managing risks arising from changes in asset and liability values and movements in rates is provided by derivative products such as forwards, futures, swaps and options. In this connection, we are an active market-maker and derivative counterparty. Customers use derivatives to manage their risks, for example, by:

- using forward foreign currency contracts to hedge their income from export sales or costs of imported materials;
- using an inflation swap to hedge future inflation-linked liabilities, for example, for pension payments;
- transforming variable payments of debt interest into fixed rate payments, or vice versa; or
- providing investors with hedges against movements in markets or particular stocks.

We charge customers a spread, representing the difference between the price charged to the customer and the theoretical cost of executing an offsetting hedge in the market. We retain that spread at maturity of the transaction if the risk management of the position has been effective.

We then use derivatives along with other financial instruments to constrain the risks arising from customer business within risk limits. Normally, our customers both buy and sell relevant instruments, in which case our focus is on managing any residual risks through transactions with other dealers or professional counterparties. Where we do not fully hedge the residual risks we may gain or lose money as market movements affect the net value of the portfolio.

Stress tests and other risk management techniques are also used to ensure that potential losses remain within our risk appetite under a wide range of potential market scenarios.

In addition, we manage risks within HSBC, including those which arise from the business we do with customers.

For further information on our risks, see page 21, and on how we manage them, see page 24.

Long-term sustainability

At HSBC, we understand that the continuing financial success of our business is closely connected to the economic, environmental and social landscape in which we operate. For us, sustainability means building our business for the long term by balancing social, environmental and economic considerations in the decisions we make. This enables us to help businesses thrive, reward shareholders and employees, pay taxes and duties in the countries in which we operate and contribute to the health and growth of communities. Achieving a sustainable return on equity and long-term profit growth is built on this foundation.

How we do business is as important as what we do: our responsibilities to our customers, employees and shareholders as well as to wider society go far beyond simply being profitable. These include our consistent implementation of the highest standards everywhere we operate to detect, deter and protect against financial crime.

Sustainability underpins our strategic priorities and enables us to fulfil our purpose. Our ability to identify and address environmental, social and ethical developments which present risks or opportunities for the business contributes to our financial success. Sustainable decision-making shapes our reputation, drives employee engagement and affects the risk profile of the business – and can help reduce costs and secure new revenue streams.

Our international presence and the long-established position of many of our businesses in HSBC's home and priority growth markets, when combined with our wide-ranging portfolio of products and services, differentiate HSBC from our competitors and give our business and operating models an inherent resilience. This has enabled the Group to remain profitable through the most turbulent of times for our industry, and we are confident that the models will continue to stand us in good stead in the future and will underpin the achievement of our strategic priorities.

Our business and operating models are described in more detail on page 12. For further information about sustainability at HSBC, see page 36.

HSBC Values

Embedding HSBC Values in every decision and every interaction with customers and with each other is a top priority for the Group and is shaping the way we do business.

The role of HSBC Values in daily operating practice is fundamental to our culture, and is particularly important in light of developments in regulatory policy, investor confidence and society's expectations of banks. HSBC Values are integral to the selection, assessment, recognition, remuneration and training of our employees. We expect our executives and employees to act with courageous integrity in the execution of their duties in the following ways:

HSBC Values

Be dependable and do the right thing

- stand firm for what is right, deliver on commitments, be resilient and trustworthy;
- take personal accountability, be decisive, use judgement and common sense, empower others.

Be open to different ideas and cultures

- communicate openly, honestly and transparently, value challenge, learn from mistakes;
- listen, treat people fairly, be inclusive, value different perspectives.

Be connected with our customers, communities, regulators and each other

- build connections, be externally focused, collaborate across boundaries;
- care about individuals and their progress, show respect, be supportive and responsive.

Our strategy

Long-term trends

Our strategy is aligned to two long-term trends:

- The world economy is becoming ever more interconnected, with growth in world trade and cross-border capital flows continuing to outstrip growth in average gross domestic product. Over the next decade we expect growth in trade and capital flows to outstrip GDP growth and 35 markets to generate 85% of world trade growth with a similar degree of concentration in cross-border capital flows.
- Of the world's top 30 economies, we expect those of Asia, Latin America, the Middle East and Africa to have increased by around four-fold in size by 2050, benefiting from demographics and urbanisation. By this time they will be larger than those of Europe and North America combined. By 2050, we expect 18 of the 30 largest economies will be from Asia, Latin America or the Middle East and Africa.

Competitive advantages

What matters in this environment is:

- having an international network and global product capabilities to capture international trade and movements in capital; and
- being able to take advantage of organic investment opportunities in the most attractive growth markets and maintaining the capacity to invest.

HSBC's competitive advantages come from:

- our meaningful presence in and long-term commitment to our key strategic markets;
- our business network, which covers over 85% of global trade and capital flows;
- our balanced business portfolio centred on our global client franchise;
- our strong ability to add to our capital base while also providing competitive rewards to our staff and good returns to our shareholders;
- our stable funding base, with about US$1.4 trillion of customer accounts of which 72% has been advanced to customers; and
- our local balance sheet strength and trading capabilities in the most relevant financial hubs.

A two-part approach

Responding to these long-term trends, we have developed a two-pronged approach that reflects our competitive advantages:

- A network of businesses connecting the world. HSBC is well positioned to capture growing international trade and capital flows. Our global reach and range of services place us in a strong position to serve clients as they grow from small enterprises into large multi-nationals through our Commercial Banking and Global Banking and Markets businesses.
- Wealth management and retail with local scale. We aim to capture opportunities arising from social mobility and wealth creation in our priority growth markets across Asia, Latin America and the Middle East, through our Premier proposition and Global Private Banking business. We expect to invest in full scale retail businesses only in markets where we can achieve profitable scale.

Business model

Market presence

Our business model is based on an international network connecting and serving a cohesive portfolio of markets.

Our comprehensive range of banking and related financial services is provided by operating subsidiaries and associates. Services are primarily delivered by domestic banks, typically with local deposit bases.

The UK and Hong Kong are our home markets, and a further 19 countries form our priority growth markets (see below). These 21 markets accounted for over 90% of our profit before tax in 2014, and are the primary focus of capital deployment. Network markets are markets with strong international relevance which serve to complement our international presence, operating mainly through Commercial Banking and Global Banking and Markets. Our combination of home, priority growth and network markets covers around 85% of all international trade and financial flows.

The final category, small markets, includes those where our operations are of sufficient scale to operate profitably, or markets where we maintain representative offices.

Our legal entities are regulated by their local regulators and on a Group-wide basis we are regulated from the UK by the Prudential Regulation Authority ('PRA') for prudential matters (safety and soundness) and by the Financial Conduct Authority ('FCA') for conduct (consumer and market protection).

HSBC's markets

	Asia	Europe	Middle East and North Africa	North America	Latin America
Home markets	– Hong Kong	– UK			
Priority growth markets	– Australia – Mainland China – India – Indonesia – Malaysia – Singapore – Taiwan	– France – Germany – Switzerland – Turkey	– Egypt – Saudi Arabia – UAE	– Canada – USA	– Argentina – Brazil – Mexico
Network markets	– Operations primarily focused on international clients and businesses of Commercial Banking and Global Banking and Markets – Together with home and priority growth markets these cover around 85% of international trade and capital flows				
Small markets	– Markets where HSBC has profitable scale and focused operations – Representative Offices				

Investment criteria

We use six filters to guide our decisions about when and where to invest. The first two – international connectivity and economic development – determine whether the business is strategically relevant. The next three – profitability, efficiency and liquidity – determine whether the financial position of the business is attractive. The sixth filter – the risk of financial crime – governs our activities in high risk jurisdictions, and is applied to protect us by restricting the scope of our business where appropriate.

Decisions over where to invest additional resources have three components:

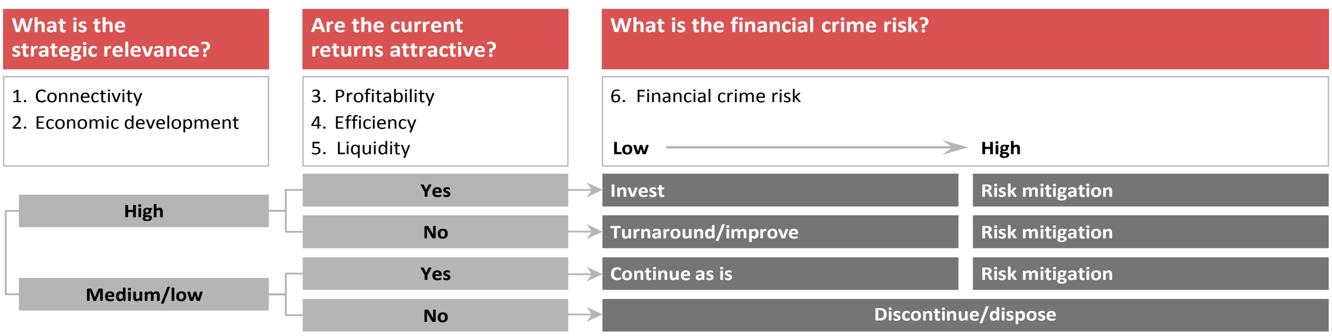
– Strategic: we will only invest in businesses aligned to our strategy, mostly in our home and priority growth markets and in target businesses and clients;

– Financial: the investment must be value accretive for the Group, and must meet minimum returns, revenue and cost hurdles; and

– Risk: the investment must be consistent with our risk appetite.

We conduct an annual geographic and business portfolio review following the six filter approach to update our market and business priorities.

Using the six filters in decision-making



Organisation

Our operating model is based on a matrix management structure comprising global businesses, geographical regions and global functions.

The matrix is overlaid on a legal entity structure headed by HSBC Holdings plc.

Holding company

HSBC Holdings, the holding company of the Group, is the primary source of equity capital for its subsidiaries and provides non-equity capital to them when necessary.

Under authority delegated by the Board of HSBC Holdings, the Group Management Board ('GMB') is responsible for the management and day-to-day running of the Group, within the risk appetite set by the Board. GMB works to ensure that there are sufficient cash resources to pay dividends to shareholders, interest to bondholders, expenses and taxes.

HSBC Holdings does not provide core funding to any banking subsidiary, nor is it a lender of last resort and does not carry out any banking business in its own right. Subsidiaries operate as separately capitalised entities implementing the Group strategy.

Global management structure

The following table lists our four global businesses, five geographical regions and 11 global functions, and summarises their responsibilities under HSBC's management structure.

For details of our principal subsidiaries see Note 22 on the Financial Statements. A simplified Group structure chart is provided on page 462 of the Annual Report and Accounts 2014.

Global management structure

HSBC Holdings plc

Global businesses	Geographical regions	Global functions
– Retail Banking and Wealth Management – Commercial Banking – Global Banking and Markets – Global Private Banking	– Europe – Asia – Middle East and North Africa – North America – Latin America	– Communications – Company Secretaries – Corporate Sustainability – Finance – HSBC Technology and Services – Human Resources – Internal Audit – Legal – Marketing – Risk (including Compliance) – Strategy and Planning
Responsible for setting globally consistent business strategies and operating models and issuing planning guidance regarding their businesses, and are accountable for their profit and loss performance and for managing their headcount.	Share responsibility for executing business strategies set by the global businesses. They represent the Group to customers, regulators, employee groups and other stakeholders; allocate capital; manage risk appetite, liquidity and funding by legal entity; and are accountable for profit and loss performance in line with global business plans.	Establish and manage all policies, processes and delivery platforms relevant to their activities, are fully accountable for their costs globally and are responsible for managing their headcount.

Legal entities

Operate under their own boards of directors as separately capitalised entities, implementing Group strategy and delivering Group products and services. They are required to consider risk and maintain a capital buffer consistent with the Group's risk appetite for their relevant country or region. They manage their own funding and liquidity within parameters set centrally.

Structural Reform

Banking structural reform and recovery and resolution planning

Globally there have been a number of developments relating to banking structural reform and the introduction of recovery and resolution regimes.

As recovery and resolution planning has developed, some regulators and national authorities have also required changes to the corporate structures of banks. These include requiring the local incorporation of banks or ring-fencing of certain businesses. In the UK, ring-fencing legislation has been enacted requiring the separation of retail and small and medium-sized enterprise ('SME') deposits from trading activity (see below). Similar requirements have been introduced or are in the process of being introduced in other jurisdictions.

Policy background to recovery and resolution

Following the financial crisis, G20 leaders requested that the Financial Stability Board ('FSB') establish more effective arrangements for the recovery and resolution of 28 (now 30) designated Global Systemically Important Banks ('G-SIBs'), resulting in a series of policy recommendations in relation to recovery and resolution planning, cross-border co-operation agreements and measures to mitigate obstacles to resolution.

In December 2013, the PRA set out rules for the recovery and resolution of UK banks and international banks operating in the UK. These rules were modified as part of the implementation of the EU Bank Recovery and Resolution Directive from January 2015.

HSBC resolution strategy and corporate structure changes

We have been working with the Bank of England, the PRA and our other primary regulators to develop and agree a resolution strategy for HSBC. It is our view that a resolution strategy whereby the Group breaks up at a subsidiary bank level at the point of resolution (referred to as a Multiple Point of Entry strategy) rather than being kept together as a Group at the point of resolution (referred to as a Single Point of Entry strategy) is the optimal approach as it is aligned to our existing legal and business structure.

In common with all G-SIBs, we are working with our regulators to understand inter-dependencies between different businesses and subsidiary banking entities in the Group in order to enhance resolvability.

We have initiated plans to mitigate or remove critical inter-dependencies to further facilitate the resolution of the Group. In particular, in order to remove operational dependencies (where one subsidiary bank provides critical services to another), we have determined to transfer such critical services from the subsidiary banks to a separately incorporated group of service companies ('ServCo group'). The ServCo group will be separately capitalised and funded to ensure continuity of services in resolution. A significant portion of the ServCo group already exists and therefore this initiative involves transferring the remaining critical services still held by subsidiary banks into the ServCo group. The services will then be provided to the subsidiary banks by the ServCo group.

UK ring-fencing

In December 2013, the UK's Financial Services (Banking Reform) Act 2013 ('Banking Reform Act') received Royal Assent. It implements most of the recommendations of the Independent Commission on Banking ('ICB'), which *inter alia* require large banking groups to 'ring-fence' UK retail banking activity in a separately incorporated banking subsidiary (a 'ring-fenced bank') that is prohibited from engaging in significant trading activity. For these purposes, the UK excludes the Crown Dependencies. Ring-fencing is to be completed by 1 January 2019.

In July 2014, secondary legislation was finalised. This included provisions further detailing the applicable individual customers to be transferred to the ring-fenced bank by reference to gross worth and enterprises to be transferred based on turnover, assets and number of employees. In addition, the secondary legislation places restrictions on the activities and geographical scope of ring-fenced banks.

In October 2014, the PRA published a consultation paper on ring-fencing rules in relation to legal structure, governance, and continuity of services and facilities. The PRA intends to undertake further consultations and finalise ring-fencing rules in due course. The PRA also published a discussion paper concerning operational continuity in resolution.

As required by the PRA's consultation paper, a provisional ring-fencing project plan was presented to the UK regulators in November 2014. This plan provided for ring-fencing of the activities prescribed in the legislation, broadly the retail and SME services that are currently part of HSBC Bank plc ('HSBC Bank'), in a separate subsidiary.

In addition, the plan reflected the operational continuity expectations of each of the PRA's consultation and discussion papers by providing for the proposed enhancement of the ServCo group. The plan remains subject to further planning and approvals internally and is ultimately subject to the approval of the PRA, FCA and other applicable regulators.

European banking structural reform

In January 2014, the European Commission published legislative proposals on the structural reform of the European banking sector which would prohibit proprietary trading in financial instruments and commodities, and enable supervisors, at their discretion, to require certain trading activities to be undertaken in a separate subsidiary from deposit taking activities.

The ring-fenced deposit taking entity would be subject to separation from the trading entity including requirements for separate capital and management structures, issuance of own debt and arms-length transactions between entities.

The draft proposals contain a provision which would permit derogation by member states that have implemented their own structural reform legislation, subject to meeting certain conditions. This derogation may benefit the UK in view of the Banking Reform Act.

The proposals are currently subject to discussion in the European Parliament and the Council. The implementation date for any separation under the final rules would depend upon the date on which the final legislation (if any) is agreed.

Governance

The Board is committed to establishing and maintaining the highest standards of corporate governance wherever we operate. Good corporate governance is critical to HSBC's long-term success and sustainability.

We believe that a robust and transparent corporate governance framework is vital to the sustainable success of HSBC. Strengthening our corporate governance framework to support the successful implementation of our Global Standards programme is a continuing focus for the Board.

Role of the Board and Committees

The strategy and risk appetite for HSBC is set by the Board, which delegates the day-to-day running of the business to the GMB. Risk Management Meetings of the GMB are held in addition to regular GMB meetings.

The key roles of the non-executive committees established by the Board are described in the chart below. The terms of reference of the principal non-executive Board committees are available at www.hsbc.com/boardcommittees.

For further details on Group corporate governance, see page 263 of the Annual Report and Accounts 2014.

The committee structure and governance framework of the HSBC Holdings Board

HSBC Holdings plc
Board of Directors

Group Risk Committee
Non-executive responsibility for oversight of, and advice to the Board on, high level risk-related matters and risk governance.

Group Audit Committee
Non-executive responsibility for oversight of, and advice to the Board on, matters relating to financial reporting and of internal controls over financial reporting.

Group Remuneration Committee
Non-executive responsibility for setting the overarching principles, parameters and governance framework of the Group's remuneration policy and the remuneration of senior executives.

Nomination Committee
Non-executive responsibility for leading the process for Board appointments and for identifying and nominating, for approval by the Board, candidates for appointment to the Board.

Group Management Board
Executive management committee which is responsible for management and day-to-day running of HSBC under the direct authority of the Board.

Financial System Vulnerabilities Committee
Non-executive responsibility for oversight of (i) controls and procedures to identify areas where HSBC and the financial system more broadly may become exposed to financial crime or system abuse, and (ii) HSBC policies and procedures sufficient to ensure the continuing obligations to regulatory and law enforcement agencies are met.

Conduct & Values Committee
Non-executive responsibility for oversight of, and advice to the Board on, HSBC policies, procedures and standards to ensure that the Group conducts business responsibly and consistently adheres to HSBC Values.

Philanthropic and Community Investment Oversight Committee[5]
Non-executive responsibility for the oversight of HSBC's philanthropic and community investment activities in support of the Group's corporate sustainability objectives.

Chairman's Committee
Acts on behalf of the Board between scheduled Board meetings to facilitate ad hoc unforeseen business requiring urgent Board approval.

For footnote, see page 39.

GMB executive committees

Group Management Board

Risk Management Meeting

Provide strategic direction and oversight of enterprise-wide management of all risks through a strong risk governance framework, with particular focus on defining risk appetite and monitoring the risk profile, including assessments of current and emerging risks.

Recommend and/or approve key risk limits, policies and methodologies for the management of risks.

Develop and implement Global Standards reflecting best practices for adoption across the Group.

Global businesses

Our four global businesses are Retail Banking and Wealth Management ('RBWM'), Commercial Banking ('CMB'), Global Banking and Markets ('GB&M') and Global Private Banking ('GPB'). They are responsible for developing, implementing and managing their business propositions consistently across the Group, focusing on profitability and efficiency. They set their strategies within the parameters of the Group strategy in liaison with the geographical regions; are responsible for issuing planning guidance regarding their businesses; are accountable for their profit and loss performance; and manage their headcount.

The main business activities of our global business and their products and services are summarised below.

Main business activities by global business in 2014

Global businesses	RBWM	CMB	GB&M	GPB
Liability driven	– Deposits – Account services	– Deposits – Payments and cash management	– Deposits – Payments and cash management – Balance sheet management	– Deposits – Account services
Asset driven	– Credit and lending	– Credit and lending – International trade and receivables finance	– Credit and lending – Asset and trade finance	– Credit and lending
Fee driven and other	– Asset management – Wealth solutions and financial planning – Broking[6] – Insurance (distribution; life manufacturing)	– Commercial insurance and investments	– Corporate finance[7] – Markets[8] – Securities services	– Investment management[9] – Financial advisory[10] – Broking[6] – Corporate finance (via GB&M)[7] – Alternative investments[11] – Trusts and estate planning

For footnotes, see page 39.

Retail Banking and Wealth Management

Products and services

RBWM takes deposits and provides transactional banking services to enable customers to manage their day-to-day finances and save for the future. We offer credit facilities to assist them in their short or longer-term borrowing requirements and we provide financial advisory, broking, insurance and investment services to help them to manage and protect their financial futures.

We develop products designed to meet the needs of specific customer segments, which may include a range of different services and delivery channels.

RBWM offers four main types of service:

- **HSBC Premier:** we provide a dedicated relationship manager to our mass affluent customers and their immediate families, offering specialist and tailored advice. Customers can access emergency travel assistance, priority telephone banking and an online 'global view' of their Premier accounts around the world.
- **HSBC Advance:** we offer our emerging affluent customers control over their day-to-day finances and access to a range of preferential products, rates and terms. HSBC Advance is also the start of a relationship where we give customers support and guidance to help them to realise their ambitions.
- **Wealth Solutions & Financial Planning:** a financial planning process designed around individual customer needs to help our clients to protect, grow and manage their wealth. We offer investment and wealth insurance products manufactured by Global Asset Management, Markets and HSBC Insurance and by selected third-party providers.
- **Personal Banking:** we provide globally standardised but locally delivered, reliable, easy to understand, good-value banking products and services using global product platforms and globally set service standards.

RBWM delivers services through four principal channels: branches, self-service terminals, telephone service centres and digital (internet and mobile).

Customers

RBWM serves nearly 50 million customers. We are committed to building lifelong relationships with our customers as they move from one stage of their lives to the next, offering tailored products and services appropriate to their diverse goals, aspirations and ambitions. We recognise that some of our customers face financial challenges and, in these cases, we aim to be tolerant, fair and understanding and to support them during difficult times.

We put the customer at the heart of everything we do. We constantly carry out research and invest resources to make sure that customers can access our services conveniently, securely and reliably. We have conducted work to ensure that we sell products that meet their needs and at a price that represents a fair exchange of value between customers and shareholders, and have introduced new incentive programmes that have no formulaic links to sales volumes but are focused on assessing how well we are meeting our customers' needs.

We measure customer satisfaction through an independent market research survey of retail banking customers in selected countries and calculate a Customer Recommendation Index to measure performance. This is benchmarked against average scores of a peer group of banks in each market and we set targets for our business relative to our competitor set of banks. We expect continuous improvements across markets in which we operate. We aim to handle customer complaints promptly and fairly, monitoring trends to further improve our services.

Commercial Banking

Products and services

CMB provides a broad range of banking and financial services to enable customers to manage and grow their businesses domestically and internationally. We aim to be recognised as the leading international trade and business bank by connecting customers to markets and by enhancing collaboration within the Group, both geographically and between global businesses. A global operating model increases transparency, enables consistency, improves efficiency and ensures the right outcomes for our customers.

CMB customer offerings typically include:

- **Credit and Lending:** we offer a broad range of domestic and cross-border financing, including overdrafts, corporate cards, term loans and syndicated, leveraged, acquisition and project finance. Asset finance is also offered in selected countries.
- **Global Trade and Receivables Finance:** we support customers' access to the world's trade flows and provide unrivalled experience in addressing today's most complex trade challenges. Our comprehensive suite of products and services, letters of credit, collections, guarantees, receivables finance, supply chain solutions, commodity and structured finance and risk distribution, can be combined into global solutions that make it easier for businesses to manage risk, process transactions and fund activities throughout the trade cycle.
- **Payments and Cash Management:** we are strategically located where most of the world's payments and capital flows originate. We provide local, regional and global transaction banking services including payments, collections, account services, e-commerce and liquidity management via e-enabled platforms to address the needs of our customers.
- **Insurance and Investments:** we offer business and financial protection, trade insurance, employee benefits, corporate wealth management and a variety of other commercial risk insurance products in selected countries.
- **Collaboration:** our CMB franchise represents a key client base for products and services provided by GB&M, RBWM and GPB, including foreign exchange, interest rate, capital markets and advisory services, payroll and personal accounts services and wealth management and wealth transition services.

HSBC is leading the development of the renminbi as a trade currency, with renminbi capabilities in more than 50 markets.

Our range of products, services and delivery channels is tailored to meet the needs of specific customer segments.

Customers

We have organised ourselves around our customers' needs and their degree of complexity by developing three distinct segments within CMB: Business Banking, Mid-Market and Large Corporates.

- Business Banking now has two distinct needs-based servicing models: relationship managers focused on customers with more complex needs; and portfolio management for customers requiring simpler, more routine products and services.
- We have brought increased focus to our Mid-Market customers and are re-configuring our organisation and resources across our home and priority growth markets to provide enhanced relationship management.
- For our Large Corporate customers, who typically have complex and multi-country needs, we provide globally managed senior coverage teams, who are also able to coordinate with other global businesses.

To ensure that our customers remain at the heart of our business, we continue to place the utmost value on customer feedback and customer engagement. We are now in the 6th year of our Client Engagement Programme, a global survey of 15 markets designed to deepen our understanding of our customers and reinforce our relationship with them. This initiative, combined with other insight programmes, helps us to identify customers' critical business issues so that we can tailor solutions and services offered to better meet their needs.

Building long-term relationships with reputable customers is core to our growth strategy and organisational values.

Global Banking and Markets

Products and services

GB&M provides wholesale capital markets and transaction banking services organised across eight client-facing businesses.

GB&M products and services include:

- Sales and trading services in the secondary market are provided in **Markets**, which includes four businesses organised by asset class:
  - **Credit** and **Rates** sell, trade and distribute fixed income securities to clients including corporates, financial institutions, sovereigns, agencies and public sector issuers. They assist clients in managing risk via interest rate and credit derivatives, and facilitate client financing via repurchase ('repo') agreements.
  - **Foreign Exchange** provides spot and derivative products to meet the investment demands of institutional investors, the hedging needs of small and medium-sized enterprises ('SME's), middle-market enterprises ('MME's) and large corporates in GB&M and CMB, and the needs of RBWM and GPB customers in our branches. Foreign Exchange trades on behalf of clients in over 90 currencies.
  - **Equities** provides sales and trading services for clients, including direct market access and financing and hedging solutions.
- **Capital Financing** offers strategic financing and advisory services focusing on a client's capital structure. Products include debt and equity capital raising in the primary market, transformative merger and acquisition advisory and execution, and corporate lending and specialised structured financing solutions such as leveraged and acquisition finance, asset and structured finance, real estate, infrastructure and project finance, and export credit.
- **Payments and Cash Management** helps clients move, control, access and invest their cash. Products include non-retail deposit taking and international, regional and domestic payments and cash management services.
- **Securities Services** provides custody and clearing services to corporate and institutional clients and funds administration to both domestic and cross-border investors.
- **Global Trade and Receivables Finance** provides trade services on behalf of GB&M clients to support them throughout their trade cycle.

In addition to the above, Balance Sheet Management is responsible for the management of liquidity and funding for the Group. It also manages structural interest rate positions within the Markets limit structure.

Customers

GB&M provides tailored financial solutions to major governmental, corporate and institutional clients worldwide. Managed as a global business with regional oversight, GB&M operates a long-term relationship management approach to build a full understanding of clients' financial requirements and strategic goals.

Client coverage is centralised in Banking, which contains relationship managers organised by sector, region and country who work to understand client needs and provide holistic solutions by bringing together our broad array of product capabilities and utilising our extensive global network.

Our goal is to be a 'Top 5' bank to our priority clients. We strive to achieve this goal by assembling client coverage teams across our geographical network who work alongside product specialists in developing individually tailored solutions to meet client needs. Our client coverage and product teams are supported by a unique customer relationship management platform and comprehensive client planning process. Our teams utilise these platforms to better serve global client relationships, which facilitates our ability to connect clients to international growth opportunities.

Global Private Banking

Products and services

Drawing on the strength of HSBC and the most suitable products from the marketplace, we work with our clients to provide solutions to grow, manage and preserve wealth for today and for the future. Our products and services include Private Banking, Investment Management and Private Wealth Solutions.

GPB products and services include:

- **Private Banking** services comprise multicurrency and fiduciary deposits, account services, and credit and specialist lending. GPB also accesses HSBC's universal banking capabilities to offer products and services such as credit cards, internet banking and corporate and investment banking solutions.
- **Investment Management** comprises advisory and discretionary investment services and brokerage across asset classes. This includes a complete range of investment vehicles, portfolio management, securities services and alternatives.
- **Private Wealth Solutions** comprise trusts and estate planning, designed to protect wealth and preserve it for future generations.

Customers

GPB serves the needs of high net worth and ultra-high net worth individuals and their families in our home and priority growth markets.

Within these broad segments, GPB has teams dedicated to serving HSBC's global priority clients, which include our most significant Group relationships, and other clients who benefit from our private banking proposition and services offered by CMB and GB&M. Our aim is to build and grow connectivity with these customers Group-wide, establishing strong relationships across all global businesses to meet clients' needs. We aim to build on HSBC's commercial banking heritage to be the leading private bank for high net worth business owners.

Relationship managers are the dedicated points of contact for our clients, tailoring services to meet their individual needs. They develop a thorough understanding of their clients – including their family, business, lifestyle and ambitions – and introduce them to specialists equipped to help build the best financial strategy. Specialists include:

- investment advisers, who discuss investment ideas in line with a client's investment and risk profile;
- credit advisers, who provide expertise in complex liquidity and lending requirements; and
- wealth planners, who have the knowledge and expertise to manage wealth now and for future generations.

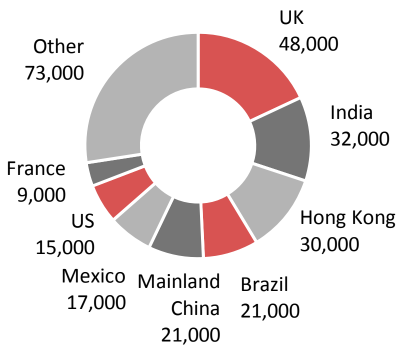
The use of digital platforms continues to grow in line with strong demand from self-directed clients. These platforms enable clients to access account information, investment research and online transactional capabilities directly. We continue to invest in digital systems to better meet clients' evolving expectations and needs.

Employees

Successfully enhancing a values-led high performance culture in HSBC is critical to implementing Global Standards sustainably. We continue to focus on embedding HSBC Values in every decision and interaction between colleagues and with customers.

- We aim to attract, retain and motivate the very best people, and our remuneration policy supports this endeavour.
- We actively manage succession planning by defining the capabilities we need and complement this by identifying talented individuals and ensuring they are provided with appropriate career and development opportunities to fulfil their potential in HSBC.
- We provide training and development opportunities to enable employees to acquire the technical and leadership skills needed to enhance their careers.
- We are committed to a diverse and inclusive culture reflective of our customer base.
- We encourage employees to engage in the local communities in which they work.

At the end of 2014 we had a total workforce of 266,000 full-time and part-time employees compared with 263,000 at the end of 2013 and 270,000 at the end of 2012. Our main centres of employment were as follows (approximate numbers):



Profile of leadership

At the date of this Report, the Executive Management of HSBC consists of four Executive Directors, 11 Group Managing Directors and 60 Group General Managers. Of these, 13 (17%) are female. This leadership team is based in 17 different countries and comprises 13 different nationalities. 71% have served with HSBC for more than 10 years and the total average tenure is 20 years.

HSBC has 13 non-executive Directors.

Employment proposition

HSBC Values

In 2014, education on HSBC Values continued for all levels of employees through induction and other training programmes that covered relevant technical, management and leadership skills. We require a high behavioural standard from all our employees, and our focus on values and courageous integrity continues to be instilled at every level in the Group. For example, our employee induction programme has been refreshed to further reinforce courageous integrity and meeting the needs of our customers. Also, an assessment of adherence to our values and supporting behaviours has been formalised as part of our performance appraisal process for all employees. In 2014, some 145,000 employees received values training in addition to 135,000 employees in 2013. A further 100,000 employees are expected to receive this training in 2015. A number of employees left the Group for breaching our values.

Employee development

The development of employees is essential if our businesses and operations are to strengthen and prosper. We take a systematic approach to identifying, developing and deploying talented employees to ensure we have a robust supply of high calibre individuals with the values, skills and experience for current and future senior management positions.

We keep our approach to training current and under constant review in order to improve the quality of our curricula and ensure employees are equipped with the technical and leadership skills to operate in a global organisation. We are standardising our training to help employees provide a consistently high quality experience for customers in all our markets and support the mitigation of current and emerging risks and the Global Standards programme.

Employee engagement

Strong employee engagement leads to positive commercial outcomes and underpins improved business performance, increased customer satisfaction, higher productivity, talent retention and reduced absenteeism.

We assess our employees' engagement through our Global People Surveys, which were held annually from 2007 to 2011 and biennially thereafter. The latest Survey, in 2013, focused on supporting a values-led high performance culture by assessing if our employees were engaged in the Group's purpose and felt able to deliver on our ambition to become the world's leading international bank.

Our employees' engagement continues to be positive when compared with the financial services industry and sector best-in-class benchmark. The overall engagement score in 2013 was 68%, which was four percentage points ahead of the financial services industry norm and eight points behind the best-in-class benchmark. Strong scores were registered in risk awareness (81% and nine points above best-in-class benchmark), leadership capability (67%) and living the HSBC Values (77%). Employee development significantly improved from six points below best-in-class in 2011 to three points above in 2013. Aspects that required attention included pride and advocacy, which were 12 and 13 points, respectively, below best in class norms and had fallen from 2011 levels. The next Global People Survey will be conducted in 2015.

HSBC also conducts a regular survey, Snapshot, which is sent to one quarter of our employees every three months. Insights from Snapshot provide a timely indication of employee sentiment towards the organisation, including signifiers of engagement. As at the end of September 2014, the favourable responses to selected questions were: support for HSBC's strategy, 81%; intend to still be working at HSBC in three years' time, 74%; pride in working for HSBC, 79%; and willingness to recommend HSBC to other senior professionals as a great place to further their career, 68%. Aspects for further attention include helping employees see the positive effects of HSBC's strategic priorities, 62%.

Succession planning

Our talent strategy aims to ensure that high-quality candidates are available to fill key positions and meet business needs across all areas of the Group. We directly align succession planning with talent management, individual development and career planning. The succession plan defines the number, distribution, types of roles and capabilities needed by HSBC, and talented individuals are then aligned to these roles. This approach in turn defines the individual's career path and development plan. In 2014, we assessed 104 senior employees with the potential to become leaders and determined their career development needs. Potential successors must demonstrate an understanding of our Global Standards and exemplify HSBC Values.

Our talent strategy supports our aspirations in emerging markets, where in 2014 the representation of those defined as talent was 34%. We closely monitor local nationals identified as short-term and medium-term successors to key leadership roles so as to improve the proportion of local nationals in senior management over the medium term.

Diversity and inclusion

HSBC is committed to a diverse and inclusive culture where employees can be confident their views are encouraged, their concerns are attended to, they work in an environment where bias, discrimination and harassment on any matter (including gender, age, ethnicity, religion, sexuality and disability) are not tolerated, and advancement is based on merit. Our diversity helps us support our increasingly diverse customer base and acquire, develop and retain a secure supply of skilled and committed employees.

Oversight of our diversity and inclusion agenda resides with senior executives on the Group Diversity Committee, complemented by a number of subsidiary People/Diversity Committees. We have over 55 employee network groups representing gender, ethnicity, age, sexuality, disability, religion, culture, working parents, health and community volunteering. These groups are instrumental in driving an inclusive culture and maintaining effective dialogue between management and employees.

Gender balance

An area of continued focus is gender representation, particularly at senior levels of our organisation. We are addressing bias in hiring, promotions and talent identification, expanding mentoring and sponsorship, introducing better support for returning parents and increasing flexible working opportunities.

The gender balance for HSBC Directors and employees at 31 December 2014 was as follows:

Gender balance

	Headcount		
	Male	**Female**	**Total**
Executive Directors	4	–	4
Non-executive Directors	6	6	12
Directors	10	6	16
Senior employees	6,719	2,076	8,795
Other employees	120,496	136,966	257,462
Total	127,225	139,048	266,273

	%		
	Male	**Female**	**Total**
Executive Directors	100	–	100
Non-executive Directors	50.0	50.0	100
Directors	62.5	37.5	100
Senior employees	76.4	23.6	100
Other employees	46.8	53.2	100
Total	47.8	52.2	100

Overall, Group-wide female representation was 52.2% at 31 December 2014, largely unchanged on 2013. Female representation at senior levels rose from 22.7% in 2013 to 23.6% in 2014, and our target is to improve this to 25% by 2015. The proportion of females in our talent pipeline improved from 32.2% in 2013 to 34.0% in December 2014 and female representation on the GMB was 20% (three out of fifteen) in December 2014.

The average age of our employees was 36.2 years and average tenure was 8.5 years.

Unconscious bias

It is recognised that social behaviour may be driven by stereotypes that operate automatically and therefore unconsciously. These stereotypes can lead to a less inclusive environment. We are addressing this by incorporating inclusive behaviours in our processes and continue to deliver 'unconscious bias' training to 8,700 managers and 18,500 employees in 2014 (8,300 managers and 50,000 employees in 2013).

In 2015, our diversity and inclusion priorities will continue to address unconscious bias through targeted education, encourage the career development of diverse talent with a continued emphasis on gender and local nationals and extend inclusion to cover wider aspects of diversity, for example, sexual orientation, ethnicity and disability. We continue to enhance a bias-free approach to performance management and improve internal and external candidate lists, connecting and utilising our Employee Resource Network Groups globally and maintaining a consistent global framework of governance and sponsorship to drive a diverse and inclusive culture throughout the Group.

Health, welfare and safety

We regard the physical and psychological health, welfare and safety of our people as being of the utmost importance. We recently introduced a global occupational health framework which requires the proactive management of employee welfare and encourages the sharing of best practice across the Group. Between August 2012 and the end of 2014, 96% of assigned HSBC employees carried out our bi-annual online health and safety training.

We run a number of employee assistance programmes tailored to local requirements. Skilled professional counsellors are available on free phone lines 24 hours a day and seven days a week to help employees manage personal or work-related problems that create stress and affect their work. Free face-to-face counselling is also provided, as is support for partners and dependents. Programmes are offered in the UK, Hong Kong, North America and India.

Whistleblowing

HSBC operates a global Compliance disclosure line (telephone and email) which is available to allow employees to make disclosures when the normal channels for airing grievances or concerns are unavailable or inappropriate. The Compliance disclosure line is available to capture employee concerns on a number of matters, including breaches of law or regulation, allegations of bribery and corruption, failure to comply with Group policies, suspicions of money laundering, breaches of internal controls and fraud or deliberate error in the financial records of any Group company. Global Regulatory Compliance is responsible for the operation of the Compliance disclosure line and the handling of disclosure cases. Cases are reviewed and referred for appropriate investigation. Whistleblowing cases may also be raised directly with senior executives, line managers, Human Resources and Security and Fraud.

Additional local whistleblowing lines are in place in several countries, operated by Security and Fraud, Human Resources and Regulatory Compliance. Disclosures made on the local whistleblowing lines are escalated to Global Regulatory Compliance or Financial Crime Compliance. Global Regulatory Compliance also monitors an external email address for complaints regarding accounting and internal financial controls or auditing matters (accountingdisclosures@hsbc.com highlighted under Investor Relations and Governance on www.hsbc.com). Cases received are escalated to the Group Chief Accounting Officer, Group Finance Director or Group Chief Executive as appropriate.

HSBC's policies and procedures for capturing and responding to whistleblowing disclosures relating to accounting or auditing matters are overseen by the Group Audit Committee. Those relating to other whistleblowing disclosures are overseen by the Conduct & Values Committee.

Disclosures and actions taken are reported on a periodic basis to the Conduct & Values Committee, Group Audit Committee and the Financial System Vulnerabilities Committee in respect of matters relating to financial crime compliance.

Risk overview

All our activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risk or combinations of risks.

As a provider of banking and financial services, we actively manage risk as a core part of our day-to-day activities. We employ a risk management framework at all levels of the organisation, underpinned by a strong risk culture and reinforced by HSBC Values and our Global Standards. It ensures that our risk profile remains conservative and aligned to our risk appetite, which describes the type and quantum of risk we are willing to accept in achieving our strategic objectives.

Risk and our strategic priorities

The Group's three strategic priorities are reflected in our management of risk.

Grow the business and dividends – we ensure risk is maintained at an acceptable and appropriate level while creating value and generating profits.

Implement Global Standards – we are transforming how we detect, deter and protect against financial crime through the deployment of Global Standards, which govern how we do business and with whom.

Streamline processes and procedures – our disposal programme has made HSBC easier to manage and control. By focusing on streamlining our processes and procedures, we are making HSBC less complex and complicated to operate, creating capacity for growth.

Our business and operating models are described on page 12. For further information on Global Standards, see page 26.

Risk in 2014

Concerns remained during 2014 over the sustainability of economic growth in both developed and emerging markets, while geopolitical tensions rose or remained high in many parts of the world.

We continued to sustain a conservative risk profile based on our core philosophy of maintaining balance sheet, liquidity and capital strength by reducing exposure to the most likely areas of stress:

– we managed selectively our exposures to sovereign debt and bank counterparties to ensure that the overall quality of the portfolio remained strong;

– we regularly assessed higher risk countries and sectors and adjusted our risk appetite, limits and exposures accordingly;

– we use stress testing, both internal and regulatory programmes, to assess vulnerabilities and proactively adjust our portfolios, where required;

– we continued to reposition and exit certain portfolios through our six filters process (see page 12) and our focus on certain products or customer segments;

– we made our client selection filters more robust in managing the risk of financial crime; and

– we mitigated risks, for example reputational and operational, when they were forecast to exceed our risk appetite.

The diversification of our lending portfolio across global businesses and geographical regions, together with our broad range of products, ensured that we were not overly dependent on a limited number of countries or markets to generate income and growth.

We monitored a range of key risk metrics in 2014 as part of our risk appetite process, supported by a limit and control framework.

Risk appetite is discussed on page 25.

Our approach to stress testing is discussed on page 117 and regulatory stress testing programmes on page 124 of the Annual Report and Accounts 2014.

Risks incurred in our business activities

Our principal banking risks are credit risk, liquidity and funding risks, market risk, operational risk, compliance risk, fiduciary risk, reputational risk, pension risk and sustainability risk. We also incur insurance risk.

The chart overleaf provides a high level guide to how our business activities are reflected in our risk measures and in the Group's balance sheet. The third-party assets and liabilities indicate the contribution each business makes to the balance sheet, while RWAs illustrate the relative size of the risks incurred in respect of each business.

For a description of our principal risks, see page 114 of the Annual Report and Accounts 2014.

Exposure to risks arising from the business activities of global businesses

HSBC

	RBWM	CMB	GB&M	GPB	Other (including Holding Company)
Global business	RBWM	CMB	GB&M	GPB	Other (including Holding Company)
Business activities	– Deposits – Accounts services – Credit and lending – Asset management – Wealth solutions and financial planning – Broking – Insurance (distribution; life manufacturing)	– Deposits – Payments and cash management – Credit and lending – International trade and receivables finance – Commercial insurance and investments	– Deposits – Payments and cash management – Balance sheet management – Credit and lending – Asset and trade finance – Corporate finance – Markets – Securities services	– Deposits – Account services – Credit and lending – Investment management – Financial advisory – Broking – Corporate finance (via GB&M) – Alternative investments – Trusts and estate planning	– HSBC holding company and central operations
Balance sheet [12]	US$bn – Assets 499 – Customer accounts 581	US$bn – Assets 373 – Customer accounts 364	US$bn – Assets 1,840 – Customer accounts 319	US$bn – Assets 88 – Customer accounts 85	US$bn – Assets 165 – Customer accounts 1
RWAs	US$bn – Credit risk 168 – Operational risk 37	US$bn – Credit risk 399 – Operational risk 33	US$bn – Credit risk 326 – Counterparty credit risk 90 – Operational risk 44 – Market risk 56	US$bn – Credit risk 17 – Operational risk 4	US$bn – Credit risk 45 – Operational risk –
Risk profile	Liquidity and funding risk (page 163), Pension risk (page 200), Fiduciary risk (page 200), Reputational risk (page 199), Compliance risk (page 189), Sustainability risk (page 201) and Insurance risk (page 190). The latter is predominantly in RBWM and CMB.				

For footnote, see page 39.

For further information on credit risk, see page 127; capital and risk-weighted assets, see page 238; market risk, including value at risk, see page 175; and operational risk see page 186 of the Annual Report and Accounts 2014.

Top and emerging risks

Identifying and monitoring top and emerging risks are integral to our approach to risk management.

We define a 'top risk' as being a current, emerged risk which has arisen across any of our risk categories, global businesses or regions and has the potential to have a material impact on our financial results or our reputation and the sustainability of our long-term business model, and which may form and crystallise within a one-year time horizon. We consider an 'emerging risk' to be one with potentially significant but uncertain outcomes which may form and crystallise beyond a year, in the event of which it could have a material effect on our ability to achieve our long-term strategy.

Our top and emerging risk framework enables us to identify and manage current and forward-looking risks to ensure our risk appetite remains appropriate. The ongoing assessment of our top and emerging risks is informed by a comprehensive suite of risk factors which may result in our risk appetite being revised.

During 2014, senior management paid particular attention to a number of top and emerging risks. Our current ones are summarised overleaf.

We made a number of changes to our top and emerging risks during 2014 to reflect our assessment of their effect on HSBC. 'Macroeconomic risks arising from an emerging market slowdown' was replaced by 'Economic outlook and government intervention' as developed economies demonstrated signs of stress in the second half of 2014. 'Third party risk management' was identified as an emerging risk due to the risks associated with the use of third-party service providers, which may be less transparent and more challenging to manage or influence. While 'People risk' is inherent within a number of our top and emerging risks, it has now been disclosed as a standalone risk, as the risks in this area continue to heighten.

When the top and emerging risks listed below resulted in our risk appetite being exceeded, or had the potential to exceed our risk appetite, we took steps to mitigate them, including reducing our exposure to areas of stress. Given the impact on the Group of breaching the US Deferred Prosecution Agreement ('US DPA'), significant senior management attention was given to tracking and monitoring our compliance with its requirements and improving policies, processes and controls to help minimise the risk of a breach.

For a detailed account of these risks see page 118 and for a summary of our risk factors, see page 113 of the Annual Report and Accounts 2014.

Top and emerging risks – T / E

	Risk	Description	Mitigants
Macroeconomic and geopolitical risk			
E	Economic outlook and government intervention	Weak economic growth in both developed and emerging market countries could adversely affect global trade and capital flows and our profits from operations in those countries.	We closely monitor economic developments in key markets and appropriate action is taken as circumstances evolve.
E	Increased geopolitical risk	Our operations are exposed to risks arising from political instability and civil unrest in a number of countries, which may have a wider effect on regional stability and regional and global economies.	We monitor the geopolitical and economic outlook, particularly in countries where we have material exposures and/or a physical presence.
Macro-prudential, regulatory and legal risks to our business model			
T	Regulatory developments affecting our business model and Group profitability	Governments and regulators continue to develop policies which may impose new requirements, particularly in the areas of capital and liquidity management and business structure.	We engage closely with governments and regulators in the countries in which we operate to help ensure that the new requirements are considered properly.
T	Regulatory investigations, fines, sanctions, commitments and consent orders and requirements relating to conduct of business and financial crime negatively affecting our results and brand	Financial service providers are at risk of regulatory sanctions or fines related to conduct of business and financial crime. Breach of the US DPA may allow the US authorities to prosecute HSBC with respect to matters covered thereunder.	Programmes to enhance the management of conduct are progressing in all global businesses and functions. We continue to take steps to address the requirements of the US DPA and other consent orders in consultation with the relevant regulatory agencies.
T	Dispute risk	HSBC is party to legal proceedings arising out of its normal business operations which could give rise to potential financial loss and significant reputational damage.	We identify and monitor emerging regulatory and judicial trends. We are enhancing our financial crime and regulatory compliance controls and resources.
Risks related to our business operations, governance and internal control systems			
T	Heightened execution risk	The complexity of projects to meet regulatory demands and risks arising from business and portfolio disposals may affect our ability to execute our strategy.	We have strengthened our prioritisation and governance processes for significant projects.
T	People risk	Significant demands are being placed on the human capital of the Group due to the extent of the regulatory reform agenda.	We have reviewed our remuneration policy to ensure we can remain competitive and retain our key talent and continue to increase the level of specialist resources in key areas.
E	Third-party risk management	Risks arising from the use of third-party service providers may be less transparent and more challenging to manage or influence.	We are strengthening our risk management processes and procedures in relation to the use and monitoring of third-party service providers.
T	Internet crime and fraud	HSBC is increasingly exposed to fraudulent and criminal activities as a result of increased usage of internet and mobile channels.	We continually assess these threats as they evolve and adapt our controls and defences to mitigate them.
T	Information security risk	HSBC and other multinational organisations continue to be the targets of cyber attacks.	We have invested significantly in staff training and enhanced multi-layered controls to protect our information and technical infrastructure.
T	Data management	New regulatory requirements necessitate more frequent and granular data submissions, which must be produced on a consistent, accurate and timely basis.	Our Data Strategy Board is driving consistent data aggregation, reporting and management across the Group.
T	Model risk	Adverse consequences could result from decisions based on incorrect model outputs or from models that are poorly developed, implemented or used.	Model development, usage and validation are subject to governance and independent review.

How we manage risk

Managing risk effectively is fundamental to the delivery of our strategic priorities.

Our enterprise-wide risk management framework fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions. It also ensures that we have a robust and consistent approach to risk management at all levels of the organisation and across all risk types.

This framework is underpinned by a strong risk culture, which is instrumental in aligning the behaviours of individuals with the Group's attitude to assuming and managing risk and ensuring that our risk profile remains in line with our risk appetite and strategy. It is reinforced by the HSBC Values and our Global Standards.

Our approach to managing risk is summarised below.

Driving our risk culture

Risk Management Framework

Controls	**Role of HSBC Board**	Approves risk appetite, plans and performance targets (page 270).
	Role of Board Committees **Group Risk Committee ('GRC')** **Financial System Vulnerabilities Committee ('FSVC')** **Conduct & Values Committee ('CVC')**	GRC advises on risk appetite, risk governance and other high-level risk related matters (page 280). FSVC advises on financial crime and financial systems abuse (page 282). CVC advises on polices and procedures to ensure we adhere to HSBC Values (page 286). Other sub-committees of the Board are described on page 276.
	Role of senior management	Formulate and implement strategy within risk appetite. Responsible for risk governance and controls.
Process	**Risk appetite**	Describes the risks we are prepared to accept based on our long-term strategy, core risk principles, HSBC Values and risk management competencies (page 205).
	Risk governance framework **Three lines of defence model** **People** **Independent Risk function**	Our risk governance framework ensures appropriate oversight of and accountability for management of risk (page 204). Our risk culture empowers our people to do the right thing for our customers, reinforced by our approach to remuneration (page 34). Our 'Three lines of defence' model defines roles and responsibilities for risk management (page 186). An independent Risk function ensures the necessary balance in risk/return decisions (page 204).
	Risk management processes and procedures **Top and emerging risks** **Risk map** **Stress testing**	Processes to identify, monitor and mitigate risks that exceed our risk appetite (page 117).
	Principal banking and insurance risks	Risks arising from our business activities that are measured, monitored and managed (page 114).

Underpinned by HSBC Values

All page references above are to the Annual Report and Accounts 2014.

Risk appetite

The Group's risk appetite statement ('RAS') is a key component in the management of risk. It describes the types and quantum of risks that we are willing to accept in achieving our medium- and long-term strategic objectives. The RAS is approved by the Board on the advice of the Group Risk Committee.

Our risk appetite is established and monitored via the Group risk appetite framework, which provides a globally consistent and structured approach to the management, measurement and control of risk in accordance with our core risk principles. The framework outlines the processes, policies, metrics and governance bodies and how to address risk appetite as part of day-to-day business and risk management activities.

The RAS guides the annual planning process by defining the desired forward-looking risk profile of the Group in achieving our strategic objectives and plays an important role in our six filters process. Our risk appetite may be revised in response to our assessment of the top and emerging risks we have identified.

Quantitative and qualitative metrics are assigned to a number of key categories including returns, capital, liquidity and funding, securitisations, cost of risk and intra-Group lending, risk categories such as credit, market and operational risk, risk diversification and concentration, and financial crime compliance. These measures are reviewed annually for continued relevance.

Measurement against the metrics:

- guides underlying business activity, ensuring it is aligned to risk appetite statements;
- enables the key underlying assumptions to be monitored and, where necessary, adjusted through subsequent business planning cycles;
- allows the business decisions needed to mitigate risk to be promptly identified; and
- informs risk-adjusted remuneration.

Risk appetite is embedded in day-to-day risk management decisions through the use of risk tolerances and limits for material risk types. This ensures that our risk profile remains aligned with our risk appetite, balancing risk and returns.

Global businesses and geographical regions are required to align their risk appetite statements with the Group's.

Some of the core metrics that were measured, monitored and presented monthly to the Risk Management Meeting of the GMB during 2014 are tabulated below:

Key risk appetite metrics

	2014	
	target	**actual**
Common equity tier 1 ratio[1]	**≥ 10%**	**11.1%**
Return on equity	**Trending upwards to 12-15% by 2016**	**7.3%**
RoRWA[13]	**2.2-2.6%**	**1.5%**
Cost efficiency ratio	**Mid-50s**	**67.3%**
Advances to customer accounts ratio	**Below 90%**	**72.2%**
Cost of risk (loan impairment charges)	**Below 15% of operating income**	**5.4%**

For footnotes, see page 39.

In the early part of 2014, we undertook our annual review of our risk appetite statement. It was approved by the Risk Managament Meeting of the GMB in January 2014 and the HSBC Holdings Board in February 2014. The core aspects of the RAS were incorporated into the 2014 scorecards for the Executive Directors, as set out on page 405 of the *Annual Report and Accounts 2013.*

We also strengthened the Group's RAS in 2014 by incorporating into it measures related to the core financial crime compliance principles of deterrence, detection and protection.

Targets for 2015 are discussed on page 32.

For details of requirements under CRD IV, see page 239 of the Annual Report and Accounts 2014.

How risk affects our performance

The management of risk is an integral part of all our activities. Risk measures our exposure to uncertainty and the consequent variability of return.

Credit metrics in our retail portfolio benefited from the continued sale of non-strategic portfolios, an improved economic environment across many markets and growth in Asia and in the core business in the US, while our wholesale portfolios remained broadly stable with an overall favourable change in key impairment metrics. Loan impairment charges fell for reasons outlined on page 29.

Operational losses rose, driven by UK customer redress programme charges and settlements relating to legal and regulatory matters. There are many factors which could affect estimated liabilities with respect to legal and regulatory matters and there remains a high degree of uncertainty as to the eventual cost of fines, penalties and redress for these matters.

HSBC is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions arising out of our normal business operations. Our provisions for legal proceedings and regulatory matters and for customer remediation at 31 December 2014 totalled US$4.0bn.

The reported results of HSBC reflect the choice of accounting policies, assumptions and estimates that underlie the preparation of our consolidated financial statements and reflect our assessment of the financial impact of risks affecting the Group.

For a description of material legal proceedings and regulatory matters, see Note 40 on the Financial Statements on page 446.

Provisions for legal proceedings and regulatory matters and for customer remediation are disclosed in Note 29 on the Financial Statements on page 420.

For details of operational losses, see page 188.

For details of our critical accounting estimates and judgements, see page 62.

Each of the page references above are to the Annual Report and Accounts 2014.

Strategic priorities

We previously defined three interconnected and equally weighted priorities for 2014 to 2016 to help us deliver our strategy:

- grow the business and dividends;
- implement Global Standards; and
- streamline processes and procedures.

Each priority is complementary and underpinned by initiatives within our day-to-day business. Together, they create value for our customers and shareholders and contribute to the long-term sustainability of HSBC.

In the process, we shall maintain a robust, resilient and environmentally sustainable business in which our customers can have confidence, our employees can take pride and our communities can trust.

Grow the business and dividends

In growing the business and dividends, our targets are to grow risk-weighted assets in line with our organic investment criteria, progressively grow dividends, while reducing the effect of legacy and non-strategic activities on our profit and RWAs.

Our strategy is to take advantage of the continuing growth of international trade and capital flows, and wealth creation, particularly in Asia, the Middle East and Latin America. We aim to achieve growth by leveraging our international network and client franchise to improve HSBC's market position in products aligned to our strategy.

To facilitate this growth, we recycle RWAs from low into high performing businesses within our risk appetite.

In 2014, we launched a number of investment priorities to capitalise on our global network and accelerate organic growth:

- **Global Trade and Receivables Finance:** We are investing in our sales and product capabilities, particularly for high growth products and trade corridors, and expanding in trade hubs as a means of reinforcing HSBC's leading position in trade.
- **Payments and Cash Management:** We aim to deliver improved client coverage and products via investments in better sales coverage and customer proposition and mobile enhancements.
- **Foreign Exchange:** We aim to improve our services to clients and efficiency by improving our electronic trading platforms and capabilities.
- **Renminbi:** Building on our market-leading position, we are investing to roll out our renminbi servicing capabilities internationally, with the aim of capturing a larger share of offshore renminbi foreign exchange and capital markets opportunities.

Industry awards and market share gains have validated our strategy. Our market shares in core international connectivity products such as Payments and Cash Management, Global Trade and Receivables Finance and Foreign Exchange have all improved consistently over the past three years. For three consecutive years, including 2014, HSBC has been voted the top global cash manager for corporate and financial institutions in the *Euromoney* Cash Management survey. In the same survey, HSBC was voted best global cash manager for non-financial institutions for a second consecutive year in 2014. We have also been voted the 'Best Overall for Products and Services' by *Asiamoney* in its Offshore Renminbi Services survey every year since the survey's inception in 2012.

We aim to continue investing in key growth markets and align global resources to city clusters with fast-growing international revenue pools:

- **UK and Hong Kong as our home markets:** Our goal is to strengthen and develop our home market position in key products, such as mortgages and personal lending.
- **China:** Mainland China continues to be of strategic significance for HSBC and presents a structural long-term growth opportunity. We therefore continue to invest in organic growth, particularly in Guangdong and other economically important regions. We strive to invest and be the first to capture opportunities that may arise from regulatory changes such as the introduction of the Shanghai Free-Trade Zone.
- **US and Germany:** We continue to improve our position in the world's largest economy and in Europe's leading trade nation through the expansion of our corporate franchise. In 2014, we broadened our customer base by enhancing our products, widening our geographical coverage and adjusting our risk appetite. International revenues increased through deeper relationships with customers and developing cross-business opportunities.

Our universal banking model enables us to generate revenues across global businesses. In 2014, cross-business collaboration revenues grew in all of our identified opportunities, except for Markets revenue from CMB customers primarily due to lower foreign exchange volatility. Approximately half of the total collaboration revenues for the year came from Markets and Capital Financing products provided to CMB customers. In GPB, net new money resulting from cross-business client referrals doubled from 2013.

Implement Global Standards

At HSBC, we are adopting the highest or most effective financial crime controls and deploying them everywhere we operate.

Two new global policies set out these controls for anti-money laundering ('AML') and sanctions. They are our Global Standards.

In line with our ambition to be recognised as the world's leading international bank, we aspire to set the industry standard for knowing our customers and detecting, deterring and protecting against financial crime. Delivering on this means introducing a more consistent, comprehensive approach to managing financial crime risk – from understanding more about our customers, what they do and where and why they do it, to ensuring their banking activity matches what we would expect it to be.

We aim to apply our financial crime risk standards throughout the lifetime of our customer relationships: from selecting and onboarding customers to managing our ongoing relationships and monitoring and assessing the changing risk landscape in the bank.

Our new global AML policy is designed to stop criminals laundering money through HSBC. It sets out global requirements for carrying out customer due diligence, monitoring transactions and escalating concerns about suspicious activity.

Our new global sanctions policy aims to ensure that we comply with local sanctions-related laws and regulations in countries where we operate, as well as with global sanctions imposed by the UN Security Council, European Union, US, UK and Hong Kong governments.

In many cases, our policy extends beyond what we are legally required to do, reflecting the fact that HSBC has no appetite for business with illicit actors.

We expect our Global Standards to underpin our business practices now and in the future, and to provide a source of competitive advantage. Global Standards are expected to allow us to:

- strengthen our response to the ongoing threat of financial crime;
- make consistent – and therefore simplify – the ways by which we monitor and enforce high standards at HSBC;
- strengthen policies and processes that govern how we do business and with whom; and
- ensure that we consistently apply our HSBC Values.

Implementing Global Standards

Each global business and Financial Crime Compliance have identified where and how they need to enhance existing procedures to meet the Global Standards. They are now in the process of deploying the systems, processes, training and support to put the enhanced procedures into practice in each country of operation.

This is being done in two stages:

- delivering policy components with limited infrastructure dependency according to an accelerated timeline; and
- implementing, in parallel, long-term strategic control enhancements and associated enhancements to infrastructure.

During 2014, we made material progress in a number of areas, including:

- global implementation of customer selection policies and governance;
- first deployment of enhanced customer due diligence procedures for gathering and verifying customer information;
- integration of global sanctions screening lists into our customer and transaction screening tools;
- targeted training for the highest risk roles and all-employee campaigns to raise awareness of financial crime risk and encourage escalation;
- global roll out of financial intelligence and investigations units to follow up on escalations and alerts, and identify emerging trends and issues; and
- the establishment of global procedures and governance to exit business that is outside our financial crime risk appetite.

Governance framework

The global businesses and Financial Crime Compliance, supported by HSBC Technology and Services, are formally accountable for delivering business procedures, controls and the associated operating environment to implement our new policies within each global business and jurisdiction. This accountability is overseen by the Global Standards Execution Committee, which is under the chairmanship of the Group Chief Risk Officer and consists of the Chief Executive Officers of each global business and the Global Head of Financial Crime Compliance.

Correspondingly, and to promote closer integration with business as usual, a report on the implementation of Global Standards is a standing item at the Group's Risk Management Meeting. The Financial System Vulnerabilities Committee and the Board continue to receive regular reports on the Global Standards programme as part of their continued role in providing oversight.

Risk appetite

Financial crime risk controls are a part of our everyday business and they are governed according to our global financial crime risk appetite statement. This aims to ensure sustainability in the long term. Our overarching appetite and approach to financial crime risk is that we will not tolerate operating without the systems and controls in place designed to detect and prevent financial crime and will not conduct business with individuals or entities we believe are engaged in illicit behaviour.

Enterprise-wide risk assessment

We have conducted our second annual enterprise-wide assessment of our risks and controls related to sanctions and AML compliance. The outcome of this assessment has formed the basis for risk management planning, prioritisation and resource allocation for 2015.

The Monitor

Under the agreements entered into with the US Department of Justice ('DoJ'), the UK FCA (formerly the Financial Services Authority ('FSA')) and the US Federal Reserve Board ('FRB') in 2012, including the five-year Deferred Prosecution Agreement ('US DPA'), an independent compliance monitor ('the Monitor') was appointed to evaluate our progress in fully implementing our obligations and produce regular assessments of the effectiveness of our Compliance function.

Michael Cherkasky began his work as the Monitor in July 2013, charged with evaluating and reporting upon the effectiveness of the Group's internal controls, policies and procedures as they relate to ongoing compliance with applicable AML, sanctions, terrorist financing and proliferation financing obligations, over a five-year period.

HSBC is continuing to take concerted action to remedy AML and sanctions compliance deficiencies and to implement Global Standards. HSBC is also working to implement the agreed recommendations flowing from the Monitor's 2013 review. We recognise we are only part way through a journey, being two years into our five-year US DPA. We look forward to maintaining a strong, collaborative relationship with the Monitor and his team.

Streamline processes and procedures

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

Since 2011, we have changed how HSBC is managed by introducing a leaner reporting structure and establishing an operating model with global businesses and functions. These changes – together with improvements in software development productivity, process optimisation and our property portfolio – realised US$5.7bn in sustainable savings, equivalent to US$6.1bn on an annualised (run rate) basis. This exceeded our commitment to deliver US$2.5–3.5bn of sustainable savings at the outset of the organisational effectiveness programme included in the first phase of our strategy.

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

The reorganisation of the Group into four global businesses and eleven global functions further allows us to run globally consistent operating models. This establishes the foundation for our next stage of streamlining.

Going forward, we aim to fund investments in growth and compliance and offset inflation through efficiency gains. This requires net cost reductions. This programme will be applied to:

- improving the end-to-end optimisation of processes and servicing channels;
- technology simplification, reducing the number of applications used across the Group; and
- enhancing infrastructure, including optimising our real estate utilisation and the location where certain activities are carried out.

Streamlining is expected to be achieved through a combination of simplifying and globalising our processes, products, systems and operations. 'Simplifying' involves identifying inefficiencies or excessive complexity and redesigning or rationalising processes to make them easier to understand and manage and more efficient. 'Globalising' involves developing standard global processes and implementing them around the Group.

Cost efficiency ratio

Our cost efficiency ratio for 2014 was 67.3%, up from 59.6% in 2013. This change was driven by higher legal, regulatory and conduct settlement costs; inflationary pressures; continued investment in strategic initiatives; and a rise in the bank levy. Cost increases were partly offset by realised sustainable savings of US$1.3bn.

Outcomes

Financial performance

Performance reflected lower gains on disposals and the negative effect of other significant items.

Reported results

	2014 US$m	2013 US$m	2012 US$m
Net interest income	**34,705**	35,539	37,672
Net fee income	**15,957**	16,434	16,430
Other income	**10,586**	12,672	14,228
Net operating income[14]	**61,248**	64,645	68,330
LICs[15]	**(3,851)**	(5,849)	(8,311)
Net operating income	**57,397**	58,796	60,019
Total operating expenses	**(41,249)**	(38,556)	(42,927)
Operating profit	**16,148**	20,240	17,092
Income from associates[16]	**2,532**	2,325	3,557
Profit before tax	**18,680**	22,565	20,649

For footnotes, see page 39.

Profit before tax of US$18.7bn on a reported basis was US$3.9bn or 17% lower than that achieved in 2013. This primarily reflected lower business disposal and reclassification gains and the negative effect, on both revenue and costs, of other significant items including fines, settlements, UK customer redress and associated provisions.

Reported net operating income before loan impairment charges and other credit risk provisions ('revenue') of US$61bn was US$3.4bn or 5% lower than in 2013. In 2014 there were lower gains (net of losses) from disposals and reclassifications (2013 included a US$1.1bn accounting gain arising from the reclassification of Industrial Bank Co. Limited ('Industrial Bank') as a financial investment following its issue of additional share capital to third parties, and a US$1.1bn gain on the sale of our operations in Panama). In addition, other significant items included adverse fair value movements on non-qualifying hedges of US$0.5bn compared with favourable movements of US$0.5bn in 2013, a US$0.6bn provision arising from the ongoing review of compliance with the Consumer Credit Act in the UK as well as a net adverse movement on debit valuation adjustments on derivative contracts of US$0.4bn. These factors were partially offset by favourable fair value movements of US$0.4bn on our own debt designated at fair value, which resulted from changes in credit spreads, compared with adverse movements of US$1.2bn in 2013 together with a US$0.4bn gain on the sale of our shareholding in Bank of Shanghai in 2014.

Loan impairment charges and other credit risk provisions ('LICs') of US$3.9bn were US$2.0bn or 34% lower than in 2013, notably in North America, Europe and Latin America.

Operating expenses of US$41bn were US$2.7bn or 7% higher than in 2013, primarily as a result of significant items which were US$0.9bn higher than in 2013. These included settlements and provisions in connection with foreign exchange investigations of US$1.2bn and a charge of US$0.6bn in the US relating to a settlement agreement with the Federal Housing Finance Agency.

Income from associates of US$2.5bn was US$0.2bn or 9% higher than 2013, primarily reflecting the non-recurrence of an impairment charge of US$106m on the investment in our banking associate in Vietnam in 2013.

The Board approved a 5% increase in the fourth interim dividend in respect of 2014 to US$0.20 per share, US$0.01 higher than the fourth interim dividend in respect of 2013. Total dividends in respect of 2014 were US$9.6bn (US$0.50 per share), US$0.4bn higher than in 2013.

The transitional CET1 ratio of 10.9% was up from 10.8% at the end of 2013 and our end point basis of 11.1% was up from 10.9% at the end of 2013, as a result of continued capital generation and management actions offset by RWA growth, foreign exchange movements and regulatory changes.

Adjusted performance

For further information on non-GAAP financial measures, see page 40 of the Annual Report and Accounts 2014.

From reported results to adjusted performance

To arrive at adjusted performance:

- we adjust for the year-on-year effects of foreign currency translation; and
- we adjust for the effect of significant items.

Reconciliations of our reported results to an adjusted basis are set out on page 44 of the *Annual Report and Accounts 2014*.

On an adjusted basis, profit before tax of US$23bn was broadly unchanged compared with 2013. Lower LICs, notably in North America, Europe and Latin America, together with a marginal rise in revenue was largely offset by higher operating expenses.

The following commentary is on an adjusted basis.

Revenue was broadly unchanged. Growth in CMB, notably in our home markets of Hong Kong and the UK, was offset by decreased revenue in RBWM, GB&M and GPB

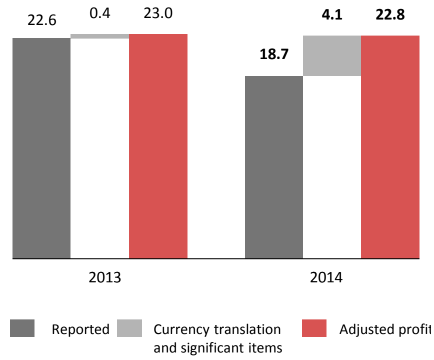
Revenue rose by US$0.1bn to US$62bn. Revenue increased in CMB following growth in average lending and deposit balances in Hong Kong, together with rising average deposit balances and wider lending spreads in the UK. Revenue also benefited from higher term lending fees in the UK.

These factors were mostly offset by lower revenue in RBWM, GB&M and GPB. In RBWM, it was primarily driven by the run-off of our US Consumer and Mortgage Lending ('CML') portfolio with revenue in Principal RBWM broadly unchanged. In GB&M, revenue was lower due to the introduction of the funding fair value adjustment ('FFVA') on certain derivative contracts which resulted in a charge of US$263m, together with a decrease from our Foreign Exchange business, partly offset by an increase in Capital Financing. In GPB, revenue was down reflecting a managed reduction in client assets as we continued to reposition the business, and reduced market volatility.

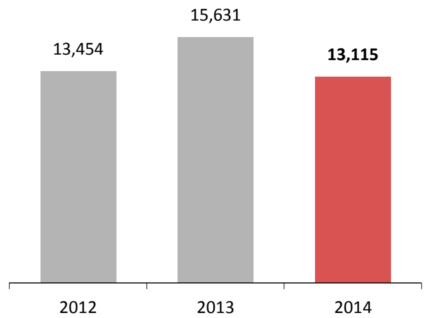
LICs fell in the majority of our regions, notably in North America, Europe and Latin America

LICs were US$1.8bn or 31% lower than in 2013, primarily in North America and mainly in RBWM, reflecting reduced levels of delinquency and new impaired loans in the CML portfolio, together with decreased lending balances from the continued portfolio run-off and loan sales. LICs were also lower in Europe, mainly reflecting a fall in individually assessed charges in the UK in CMB and GB&M, and higher net releases of credit risk provisions on available-for-sale asset-backed securities ('ABS's) in GB&M in the UK. LICs were lower in Latin America too, primarily in Mexico and, to a lesser extent, in Brazil. In Mexico, the decrease in LICs mainly reflected lower individually assessed charges in CMB, while in Brazil LICs were lower in both RBWM and CMB, partly offset by an increase in GB&M.

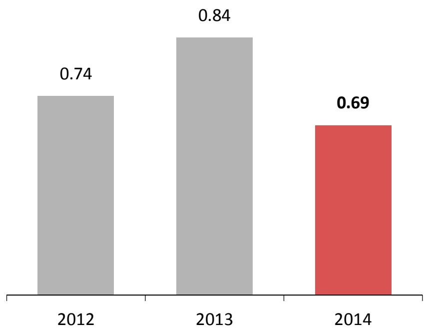
Adjusted profit before tax
(US$bn)



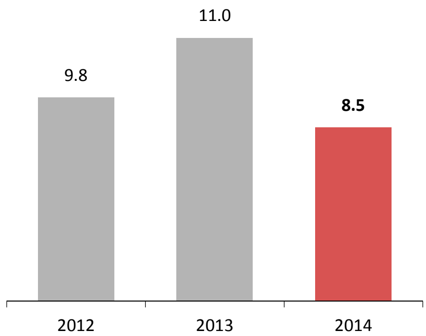
Reported profit attributable to ordinary shareholders
(US$m)



Reported earnings per share
(US$)



Return on tangible equity
(%)



Operating expenses were higher, in part reflecting increases in Regulatory Programmes and Compliance costs and inflation, partly offset by further sustainable cost savings

Operating expenses were US$38bn, US2.2bn or 6% higher than in 2013. Regulatory Programmes and Compliance costs increased as a result of continued focus on Global Standards and the broader regulatory reform programme being implemented by the industry to build the necessary infrastructure to meet today's enhanced compliance standards.

Operating expenses also increased due to inflationary pressures, including wage inflation, primarily in Asia and Latin America, and an increase in the UK bank levy charge compared with 2013. We continued to invest in strategic initiatives in support of organically growing our business, primarily in CMB. We also increased expenditure on marketing and advertising to support revenue generating initiatives, primarily in RBWM.

These factors were partially offset by further sustainable cost savings in the year of US$1.3bn, primarily by re-engineering certain of our back office processes.

The number of employees expressed in full-time equivalent numbers ('FTE's) at the end of 2014 increased by 3,500 or 1%. The average number of FTEs was broadly unchanged as reductions through sustainable savings programmes were offset by the initiatives related to the Regulatory Programmes and Compliance and business growth.

Income from associates rose, mainly in Asia and the Middle East and North Africa

Income from associates increased, primarily reflecting higher contributions from Bank of Communications Co, Limited ('BoCom') and The Saudi British Bank, principally reflecting balance sheet growth.

The effective tax rate was 21.3% compared with 21.1% in 2013.

For more details of the Group's financial performance, see page 46 of the Annual Report and Accounts 2014.

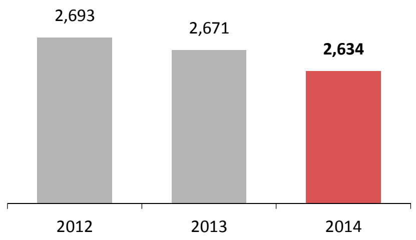
Balance sheet strength

Total reported assets were US$2.6 trillion, 1% lower than at 31 December 2013. On a constant currency basis, total assets were US$85bn or 3% higher. Our balance sheet remained strong with a ratio of customer advances to customer accounts of 72%. This was a consequence of our business model and of our conservative risk appetite, which is based on funding the growth in customer loans with growth in customer accounts.

On a constant currency basis, loans and advances grew by US$28bn and customer accounts increased by US$47bn.

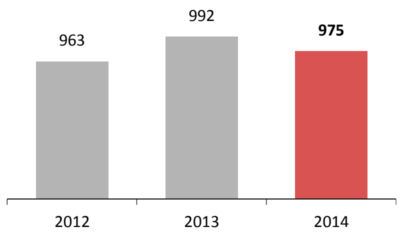
For further information on the Balance Sheet, see page 57, and on the Group's liquidity and funding, see page 163 of the Annual Report and Accounts 2014.

Total assets
(US$bn)

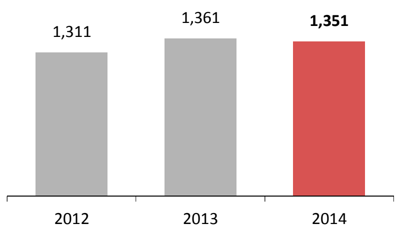


Post-tax return on average total assets
(%)

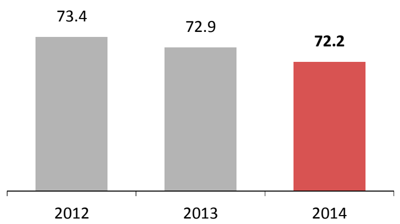
Loans and advances to customers[17]
(US$bn)



Customer accounts[17]
(US$bn)



Ratio of customer advances to customer deposits[17]
(%)



For footnote, see page 39.

Capital strength

Our approach to managing Group capital is designed to ensure that we exceed current regulatory requirements and are well placed to meet those expected in the future.

We monitor capital adequacy, *inter alia*, by using capital ratios, which measure capital relative to a regulatory assessment of risks taken, and the leverage ratio, which measures capital relative to exposure.

In June 2013, the European Commission published the final Regulation and Directive, known collectively as CRD IV, to give effect to the Basel III framework in the EU. This came into effect on 1 January 2014.

Under the new regime, common equity tier 1 ('CET1') represents the highest form of eligible regulatory capital against which the capital strength of banks is measured. In 2014 we managed our capital position to meet an internal target ratio on a CET1 end point basis of greater than 10%. This has since been reviewed and, in 2015, we expect to manage Group capital to meet a medium-term target for return on equity of more than 10%. This is modelled on a CET1 ratio on an end point basis in the range of 12% to 13%.

Leverage ratio

The following table presents our estimated leverage ratio in accordance with PRA instructions. The numerator is calculated using the CRD IV end point tier 1 capital definition and the exposure measure is calculated using the EU delegated act published in January 2015 (which is based on the Basel III 2014 revised definition).

Estimated leverage ratio

	2014 US$bn
At 31 December	
Tier 1 capital under CRD IV (end point)	**142**
Exposures after regulatory adjustment	**2,953**
Estimated leverage ratio (end point)	**4.8%**

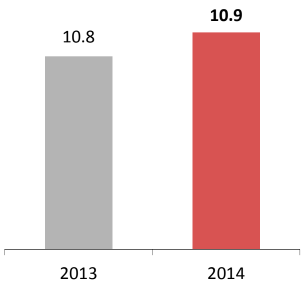
For further details of the leverage ratio, see page 251 of the Annual Report and Accounts 2014.

For further information on the Group's capital and our risk-weighted assets, see page 239 of the Annual Report and Accounts 2014.

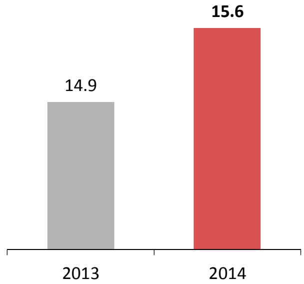
Capital ratios and risk-weighted assets

CRD IV[1]

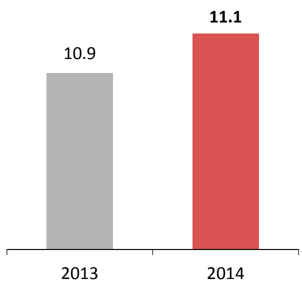
Common equity tier 1 ratio (transitional)
(%)



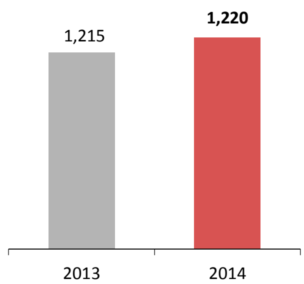
Total capital ratio (transitional)
(%)



Common equity tier 1 ratio (end point)
(%)

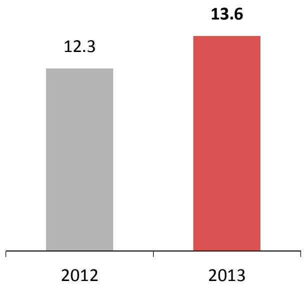


Risk-weighted assets ('RWA's)
(US$bn)

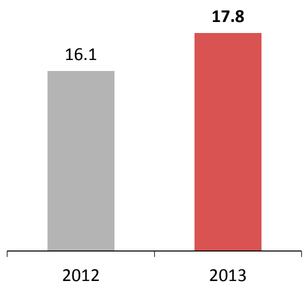


Basel 2.5[1]

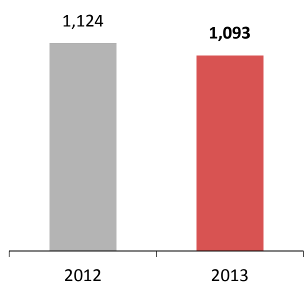
Core tier 1 ratio
(%)



Total capital ratio
(%)



Risk-weighted assets
(US$bn)



For footnote, see page 39.

Meeting our targets

We set financial targets against which we measure our performance.

In 2011, we articulated our ambition to be the leading international bank and specified financial metrics against which we would measure performance through 2013. Targets were set under our understanding at the time of capital requirements and included a CET1 ratio of 9.5-10.5% under Basel III; return on equity ('ROE') of 12-15%; and a cost efficiency ratio ('CER') of 48-52% supported by US$2.5-3.5bn in sustainable cost savings over three years. Over the period to 2013, we strengthened our capital position, realised US$4.9bn in sustainable savings and increased dividend pay-outs to shareholders in line with targets.

In May 2013, we defined our strategic priorities for the period from 2014 to 2016 and revisited the financial metrics used to track performance. We continued to target an ROE of 12-15% and added a further target of US$2-3bn in sustainable savings. To allow for investment in growth initiatives and to reflect the increasing requirements involved in operating as a global bank, we revised the CER target to the mid-50s, adding that revenues must grow faster than costs ('positive jaws'). We defined a target CET1 ratio, on an end point basis, as greater than 10% and continued to seek progressive dividends for shareholders. We also set a cap on our loans to deposits ratio of 90%.

During 2014, we achieved a CET1 ratio on an end point basis of 11.1% and declared US$9.6bn of total dividends in respect of the year. We realised incremental sustainable savings of US$1.3bn and maintained a loans-to-deposits ratio of 72%. The ROE of 7.3% and the CER of 67.3% fell short of our target.

Changing regulatory and operating environment

When we set our targets in 2011, we did so based on a CET1 ratio on an end point basis of greater than 10%. Whilst this factored in foreseeable capital requirements, it did not anticipate, and could not have anticipated, the full extent of capital commitments and additional costs asked of us in the years to come. These factors have included:

- progressively strengthening our capital levels in response to increasing capital requirements;
- the stepped increase in costs due to the implementation of regulatory change and enhancing risk controls, notably around financial system integrity and conduct;
- an increase in the bank levy;
- the continuing low interest rate environment; and
- the impact of significant items, notably the high level of fines, settlements, UK customer redress and associated provisions.

As a consequence, we are setting new targets that better reflect the present and ongoing operating environment.

From 2015, our return on equity target will therefore be replaced with a medium-term target of more than 10%. This is modelled on a CET1 ratio on an end point basis in the range of 12% to 13%.

At the same time, we are reaffirming our target of growing business revenues faster than operating expenses (on an adjusted basis).

We also remain committed to delivering a progressive dividend. The progression of dividends will be consistent with the growth of the overall profitability of the Group and is predicated on our continued ability to meet regulatory capital requirements.

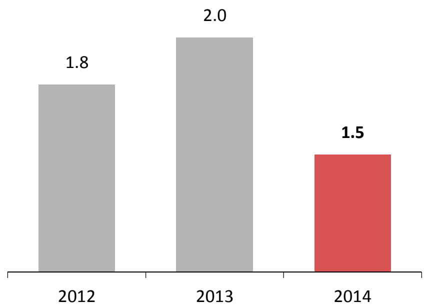
We remain strongly capitalised, providing capacity for both organic growth and dividend return to shareholders.

Brand value

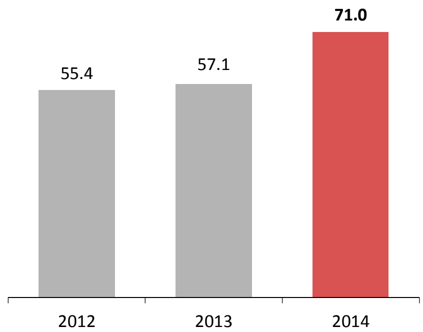
Maintenance of the HSBC brand and our overall reputation remains a priority for the Group.

This is our fourth year of using the Brand Finance valuation method reported in *The Banker* magazine as our brand value benchmark. The Brand Finance methodology provides a comprehensive measure of the strength of the brand and its impact across all business lines and customer segments. It is wholly independent and is publicly reported. Our target is a top three position in the banking peer group and we have achieved this target with an overall value of US$27.3bn

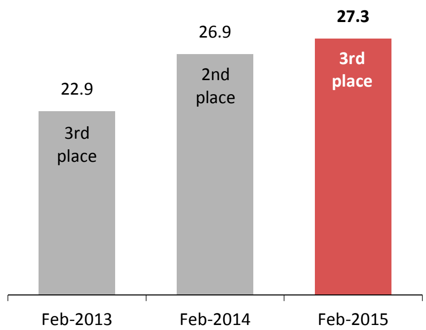
Pre-tax return on risk-weighted assets[13]
(%)



Dividend payout ratio
(%)



Brand value
(US$bn)



For footnote, see page 39.

(up 2% from 2014), placing us third. We maintain an AAA rating for our brand in this year's report.

In addition to the Brand Finance measure, we have reviewed our performance in the *Interbrand* Annual Best Global Brands report, published in September 2014. This showed HSBC as the top ranked banking brand with a valuation of US$13.1bn (up from US$12bn in 2013) and in second place when all financial services brands are considered.

We believe this performance is driven by an underlying strong brand equity established in recent years and a consistent and active programme of activities in support of the brand throughout 2014.

Economic contribution

By running a sustainable business, HSBC is able to make a valuable contribution to the economy by paying dividends to our shareholders, salaries to our employees, payments to suppliers, and tax revenues to governments in the countries and territories where we operate. We also finance companies so that they, in turn, can create employment.

HSBC's net tax paid[18]

	2014 US$bn	2013 US$bn
Tax on profits	**3.6**	4.7
Employer taxes	**1.6**	1.6
UK bank levy[19]	**1.0**	0.7
Irrecoverable value-added tax	**0.9**	0.8
Other duties and levies	**0.8**	0.8
Year ended 31 December	**7.9**	8.6

For footnotes, see page 39.

Taxes collected for government[20]

	2014 US$bn	2013 US$bn
Region		
UK	**1.7**	1.5
Rest of Europe	**1.1**	1.3
Asia	**2.0**	1.5
North America	**1.0**	1.0
Latin America	**3.3**	3.5
Year ended 31 December	**9.1**	8.8

For footnote, see page 39.

Distribution of economic benefits

	2014 US$bn	2013 US$bn	2012 US$bn
Net cash tax outflow	**7.9**	8.6	9.3
Distributions to shareholders and non-controlling interests	**10.6**	10.2	8.7
Employee compensation and benefits	**20.4**	19.2	20.5
General administrative expenses including premises and procurement	**18.6**	17.1	20.0

Pro-forma post-tax profit allocation[21]

	2014 %	2013 %
Retained earnings/capital	**32**	53
Dividends	**53**	35
Variable pay	**15**	12
Year ended 31 December	**100**	100

For footnote, see page 39.

Market capitalisation and total shareholder return

US$0.50 ordinary shares in issue	**Market capitalisation**	Closing market price: London	Closing market price: Hong Kong	Closing market price: American Depositary Share[22]
19,218m	US$182bn	£6.09	HK$74.00	US$47.23
2013: 18,830m	2013: US$207bn	2013: £6.62	2013: HK$84.55	2013: US$55.13
2012: 18,476m	2012: US$194bn	2012: £6.47	2012: HK$81.30	2012: US$53.07

	Total shareholder return[23]: Over 1 year	Over 3 years	Over 5 years
To 31 December 2014	97	144	109
Benchmarks:			
– MSCI Banks[24]	100	160	132

For footnotes, see page 39.

Remuneration

Our remuneration strategy rewards commercial success and compliance with our risk management framework.

The quality of our people and their commitment to the Group are fundamental to our success. We therefore aim to attract, retain and motivate the very best people who are committed to a long-term career with HSBC in the long-term interests of shareholders.

Employee remuneration

Our remuneration strategy is designed to reward competitively the achievement of long-term sustainable performance. HSBC's reward package comprises four key elements of remuneration:

- fixed pay;
- benefits;
- annual incentive; and
- the Group Performance Share Plan ('GPSP').

The governance of our remuneration principles and oversight of their implementation by the Group Remuneration Committee ensures what we pay our people is aligned to our business strategy and performance is judged not only on what is achieved over the short- and long-term but also, importantly, on how it is achieved, as we believe the latter contributes to the long-term sustainability of the business.

Full details of our remuneration policy may be found under Remuneration Policy on our website (http://www.hsbc.com/investor-relations/governance).

Industry changes and key challenges

New regulatory requirements such as the bonus cap have influenced how we pay our senior executives and those of our employees identified by the PRA as having a material impact on the institution's risk profile, being what are termed 'material risk takers' ('MRTs'). This year, a new requirement has been introduced for firms to ensure that clawback (i.e. a firm's ability to recoup paid and/or vested awards) can be applied to all variable pay awards granted on or after 1 January 2015 for a period of at least seven years from the date of award. These requirements present challenges for HSBC in ensuring that the total compensation package for our employees in all of the markets in which we operate around the world remains competitive, in particular, relative to other banks not subject to these requirements.

Looking ahead to 2015/2016, further significant regulatory changes to executive remuneration are expected and it is possible that we will need to make changes to our remuneration policy in 2016. The number and volume of changes that have been and are being proposed hinders our ability to communicate with any certainty to our current and potential employees the remuneration policies and structures that would apply to them. It also contributes to a general misunderstanding about how our policies work and the effect of those policies on employee performance.

For full details of industry changes and key challenges, see page 300 of the Annual Report and Accounts 2014.

Variable pay pool

The total variable pay pool for 2014 was US$3.7bn, down from US$3.9bn in 2013:

	Group	
	2014 US$m	2013 US$m
Variable pay pool[25]		
– total	**3,660**	3,920
– as a percentage of pre-tax profit (pre-variable pay)	**16%**	15%
– percentage of pool deferred	**14%**	18%

For footnote, see page 39.

The Group Remuneration Committee considers many factors in determining HSBC's variable pay pool, including the performance of the Group considered in the context of our risk appetite statement.

This ensures that the variable pay pool is shaped by risk considerations and by an integrated approach to business, risk and capital management which supports achievement of our strategic objectives.

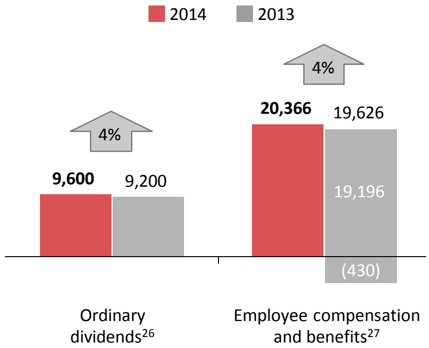
The Group Remuneration Committee also takes into account Group profitability, capital strength, shareholder returns, the distribution of profits between capital, dividends and variable pay, the commercial requirement to remain market competitive and overall affordability.

For full details of variable pay pool determination, see pages 309 of the Annual Report and Accounts 2014.

Relative importance of expenditure on pay

The following chart provides a breakdown of total staff pay relative to the amount paid out in dividends.

Relative importance of expenditure on pay
(US$m)



For footnotes, see page 39.

Directors' remuneration

The remuneration policy for our executive and non-executive Directors was approved at the Annual General Meeting on 23 May 2014. The full policy is available in the Directors' Remuneration Report in the *Annual Report and Accounts 2013*, a copy of which can be obtained by visiting the following website: http://www.hsbc.com/investor-relations/financial-and-regulatory-reports.

The single total figure for Directors' remuneration required by Schedule 8 of the Large and Medium-Sized Companies (Accounts and Reports) Regulations 2008 is as follows:

Executive Directors

	Douglas Flint		Stuart Gulliver		Iain Mackay		Marc Moses	
	2014 £000	2013 £000	**2014 £000**	2013 £000	**2014 £000**	2013 £000	**2014 £000**	2013 £000
Fixed pay								
Base salary	**1,500**	1,500	**1,250**	1,250	**700**	700	**700**	–
Fixed pay allowance	**–**	–	**1,700**	–	**950**	–	**950**	–
Pension	**750**	750	**625**	625	**350**	350	**350**	–
	2,250	2,250	**3,575**	1,875	**2,000**	1,050	**2,000**	–
Variable pay								
Annual incentive	**–**	–	**1,290**	1,833	**867**	1,074	**1,033**	–
GPSP	**–**	–	**2,112**	3,667	**1,131**	2,148	**1,131**	–
	–	–	**3,402**	5,500	**1,998**	3,222	**2,164**	–
Total fixed and variable pay	**2,250**	2,250	**6,977**	7,375	**3,998**	4,272	**4,164**	–
Benefits	**136**	48	**589**	591	**43**	33	**6**	–
Non-taxable benefits	**105**	102	**53**	67	**28**	53	**33**	–
Notional return on deferred cash	**41**	27	**–**	–	**11**	7	**36**	–
Total single figure of remuneration	**2,532**	2,427	**7,619**	8,033	**4,080**	4,365	**4,239**	–

Douglas Flint, as Group Chairman, is not eligible for an annual incentive but was eligible under the policy to receive a one-time GPSP award for 2014.

Marc Moses, the Group Chief Risk Officer, was appointed an executive Director with effect from 1 January 2014, reflecting the criticality of the Risk function to HSBC and his leadership of the function, and recognises his personal contribution to the Group. His 2013 figures have not been disclosed.

For full details of Directors' remuneration, see page 307 of the Annual Report and Accounts 2014.

Remuneration policy going forward

Our remuneration policy was approved by shareholders at the 2014 Annual General Meeting and will apply for performance year 2015. The table below summarises how each element of pay will be implemented in 2015.

External reporting

The required remuneration disclosures for Directors, MRTs and highest paid employees in the Group are made in the Directors' Remuneration Report on pages 300 to 323 of the *Annual Report and Accounts 2014*.

Purpose and link to strategy	Operation and planned changes to policy
Fixed pay	
Base salary	Base salary levels will remain unchanged from their 2014 levels as follows: • Douglas Flint: £1,500,000 • Stuart Gulliver: £1,250,000 • Iain Mackay: £700,000 • Marc Moses: £700,000
Fixed pay allowance[28]	Fixed pay allowances will remain unchanged from their 2014 levels as follows: • Douglas Flint: Nil • Stuart Gulliver: £1,700,000 • Iain Mackay: £950,000 • Marc Moses: £950,000
Pension	Pension allowances to apply in 2015 as a percentage of base salary will remain unchanged as follows: • Douglas Flint: 50% • Stuart Gulliver: 50% • Iain Mackay: 50% • Marc Moses: 50%
Benefits	
Benefits	No changes are proposed to the benefits package for 2015.
Variable pay	
Annual incentive[28]	No changes are proposed to the annual incentive.
GPSP	No changes are proposed to the GPSP.

For footnote, see page 39.

Sustainability

Sustainability underpins our strategic priorities and enables us to fulfil our purpose as an international bank.

At HSBC, how we do business is as important as what we do. For us, sustainability means building our business for the long term by balancing social, environmental and economic considerations in the decisions we make. This enables us to help businesses thrive and contribute to the health and growth of communities.

Approach to corporate sustainability

Corporate sustainability is governed by the Conduct & Values Committee, a sub-committee of the Board which oversees and advises on a range of issues including adherence to HSBC's values and ensuring we respond to the changing expectations of society and key stakeholders.

Sustainability priorities are set and programmes are led by the Global Corporate Sustainability function. HSBC's country operations, global functions and global businesses work together to ensure sustainability is embedded into the Group's business and operations and properly implemented. Executives within the Risk and the HSBC Technology and Services functions hold a specific remit to deliver aspects of the sustainability programme for the Group.

Our sustainability programme focuses on three areas: sustainable finance; sustainable operations, and sustainable communities.

Sustainable finance

We anticipate and manage the risks and opportunities associated with a changing climate, environment and economy. In a rapidly changing world, we must ensure our business anticipates and prepares for shifts in environmental priorities and societal expectations.

Sustainability risk framework

We manage the risk that the financial services which we provide to customers may have unacceptable effects on people or the environment. Sustainability risk can also lead to commercial risk for customers, credit risk for HSBC and significant reputational risk.

For over 10 years we have been working with our business customers to help them understand and manage their environmental and social impact in relation to sensitive sectors and themes. We assess and support customers using our own policies which we regularly review and refine. We have policies covering agricultural commodities, chemicals, defence, energy, forestry, freshwater infrastructure, mining and metals, World Heritage Sites and Ramsar Wetlands. We also apply the Equator Principles.

We welcome constructive feedback from non-governmental organisations and campaign groups and regularly discuss matters of shared interest with them.

Our sustainability risk framework is based on robust policies, formal processes and well-trained, empowered people.

In 2014, we trained risk and relationship managers in sustainability risk, focusing on the recent policy updates and revised processes. Our designated Sustainability Risk Managers provided training to executives from Risk, GB&M and CMB in every geographical region.

We have used the Equator Principles since 2003. A new version of the Equator Principles – EP3 – was launched in 2013, and HSBC introduced these changes on 1 January 2014 following training and the development of clear templates to ensure the transition was smooth.

Data and the independent assurance of our application of the Equator Principles will be available at hsbc.com in April 2015.

Policy reviews and updates in 2014

In 2014, we published the reports of two independent reviews into the content and implementation of our Forest Land and Forest Products Sector Policy, by Proforest and PricewaterhouseCoopers LLP, respectively. We also issued new policies on forestry, agricultural commodities and World Heritage Sites and Ramsar Wetlands, reflecting the recommendations. These documents can be found online at hsbc.com/sus-risk.

Forestry policy

The new forestry policy, issued in March 2014, requires forestry customers to gain 100% certification by the Forest Stewardship Council ('FSC') or the Programme for the Endorsement of Forest Certification ('PEFC') in high risk countries by 31 December 2014. Certification requires that customers are operating legally and sustainably.

Feedback from stakeholders on the new policy was positive. Timber customers from affected countries such as Turkey and Mexico were receptive to the new standards, gained certification as a result of the new requirement and benefited from advice. Other customer relationships will end as soon as contractual terms allow, in cases where customers have been unable or unwilling to meet the new standards.

Agricultural commodities policy

The new agricultural commodities policy requires palm oil customers to become members of the Roundtable on Sustainable Palm Oil ('RSPO') by 30 June 2014, to have at least one operation certified by the end of 2014 and all operations by the end of 2018.

A number of customer relationships will be closed where the deadline has not been met. Other customers have succeeded in joining the RSPO and having at least one operation certified by the end of 2014. One example is an Indonesian processing, refining and export company. HSBC started to engage with this and other companies in January 2014 on the changes and continued to offer advice. The management of the company sought expert advice from third parties to understand more about RSPO certification, which they found was less complex than they had imagined. Two units of the company obtained RSPO certification in June 2014, and one further is planned.

In order to encourage the shift towards sustainable palm oil we have introduced a discounted prepayment export finance product for trade flows of certified sustainable palm oil. This structured, bespoke financing was launched in Singapore and Indonesia in 2014 and in Malaysia in early 2015.

The inaugural financing using this product was for a major palm oil exporter which has been a member of the RSPO for ten years and is now fully certified. The product is available to both existing and future clients and is hoped to encourage an expansion in the proportion of palm oil that is certified sustainable.

Customers in Malaysia, Indonesia, mainland China, Taiwan, South Korea, Thailand, Turkey and Mexico have decided to certify their operations as a result of HSBC's new policies and deadlines. A number of others were already certified. Fuller reporting on the effect of these new policies will be available in April 2015 at hsbc.com.

The World Heritage Sites and Ramsar Wetlands policy
This is designed to protect unique sites of outstanding international significance as listed by the UN and wetlands of international importance. The policy relates to all business customers involved in major projects, particularly in sectors such as forestry, agriculture, mining, energy, property and infrastructure development.

The policy helps HSBC to make balanced and clear decisions on whether or not to finance projects which could have an effect on these sites or wetlands. HSBC has avoided financing projects in light of the policy.

Our approach to managing sustainability risk is described on page 237 of the Annual Report and Accounts 2014.

Climate business
We understand that in response to climate change there is a shift required towards a lower-carbon economy. We are committed to accelerating that shift by supporting customers involved in 'climate business' by seeking long-term low-carbon commercial business opportunities. Our climate business includes clients in the solar, wind, biomass, energy efficiency, low-carbon transport and water sectors. In 2014, our Climate Change Research team was recognised as the top team in the industry. We were also a leader in public markets equity-related wind financings for international companies, including the largest wind turbine equity raising since 2010 as part of the €1.4bn Vestas refinancing.

'Green bonds' are any type of bond instruments where the proceeds will be exclusively applied to finance climate or environmental projects. In April 2014, HSBC became a member of the International Capital Market Association Executive Committee for the Green Bond Principles. The Green Bond Principles are voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance of a green bond.

In 2014, we commissioned a report, 'Bonds and Climate Change: the state of the market in 2014' from the Climate Bonds Initiative to help raise awareness of climate financing.

HSBC has been at the forefront of this fast-developing area. In 2014, we were the sole global coordinator and joint leader, manager and bookrunner for the first green bond issue by an Asian corporate issuer, Advanced Semiconductor Engineering Inc. We also acted as sole global coordinator on the first green bond issued by Abengoa, the first high-yield green bond to be issued in Europe as well as the being a joint lead manager and bookrunner for the first government issuer in the Canadian market for the Province of Ontario.

UN Environment Programme Finance Initiative Principles for Sustainable Insurance
As a signatory to the Principles for Sustainable Insurance ('PSI'), a global sustainability framework, HSBC's Insurance business has committed to integrating environmental, social and governance issues across its processes, and to publicly disclosing its progress in doing so on an annual basis. A global programme manager has been appointed to provide leadership, co-ordination and control of Insurance sustainability initiatives world-wide and ensure alignment with the Group's approach and the requirements of the PSI initiative. This includes driving appropriate activities both within the Insurance business and with partners, regulators and other industry players; disseminating industry best practice, and developing global insurance sustainability initiatives.

Sustainable operations
Managing our own environmental footprint supports business efficiency and is part of our long-term contribution to society. We work together and with our suppliers to find new ways to reduce the impact of our operations on the environment. We are purchasing renewable energy, designing and operating our buildings and data centres more efficiently and reducing waste. We have committed to cut our annual per employee carbon emissions from 3.5 to 2.5 tonnes by 2020.

Sustainability Leadership Programme
To deliver our ten sustainability goals we have trained 847 senior managers through HSBC's Sustainability Leadership Programme since 2009. The programme is a mix of hands-on learning and leadership development sessions and is aligned to the HSBC Values agenda. The programme participants are expected to embed sustainability into decision-making and project delivery in the businesses and functions where they work.

Renewable energy procurement
In 2014, we signed three power purchase agreements with renewable energy generators in the UK and India. This is expected to provide 9% of HSBC's energy. In August, a 10-megawatt solar power plant in Hyderabad, India came online to provide the Group with clean energy. This is expected to power three Global Service Centres and a Technology Centre in India. HSBC played a key role in facilitating the project by agreeing to purchase the plant's energy at a government backed fixed price for the next ten years. The plant will provide a clean and reliable source of energy. In addition, we have redefined our renewables target only to count energy from newly constructed renewable energy sources which have been commissioned by HSBC.

Paper use
Our paper goal is being achieved in three ways: ensuring that the paper we buy is from a sustainable source in accordance with our paper sourcing policy, reducing the volume of paper consumed by our offices and branches and providing paperless banking for all retail and commercial customers. We have continued to reduce the total amount of paper purchased and to increase the proportion of paper we use that is certified as sustainably sourced by the FSC and PEFC. Since 2011, we have achieved a 53% reduction in paper purchased. Certified sustainably sourced paper reached 92% of all paper used by the end of 2014.

Our 10-point sustainable operations strategy

1. Sustainability engagement: encourage employees to deliver improved efficiency by 2020
2. Supply chain collaboration: sustainable savings through efficiency and innovation
3. HSBC Eco-efficiency fund: US$50m annually to develop new ways of working, based on employee innovations
4. Energy: reduce annual energy consumption per employee by 1MWh by 2020, compared to 6.2MWh in 2011
5. Waste: use less, and recycle 100% of our office waste and electronic waste
6. Renewables: aim to increase energy consumption from renewables to 25% by 2020 from zero
7. Green buildings: design, build and run energy efficient, sustainable buildings to the highest international standards
8. Data centres: achieve an energy efficiency (power usage effectiveness) rating of 1.5 by 2020
9. Travel: reduce travel emissions per employee
10. Paper: paperless banking available for all retail and commercial customers and 100% sustainably sourced paper by 2020

Carbon emissions

HSBC's carbon dioxide emissions are calculated on the basis of the energy used in our buildings and employee business travel from over 28 countries (covering about 93% of our operations by FTE). The data gathered on energy consumption and distance travelled are converted to carbon dioxide emissions using conversion factors from the following sources, if available, in order of preference:

1. factors provided by the data/service providers;
2. factors provided by the local public environmental authorities. For electricity, if specific factors cannot be obtained from the above two sources we use the latest available carbon emission factors for national grid electricity from the International Energy Agency as recommended for use by the Greenhouse Gas Protocol; and
3. for other types of energy and travel, if no specific factors can be obtained from the first two sources, we use the latest available factors provided by the UK Department for Environment, Food and Rural Affairs and/or the Department of Energy and Climate Change in the UK.

To incorporate all of the operations over which we have financial (management) control, the calculated carbon dioxide emissions are scaled up on the basis of the FTE coverage rate to account for any missing data (typically less than 10% of FTEs). In addition, emission uplift rates are applied to allow for uncertainty on the quality and coverage of emission measurement and estimation. The rates are 4% for electricity, 10% for other energy and 6% for business travel, based on the Intergovernmental Panel on Climate Change Good Practice Guidance and Uncertainty Management in National Greenhouse Gas Inventories, and our internal analysis of data coverage and quality.

Carbon dioxide emissions in tonnes

	2014	2013
Total	**752,000**	889,000
From energy	**633,000**	755,000
From travel	**119,000**	134,000

Carbon dioxide emissions in tonnes per FTE

	2014	2013
Total	**2.92**	3.43
From energy	**2.46**	2.91
From travel	**0.46**	0.52

Our greenhouse gas reporting year runs from October to September. For the year ended 30 September 2014, carbon dioxide emissions from our global operations were 752,000 tonnes.

Sustainable communities

We believe that education and resources such as safe water and sanitation are essential to resilient communities which are, in turn, the basis of thriving economies and businesses.

We provide financial contributions to community projects, and thousands of employees across the world get involved by volunteering their time and sharing their skills.

Volunteering and donations

Thousands of HSBC employees globally are involved every year in volunteering for our Community Investment programmes. Further details on our programmes are available at hsbc.com and will be updated with information for 2014 in April 2015.

In 2014, we donated a total of US$114m to community projects (2013: US$117m). Of this, US$66m was donated in Europe (2013: US$64m); US$28m was donated in Asia-Pacific (2013: US$24m); US$3m was donated in the Middle East (2013: US$5m); US$10m was donated in North America (2013: US$11m); and US$7m was donated in Latin America (2013: US$12m).

Employees gave 303,922 hours of their time to volunteer during the working day (2013: 255,925 hours).

Human rights

We apply human rights considerations directly as they affect our employees and indirectly through our suppliers and customers, in the latter case in particular through our project finance lending and sustainability risk policies. Human rights issues most directly relevant for HSBC are those relating to the right to just and favourable conditions of work and remuneration, the right to equal pay for equal work, the right to form and join trade unions, the right to rest and leisure and the prohibition of slavery and child labour. Alongside our own commitments, such as our HSBC Code of Conduct for Suppliers (in place since 2005), the HSBC Global Standards Manual and HSBC Values, we have signed up to global commitments and standards, including the UN Global Compact, the Universal Declaration of Human Rights and the Global Sullivan Principles.

Further detail on our 2014 performance will be available from the end of April 2015 on our website, along with independent assurance of our application of the Equator Principles and carbon emissions.

On behalf of the Board

D J Flint
Group Chairman
HSBC Holdings plc

23 February 2015

Footnotes to Strategic Report

1 *On 1 January 2014, CRD IV came into force and capital and RWAs at 31 December 2014 are calculated and presented on this basis. Prior to this, capital and RWAs were calculated and presented on a Basel 2.5 basis. In addition, capital and RWAs at 31 December 2013 were also estimated based on the Group's interpretation of final CRD IV legislation and final rules issued by the PRA. At 31 December 2012, the CRD IV estimated capital and RWAs were based on the July 2011 draft CRD IV text.*

2 *Dividends recorded in the financial statements are dividends per ordinary share declared in a year and are not dividends in respect of, or for, that year. The third interim dividend for 2013 of US$0.10 was paid on 11 December 2013. The fourth interim dividend for 2013 of US$0.19 was paid on 30 April 2014. First, second and third interim dividends for 2014, each of US$0.10 per ordinary share, were paid on 10 July 2014, 9 October 2014 and 10 December 2014, respectively. Note 9 on the Financial Statements provides more information on the dividends declared in 2014. On 23 February 2015, the Directors declared a fourth interim dividend for 2014 of US$0.20 per ordinary share in lieu of a final dividend, which will be payable to ordinary shareholders on 30 April 2015 in cash in US dollars, or in pounds sterling or Hong Kong dollars at exchange rates to be determined on 20 April 2015, with a scrip dividend alternative. The reserves available for distribution at 31 December 2014 were US$48,883m.*
Quarterly dividends of US$15.5 per 6.20% non-cumulative Series A US dollar preference share, equivalent to a dividend of US$0.3875 per Series A American Depositary Share, each of which represents one-fortieth of a Series A US dollar preference share, were paid on 17 March 2014, 16 June 2014, 15 September 2014 and 15 December 2014.
Quarterly coupons of US$0.508 per security were paid with respect to 8.125% capital securities on 15 January 2014, 15 April 2014, 15 July 2014 and 15 October 2014.
Quarterly coupons of US$0.50 per security were paid with respect to 8% capital securities on 17 March 2014, 16 June 2014, 15 September 2014 and 15 December 2014.

3 *The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.*

4 *The return on average ordinary shareholders' equity is defined as profit attributable to ordinary shareholders of the parent company divided by average ordinary shareholders' equity.*

5 *Established on 5 December 2014.*

6 *Intermediation of securities, funds and insurance products, including Securities Services in GB&M.*

7 *Merger and acquisition, event and project financing, and co-investments in GPB.*

8 *Including Foreign Exchange, Rates, Credit and Equities.*

9 *Including portfolio management.*

10 *Including private trust and estate planning (for financial and non-financial assets).*

11 *Including hedge funds, real estate and private equity.*

12 *The sum of balances presented does not agree to consolidated amounts because inter-company eliminations are not presented here.*

13 *Pre-tax return on average risk-weighted assets is calculated using average RWAs based on a Basel 2.5 basis for all periods up to and including 31 December 2013 and on a CRD IV end point basis for all periods from 1 January 2014.*

14 *Net operating income before loan impairment charges and other credit risk provisions, also referred to as 'revenue'.*

15 *Loan impairment charges and other credit risk provisions.*

16 *Share of profit in associates and joint ventures.*

17 *From 1 January 2014, non-trading reverse repos and repos are presented as separate lines in the balance sheet. Previously, non-trading reverse repos were included within 'Loans and advances to banks' and 'Loans and advances to customers' and non-trading repos were included within 'Deposits by banks' and 'Customer accounts'. Comparative data have been re-presented accordingly. Non-trading reverse repos and repos have been presented as separate lines in the balance sheet to align disclosure with market practice and provide more meaningful information in relation to loans and advances. The extent to which reverse repos and repos represent loans to/from customers and banks is set out in Note 17 on the Financial Statements.*

18 *Taxes paid by HSBC relate to HSBC's own tax liabilities and is reported on a cash flow basis.*

19 *UK bank levy paid reflects the payments made to the tax authorities during the calendar year and may differ from the recognition of liabilities charged to the income statement.*

20 *Taxes collected relate to those taxes which HSBC is liable to pay as agent for taxation authorities across the world and include all employee-related taxes, together with taxes withheld from payments of interest and charged on the provision of goods and services to its customers. Taxes collected are reported on a cash flow basis.*

21 *Excludes movements in the fair value of own debt and before variable pay distributions.*

22 *Each American Depositary Share represents five ordinary shares.*

23 *Total shareholder return is defined as the growth in share value and declared dividend income during the relevant period.*

24 *The Morgan Stanley Capital International World Bank Index.*

25 *The 2014 Group pre-tax pre-variable pay profit calculation as described in the Directors' Remuneration Report on page 309 of the* Annual Report and Accounts 2014. *The percentage of variable pay deferred for the Code Staff population was 50%.*

26 *Dividends per ordinary share in respect of that year. For 2014, this includes the first, second and third interim dividends paid in 2014 of US$5.8bn (gross of scrip) and a fourth interim dividend of US$3.8bn.*

27 *Employee compensation and benefits in 2013 totalled US$19,196m which included an accounting gain arising from a change in the basis of delivering ill-health benefits in the UK of US$430m. Excluding this accounting gain, 2013 employee compensation and benefits totalled US$19,626m.*

28 *This approach applies to all executive Directors with the exception of the Group Chairman, Douglas Flint, who is not eligible for a fixed pay allowance or variable pay awards.*

Directors

Douglas Flint, CBE
Group Chairman

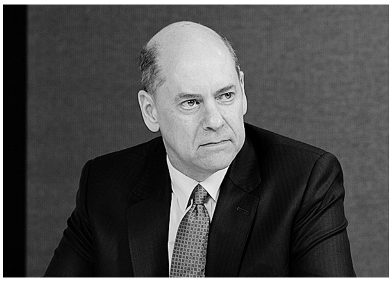
Stuart Gulliver
Group Chief Executive

Phillip Ameen
Independent non-executive Director

Kathleen Casey
Independent non-executive Director

Safra Catz
Independent non-executive Director

Laura Cha, GBS
Independent non-executive Director

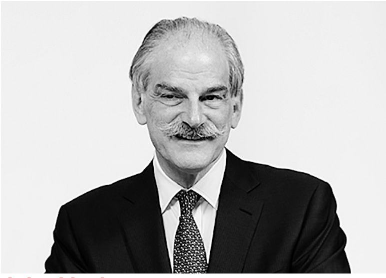


Lord Evans of Weardale
Independent non-executive Director

Joachim Faber
Independent non-executive Director

Rona Fairhead, CBE
Independent non-executive Director

Sam Laidlaw
Independent non-executive Director



John Lipsky
Independent non-executive Director

Rachel Lomax
Independent non-executive Director

Directors (continued)

Iain Mackay
Group Finance Director

Heidi Miller
Independent non-executive Director

Marc Moses
Group Chief Risk Officer

Sir Simon Robertson
Deputy Chairman and senior independent non-executive Director

Jonathan Symonds
Independent non-executive Director

Ben Mathews
Group Company Secretary

For full biographies of the Directors, see page 264 of the *Annual Report and Accounts 2014* and online at www.hsbc.com.

Supplementary information

Status of the *Strategic Report 2014*

This *Strategic Report 2014* is a part of HSBC Holdings plc *Annual Report and Accounts 2014* and is not the Group's statutory accounts. It does not contain the full text of the Directors' Report and it does not contain sufficient information to allow as full an understanding of the results and state of affairs of the Group and of its policies and arrangements concerning Directors' remuneration as would be provided by the full *Annual Report and Accounts 2014*.

Copies of the *Annual Report and Accounts 2014*

Further copies of the *Strategic Report 2014* and the *Annual Report and Accounts 2014* may be obtained from Global Communications, HSBC Holdings plc, 8 Canada Square, London E14 5HQ, United Kingdom; from Communications (Asia), The Hongkong and Shanghai Banking Corporation Limited, 1 Queen's Road Central, Hong Kong; or from Global Publishing Services, HSBC – North America, SC1 Level, 452 Fifth Avenue, New York, NY 10018, USA. The *Strategic Report 2014* and the *Annual Report and Accounts 2014* may also be downloaded from the HSBC website, www.hsbc.com.

Shareholder enquiries and communications

Enquiries

Any enquiries relating to your shareholdings on the share register, for example transfers of shares, change of name or address, lost share certificates or dividend cheques, should be sent to the Registrars at the address given below. The Registrars offer an online facility, Investor Centre, which enables shareholders to manage their shareholding electronically.

Principal Register

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Email via website:
www.investorcentre.co.uk/contactus
Investor Centre:
www.investorcentre.co.uk

Hong Kong Overseas Branch Register

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Rooms 1712-1716, 17th Floor
Hopewell Centre
183 Queen's Road East
Hong Kong

Telephone: +852 2862 8555
Email:
hsbc.ecom@computershare.com.hk
Investor Centre:
www.investorcentre.com/hk

Bermuda Overseas Branch Register

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6 Front Street
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Investor Centre:
www.investorcentre.co.uk/bm

Holders of ADSs

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Depositary Receipts
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USA

Telephone (US): +1 877 283 5786
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Holders of shares through Euroclear France

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Persons whose shares are held on their behalf by another person may have been nominated to receive communications from HSBC pursuant to section 146 of the UK Companies Act 2006 ('nominated person'). The main point of contact for a nominated person remains the registered shareholder (for example your stockbroker, investment manager, custodian or other person who manages the investment on your behalf). Any changes or queries relating to a nominated person's personal details and holding (including any administration thereof) must continue to be directed to the registered shareholder and not HSBC's Registrars. The only exception is where HSBC, in exercising one of its powers under the UK Companies Act 2006, writes to nominated persons directly for a response.

Electronic communications

Shareholders may at any time choose to receive corporate communications in printed form or to receive notifications of their availability on HSBC's website. To receive future notifications of the availability of a corporate communication on HSBC's website by email, or revoke or amend an instruction to receive such notifications by email, go to www.hsbc.com/ecomms. If you provide an email address to receive electronic communications from HSBC, we will also send notifications of your dividend entitlements by email. If you received a notification of the availability of this document on HSBC's website and would like to receive a printed copy or, if you would like to receive future corporate communications in printed form, please write or send an email (quoting your shareholder reference number) to the appropriate Registrars at the address given below. Printed copies will be provided without charge.

A Chinese translation of this and future documents may be obtained on request from the Registrars. Please also contact the Registrars if you have received a Chinese translation of this document and do not wish to receive such translations in future.

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本文件及日後的相關文件均備有中譯本，如有需要，請向適當的股份登記處索取。股東如收到本報告的中譯本，但不希望再收取此等譯本，亦請聯絡股份登記處。

股東如已委託其他人士代為持有股份，可能會獲提名（「獲提名人士」）收取滙豐根據英國《2006年公司法》第146條的規定發出的通訊。獲提名人士之主要聯絡人仍為登記股東（例如：股票經紀、投資經理、託管商或代表　閣下管理投資的其他人士）。獲提名人士的個人資料及持股量（包括任何相關管理事宜）如有任何變更或查詢，必須繼續交由登記股東而非滙豐的股份登記處辦理。除非滙豐根據英國《2006年公司法》行使其中一項權力時，直接致函獲提名人士要求回應，則屬例外。

Report of the auditor

The auditor's report on the full accounts for the year ended 31 December 2014 was unqualified, and their statement under section 496 (whether the *Strategic Report 2014* and the Directors' Report are consistent with the accounts) of the Companies Act 2006 was unqualified.

Published by Group Finance, HSBC Holdings plc, London

Designed by Black Sun Plc, London

Printed by Park Communications Limited, London, on Revive 50 White Silk (cover) and Revive 100 White Offset (text pages) using vegetable oil-based inks. Made in Italy, the cover board comprises 50% virgin fibre, 25% de-inked post-consumer waste and 25% pre-consumer waste. Made in Austria, the text paper comprises 100% de-inked post-consumer waste. Pulps used are totally chlorine-free.

Stock number 99382-5

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Photography
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HSBC: then and now

It is 150 years since HSBC was founded in Hong Kong to finance trade between Asia and Europe. Much has changed since then, as our cover photos demonstrate. The top photo shows Hong Kong harbour, with the HSBC office (extreme left) a few years after it was established in 1865. The bottom image shows the harbour today, with the HSBC building sixth from left (partially hidden).

Hong Kong has been transformed both physically and economically, from trading outpost to international financial centre. HSBC has mirrored Hong Kong's rise to global prominence, growing from a small regional trading bank into one of the world's largest banking and financial services organisations today.

HSBC's Hong Kong office is still at 1 Queen's Road Central, as it was in 1865. The current HSBC building is the fourth to occupy the site, but the values on which the bank was founded remain the same. HSBC still aims to be where the growth is, connecting customers to opportunities, enabling businesses to thrive and economies to prosper, and helping people to fulfil their hopes and realise their ambitions.

We are proud to have served our customers with distinction for 150 years.

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