



HSBC Bank Capital Funding (Sterling 2) L.P.

(established in Jersey as a limited partnership under the Limited Partnerships (Jersey) Law 1994)

£300,000,000

5.862% Non-cumulative Step-up Perpetual Preferred Securities

having the benefit of a subordinated guarantee of

HSBC Bank plc

(incorporated with limited liability under the laws of England and Wales with registered number 14259)

Issue Price: £1,000 per Preferred Security

The £300,000,000 5.862% Non-cumulative Step-up Perpetual Preferred Securities, (the "Preferred Securities") each issued for a capital contribution of £1,000 (referred to herein as the "nominal amount"), representing limited partnership interests in HSBC Bank Capital Funding (Sterling 2) L.P., (the "Issuer"), will be issued on 7 April 2004 (the "Issue Date"). The Preferred Securities will entitle investors, subject to certain conditions described herein, to receive non-cumulative cash distributions ("Distributions") annually in arrear on 7 April in each year until 7 April 2020 and thereafter semi-annually in arrear on 7 April and 7 October in each year. Distributions shall accrue from (and including) the Issue Date to (but excluding) 7 April 2020 at a fixed rate per annum of 5.862% and semi-annually in arrear from (and including) 7 April 2020, at a floating rate per annum equal to the sum of 1.85% and six-month LIBOR for the relevant Distribution Period (as defined herein). The first Distribution will, if payable, be paid on 7 April 2005, and will be calculated in respect of the period from (and including) 7 April 2004 to (but excluding) 7 April 2005. See "*Description of the Preferred Securities – Distributions*".

The Issuer is a Jersey limited partnership and is not a legal entity separate from its partners. All obligations of the Issuer to make payments in respect of the Preferred Securities are guaranteed on a subordinated basis pursuant to a guarantee dated 7 April 2004 (the "Guarantee") given by HSBC Bank plc (the "Bank"). See "*Description of the Guarantee*".

The Preferred Securities are perpetual securities and not subject to any mandatory redemption provisions. The Preferred Securities may be redeemed, at the option of HSBC Bank (General Partner) Limited, a wholly owned Jersey incorporated subsidiary of the Bank, as general partner of the Issuer (the "General Partner"), on 7 April 2020 or on each Distribution Date thereafter, in whole but not in part each at its nominal amount, subject to satisfaction of the Redemption Conditions (each as defined herein). The Preferred Securities are also redeemable, subject to satisfaction of certain conditions, in whole but not in part, at any time following the occurrence of a Tax Event or a Regulatory Event (each as defined herein). Under existing regulations, neither the Issuer nor the Bank nor any of its subsidiaries may redeem or purchase any Preferred Securities unless the Financial Services Authority, or any successor organisation thereto in the United Kingdom (the "FSA"), has given its prior written consent. See "*Description of the Preferred Securities – Redemption and Purchase*". These requirements and restrictions do not affect the ability of the Bank and its subsidiaries and affiliates to engage in market-making activities in relation to the Preferred Securities.

In the event of the dissolution or winding-up of the Issuer, holders of Preferred Securities will be entitled, subject to satisfaction of certain conditions, to receive a Liquidating Distribution (as defined herein). See "*Description of the Preferred Securities – Liquidating Distributions*". Upon the occurrence of a Substitution Event (as defined herein) or, subject to certain conditions, at the option of the General Partner following a Tax Event or Regulatory Event, the Preferred Securities may be substituted by the Substitute Preference Shares (as defined herein). If any Preferred Securities are outstanding on 7 April 2049 and no notice to redeem such Preferred Securities on or before 7 April 2049 has been given, the Preferred Securities will be substituted by the Substitute Preference Shares. See "*Description of the Preferred Securities – Substitution by Substitute Preference Shares*".

The Preferred Securities are expected to be assigned on issue a rating of "A" by Standard & Poor's Ratings Services, a Division of The McGraw Hill Companies Inc., "A1" by Moody's Investors Service Limited and "AA-" by Fitch Ratings. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revisions, suspension or withdrawal at any time by the relevant rating organisation.

Application has been made to list the Preferred Securities on the Luxembourg Stock Exchange (the "Luxembourg Stock Exchange").

See "Investment Considerations" for a discussion of certain factors that should be considered by prospective investors.

The Preferred Securities have not been, and will not be, registered under the United States Securities Act of 1933, as amended (the "Securities Act") or any US State Securities Laws. The Preferred Securities are being offered outside the United States by the Managers (as defined in "*Subscription and Sale*" below) in accordance with Regulation S under the Securities Act ("Regulation S"), and may not be offered or sold within the United States or to, or for the account or benefit of, US persons except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act.

The Preferred Securities will be evidenced by a single global certificate in registered form (the "Global Certificate") registered in the name of a nominee of, and deposited with, a common depository for Euroclear Bank, S.A./N.V. as operator of the Euroclear System ("Euroclear") and Clearstream Banking, société anonyme, Luxembourg ("Clearstream, Luxembourg"). Definitive certificates evidencing Preferred Securities will only be available in certain limited circumstances. See "*Summary of Provisions relating to the Preferred Securities while in Global Form*".

HSBC Bank plc

Credit Suisse First Boston

Landesbank Baden-Württemberg

RBC Capital Markets

Goldman Sachs International

Morgan Stanley

The General Partner, acting on behalf of the Issuer, accepts responsibility for the information contained in this Offering Circular (other than the Bank Group Information (as defined below)). To the best of the knowledge and belief of the General Partner (which has taken all reasonable care to ensure that such is the case) the information contained in this Offering Circular is true and accurate in all material respects and is not misleading, the opinions and intentions expressed in this Offering Circular are honestly held and there are no other facts the omission of which makes this Offering Circular as a whole or any such information or the expression of any such opinion or intention misleading. In addition, the Bank accepts responsibility for all information contained in this Offering Circular set out under the sections entitled "Consolidated Capitalisation and Indebtedness of the Bank", "Description of the Bank", "Description of the Guarantee", "Description of the Substitute Preference Shares" and Annex A – HSBC Bank plc 2003 Annual Report and Accounts (together, the "Bank Group Information"). To the best of the knowledge and belief of the Bank (which has taken all reasonable care to ensure that such is the case), the Bank Group Information is in accordance with the facts and does not omit anything likely to affect the import of such information.

The term "the Bank Group" has the meaning given in "Description of the Preferred Securities". Any reference in this Offering Circular to an action taken by the Issuer shall be taken to mean an action taken by the General Partner on behalf of the Issuer. The term "the HSBC Group" means HSBC Holdings plc together with its subsidiary undertakings.

Neither the Issuer nor the Bank has authorised the making or provision of any representation or information regarding the Issuer, the Bank or the Preferred Securities other than as contained in this Offering Circular or as approved for such purpose by the Issuer and the Bank. Any such representation or information should not be relied upon as having been authorised by the Issuer, the General Partner, the Bank or the Managers.

Neither the delivery of this Offering Circular nor the offering, sale or delivery of any Preferred Securities shall in any circumstances create any implication that there has been no adverse change, or any event reasonably likely to involve any adverse change, in the condition (financial or otherwise) of the Issuer or the Bank since the date of this Offering Circular.

Prospective investors should inform themselves as to the legal requirements and tax consequences within the countries of their residence and domicile for or of the acquisition, holding or disposal by them of Preferred Securities and any foreign exchange restrictions that might be relevant to them. This Offering Circular does not constitute an offer of or an invitation by or on behalf of the Issuer or any of its partners, or the Managers to subscribe for or purchase any of the Preferred Securities.

Investors should satisfy themselves that they understand all the risks associated with making investments in the Preferred Securities. If a prospective investor is in any doubt whatsoever as to the risks involved in investing in the Preferred Securities, he should consult his professional advisers. This Offering Circular does not constitute investment advice or a recommendation to buy, subscribe for or underwrite any Preferred Securities by the Issuer or any of its partners, the Bank or the Managers.

EACH PURCHASER OF THE PREFERRED SECURITIES MUST COMPLY WITH ALL APPLICABLE LAWS AND REGULATIONS IN FORCE IN ANY JURISDICTION IN WHICH IT PURCHASES, OFFERS OR SELLS THE PREFERRED SECURITIES OR POSSESSES OR DISTRIBUTES THIS OFFERING CIRCULAR AND MUST OBTAIN ANY CONSENT, APPROVAL OR PERMISSION REQUIRED BY IT FOR THE PURCHASE, OFFER OR SALE BY IT OF THE PREFERRED SECURITIES UNDER THE LAWS AND REGULATIONS IN FORCE IN ANY JURISDICTION TO WHICH IT IS SUBJECT OR IN WHICH IT MAKES SUCH PURCHASES, OFFERS OR SALES, AND NONE OF THE GENERAL PARTNER, THE ISSUER, THE BANK OR THE MANAGERS SHALL HAVE ANY RESPONSIBILITY THEREFOR.

Investors in the Preferred Securities will be deemed to have represented that they do not own, directly or indirectly, 10% or more of the ordinary shares of the Bank. If at any time the General Partner becomes aware that an investor in the Preferred Securities owns, directly or indirectly,

10% or more of the ordinary shares of the Bank, it will, on behalf of the Issuer, have the right to suspend payment of Distributions in respect of such Investor's Preferred Securities. Investors in the Preferred Securities are required to provide written notice to the General Partner on behalf of the Issuer if at any time any such holder of Preferred Securities owns, directly or indirectly, 10% or more of the ordinary shares of the Bank.

The distribution of this Offering Circular and the offering of the Preferred Securities in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the General Partner, the Issuer, the Bank and the Managers to inform themselves about, and to observe, any such restrictions. In particular, there are restrictions on the distribution of this Offering Circular and the offer and sale of the Preferred Securities, in the United States and the United Kingdom. See "Subscription and Sale".

No action has been taken to permit a public offering of the Preferred Securities in any jurisdiction where action would be required for such purpose. Accordingly, the Preferred Securities may not be offered or sold, directly or indirectly, and this Offering Circular may not be distributed in any jurisdiction, except in accordance with the legal requirements applicable in that jurisdiction. In particular, the Preferred Securities have not been, and will not be, registered under the Securities Act and are subject to United States tax law requirements. Subject to certain exceptions, the Preferred Securities may not be offered, sold or delivered within the United States or to US persons. A further description of certain restrictions of the offering and sale of the Preferred Securities and on the distribution of this Offering Circular is given under "Subscription and Sale".

The Jersey Financial Services Commission has given and has not withdrawn its consent under Article 8 of the Control of Borrowing (Jersey) Order 1958 to the creation by the Issuer of the Preferred Securities. The Jersey Financial Services Commission is protected by the Borrowing (Control) (Jersey) Law 1947, as amended, against liability arising from the discharge of its functions under that Law.

Nothing in this Offering Circular or anything communicated to Holders of, or investors in, the Preferred Securities (or any such potential Holders or investors) by the General Partner is intended to constitute or should be construed as advice on the merits of the purchase of, or subscription for, the Preferred Securities or the exercise of any rights attached thereto for the purposes of the Financial Services (Jersey) Law 1998, as amended.

An investment in the Preferred Securities is only suitable for financially sophisticated investors who are capable of evaluating the merits and risks of such investment and who have sufficient resources to be able to bear any losses which may result from such an investment.

This Offering Circular is for distribution only to persons who (i) are outside the United Kingdom, (ii) investment professionals falling within article 14(5) of the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (the "Promotion of Collective Investment Schemes Order") and article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (the "Financial Promotion Order") who have professional experience of participating in unregulated schemes and of matters relating to investments and (iii) persons falling within article 22(2) of the Promotion of Collective Investment Schemes Order and article 49(2) of the Financial Promotion Order (all such persons together being referred to as "relevant persons"). This Offering Circular is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this Offering Circular relates is available only to relevant persons and will be engaged in only with relevant persons.

The Managers are acting for HSBC Bank Capital Funding (Sterling 2) L.P. in connection with the issue of the Preferred Securities and no-one else and will not be responsible to any person other than HSBC Bank Capital Funding (Sterling 2) L.P. for providing the protections afforded to clients of the Managers, nor for providing advice in relation to the issue of the Preferred Securities. HSBC Bank plc can be contacted at 4th Floor, 8 Canada Square, London E14 5HQ.

FORWARD-LOOKING STATEMENTS

This Offering Circular contains various forward-looking statements regarding events and trends that are subject to risks and uncertainties that could cause the actual results and financial position of the Bank or the Bank Group to differ materially from the information presented herein. When used in this Offering Circular, the words “estimate”, “project”, “intend”, “anticipate”, “believe”, “expect”, “should” and similar expressions, as they are related to the Bank Group and its management, are intended to identify such forward-looking statements. You should not place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Bank Group does not undertake any obligation to publicly release the result of any revisions to these forward-looking statements to reflect any events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

PRESENTATION OF FINANCIAL INFORMATION

In this Offering Circular, references to “€” and “euro” are to the single currency introduced at the start of the Third Stage of the European Economic and Monetary Union pursuant to the Treaty establishing the European Community, as amended, references to “£”, “sterling” and “pounds sterling” are to the lawful currency of the United Kingdom and references to “US\$” and “US dollars” are to the lawful currency of the United States.

IN CONNECTION WITH THE OFFERING, HSBC BANK PLC IN ITS CAPACITY AS LEAD MANAGER, (THE “STABILISING MANAGER”) (OR ANY PERSON ACTING FOR IT) MAY OVER-ALLOT OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE PREFERRED SECURITIES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL FOR A LIMITED PERIOD. HOWEVER, THERE MAY BE NO OBLIGATION ON HSBC BANK PLC OR ANY AGENT OF IT TO DO THIS. SUCH STABILISING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME AND MUST BE BROUGHT TO AN END AFTER A LIMITED PERIOD. SUCH STABILISING SHALL BE IN COMPLIANCE WITH ALL APPLICABLE LAWS, REGULATIONS AND RULES.

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SUMMARY OF THE OFFERING

The following is qualified in its entirety, by the more detailed information included elsewhere in this Offering Circular. Capitalised terms not otherwise detailed in this summary have the meaning given to them in "Description of the Preferred Securities".

Issuer HSBC Bank Capital Funding (Sterling 2) L.P., a limited partnership established in Jersey and registered under the Limited Partnerships (Jersey) Law, 1994 (the "Law"). The Issuer will be consolidated in the group accounts of HSBC Bank plc (the "Bank"). The general partner of the Issuer is HSBC Bank (General Partner) Limited (the "General Partner"), a wholly owned Jersey incorporated subsidiary of the Bank.

Guarantor HSBC Bank plc.

Issue Details £300,000,000 5.862% Non-cumulative Step-up Perpetual Preferred Securities, each with a nominal amount of £1,000, constituting limited partnership interests in the Issuer (the "Preferred Securities").

The Bank will guarantee, on a subordinated basis, all payments in respect of the Preferred Securities.

The Preferred Securities, together with the Guarantee, are intended to provide investors with rights to income and capital distributions and distributions upon liquidation of the Bank that are equivalent to the rights they would have had if they had purchased non-cumulative perpetual preference shares of the Bank.

The total nominal amount of the Preferred Securities will at issue be included in the tier 1 capital of the Bank.

Neither the Issuer nor any member of the Bank Group will make or procure any payment to investors if such a payment could not lawfully have been made had investors held shares ranking *pari passu* with Substitute Preference Shares of the Bank instead of the Preferred Securities.

Income Distributions Non-cumulative distributions (the "Distributions") will accrue on the nominal amount of the Preferred Securities (i) from (and including) 7 April 2004 (the "Issue Date") to (but excluding) the First Optional Redemption Date (as defined below) at a fixed rate per annum of 5.862% payable annually in arrear, and (ii) from and (including) the First Optional Redemption Date for each successive six month period thereafter at a floating rate per annum equal to the sum of 1.85% and six-month LIBOR for such period payable semi-annually in arrear subject in each case to "*Limitations on Payment*" below.

See "*Description of the Preferred Securities – Distributions*".

Distribution Dates Distributions will, if payable, be paid on 7 April in each year beginning on 7 April 2005 up to and including 7

April 2020 and thereafter on 7 April and 7 October in each year, the first such Distribution being calculated in respect of the period from (and including) 7 April 2004 to (but excluding) 7 April 2005. The date on which a Distribution will, if payable, be paid is referred to as a "Distribution Date". The period from (and including) the Issue Date to (but excluding) the first Distribution Date and each period from (and including) a Distribution Date to (but excluding) the next succeeding Distribution Date is referred to as a "Distribution Period".

Limitations on Payment

The Issuer will pay Distributions out of, and to the extent of, its legally available resources. Distributions will not be paid on the Preferred Securities in respect of any Distribution Period on the next following Distribution Date to the extent that:

- (i) on the relevant Distribution Date the Bank (a) is prevented by applicable UK banking regulations or other requirements from making payment in full (A) of dividends or other distributions on its Parity Obligations (as defined below) or (B) under the Guarantee or (b) is unable to make such payment of dividends or other distributions on its Parity Obligations or under the Guarantee without causing a breach of the FSA's capital adequacy requirements from time to time applicable to the Bank; or
- (ii) the amount of such Distribution (if paid in full), together with the sum of any dividends and other distributions on the Bank's Parity Obligations due and payable on that Distribution Date or under the Guarantee, would exceed the Adjusted Distributable Reserves (as defined below) of the Bank. No payment will be made by, or may be claimed from, the Bank in respect of a Distribution to the extent that it is not paid by reason of the limitations described above.

See "Description of the Preferred Securities – Distributions".

Dividend Stopper

The Bank will covenant in the Guarantee that, if for any single Distribution Period ending on or before the First Optional Redemption Date or thereafter for any two consecutive Distribution Periods, Distributions have not been made in full, by reason of the limitations on payment described above, it will not pay dividends or other distributions in respect of its ordinary shares or effect any repurchase or redemption in respect of its ordinary shares or any other Bank securities or obligations ranking junior to the Guarantee or repurchase or redeem any Parity Obligations which are securities until after the next following Distribution Date on which a Distribution in respect of the Preferred Securities is paid in full.

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| No Fixed Maturity | The Preferred Securities are perpetual securities and have no maturity date. The Preferred Securities may be redeemed at the option of the General Partner in the circumstances described under " <i>Optional Redemption</i> ", " <i>Tax Call</i> " and " <i>Regulatory Call</i> " below. |
| Optional Redemption | <p>The Preferred Securities are redeemable, in whole but not in part and subject to paragraph 7.3 of "<i>Description of the Preferred Securities</i>", the Law and the limitations on redemption described below, at the option of the General Partner on 7 April 2020 (the "First Optional Redemption Date") or on each Distribution Date thereafter at the Optional Redemption Price.</p> <p>The Optional Redemption Price of each of the Preferred Securities is an amount equal to its nominal amount.</p> <p>See "<i>Description of the Preferred Securities – Redemption and Purchase</i>".</p> |
| Tax Call | The Preferred Securities are redeemable, in whole but not in part and subject to paragraph 7.3 of " <i>Description of the Preferred Securities</i> ", the Law and the limitations on redemption described below, at the option of the General Partner at any time that a Tax Event has occurred and is continuing, at the Tax Redemption Price. |
| Tax Redemption Price | <p>The "Tax Redemption Price" of each of the Preferred Securities is an amount equal to its nominal amount together with any accrued but unpaid Distribution in respect of the Distribution Period (as defined above) in which the redemption date falls.</p> <p>See "<i>Description of the Preferred Securities – Redemption and Purchase</i>".</p> |
| Tax Event | "Tax Event" means that, whether or not as a result of a change in any law or regulation of the United Kingdom or Jersey, or in any treaty to which the United Kingdom or Jersey is a party, or in the official interpretation or application of any law, regulation or treaty by any relevant body in Jersey or the United Kingdom or any action taken by any appropriate authority, there is more than an insubstantial risk that (i) the Issuer or the General Partner would be subject to more than a <i>de minimis</i> amount of tax (except, in the case of the General Partner only, for any such tax that would arise as a result of (a) profits arising to it as a result of payments received by it from the Issuer or (b) activities (if any) carried on by it other than those permitted or contemplated in the Partnership Agreement (as defined under "HSBC Bank Capital Funding (Sterling 2) L.P.") in Jersey or the United Kingdom), (ii) payments to Holders would be subject to deduction or withholding for or on account of tax or would give rise to any obligation to account for any tax in Jersey or the United Kingdom, (iii) payments by the Bank in respect of the Subordinated Note (as defined below) would be subject to deduction or withholding for or on account of tax in the United |

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| | <p>Kingdom or (iv) the Bank would not obtain relief for the purposes of UK corporation tax for any payment of interest in respect of the Subordinated Note.</p> |
| Regulatory Call | <p>The Preferred Securities are redeemable, in whole but not in part and subject to paragraph 7.3 of <i>"Description of the Preferred Securities"</i>, the Law and the limitations on redemption described below, at the option of the General Partner at any time that a Regulatory Event (as defined below) has occurred and is continuing, at the Regulatory Event Redemption Price.</p> <p>The "Regulatory Event Redemption Price" of each of the Preferred Securities is an amount equal to, in the case of a redemption on a date which is prior to the First Optional Redemption Date, the higher of (i) its nominal amount together with any accrued but unpaid Distribution in respect of the Distribution Period in which the redemption date falls and (ii) the Make Whole Amount (as defined below) and, in the case of a redemption on or after the First Optional Redemption Date, its nominal amount together with any accrued but unpaid Distribution in respect of the Distribution Period in which the relevant redemption date falls.</p> <p>See <i>"Description of the Preferred Securities – Redemption and Purchase"</i>.</p> |
| Regulatory Event | <p>"Regulatory Event" means that for any reason, there is more than an insubstantial risk that for the purposes of the FSA's capital adequacy requirements applicable to banks in the United Kingdom at that time, the Preferred Securities may not be included in the tier 1 capital of the Bank on both a solo basis and on a consolidated basis.</p> |
| Substitution after a Regulatory Event or a Tax Event | <p>If a Regulatory Event or a Tax Event has occurred and is continuing, as an alternative to redemption and at the option of the General Partner, the Substitute Preference Shares (as defined below) may (provided that proceedings have not been commenced for the liquidation, dissolution or winding up of the Bank in England) be substituted for the Preferred Securities as if the Regulatory Event or the Tax Event constituted a Substitution Event.</p> |
| Limitations on Redemption | <p>The Preferred Securities may only be redeemed if (i) the aggregate of the Bank's Adjusted Distributable Reserves and the proceeds of any issue of Replacement Capital made for the purpose of funding such redemption is at least equal to the full amount payable on redemption, and (ii) the prior consent of the FSA, if required, has been obtained.</p> |
| Make Whole Amount | <p>In respect of a Preferred Security, "Make Whole Amount" means at any time prior to the First Optional Redemption Date an amount equal to the sum of (i) the present value of its nominal amount; and (ii) the present value of each remaining scheduled Distribution to and including the First Optional Redemption Date,</p> |

discounted from the First Optional Redemption Date or the relevant Distribution Date, respectively, in each case to the Early Redemption Date at a rate equal to the sum of (x) 0.375% and (y) the Reference Rate (as defined below).

Substitution Event A Substitution Event will occur if:

- (i) on the Distribution Date in April 2049 the Preferred Securities (or any of them) are outstanding and no notice has been given to redeem the then outstanding Preferred Securities on or before the Distribution Date in April 2049;
- (ii) the Bank's total capital ratio, calculated on a solo basis and consolidated basis in accordance with applicable UK bank capital adequacy regulations, falls below the then minimum ratio required by such regulations (currently 8%); or
- (iii) the Bank's board of directors in its sole discretion has notified the FSA and the Issuer that it has determined that (ii) above is expected to occur in the near term.

Upon the occurrence of a Substitution Event and provided that proceedings have not been commenced for the liquidation, dissolution or winding up of the Bank in England, the Preferred Securities will, as soon as reasonably practicable thereafter, be substituted by the Substitute Preference Shares.

See "Description of the Preferred Securities – Substitution by Substitute Preference Shares".

Substitute Preference Shares The Substitute Preference Shares will be fully-paid non-cumulative redeemable perpetual preferred shares issued by the Bank having economic terms which are in all material respects equivalent to those of the Preferred Securities and the Guarantee taken together. The Bank will take all reasonable steps to procure that the Substitute Preference Shares will at the relevant time be admitted to listing on the Official List of the Financial Services Authority (in its capacity as competent authority for the purposes of Part IV of the Financial Services and Markets Act 2000 (the "FSMA")) (the "UK Listing Authority") and to trading on the London Stock Exchange plc's market for listed securities (the "London Stock Exchange") or another Recognised Stock Exchange.

Rights upon Liquidation In the event of the dissolution or winding up of the Issuer, each investor will, subject to certain limitations, be entitled to receive out of the assets of the Issuer available for distribution the Liquidating Distribution. The Liquidating Distribution will be made (i) before any distribution of assets is made to the General Partner or HSBC Preferential LP (UK), an unlimited liability company incorporated in England and Wales and tax

resident in the United Kingdom, as holder of the Preferential Right and (ii) *pari passu* with equivalent claims under all outstanding Parity Obligations of the Issuer which in turn rank *pari passu* with the Liquidating Distribution but (iii) after the claims of all other creditors of the Issuer, and holders of obligations of the Issuer, whose claims are not *pari passu* with or subordinated to the Preferred Securities.

“Preferential Right” means the preferential limited partnership interest in the Issuer initially held by HSBC Preferential LP (UK) and entitling it to receive in preference to the rights of the General Partner all amounts received by the Issuer in excess of those required to make payments of any Distribution (and, if relevant, Additional Amounts) on any Distribution Date or any Liquidating Distribution or relevant portion thereof (and, if relevant, Additional Amounts) to Holders.

See “Description of the Preferred Securities – Liquidating Distributions”.

Withholding Tax and Gross Up Except in certain limited cases and subject to the limitations on payments described above, the Issuer or the Bank pursuant to the Guarantee, will pay such additional amounts (“Additional Amounts”) as may be necessary in order that the net payments in respect of the Preferred Securities, after withholding for any taxes imposed by Jersey or the United Kingdom, as the case may be, on such payments will equal the amount which would have been received in the absence of any such withholding.

Certain Restrictions Other than the Issuer’s ordinary expenses, which will be borne by the Bank and/or the General Partner, and except for fees and commissions payable in connection with the issue of the Preferred Securities, the General Partner has covenanted not to incur any indebtedness in the name of the Issuer or other obligations ranking, in respect of distributions or other payments, senior to the rights of Holders.

Parity Obligations “Parity Obligations” means (i) in relation to the Bank, any preference shares or other obligations of the Bank that constitute tier 1 capital of the Bank on a consolidated basis and do not rank in all material respects senior or junior to the Bank’s obligations under the Guarantee and any other guarantee or support agreement given by the Bank in respect of any preference shares, or other preferred securities (not constituting debt obligations) having in all material respects the same ranking as preference shares, issued by any subsidiary undertaking of the Bank that constitutes tier 1 capital of the Bank on a consolidated basis and does not rank in all material respects senior or junior to the Guarantee and (ii) in relation to the Issuer, any preferred securities (other than the Preferred Securities) issued by it or other obligations of it which are entitled to the benefit of the Guarantee or any

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| Guarantee. | <p>guarantee of the Bank ranking <i>pari passu</i> with the Guarantee.</p> <p>The Bank will guarantee, on a subordinated basis, all payments in respect of the Preferred Securities.</p> <p>The Guarantee will constitute unsecured obligations of the Bank which will, in the event of the winding up of the Bank, be subordinated in right of payment to the claims of all other creditors of the Bank (including certain subordinated creditors) other than creditors whose claims rank or are expressed to rank <i>pari passu</i> with or junior to the Guarantee or other obligations of the Bank ranking <i>pari passu</i> with or junior to the Guarantee.</p> <p>The Bank will not be obliged to make a payment under the Guarantee (i) unless it is able to make such payment and be Solvent (as defined in the Guarantee) immediately thereafter and (ii) if such payment would cause it to be in breach of applicable banking regulations or capital adequacy requirements.</p> <p>See "<i>Description of the Guarantee</i>".</p> |
| Subordinated Note | <p>Payments in respect of the Preferred Securities will be funded by payments received by the Issuer under the £300,000,000 5.862% Fixed/Floating Rate Subordinated Notes in bearer form issued by the Bank on the Issue Date (the "Subordinated Note"). The Subordinated Note will have economic terms which are in all material respects equivalent terms to those of the Preferred Securities, save that (i) the interest payable on the Subordinated Note will be cumulative and (ii) the Subordinated Note will be due on 30 April 2049.</p> <p>In the event that the Subordinated Note or any Replacement Debt is redeemed while any Preferred Securities remain outstanding and are not subject to a notice of redemption, the General Partner has undertaken to invest the proceeds of redemption of the Subordinated Note or any Replacement Debt in a subordinated note of the Bank with a maturity date of 30 April 2049 and economic terms essentially equivalent to the Subordinated Note (including that the interest rate will reflect the then current Distribution Rate provisions of the Preferred Securities).</p> <p>Interests in the Subordinated Note will not be delivered or otherwise made available in any form to Holders, and the rights of such Holders shall be represented solely by the Preferred Securities.</p> |
| Voting Rights | <p>Except as stated below and provided for in the Law, Holders will not be entitled to receive notice of, attend or vote at any meeting of partners of the Issuer or participate in the management of the Issuer.</p> <p>If for any Distribution Period ending on or before the First Optional Redemption Date or thereafter for any two consecutive Distribution Periods, the Distributions have</p> |

not been paid in full (and/or the Bank has not made the required payments under the Guarantee in respect of such Distribution), Holders will be entitled by written notice to the Issuer given by the Holders of a majority in nominal amount of the Preferred Securities or by a resolution passed at an appropriately constituted meeting to appoint a special representative to enforce Holder's statutory rights, including provision of information on the affairs of the Issuer. Such special representative must vacate its office if, after its appointment, a full Distribution is made by the Issuer, or by the Bank under the Guarantee, for a full Distribution Period, or an amount equivalent to the Distribution to be paid in respect of a full Distribution Period has been paid or irrevocably set aside in a separately designated trust account for payment to Holders.

Variation of Rights Any variation of the rights of Holders (except where such variation is solely of a formal, minor or technical nature in which case it may be approved by the General Partner without the consent of Holders) will take effect only if approved in writing by at least one-third of Holders or if approved by a resolution passed by three-quarters of those present in person or by proxy at a meeting of Holders at which the quorum shall be one-third by nominal amount of the Holders.

Form of the Securities The Preferred Securities will be issued in registered form. The Preferred Securities will be sold to non-US persons outside the United States pursuant to Regulation S and will, on issue, be evidenced by a Global Certificate. The Global Certificate will be registered in the name of a nominee of, and deposited with a common depositary for Euroclear and Clearstream, Luxembourg. For so long as the Preferred Securities are deposited and registered as described above, book-entry interests in the Preferred Securities will be shown on, and transfers thereof will be effected only through, records maintained by Euroclear and Clearstream, Luxembourg. Definitive certificates evidencing Preferred Securities will be issued only in limited circumstances.

See "Description of the Preferred Securities – Transfers and Form".

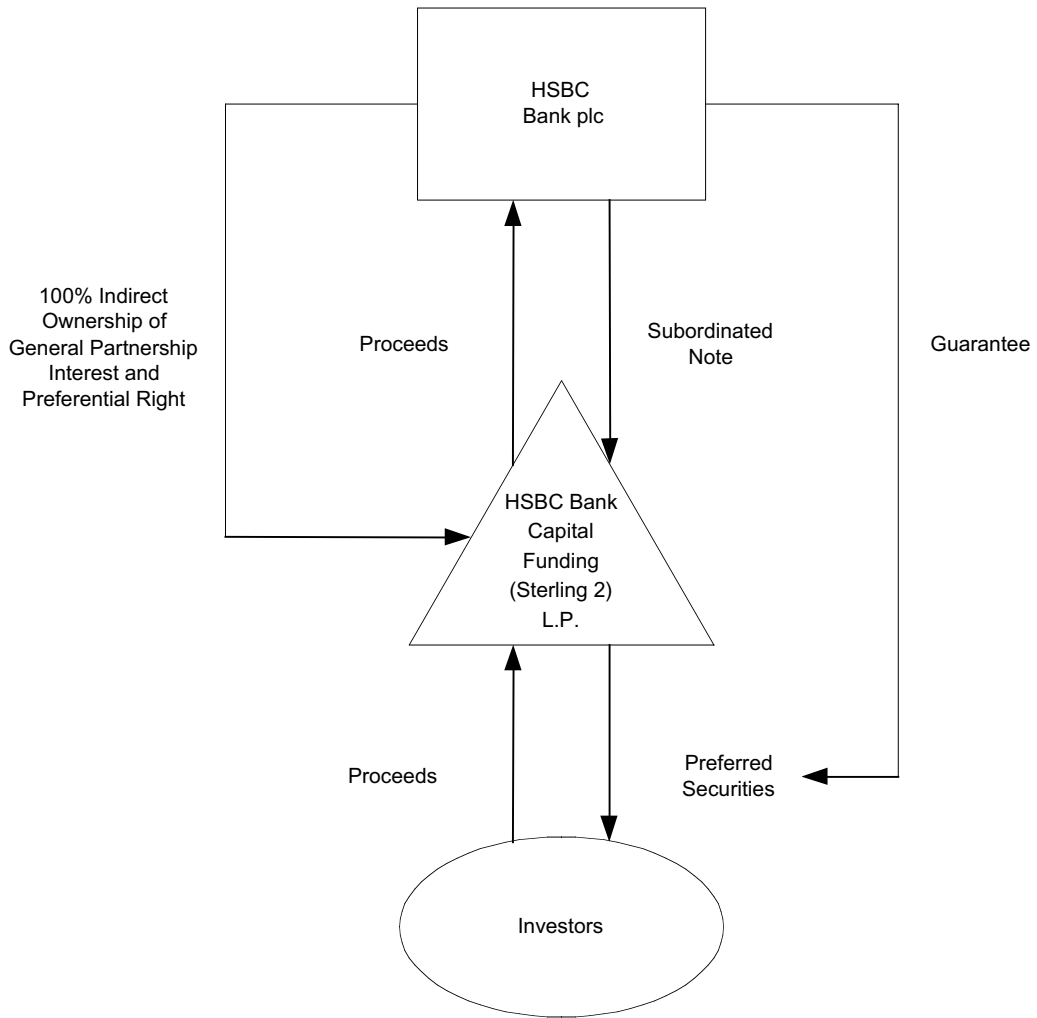
Rating The Preferred Securities are expected to be assigned on issue a rating of "A" by Standard & Poor's Ratings Services, a Division of The McGraw Hill Companies Inc., "A1" by Moody's Investors Service Limited and "AA-" by Fitch Ratings. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the relevant rating organisation.

Governing Law The Guarantee and the Subordinated Note will be governed by English law. The Partnership Agreement and the Preferred Securities will be governed by Jersey law.

Listing Application has been made for the Preferred Securities to be listed on the Luxembourg Stock Exchange.

Global Certificate ISIN: XS0189704140
Common Code: 018970414

Transaction Structure



USE OF PROCEEDS

The proceeds from the issue of the Preferred Securities, which are expected to amount to £300,000,000, will be used by the Issuer to subscribe for the Subordinated Note. The Bank will use the proceeds from the issue of the Subordinated Note for general corporate purposes and for augmenting the capital base of the Bank. The Managers will receive fees and commissions as set out under "*Subscription and Sale*".

INVESTMENT CONSIDERATIONS

Prospective investors should consider carefully the following information in conjunction with the other information contained in this Offering Circular before purchasing any Preferred Securities.

Distributions on the Preferred Securities are not cumulative.

Distributions on the Preferred Securities are not cumulative. As set out in "*Description of the Preferred Securities – Distributions*", Distributions will be paid on each Distribution Date out of interest received by the Issuer under the Subordinated Note. Distributions may not be paid in full, or at all, if the Bank does not have sufficient distributable profits or if the Bank is limited in making payments on other obligations, including the Guarantee. If Distributions for any Distribution Period are not paid by reason of the above limitations, investors will not be entitled to receive such Distributions (or any Guaranteed Payment in respect of such Distributions) whether or not funds are or subsequently become available.

The Preferred Securities have no fixed redemption date and investors have no rights to call for redemption of the Preferred Securities.

The Preferred Securities have no fixed final redemption date and holders have no rights to call for the redemption of the Preferred Securities. Although the Preferred Securities may be redeemed in certain circumstances (including at the option of the General Partner on 7 April 2020 or following the occurrence of a Tax Event or a Regulatory Event), there are limitations on redemption of the Preferred Securities, including satisfaction of the Redemption Conditions (as described herein) relating to FSA consent and the availability of sufficient funds to effect redemption.

Any Preferred Securities outstanding on the Distribution Date in April 2049 will be substituted by Substitute Preference Shares.

If any Preferred Securities are outstanding on the Distribution Date in April 2049 and no notice has been given to redeem such Preferred Securities on or before the Distribution Date in April 2049, such Preferred Securities will be substituted by the Substitute Preference Shares.

Investors will only receive Distributions on Preferred Securities from the Issuer if the Bank pays interest on the Subordinated Note.

The ability of the Issuer to make payments on the Preferred Securities is dependent upon the Bank making the related payments on the Subordinated Note when due. If the Bank defaults on its obligations to make payments on the Subordinated Note, the Issuer will not have sufficient funds to make payments on the Preferred Securities. In those circumstances, investors will have to rely upon the Guarantee from the Bank for payment of these amounts.

The Bank's obligations under the Guarantee are limited to the amounts of the payments due under the Preferred Securities.

The Bank's obligation to make payments under the Guarantee is limited to the extent of the amounts due under the Preferred Securities. Distributions will not be paid under the Preferred Securities if the Bank does not have available sufficient distributable profits to make payments in full on the Guarantee and all securities ranking equally to the Guarantee as to rights to dividends. Even if it has sufficient distributable profits available, Distributions will not be paid under the Preferred Securities if, on the date of such payment the Bank is prevented by applicable UK banking regulations or other requirements from making payment in full under the Guarantee or of any dividends or other distributions on its obligations that rank equally to the Guarantee or the Bank is unable to make such payment of dividends or other distributions without causing a breach of the capital adequacy requirements applicable to the Bank Group.

Investors will have no right to seek payment of amounts under the Guarantee that would exceed the amount investors would have been able to receive had investors been investors in directly issued non-cumulative, non-voting preference shares of the Bank.

Under no circumstances does the Guarantee provide for acceleration of any payments on, or repayment of, the Preferred Securities.

The Bank is not required to pay investors under the Guarantee unless it first makes other required payments.

The Bank's obligations under the Guarantee will rank junior to all of its liabilities to creditors and claims of holders of senior ranking securities. In the event of the winding-up, liquidation or dissolution of the Bank, its assets would be available to pay obligations under the Guarantee only after the Bank has made all payments on such senior ranking liabilities and claims. None of the Preferred Securities, the Subordinated Note or the Guarantee limit the ability of the Bank and its affiliates (other than as described in "*Summary of the Offering – Certain Restrictions*") to incur additional indebtedness, including indebtedness that ranks senior in priority of payment to the Guarantee.

Non-payment of Distributions may adversely affect the trading price of the Preferred Securities.

If in the future, payments are limited on the Preferred Securities because the Bank has insufficient available distributable profits, the Preferred Securities may trade at a lower price. If any investor sells the Preferred Securities during such a period, such investor may not receive the same price as another investor who does not sell its Preferred Securities until sufficient distributable profits are available to resume Distribution payments. In addition, because the Bank's obligation to make payments under the Guarantee is limited to the extent of the underlying payment obligations on the Preferred Securities which may be limited due to insufficient distributable profits, the market price for the Preferred Securities may be more volatile than other securities that do not reflect these limitations.

Investors should not rely on Distributions from the Preferred Securities – they may be redeemed at any time if certain adverse consequences occur as a result of the application of UK or Jersey tax law or regulations or on the occurrence of a regulatory event in the UK and certain conditions are satisfied.

If certain consequences occur, which are more fully described below in "*Description of the Preferred Securities*", as a result of the application of UK or Jersey tax law or regulations or on the occurrence of a regulatory event in the UK and certain other conditions (which are more fully described in "*Description of the Preferred Securities*") are satisfied, the Preferred Securities could be redeemed by the Issuer.

There can be no assurance as to the market prices for the Preferred Securities or the Substitute Preference Shares; therefore, investors may suffer a loss.

The Bank cannot give investors any assurance as to the market prices for the Preferred Securities or, following a Substitution Event, Substitute Preference Shares that may be distributed in exchange for the Preferred Securities. Accordingly, the Preferred Securities and Substitute Preference Shares may trade at a discount to the price at which investors purchased the Preferred Securities. In addition, because the Bank's obligation to make payments under the Guarantee is limited to the extent of the underlying payment obligations on the Preferred Securities which may in turn be limited due to insufficient distributable profits being available, the market price for these securities may be more volatile than other securities that do not reflect these limitations.

HSBC BANK CAPITAL FUNDING (STERLING 2) L.P.

Introduction

HSBC Bank Capital Funding (Sterling 2) L.P. was registered in Jersey on 31 March 2004 under the Limited Partnerships (Jersey) Law, 1994 for an unlimited duration, with HSBC Bank (General Partner) Limited as the general partner (the "General Partner"). The General Partner, HSBC Issuer Services Common Depositary Nominee (UK) Limited (the "Initial Partner"), HSBC Preferential LP (UK) (the "Preferential Limited Partner") and the Bank have entered into a partnership agreement dated 31 March 2004 (the "Partnership Agreement") for the purpose of establishing the Issuer. The Issuer is not a legal entity separate from its partners. The Partnership Agreement is not intended to create a trust relationship between any of the partners. The Preferred Security limited partnership interests are held on the investors' behalf in the name of HSBC Issuer Services Common Depositary Nominee (UK) Limited.

Control of the Issuer

The General Partner, a wholly owned subsidiary of, and controlled by, the Bank, is the sole general partner in the Issuer and, as such, controls the Issuer. The General Partner, the Initial Partner and the Preferential Limited Partner also hold partnership interests in HSBC Bank Capital Funding (Sterling 1) L.P., a separately established Jersey limited partnership.

Provided that limited partners do not become involved with the management of the Issuer other than in the circumstances provided for in the Partnership Agreement (see "*Description of the Preferred Securities - Voting Rights*"), and in accordance with applicable law, the liability of the limited partners to contribute to the debts or obligations of the Issuer will be limited to the amount which they have contributed or agreed to contribute to the partnership, being £1,000 per Preferred Security.

Sole Activity

The Issuer was established for the sole purpose of raising finance for the Bank. The General Partner has not carried out any operations on behalf of the Issuer since registration of the Issuer other than in relation to the creation of the Preferred Securities. The capital contributions to be made by the limited partners will be used by the General Partner on behalf of the Issuer to subscribe for the Subordinated Note.

Management

The Issuer will be operated by the General Partner and its duly appointed delegates. The registered office of the Issuer and of the General Partner is HSBC House, Esplanade, St Helier, Jersey JE4 8UB. Except as provided for in the Law and as described in paragraph 8 of the section entitled "*Description of the Preferred Securities*", no holder of a Preferred Security may participate in the management of the Issuer. The Bank has undertaken in the Guarantee to ensure that the General Partner will at all times be a directly or indirectly owned subsidiary of the Bank.

The General Partner has agreed in the Partnership Agreement to contribute capital from time to time to the extent necessary to pay all costs, expenses, debts, liabilities and obligations incurred in the proper maintenance and business of the Issuer (other than in respect of payments on the Preferred Securities or the Preferential Right). The General Partner has also agreed that it will at all times maintain sole ownership of its general partnership interest in the Issuer subject to the terms of the Partnership Agreement. The Partnership Agreement provides that all of the Issuer's operations will be conducted by the General Partner and the General Partner will have unlimited liability for the repayment, satisfaction and discharge of all debts and obligations of the Issuer to persons other than partners in accordance with the Limited Partnerships (Jersey) Law, 1994. Neither the Issuer nor the General Partner shall be liable to

make any payment to any limited partner in respect of the Preferred Securities or the Preferential Right other than out of partnership assets.

If the Issuer is dissolved or wound up, the Partnership Agreement provides that the General Partner will only be entitled to any assets of the Issuer remaining after (i) all debts and other liabilities of the Issuer have been satisfied in full and (ii) the full Liquidating Distribution to which the holders of Preferred Securities are entitled having regard to the limitations set out herein has been paid to or irrevocably set aside for the holders and any amount payable in respect of the Preferential Right has been paid.

The General Partner has undertaken that, if the Subordinated Note is redeemed while the Preferred Securities remain outstanding and are not subject to a notice of redemption, it will invest the proceeds of the Subordinated Note or any Replacement Debt in a subordinated note of the Bank, with a maturity date of 30 April 2049 and economic terms essentially equivalent to the Subordinated Note (including that the interest rate will reflect the then current Distribution Rate provisions of the Preferred Securities).

Capital Contributions

Save for capital contributions to be made by the General Partner from time to time to meet certain operating expenses of the partnership, the capital commitment of £1,000 which the General Partner may call from HSBC Preferential LP (UK) as the Preferential Limited Partner, and the capital contribution of £300,000,000 to be made by the limited partners in relation to the Preferred Securities, there are intended to be no other contributions to the Issuer.

Indebtedness

Since the date of its registration, the Issuer has not had any loan capital outstanding, has not incurred any borrowings, has had no contingent liabilities except as disclosed herein, has not granted any guarantees and does not intend to have outstanding any such loan capital, incur any such borrowings, have any such contingent liabilities or grant any such guarantees. The General Partner has undertaken not to incur any indebtedness in the name of the Issuer other than the costs and expenses incidental to maintaining the Register, paying the fees and commissions for listing, registrar and paying agency charges in respect of the Preferred Securities, holding and exercising its rights under the Subordinated Note or any Replacement Debt and the maintenance of a custodian thereof and the administration of the Issuer.

DESCRIPTION OF THE BANK

HSBC Bank plc and its subsidiaries form a UK-based group providing a comprehensive range of banking and related financial services.

HSBC Bank plc (formerly Midland Bank plc) was formed in England in 1836 and subsequently registered as a limited company in 1880. In 1923, the company adopted the name of Midland Bank Limited which it held until 1982 when the name was changed to Midland Bank plc.

During the year ended 31 December 1992, Midland Bank plc became a wholly owned subsidiary undertaking of HSBC Holdings plc ("HSBC Holdings"), whose Group Head Office is at 8 Canada Square, London E14 5HQ. HSBC Bank plc adopted its current name, changing from Midland Bank plc, in the year ended 31 December 1999.

The HSBC Group is one of the largest banking and financial services organisations in the world, with over 9,500 offices in 79 countries and territories in Europe, Hong Kong, the rest of Asia-Pacific, including the Middle East and Africa, North America and South America. Its total assets at 31 December 2003 were £579 billion. The Bank is the HSBC Group's principal operating subsidiary undertaking in Europe.

As at 31 December 2003, the Bank's principal subsidiary undertakings and their main geographical areas of activity were:

- CCF S.A. (formerly Crédit Commercial de France S.A.) France
- HSBC Asset Finance (UK) Limited United Kingdom
- HSBC Bank A.S. Turkey
- HSBC Bank International Limited Jersey
- HSBC Bank Malta p.l.c. Malta
- HSBC Guyerzeller Bank AG Switzerland
- HSBC Invoice Finance (UK) Limited United Kingdom
- HSBC Life (UK) Limited United Kingdom
- HSBC Rail (UK) Limited United Kingdom
- HSBC Private Bank (Guernsey) Limited Guernsey
- HSBC Private Bank (Suisse) SA Switzerland
- HSBC Private Bank (UK) Limited
(formerly HSBC Republic Bank (UK) Limited) United Kingdom
- HSBC Trinkaus & Burkhardt KGaA Germany
- HSBC Trust Company (UK) Limited United Kingdom

The Bank divides its activities into the following business segments: UK Personal Banking; UK Commercial Banking; UK Corporate, Investment Banking and Markets; International Banking; CCF; HSBC Private Banking; and HSBC Trinkaus & Burkhardt.

UK Personal Banking provides current accounts, savings, personal lending, mortgages, cards and wealth management services to customers through a number of channels under the HSBC and First Direct Brands.

UK Commercial Banking provides products and services to a broad range of commercial organisations from sole proprietors to major companies.

Corporate, Investment Banking and Markets, formed out of the alignment of Corporate and Institutional Banking, Global Markets UK and Investment Banking, provides tailored financial solutions to major government, corporate and institutional clients.

International Banking provides a range of retail financial services, primarily across Europe, to local and expatriate customers and wholesale banking to corporate and institutional clients.

CCF offers a wide range of retail, commercial and asset management products to individuals, companies and institutional customers through a network of regional banks in France.

HSBC Private Banking offers an array of client services to high net worth customers, including advisory portfolio management, discretionary asset management, tax, trust and estate planning, mutual funds and currency and securities transactions.

HSBC Trinkaus & Burkhardt, based in Düsseldorf, Germany, offers a comprehensive range of services to wealthy private clients and medium sized companies, institutional investors, public corporations and financial institutions.

The Bank has 1,602 branches in the United Kingdom. Outside the United Kingdom, it has branches in Australia, Belgium, Cyprus, the Czech Republic, France, Greece, Guernsey, the Hong Kong Special Administrative Region, Ireland, the Isle of Man, Israel, Italy, Jersey, the Netherlands, South Africa, Spain and Sweden; it has representative offices in Argentina, Côte d'Ivoire, Ghana, Mexico, Singapore, Uganda and Venezuela; and it has subsidiaries in Armenia, France, Germany, Greece, Kazakhstan, Malta, Poland, Russia, Spain, Switzerland and Turkey. Through these undertakings, the Bank provides a comprehensive range of banking and related financial services.

In February 2003, the Bank acquired the remaining 40 per cent of Equator Holdings Limited it did not already own, for a cash consideration of £4 million, from Nedbank Africa Investments Limited. This, together with the transfer of the majority of the assets and liabilities of HSBC Equator Bank plc to a new branch of the Bank in South Africa in February 2004, forms part of the Group's strategy to build its business in South Africa. The transfer was effected by means of an Order of the Court sanctioning a banking business transfer scheme under Part VII of the Financial Services and Markets Act 2000.

In October 2003, the Bank acquired Polski Kredyt Bank S.A. for a cash consideration of £5 million. The bank has been re-named HSBC Bank Polska S.A. and focuses on consumer finance business and corporate, investment banking and markets and treasury business.

During 2003, the CCF group increased its interest in Banque Eurofin from 59.84 per cent to 83.94 per cent for a consideration of £21 million. As part of the CCF group's reorganisation of its private banking business, Banque Eurofin was subsequently merged into HSBC Private Bank France. In November 2003, the CCF group acquired the remaining 49 per cent of Elysées-Fonds not already owned, for a consideration of £10 million.

CONSOLIDATED CAPITALISATION AND INDEBTEDNESS OF THE BANK

The following shows the audited consolidated capitalisation and indebtedness of HSBC Bank plc as at 31 December 2003:

| | | Authorised | Issued and fully paid |
|------|---------|---|-----------------------------|
| | | £m | £m |
| | | Ordinary Share Capital of HSBC Bank plc: | |
| | | | Proceeds of Issue £m |
| | | 1,000 | 797 |
| | | | - |
| | | 1 | 490 |
| | | | Amount Outstanding £m |
| | | Minority Interests – Non Equity | |
| € | 1,900m | | 1,342 |
| £ | 700m | | 700 |
| | | | 2,042 |
| | | Consolidated Loan Capital | |
| | | Undated subordinated loan capital of HSBC Bank plc | |
| US\$ | 750m | | 420 |
| US\$ | 500m | | 280 |
| US\$ | 300m | | 168 |
| £ | 150m | | 150 |
| £ | 150m | | 150 |
| | | | 1,168 |
| | | Undated subordinated loan capital of subsidiary undertakings | |
| ¥ | 10,000m | | 52 |
| | | | 48 |
| | | | 100 |
| | | Dated subordinated loan capital of HSBC Bank plc | |
| US\$ | 400m | | 223 |
| £ | 200m | | 200 |
| US\$ | 500m | | 280 |
| US\$ | 375m | | 209 |
| US\$ | 300m | | 168 |
| € | 250m | | 177 |
| € | 600m | | 424 |
| £ | 350m | | 350 |
| £ | 350m | | 350 |
| £ | 300m | | 298 |
| US\$ | 300m | | 168 |
| £ | 500m | | 500 |
| £ | 225m | | 223 |
| | | | 3,570 |
| | | Dated subordinated loan capital of subsidiary undertakings | |
| € | 152m | | 107 |
| | | | 314 |
| | | | 421 |
| | | | 5,259 |
| | | Total Consolidated Loan Capital | |

Notes:

- (1) The authorised share capital of HSBC Bank plc comprises 999,999,999 ordinary shares of nominal value £1 each; 150,000,000 Sterling preference shares of nominal value £1 each; 244,000,000 US Dollar preference shares of nominal value US\$0.01 each; and one preferred ordinary share of nominal value £1.
- (2) The issued, allotted and fully paid share capital of HSBC Bank plc comprises 796,969,095 ordinary shares of nominal value £1 each; 35,000,000 non-cumulative US Dollar preference shares of nominal value US\$0.01 each; and one preferred ordinary share of nominal value £1, all of which are beneficially owned by HSBC Holdings plc.
- (3) The proceeds of the capital contribution referred to under Minority Interests – Non Equity were on-lent by HSBC Capital Funding 1 (UK) Limited Partnership (a subsidiary undertaking of the Bank) to the Bank's Paris branch by issue of €900 million 7.75% Non-cumulative Subordinated Notes 2040 and €1,000 million Floating Rate Subordinated Loan 2012.
- (4) The 5.844% Non-Cumulative Step-up Perpetual Preferred Securities have the benefit of a subordinated guarantee of HSBC Bank plc. None of the other above Minority Interests or Consolidated Loan Capital is secured or guaranteed.
- (5) On 17 March 2004, HSBC Holdings plc subscribed for one ordinary share in HSBC Bank plc for £700 million, issued at a premium.
- (6) Since 31 December 2003, HSBC Trinkaus und Burkhardt KGaA has issued an aggregate amount of €67.5 million of subordinated bonds and subordinated schuldscheinleihen with rates between 5% and 5.43% and maturing in 2014 and 2019.
- (7) On 18 March 2004, CCF redeemed the US\$36.6 million outstanding subordinated collared floating rate notes due 2004, and on 25 March 2004, CCF called and redeemed the €152 million subordinated callable floating rate notes due 2008.
- (8) As at 31 December 2003, HSBC Bank plc had other indebtedness of £221,388 million (including deposits by banks of £29,287 million, customer accounts of £146,103 million, debt securities in issue of £9,769 million and other liabilities of £36,229 million) and contingent liabilities of £15,823 million (comprising acceptances and endorsements of £455 million and guarantees and assets pledged as collateral security of £15,368 million). In addition, as at 31 December 2003, HSBC Bank plc had pledged assets of £12,441 million as security for liabilities of £1,874 million.

DESCRIPTION OF THE PREFERRED SECURITIES

The Preferred Securities are limited partnership interests in the Issuer. The following summary should be read in conjunction with, and is subject to the terms of, the Partnership Agreement, a copy of which is available as described under "General Information".

Description of the Preferred Securities

1. Definitions

In this Description of the Preferred Securities, except to the extent that the context otherwise requires:

"Additional Amounts" has the meaning given to that term in paragraph 6;

"Adjusted Distributable Reserves" means at any time the lawful distributable reserves of the Bank at such time less the cumulative amount since the Issue Date of all redemptions of and payments on (a) any shares or other securities or obligations of the Bank that are accounted for under then generally accepted accounting principles in the United Kingdom as shareholders' funds in the Bank's accounts and (b) all shares, securities or other obligations of an undertaking which are accounted for under then generally accepted accounting principles in the United Kingdom as minority interest capital in the Bank's consolidated accounts, and with recourse (whether by way of guarantee, support agreement or otherwise) to the Bank that are similar in material respects to the Preferred Securities and the Guarantee, taken together, whether or not Parity Obligations, except in each case for such amounts as have been either charged to the lawful distributable reserves of the Bank or funded at that time by an issue of Replacement Capital made for the purpose of funding such redemption as described in item (ii)(b) of the definition of "Redemption Conditions";

"Bank" means HSBC Bank plc;

"Bank Group" means the Bank together with its Subsidiaries;

"Business Day" means a day other than a Saturday or Sunday on which commercial banks and foreign exchange markets settle payments in pounds sterling and are open for general business in London;

"Calculation Agent" means HSBC Bank plc or any successor calculation agent appointed under the Agency Agreement to be dated 7 April 2004 between, *inter alia*, the Bank, the General Partner and HSBC Bank plc in its capacity as Calculation Agent;

"Calculation Date" means the date which is three Business Days prior to the Early Redemption Date;

"Clearstream, Luxembourg" means Clearstream Banking, société anonyme, Luxembourg;

"Day Count Fraction" means, prior to the First Optional Redemption Date, the actual number of days in the period from and including the date from which the relevant Distribution begins to accrue for the relevant period of calculation to but excluding the date on which it falls due, divided by the actual number of days in the Distribution Period in which such period of calculation falls and, on or after the First Optional Redemption Date, the actual number of days in the relevant period divided by 365;

"Distributions" means the non-cumulative cash distributions on the Preferred Securities as described in paragraph 2 and "Distribution" has a corresponding meaning;

"Distribution Date" means 7 April in each year commencing 7 April 2005 and ending on the First Optional Redemption Date and thereafter 7 April and 7 October in each year ;

“Distribution Determination Date” means the date which is five Business Days prior to a Distribution Date;

“Distribution Period” means the period from (and including) the Issue Date to (but excluding) the first Distribution Date and each period thereafter from (and including) one Distribution Date to (but excluding) the next following Distribution Date;

“Distribution Rate” means in respect of the Preferred Securities, (i) for each Distribution Period until the First Optional Redemption Date, 5.862% per annum and, (ii) for each Distribution Period thereafter, the sum of six-month LIBOR and 1.85% for such Distribution Period;

“Early Redemption Date” means any date designated for redemption of the Preferred Securities for tax or regulatory reasons as described under paragraphs 4.3 and 4.4;

“Euroclear” means Euroclear Bank, S.A./N.V. as operator of the Euroclear System or its successor;

“First Optional Redemption Date” means 7 April 2020;

“FSA” means the Financial Services Authority in the United Kingdom and shall include any successor organisation responsible for the supervision of banks in the United Kingdom;

“General Partner” means HSBC Bank (General Partner) Limited;

“Guarantee” means the subordinated guarantee in respect of the Preferred Securities to be executed by the Bank on 7 April 2004 as a deed poll;

“Guaranteed Payments” means collectively (i) all Distributions due on the Preferred Securities, (ii) any Distributions on the Preferred Securities which would have been due had the Issuer had sufficient legally available resources but only if, and to the extent that, the Issuer did not have such legally available resources solely due to a failure by the Bank to pay interest on the Subordinated Note or the Replacement Debt as and when due and payable under the terms thereof, (iii) any Liquidating Distribution, (iv) any cash amounts to which the Holders are entitled in respect of redemption of the Preferred Securities and (v) any Additional Amounts, payment of which is in each case guaranteed by the Bank under the Guarantee;

“Holder” means, in respect of each Preferred Security, each person registered on the Register as the limited partner holding such Preferred Security at the relevant time;

“Issue Date” means 7 April 2004;

“Issuer” means HSBC Bank Capital (Sterling 2) L.P. acting by the General Partner;

“Jersey” means the Island of Jersey;

“Law” means the Limited Partnerships (Jersey) Law, 1994, as amended or restated from time to time;

“Limited Partnerships Registrar” means the person appointed as Registrar of Limited Partnerships pursuant to the Law;

“Liquidating Distribution” in respect of any Preferred Security upon a dissolution or winding up of the Issuer, means the nominal amount together with any accrued but unpaid Distribution from and including the commencement of the Distribution Period in which the date of the dissolution or winding up falls (less any interim Liquidating Distribution that may have been paid);

“London Stock Exchange” means the London Stock Exchange plc;

“Make Whole Amount” in respect of a Preferred Security means, at any time prior to the First Optional Redemption Date, an amount equal to the sum of:

- (i) the present value of its nominal amount; and
- (ii) the present value of each remaining scheduled Distribution to and including the First Optional Redemption Date

discounted from (i) in relation to the nominal amount, the First Optional Redemption Date, and (ii) in relation to each such remaining scheduled Distribution, the relevant Distribution Date, in each case to the Early Redemption Date at a rate equal to the sum of (x) 0.375% and (y) the Reference Rate on an annual compounding basis (rounded to four decimal places);

“Optional Redemption Date” means the First Optional Redemption Date and each Distribution Date thereafter;

“Optional Redemption Price” in respect of a Preferred Security means an amount equal to its nominal amount;

“Parity Obligations” means (i) in relation to the Bank, any preference shares or other obligations of the Bank that constitute tier 1 capital of the Bank on a consolidated basis and do not rank in all material respects senior or junior to the Bank’s obligations under the Guarantee and any other guarantee given or support agreement entered into by the Bank in respect of any preference shares, or other preferred securities (not constituting debt obligations) having in all material respects the same ranking as preference shares, issued by any Subsidiary, that constitute tier 1 capital of the Bank on a consolidated basis and do not rank in all material respects senior or junior to the Guarantee and (ii) in relation to the Issuer, any preferred securities (other than the Preferred Securities) issued by it or other obligations of it which are entitled to the benefit of the Guarantee or any guarantee of the Bank ranking *pari passu* with the Guarantee;

“Partnership Agreement” means the limited partnership agreement dated 31 March 2004 between the General Partner, HSBC Issuer Services Common Depositary Nominee (UK) Limited as the Initial Partner, HSBC Preferential LP (UK), an unlimited liability company incorporated in England and Wales and tax resident in the United Kingdom, as the holder of the Preferential Right and the Bank pursuant to which the Issuer was established, as the same may be amended from time to time;

“Paying Agent” means each of HSBC Private Bank (Jersey) Limited, HSBC Bank plc and Kredietbank S.A. Luxembourgeoise and/or such other entity as is appointed by the General Partner on behalf of the Issuer and notified to the Holders in the manner described in paragraph 10;

“Permitted Reorganisation” means a solvent reconstruction, amalgamation, reorganisation, merger or consolidation whereby all or substantially all business, undertaking and assets of the Bank are transferred to a successor entity which assumes all the obligations under the Guarantee;

“Preferential Right” means the preferential limited partnership interest in the Issuer initially held by HSBC Preferential LP (UK) and entitling it to receive in preference to the rights of the General Partner all amounts received by the Issuer in excess of those required to make payments of any Distribution (and, if relevant, Additional Amounts) on any Distribution Date or any Liquidating Distribution or relevant proportion thereof (and, if relevant, Additional Amounts) to Holders in accordance with paragraphs 2 or 3 below;

“Preferred Capital Contribution” means, in relation to the Preferred Securities, the aggregate contribution to the assets of the Issuer (being a whole multiple of £1,000) paid in cash to or to the order of the Issuer in respect of the Preferred Securities;

“Preferred Securities” means the £300,000,000 5.862% Non-cumulative Step-up Perpetual Preferred Securities, ranking *pari passu* amongst themselves and representing the interest of a Holder in the Issuer attributable to the relevant proportion of the Preferred Capital Contribution (being a whole multiple of £1,000);

“Recognised Stock Exchange” has the meaning given to that term in section 841 of the Income and Corporation Taxes Act 1988 of the United Kingdom;

“Redemption Conditions” means (i) that the consent of the FSA to the redemption, if then required, has been obtained and (ii) that the aggregate of (a) the Adjusted Distributable Reserves of the Bank as at the date proposed for redemption and (b) the proceeds available from an issue of Replacement Capital that has been made for the purpose of funding the redemption, is at least equal to the aggregate of the full amount payable on the redemption (including any Distribution payable on redemption);

“Redemption Date” means an Early Redemption Date or an Optional Redemption Date, as applicable;

“Reference Rate” means, in respect of the Calculation Date, the gross redemption yield (as calculated by the Calculation Agent on the basis indicated by the United Kingdom Debt Management Office in the paper “Formulae for Calculating Gilt Prices from Yields” page 4, Section one Price/Yield Formulae “Conventional Gilts; Double-dated and Undated Gilts with Assumed (or Actual) Redemption on a Quasi Coupon Date” (published 8th June 1998) on a semi-annual compounding basis (rounded, if necessary, to four decimal places) of the Reference Security, with the price of the Reference Security for this purpose being the arithmetic average of the bid and offered prices of the Reference Security quoted (to four decimal places) by the Reference Rate Market Makers at 3.00 p.m. (London time) on the Calculation Date on a dealing basis for settlement on the next following Business Day;

“Reference Rate Market Makers” means three brokers of gilts and/or gilt-edged market makers chosen by the Calculation Agent for the purpose of calculating the Reference Rate;

“Reference Security” means such U.K. government gilt-edged security as has, immediately prior to the Early Redemption Date, a maturity nearest to the next Optional Redemption Date as may be selected by the Calculation Agent with the advice of the Reference Rate Market Makers;

“Register” means the register of Holders maintained outside the United Kingdom on behalf of the Issuer under the Law;

“Registrar” means, in relation to the Preferred Securities, HSBC Private Bank (Jersey) Limited or such other entity appointed by the General Partner on behalf of the Issuer having its office outside the United Kingdom and notified to the Holders in the manner described in paragraph 10;

“Regulatory Event” means that for any reason there is more than an insubstantial risk that for the purposes of the FSA’s capital adequacy requirements applicable to banks in the United Kingdom at that time, the Preferred Securities may not be included in the tier 1 capital of the Bank on both a solo basis and a consolidated basis;

“Regulatory Event Redemption Price” means, in relation to a redemption of a Preferred Security prior to the First Optional Redemption Date, an amount equal to the higher of (i) its nominal amount (together with any accrued but unpaid Distribution in respect of the Distribution Period in which the relevant redemption falls) and (ii) the Make Whole Amount and, in relation to any other redemption of a Preferred Security, means its nominal amount (together with any accrued but unpaid Distribution in respect of the Distribution Period in which the relevant redemption falls);

“Relevant Proportion” means (a) in relation to any partial payment of a Distribution, the amount of Adjusted Distributable Reserves as of the Distribution Determination Date divided by the sum of (i) the total amount originally scheduled to be paid by way of Distribution on the Preferred Securities on the relevant Distribution Date and (ii) the sum of any dividends or other distributions or payments in respect of the Bank’s Parity Obligations due and payable on that Distribution Date, converted where necessary into the same currency in which Adjusted Distributable Reserves are reported by the Bank; and (b) in relation to any partial payment of any Liquidating Distribution, the total amount available for any such payment and for making any Liquidating Distribution on any Parity Obligations divided by the sum of (i) the full Liquidating Distribution before any reduction or abatement hereunder and (ii) the amount (before any reduction or abatement hereunder) of the full liquidating distribution on any Parity Obligations of the Bank, converted where necessary into the same currency in which liquidation payments are made to creditors of the Bank;

“Replacement Capital” means shares, securities or other obligations as are mentioned in (a) or (b) in the definition of Adjusted Distributable Reserves;

“Replacement Debt” has the meaning given to that term in paragraph 9.2;

“six-month LIBOR” means:

- (a) the offered rate (rounded, if necessary, up to the nearest one hundred thousandth of a percentage point (0.000005 per cent. being rounded upwards)) for six-month pounds sterling deposits as at 11.00 a.m. (London time) on the first day of the relevant Distribution Period as appears on the display designated as page “3750” on the Moneyline Telerate Service (or such other page or service as may replace it for the purpose of displaying such information) as determined by the Calculation Agent;
- (b) if such offered rate does not appear, the arithmetic mean (rounded, if necessary, up to the nearest one hundred thousandth of a percentage point (0.000005 per cent. being rounded upwards)) of offered quotations to leading banks in the London interbank market for six-month pounds sterling deposits as at 11.00 a.m. (London time) on the first day of the relevant Distribution Period obtained by the Calculation Agent from the principal London offices of four major banks provided at least two of the major banks provide the Calculation Agent with such offered quotations; and
- (c) if, on the first day of the relevant Distribution Period to which the provisions of sub-paragraph (b) above apply, one only or none of the major banks provides the Calculation Agent with such a quotation, the arithmetic mean (rounded, if necessary, up to the nearest one hundred thousandth of a percentage point (0.000005 per cent. being rounded upwards)) of the pounds sterling lending rates which major banks in London selected by the Calculation Agent are quoting at approximately 11.00 a.m. (London time) on the first day of the relevant Distribution Period to leading banks in London for a period of six months,

except that, if the banks so selected by the Calculation Agent are not quoting as mentioned above, six-month LIBOR shall be the rate equal to six-month LIBOR in effect for the last preceding Distribution Period;

“Securities Act” means the US Securities Act of 1933, as amended;

“Special Representative” has the meaning given to that term in paragraph 8;

“Stock Exchange” means the Luxembourg Stock Exchange (or any successor organisation) or the London Stock Exchange or such other Recognised Stock Exchange approved by the General Partner on which the Preferred Securities (or any Substitute Preference Shares) may be listed from time to time;

“Subordinated Note” means the £300,000,000 5.862% Fixed/Floating Rate Subordinated Notes in bearer form due on 30 April 2049 to be issued by the Bank on the Issue Date and subscribed for by the Issuer using the proceeds of the issue of the Preferred Securities;

“Subsidiary” means any entity which is for the time being a subsidiary undertaking of the Bank (within the meaning given to this term in the United Kingdom Companies Act 1989) and “Subsidiaries” has a corresponding meaning;

“Substitute Preference Shares” has the meaning given to that term in paragraph 5.1;

“Substitution Event” means that (i) on the Distribution Date in April 2049 the Preferred Securities (or any of them) are outstanding and no notice has been given to redeem the then outstanding Preferred Securities on or before the Distribution Date in April 2049 pursuant to paragraph 4; (ii) the Bank’s total capital ratio, calculated on a solo basis and consolidated basis in accordance with applicable UK bank capital adequacy regulations, has fallen below the then applicable minimum ratio required by such regulations (currently 8%); or (iii) the Bank’s board of directors in its sole discretion has notified the FSA and the Issuer that it has determined, in view of the Bank’s deteriorating financial condition, that (ii) above is expected to occur in the near term;

“Substitution Event Date” means the earliest of (a) the Distribution Date in April 2049; (b) the date falling 30 days after notice is given by the Bank in accordance with paragraph 10 that Substitute Preference Shares are available for issue following a Substitution Event falling within (ii) or (iii) of the definition of Substitution Event; or (c) the day on which a Former Holder is registered as the holder of Substitute Preference Shares;

“Tax Event” means that, whether or not as a result of a change in any law or regulation of the United Kingdom or Jersey, or in any treaty to which the United Kingdom or Jersey is a party, or in the official interpretation or application of any law, regulation or treaty by any relevant body in the United Kingdom or Jersey or any action taken by any appropriate authority, there is a more than insubstantial risk that (i) the Issuer or the General Partner would be subject to more than a de minimis amount of tax (except, in the case of the General Partner only, for any such tax that would arise as a result of (a) profits arising to it as a result of payments received by it from the Issuer or (b) activities (if any) carried on by it other than those permitted or contemplated in the Partnership Agreement) in Jersey or the United Kingdom, (ii) payments to Holders would be subject to deduction or withholding for or on account of tax or would give rise to any obligation to account for any tax in Jersey or the United Kingdom, (iii) payments by the Bank in respect of the Subordinated Note would be subject to deduction or withholding for or on account of tax in the United Kingdom, or (iv) the Bank would not obtain relief for the purposes of United Kingdom corporation tax for any payment of interest in respect of the Subordinated Note;

“Tax Redemption Price” means, in respect of a redemption of a Preferred Security, the Optional Redemption Price together with any accrued but unpaid Distribution in respect of the Distribution Period in which the Preferred Security is redeemed;

“Treaty” means the Treaty establishing the European Community, as amended;

“UK” and the “United Kingdom” means the United Kingdom of Great Britain and Northern Ireland; and

“UK Listing Authority” means the Financial Services Authority in its capacity as a competent authority for the purposes of Part VI of the Financial Services and Markets Act 2000.

2. Distributions

- 2.1 Subject as provided by the Law and in paragraphs 2.3, 2.9 and 7.3, Distributions shall accrue from the Issue Date and shall be payable in arrear on each Distribution Date (or where any Distribution Date is not a Business Day, on the succeeding Business Day without interest in respect of such delay).
- 2.2 Subject to the Law, Distributions in respect of any Distribution Period will be payable at the applicable Distribution Rate on the nominal amount of the Preferred Security.

The Calculation Agent will at or as soon as practicable after each time at which the Distribution Rate is to be determined, determine the Distribution Rate for the relevant Distribution Period. Each such determination will be notified to the Issuer, the Registrar, the Stock Exchange and the Holders before the commencement of the relevant Distribution Period.

- 2.3 Distributions will be non-cumulative and will accrue on a day by day basis in accordance with the Day Count Fraction. Distributions will be payable out of the Issuer's own legally available resources on the relevant Distribution Date, subject as provided below. Notwithstanding receipt of any interest due under the Subordinated Note or any other resources legally available for distribution by the Issuer, neither the Issuer nor the Bank will, save to the extent provided in paragraph 2.4, pay a Distribution or make any payment in respect of a Distribution under the Preferred Securities or the Guarantee if, on the relevant Distribution Date:
- 2.3.1 the Bank would be prevented by applicable UK banking regulations or other requirements from making payment in full (a) of dividends or other distributions due and payable on its Parity Obligations or (b) under the Guarantee; or
- 2.3.2 the amount of such Distribution (if paid in full), together with the sum of any dividends and other distributions on the Bank's Parity Obligations due and payable on that Distribution Date or under the Guarantee, would exceed the Adjusted Distributable Reserves of the Bank as of the Distribution Determination Date immediately preceding the relevant Distribution Date.
- 2.4 If Distributions, whether by reason of the provisions of paragraph 2.3 or any equivalent article or term of a Parity Obligation, on any Distribution Date are not paid in full on the Preferred Securities or dividends or other distributions are not paid in full on any Parity Obligations, but Adjusted Distributable Reserves are sufficient so as to allow payment of part of any Distribution, then each Holder will be entitled to receive the Relevant Proportion of any such Distribution. No Holder shall have any claim in respect of any Distribution or part thereof not payable as a result of the limitations set out in paragraph 2.3. Accordingly, such amount will not accumulate for the benefit of the Holders or entitle the Holders to any claim in respect thereof against the Issuer or the Bank under the Guarantee.
- 2.5 The Bank has covenanted in the Guarantee in favour of Holders that, in the event that for any single Distribution Period ending on or before the First Optional Redemption Date or thereafter for any two consecutive Distribution Periods, Distributions are not paid in full as a result of paragraph 2.3, it will not (a) declare or pay any dividends or other distributions in respect of its ordinary shares or (if permitted) effect any repurchase or redemption of its ordinary shares or any other security of the Bank ranking junior to the Guarantee (or contribute any moneys to a sinking fund for the redemption of any such shares or securities) until after the next following Distribution Date on which a Distribution in respect of the Preferred Securities is paid in full (or an amount equivalent to the Distribution to be paid in respect of the next Distribution Period has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders) or (b) (if permitted) repurchase or redeem Parity Obligations which are securities until after the next following Distribution Date on which a Distribution in respect of the

Preferred Securities is paid in full (or an amount equivalent to the Distribution to be paid in respect of the next Distribution Period has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders).

- 2.6 The Bank will determine whether as of each Distribution Determination Date sufficient Adjusted Distributable Reserves exist to allow a payment of some or all of the relevant Distribution. In the event that any Distribution cannot be paid in full, the Bank will notify or procure notification to the Stock Exchange, the General Partner, the Registrar and the Paying Agent, and to Holders in accordance with paragraph 10, of the fact and of the amount, if any, to be paid in respect of that Distribution.
- 2.7 Save as described above, Holders will have no right to participate in the profits of the Issuer or the Bank and, in particular, will have no rights to receive from the Issuer amounts paid under the Subordinated Note in excess of Distributions due and payable under the Preferred Securities. In the event that any amounts paid in respect of the Subordinated Note exceed the amount (if any) then due by way of Distribution under the Preferred Securities, the amount of such excess will be paid to the holder of the Preferential Right and Holders will have no rights in respect thereof.
- 2.8 The liability of a Holder to contribute to the debts or obligations of the Issuer (if any) shall not (subject to the Law) exceed the amount of that Holder's Preferred Capital Contribution.
- 2.9 If at any time the General Partner becomes aware that a Holder of Preferred Securities owns, directly or indirectly, 10% or more of the ordinary shares of the Bank, the General Partner on behalf of the Issuer will have the right to suspend payment of Distributions in respect of Preferred Securities held for such holder. Holders are required to provide written notice to the General Partner on behalf of the Issuer if at any time any such investor owns, directly or indirectly, 10% or more of the ordinary shares of the Bank. Any amounts so suspended will be forfeited and may not be subsequently claimed.

3. Liquidating Distributions

- 3.1 In the event of the commencement of any dissolution or winding up of the Issuer before any redemption of the Preferred Securities or any substitution of the Preferred Securities by Substitute Preference Shares under paragraph 5, the Holders at that time will be entitled to receive the Liquidating Distribution, in respect of each Preferred Security held, out of the assets of the Issuer available for distribution to such Holders under the Law. Such entitlement will arise (i) before any distribution of assets is made to the General Partner or to the holder of the Preferential Right and (ii) *pari passu* with the equivalent claims under all outstanding Parity Obligations of the Issuer but (iii) after the claims of all other creditors of the Issuer and holders of obligations of the Issuer which are not Parity Obligations nor subordinated to the Preferred Securities.

Notwithstanding the availability of sufficient assets of the Issuer to pay the Liquidating Distribution, if, at the time the Liquidating Distribution is to be paid, proceedings have been commenced for the winding-up of the Bank in England other than pursuant to a Permitted Reorganisation, the Liquidating Distribution paid to Holders shall not exceed the amount per security that would have been paid as a liquidation distribution out of the assets of the Bank had the Preferred Securities been directly issued preference shares issued by the Bank with equivalent rights of participation in the capital of the Bank (whether or not the Bank could in fact have issued such securities) and ranked (i) junior to depositors and all other creditors (including the holders of subordinated debt) of the Bank, (ii) *pari passu* with all Parity Obligations of the Bank and (iii) senior to the holders of the Bank's ordinary shares and any other securities or obligations of the Bank which are subordinated to the Guarantee.

- 3.2 If the Liquidating Distribution and any other such liquidation distributions cannot be made in full by reason of the limitation described in paragraph 3.1 or any equivalent

article or term of a Parity Obligation, but there are funds available for payment so as to allow payment of part of the Liquidating Distribution then each Holder will be entitled to receive the Relevant Proportion of the Liquidating Distribution. After payment of the Liquidating Distribution, or the Relevant Proportion thereof, if applicable, Holders will have no right or claim to any of the remaining assets of the Issuer or against the Bank under the Guarantee and the holder of the Preferential Right shall be entitled to receive any remaining assets of the Issuer.

- 3.3 In the event that proceedings are commenced for the liquidation, dissolution or winding up of the Bank in England other than pursuant to a Permitted Reorganisation, the General Partner shall file a statement of dissolution of the Issuer with the Limited Partnerships Registrar and the amount to which Holders shall be entitled as a Liquidating Distribution will be as set out in paragraphs 3.1 and 3.2.
- 3.4 Subject to paragraph 3.3, unless (i) the FSA has given its consent, if then required, and (ii) the aggregate of (a) the Adjusted Distributable Reserves of the Bank as at the date of such liquidation, dissolution or winding up and (b) the proceeds available from an issue of Replacement Capital that has been made for the purpose of funding the Liquidating Distribution is at least equal to the aggregate Liquidating Distribution, the General Partner will not permit, or take any action that would or might cause, the liquidation, dissolution or winding up of the Issuer. Notwithstanding the foregoing restriction imposed on the General Partner, if for any other reason the Issuer is liquidated, dissolved or wound up in circumstances where proceedings have not been commenced for the liquidation, dissolution or, as the case may be, winding up of the Bank, the Liquidating Distribution shall only be payable up to an amount equal to the aggregate of (ii)(a) and (b) above. No Holder shall have any claim (whether against the Issuer or under the Guarantee) in respect of any Liquidating Distribution or part thereof not paid when it would, but for the operation of this paragraph 3.4, otherwise have become due.
- 3.5 Paragraph 3.4 will not apply in circumstances where a Substitution Event has occurred and the Substitute Preference Shares have been issued.

4. Redemption and Purchase

- 4.1 The Preferred Securities have no fixed final redemption date and Holders have no rights at any time to call for the redemption of the Preferred Securities.
- 4.2 The Preferred Securities may be redeemed, in whole but not in part, at the option of the General Partner, subject to the satisfaction of the Redemption Conditions, paragraph 7.3 and to the Law, on any Optional Redemption Date upon not less than 30 nor more than 60 days' notice to the Holders specifying the Optional Redemption Date (which notice shall be irrevocable) at the Optional Redemption Price. Upon the expiry of such notice, the Preferred Securities shall be redeemed by payment of the Optional Redemption Price to the Holders.
- 4.3 If at any time a Tax Event has occurred and is continuing then either (i) the General Partner may (provided that proceedings have not been commenced for the liquidation, dissolution or winding up of the Bank in England) elect to substitute the Substitute Preference Shares for the Preferred Securities in the manner provided in paragraph 5 as if such event were a Substitution Event; or (ii) the Preferred Securities may be redeemed, in whole but not in part, at the option of the General Partner, subject to the satisfaction of the Redemption Conditions, paragraph 7.3 and to the Law, at any time upon not less than 30 nor more than 60 days' notice to the Holders specifying the Early Redemption Date (which notice shall be irrevocable), at the Tax Redemption Price. Where a notice of redemption has been given in accordance with the foregoing sentence, the General Partner shall also notify the Holders of the Tax Redemption Price as soon as reasonably practicable after it has been determined (and in any event not later than the second Business Day before the Early Redemption Date). Prior to the publication of any notice of redemption pursuant to the foregoing, the General Partner shall deliver to the Registrar a

certificate signed by two Directors of the Bank stating that the Issuer is entitled to effect such redemption and an opinion of counsel to the Bank experienced in such matters to the effect that a Tax Event has occurred (and specifying which of paragraphs (i) to (iv) as set out in the definition of "Tax Event" is applicable). The delivery of such opinion shall constitute conclusive evidence of the occurrence of a "Tax Event" for all purposes of the Partnership Agreement and Preferred Securities. Upon the expiry of such notice, the Preferred Securities shall be redeemed by the payment of the Tax Redemption Price to the Holders.

- 4.4 If at any time a Regulatory Event has occurred and is continuing, either (i) the General Partner may (provided that proceedings have not been commenced for the liquidation, dissolution or winding up of the Bank in England) elect to substitute the Substitute Preference Shares for the Preferred Securities in the manner provided in paragraph 5 as if such event were a Substitution Event or (ii) the Preferred Securities may be redeemed, in whole but not in part, at the option of the General Partner, subject to satisfaction of the Redemption Conditions, paragraph 7.3 and to the Law, at any time upon not less than 30 nor more than 60 days' notice to the Holders specifying the Early Redemption Date (which notice shall be irrevocable), at the Regulatory Event Redemption Price. Where a notice of redemption has been given in accordance with the foregoing sentence, the General Partner shall also notify the Holders of the Regulatory Event Redemption Price as soon as reasonably practicable after it has been determined (and in any event not later than the second Business Day before the Early Redemption Date). Prior to the publication of any notice of redemption pursuant to the foregoing, the General Partner shall deliver to the Registrar a certificate signed by two Directors of the Bank stating that the Issuer is entitled to effect such redemption and an opinion of counsel to the Bank experienced in such matters to the effect that a Regulatory Event has occurred. Upon the expiry of such notice, the Preferred Securities shall be redeemed by the payment of the Regulatory Event Redemption Price to the Holders.
- 4.5 Under FSA requirements at the date hereof, the Issuer may not redeem, and neither the Issuer nor the Bank nor any of its Subsidiaries may purchase, any Preferred Securities unless the FSA gives its prior written consent, and the FSA may impose conditions on any such redemption or purchase. These requirements and restrictions do not affect the ability of the Bank or its Subsidiaries to engage in market-making activities in relation to the Preferred Securities.
- 4.6 Once a notice to redeem the Preferred Securities has been given under any of paragraphs 4.2, 4.3 or 4.4, no similar notice may be given under either of the other paragraphs. If at any time the Preferred Securities may be redeemed under more than one such paragraph, the General Partner may elect under which paragraph the notice of redemption is to be given.

5. Substitution by Substitute Preference Shares

- 5.1 As soon as reasonably practicable following the occurrence of a Substitution Event (provided that proceedings have not been commenced for the liquidation, dissolution or winding up of the Bank in England), the General Partner on behalf of the Issuer shall take all reasonable steps to cause the substitution for the Preferred Securities of fully-paid non-cumulative redeemable perpetual preferred shares issued directly by the Bank having economic terms which are in all material respects equivalent (as more fully set out in the following paragraph) to those of the Preferred Securities and the Guarantee taken together (the "Substitute Preference Shares").

The Substitute Preference Shares shall, among other things, provide economic terms that are equivalent to those of the Preferred Securities in respect of the non-cumulative nature of the distributions thereon, the status of the Preferred Securities and the rights attaching to the Preferred Securities in respect of rights on a winding up of the Bank. The

Substitute Preference Shares shall be redeemable or effectively redeemable and will contain provisions similar to those contained in paragraphs 2.2 and 4.2.

- 5.2 Prior to the issue of any Substitute Preference Shares, application will be made by the Bank for admission of such Substitute Preference Shares to be admitted to listing on the Official List of the UK Listing Authority and to trading on the London Stock Exchange or another Recognised Stock Exchange. As soon as practicable after the occurrence of a Substitution Event (provided that proceedings have not been commenced for the winding up of the Bank in England), the Bank will give written notice to the Holders enclosing a substitution confirmation which each Holder will be required to complete. To receive Substitute Preference Shares, each Holder must deliver to a Paying Agent the duly completed substitution confirmation together with the certificate evidencing its holding of Preferred Securities. Any such substitution shall be effected subject in each case to any applicable fiscal laws or other laws or regulations. Following such substitution, the allotted Substitute Preference Shares will rank, for any dividend from the Distribution Date, immediately preceding the allotment of the Substitute Preference Shares. From the Substitution Event Date, the Holder (a "Former Holder") (a) will have no entitlement to any accrued Distribution or any other payment on, or right in respect of, the Preferred Securities, (b) will be removed from the Register and all rights of the Former Holder to participate in the assets of the Issuer or to be returned any amount in respect of the Preferred Securities (including the Preferred Capital Contribution made by or on behalf of the Former Holder) will be extinguished and (c) shall cease to be a limited partner of the Issuer. If (i) Substitute Preference Shares are issued upon a Substitution Event, the Bank will confer upon Holders the option (A) to receive such Substitute Preference Shares in certificated form or (B) subject to such Holders agreeing to pay any UK stamp duty or stamp duty reserve tax ("SDRT") which would arise on the issue of the Substitute Preference Shares and providing appropriate indemnities against any such stamp duty or SDRT, to require the Bank to issue such Substitute Preference Shares to a clearing system (or a nominee for such clearing system), or if (ii) Substitute Preference Shares are issued other than upon a Substitution Event, the Bank will (A) issue such Substitute Preference Shares to a clearing system or a nominee for such clearing system and (B) pay any UK stamp duty or SDRT payable on the issue of Substitute Preference Shares.
- 5.3 Certificates (if any) for Substitute Preference Shares issued on substitution will be dispatched by mail free of charge (but uninsured and at the risk of the person entitled thereto) within one month after receipt of a duly completed substitution confirmation. If Substitute Preference Shares are required to be issued, Holders will continue to be entitled to receive Distributions and/or a Liquidating Distribution in respect of the Preferred Securities until the Substitution Event Date. Thereafter the Former Holders will have no further rights, title or interest in or to their Preferred Securities. Upon an involuntary dissolution of the Issuer occurring after the occurrence of a Substitution Event but prior to the Substitution Event Date, Holders will have no further rights, title or interest in or to Preferred Securities except the right to have their respective Preferred Securities substituted in the manner described above.

6. Additional Amounts

All payments in respect of the Preferred Securities by the Issuer will be made without withholding or deduction for, or on account of, any tax imposed by the United Kingdom or Jersey, unless the withholding or deduction of such tax is required by law. In the event of such withholding or deduction, each Holder will, if permitted by the FSA, be entitled to receive, as a further Distribution, such additional amounts ("Additional Amounts") as may be necessary in order that the net amounts received by the Holders after such withholding or deduction shall equal the amounts which would have been receivable in respect of the Preferred Securities in the absence of such withholding or deduction; except that no such Additional Amounts will be payable to a Holder (or to a third party on his or her behalf) with respect to any Preferred Security:

- 6.1 where the Holder is liable to such tax, duty or charge by reason of such Holder having some connection with the jurisdiction by which such tax, duty or charge has been imposed other than the mere holding of such Preferred Security; or
 - 6.2 if such withholding or deduction may be avoided by complying with any statutory requirement or by making a declaration of non-residence or other similar claim for exemption to any authority of or in the United Kingdom or Jersey, unless such Holder proves that he is not entitled so to comply or to make such declaration or claim; or
 - 6.3 if the Holder (or the third party to whom payment is made on behalf of the Holder) is a partnership or is not the sole beneficial owner of the Preferred Security, or holds the Preferred Security in a fiduciary capacity, to the extent that any of the members of the partnership, the beneficial owner or the settlor or beneficiary with respect to the fiduciary would not have been entitled to the payment of an additional amount had each of the members of the partnership, the beneficial owner, settlor or beneficiary (as the case may be) received directly his beneficial or distributive share of the payment; or
 - 6.4 where presentation is required presented for payment more than 30 days after the relevant Distribution Date, except to the extent that the Holder thereof would have been entitled to such Additional Amounts if it had presented the same for payment on the last day of such period of 30 days; or
 - 6.5 where presentation is required if such withholding or deduction may be avoided by presenting the relevant Preferred Security to another Paying Agent; or
 - 6.6 if such withholding or deduction is imposed on or in respect of a payment to an individual Holder and is required to be made pursuant to Council Directive 2003/48/EC of 3 June 2003 on the taxation of savings income in the form of interest payments or any European Union Directive otherwise implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any law implementing, or complying with, or introduced in order to conform to, any such Directive,
- provided that the Issuer's obligation to make any such payments is subject to the Law and to the limitations provided in paragraphs 2.3, 3.1 and 3.4.

7. Payments

- 7.1 Distributions will be payable subject to the Law on the relevant Distribution Date (or, where any Distribution Date is not a Business Day, on the next Business Day immediately following the Distribution Date, without interest in respect of such delay) to the Holders five Business Days prior to the relevant Distribution Date (the "Relevant Record Date"). If the General Partner gives a notice of redemption pursuant to paragraph 4.2, 4.3 or 4.4 in respect of the Preferred Securities, then, on the Redemption Date, the General Partner shall procure that the Optional Redemption Price, the Tax Redemption Price or the Regulatory Event Redemption Price, as the case may be, will be paid by the Registrar or by the Paying Agents on behalf of the Issuer to the Holders. Upon such payment, all rights of Holders to participate in the assets of the Issuer or to be returned any amount in respect of the Preferred Securities (including the Preferred Capital Contribution made by or on behalf of the Holders) will be extinguished and each Holder shall thereupon cease to be a limited partner of the Issuer provided its holding of Preferred Securities is redeemed in accordance with the foregoing and the Preferred Capital Contribution will, on payment of the Optional Redemption Price, the Tax Redemption Price or the Regulatory Event Redemption Price, as the case may be, be deemed repaid.
- 7.2 Subject to all applicable fiscal or other laws and regulations:
 - 7.2.1 each payment in respect of Distributions will be made by cheque and mailed on the relevant Distribution Date to the Holder of record at such Holder's address as it

appears on the Register on the Relevant Record Date for the Preferred Securities;
and

7.2.2 any payment of amounts in respect of the Optional Redemption Price, the Tax Redemption Price, the Regulatory Event Redemption Price or the Liquidating Distribution (or relevant proportion thereof) in respect of any Preferred Security will be made by pounds sterling cheque drawn on a bank in London against presentation and surrender of the relevant certificate of entitlement at the office of the Registrar or any Paying Agent,

provided, however, that a Holder may receive such payment by direct transfer to a pounds sterling account maintained by the Holder with a bank in London arranged by a Paying Agent if appropriate direct transfer instructions have been received by the Registrar in sufficient time prior to the relevant date of payment. Holders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a Business Day, if the Holder is late in surrendering certificates (if required to do so) or if a cheque mailed in accordance with this paragraph arrives after the due date for payment.

In the event that payment of the Optional Redemption Price, the Tax Redemption Price or the Regulatory Event Redemption Price is improperly withheld or refused and not paid by the Issuer, Distributions on such Preferred Security, subject as described in paragraph 2.3 and 2.9, will continue to accrue, on a day by day basis compounding annually, from the Redemption Date to the date of actual payment of the Optional Redemption Price, the Tax Redemption Price or the Regulatory Event Redemption Price, as the case may be.

- 7.3 The Issuer will not, and the Bank has undertaken in the Guarantee that it will not and it will procure that no member of the Bank Group will, make or procure any payment to Holders, if such a payment could not lawfully have been made had Holders held shares ranking *pari passu* with Substitute Preference Shares instead of the Preferred Securities.
- 7.4 The Issuer will, and the Bank has undertaken in the Guarantee that it will procure that the Issuer will, maintain at all times whilst the Preferred Securities are in issue (a) a Paying Agent outside the European Union and Jersey or in a Member State of the European Union that will not be obliged to withhold or deduct for or on account of tax pursuant to Council Directive 2003/48/EC of 3 June 2003 on the taxation of savings income in the form of interest payments or any European Union Directive otherwise implementing the conclusions of the ECOFIN Council meeting of 26 and 27 November 2000 or any law implementing or complying with, or introduced in order to conform to, any such Directive, (b) for so long as the Preferred Securities are listed on the Luxembourg Stock Exchange and the rules thereof so require, a Paying Agent in Luxembourg, and (c) a Registrar having its office outside the United Kingdom.

8. Voting Rights

- 8.1 Except as described below and provided for in the Law, Holders will not be entitled to receive notice of or attend or vote at any meeting of partners of the Issuer or participate in the management of the Issuer.
- 8.2 If for any single Distribution Period ending on or before the First Optional Redemption Date or thereafter for any two consecutive Distribution Periods:
- 8.2.1 Distributions have not been paid in full on the Preferred Securities by the Issuer;
and/or
- 8.2.2 the Bank has not made the required payments under the Guarantee in respect of such Distributions,

then the Holders together with the holders of any other preferred securities of the Issuer having the right to vote for the election of a special representative (the "Special

Representative”) in such event, acting as a single class without regard to class, will be entitled to appoint a Special Representative, by written notice to the Issuer given by the holders of a majority by outstanding nominal amount of such Preferred Securities and any other preferred securities having the said right or by resolution passed by the holders of a majority by outstanding nominal amount of such Preferred Securities and any other such preferred securities present in person or by proxy at a separate general meeting of such holders convened for the purpose. The Special Representative shall be authorised to represent the Holders to enforce their statutory rights as limited partners including the provision of information on the affairs of the Issuer; however, it has no rights in addition to those held by Holders. The Special Representative shall not, by virtue only of acting in such capacity, be admitted or authorised to act as a general partner in relation to the Issuer or be admitted as a Holder or otherwise be deemed to be a general partner or a Holder in the Issuer and shall have no liability for the debts, obligations or liabilities of the Issuer or for any unpaid contribution of a partner in its capacity as Special Representative.

Not later than 30 days after such entitlement arises, if the written notice of the Holders of outstanding Preferred Securities and the holders of any other preferred securities of the Issuer having the right to vote for the election of a Special Representative in the circumstances described in the preceding paragraph has not been given as provided for in the preceding paragraph, the General Partner will convene a separate general meeting for the purpose. If the General Partner fails to convene such meeting within such 30-day period, the Holders of 10% by outstanding nominal amount of the Preferred Securities and such other preferred securities will be entitled to convene such a meeting for the purpose. The Partnership Agreement contains provisions concerning the convening and conduct of meetings of Holders. Any Special Representative so appointed shall, subject to the terms of such other preferred securities, vacate office if, after its appointment a full Distribution is made by the Issuer or by the Bank under the Guarantee for one annual Distribution Period or two half-yearly Distribution Periods or an amount equivalent to the Distributions to be paid in respect of one Distribution Period has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders.

- 8.3 The consent in writing of the Holders of at least one-third of the outstanding Preferred Securities or the sanction of a resolution, passed by a majority of at least three-quarters of those present in person or by proxy at a separate meeting of the Holders at which the quorum shall be one or more Holders holding at least one-third in nominal amount of the issued Preferred Securities, shall be required in order to give effect to any variation or abrogation of the rights, preferences and privileges of the Preferred Securities by way of amendment of the Partnership Agreement or otherwise (including, without limitation, the authorisation or creation of any securities or ownership interests of the Issuer ranking, as to participation in the profits or assets of the Issuer, senior to the Preferred Securities) (unless otherwise required by applicable law). Notwithstanding the foregoing, but subject to the Law, the General Partner may, without such consent in writing or such sanction, amend the Partnership Agreement (including the rights, preferences and privileges of the Preferred Securities) if, as determined by the General Partner, the proposed amendment is solely of a formal, minor or technical nature or is to correct an error or cure an ambiguity, provided that the proposed amendment does not reduce the amounts payable to Holders, impose any obligation on the Holders or adversely affect their voting rights.
- 8.4 Notwithstanding the foregoing, no vote of the Holders will be required for the redemption, cancellation or substitution of the Preferred Securities in accordance with the Partnership Agreement.
- 8.5 Subject to the Law, the Issuer may not be dissolved by the General Partner whilst any Preferred Security is in issue, unless all the Holders and the General Partner have approved such action. Such approval shall not be required if the dissolution of the Issuer

is proposed or initiated because of the liquidation, dissolution or winding-up, as the case may be, of the General Partner or the Bank.

8.6 Any Preferred Security, and any preferred security of a type referred to in paragraph 8.2, that is at any time owned by the Bank, or any entity of which the Bank, either directly or indirectly, owns 20% or more of the voting shares or similar ownership interests, shall not carry a right to vote in a meeting of Holders or at any meeting called to vote for the election of a Special Representative pursuant to paragraph 8.2 and shall, for voting purposes, be treated as if it were not in issue other than in the case of the approval required by paragraph 8.5.

8.7 The General Partner will cause a notice of any meeting at which Holders are entitled to vote and any voting forms to be mailed to each Holder. Each such notice will include a statement setting forth (a) the date, time and place of such meeting, (b) a description of any resolution to be proposed for adoption at such meeting on which such Holders are entitled to vote and (c) instructions for the delivery of proxies.

9. Covenant of the General Partner

9.1 The General Partner has undertaken not to incur any indebtedness in the name of the Issuer other than costs and expenses incidental to creating the Preferred Securities (which may include fees and commissions payable in respect of the issue, subscription and sale of the Preferred Securities) and the Issuer, performing its obligations in respect of the Partnership Agreement, maintaining the listing of the Preferred Securities, the Register, the Registrar and Paying Agents in respect of the Preferred Securities, its holding of the Subordinated Note or any Replacement Debt and the maintenance of a custodian thereof, the exercise of the Issuer's rights in respect of the Subordinated Note or any Replacement Debt and the administration of the Issuer.

9.2 The General Partner has undertaken that if the Subordinated Note is redeemed while the Preferred Securities remain outstanding and are not subject to a notice of redemption, it will invest the proceeds of the Subordinated Note or any Replacement Debt in a subordinated note issued by the Bank, with a maturity date of 30 April 2049 and economic terms essentially equivalent to the Subordinated Note (including that the interest rate will reflect the then current Distribution Rate provisions of the Preferred Securities) (the "Replacement Debt").

10. Notices

All notices to the Holders will be mailed to the Holders of record at their respective addresses in the Register and shall be deemed to have been given on the weekday (being a day other than a Saturday or a Sunday) after the date of mailing *provided however, that*, so long as the Preferred Securities are listed on the Stock Exchange (and the rules of that exchange so require), notices will also be published in a leading newspaper having general circulation in Luxembourg (which is expected to be *Luxemburger Wort*). Any such notice shall be deemed to have been given on the date of such publication or, if published more than once or on different dates, on the first date on which such publication is made.

11. Transfers and Form

11.1 The Preferred Securities will be issued in registered form.

11.2 The Preferred Securities will be evidenced by a single global certificate in fully registered form (the "Global Certificate") and will be registered in the name of a nominee of, and deposited with a common depository for, Clearstream, Luxembourg and Euroclear.

11.3 Except in the limited circumstances described below, owners of interests in the Preferred Securities evidenced by the Global Certificate will not be entitled to receive physical

delivery of definitive certificates. The Preferred Securities and certificates are not issuable in bearer form.

- 11.4 If (i) either of Euroclear or Clearstream, Luxembourg is closed for business for a continuous period of 14 days or more (other than for purposes of a public holiday) or announces an intention permanently to cease business or does in fact do so, or (ii) as a result of a change in law, transfer duties or similar taxes become payable on transfers of the Preferred Securities in Euroclear and/or Clearstream, Luxembourg, the Issuer will issue individual definitive certificates in respect of Preferred Securities in registered form in exchange for the Global Certificate. Upon receipt of such notice from Euroclear and/or Clearstream, Luxembourg, the Issuer will use its best efforts to make arrangements with Euroclear and Clearstream, Luxembourg for the exchange of the Global Certificate for individual definitive certificates and cause the requested individual definitive certificates to be executed and delivered to the Registrar in sufficient quantities and authenticated by the Registrar for delivery to holders of Preferred Securities. Persons exchanging interests in the Global Certificate for individual definitive certificates will be required to provide the Registrar with written instructions and other information required by the Issuer and the Registrar to complete, execute and deliver such individual definitive certificates and to make appropriate entries in the Register in respect of the Preferred Securities. In all cases, definitive certificates delivered in exchange for a Global Certificate or an interest in the Preferred Securities evidenced thereby will be registered in the names, and issued in any approved denominations, requested by Euroclear and Clearstream, Luxembourg.
- 11.5 If definitive certificates are made available in respect of Preferred Securities they will be available from the Registrar and from each Paying Agent at its specified offices, and will be posted to the relevant Holders at the address shown in the Register or, as applicable, in the relevant instrument of transfer within three Business Days of issue, by uninsured post at the risk of such Holders. Transfers of Preferred Securities if evidenced by definitive certificates may be effected by presentation of the relevant certificate (with the transfer certificate relating thereto duly completed on behalf of the transferor and the transferee) at the specified office of the Registrar or any Paying Agent. Where a Holder transfers only some of the Preferred Securities evidenced by any such certificate he shall be entitled to a certificate for the balance without charge. Holders will not be required to bear the costs and expenses of effecting any registration of transfer as provided above, except for any costs or expenses of delivery other than by regular uninsured mail and except that the Issuer may require the payment of a sum sufficient to cover any stamp duty, tax or other governmental charge that may be imposed in relation to the registration.

12. Replacement Certificates

If a certificate is damaged or defaced or alleged to have been lost, stolen or destroyed, a new certificate evidencing the same Preferred Securities may be issued on payment of such fee and on such terms (if any) as to evidence and indemnity and the payment of out-of-pocket expenses as the General Partner may think fit and on payment of the costs of the General Partner incidental to its investigation of the evidence and, if damaged or defaced, on surrendering the old certificate at the specified office of any Paying Agent.

13. Prescription

Unclaimed Distributions, Optional Redemption Price, Tax Redemption Price, Regulatory Event Redemption Price and Liquidating Distributions will be prescribed after ten years in accordance with Jersey law.

14. Governing Law

The Preferred Securities and the Partnership Agreement shall be governed by, and construed in accordance with, Jersey law. Determinations in respect of amounts of Adjusted Distributable Reserves shall, however, be made in accordance with English law.

SUMMARY OF PROVISIONS RELATING TO THE PREFERRED SECURITIES WHILE IN GLOBAL FORM

Initial Issue of Preferred Securities

The Preferred Securities will be issued in registered form and will be initially evidenced by interests in the Global Certificate which will be registered in the name of a nominee of, and deposited with, a common depository for Euroclear and Clearstream, Luxembourg on the Issue Date. Upon the registration of the Global Certificate in the name of a nominee of, and delivery of the Global Certificate to, the common depository for Euroclear and Clearstream, Luxembourg, Euroclear or Clearstream, Luxembourg will credit each subscriber with such number of Preferred Securities as is equal to the number thereof for which it has subscribed and paid.

Accountholders

So long as the Preferred Securities are registered in the name of a nominee of a common depository for Euroclear and Clearstream, Luxembourg, the nominee of the common depository for Euroclear and Clearstream, Luxembourg will be the sole registered owner or holder of the Preferred Securities evidenced by the Global Certificate for all purposes under the Partnership Agreement. Except as set forth under "*Description of Preferred Securities – Transfers and Form*" and under "*– Transfers of Interests*" below, the persons shown in the records of Euroclear, Clearstream, Luxembourg or any other clearing system (an "Alternative Clearing System") as the holders of the Preferred Security evidenced by the Global Certificate (each an "Accountholder") will not be entitled to have Preferred Securities registered in their names, will not receive or be entitled to receive physical delivery of definitive certificates evidencing interests in the Preferred Securities and will not be considered registered owners or holders thereof under the Partnership Agreement. Accordingly, each Accountholder must rely on the rules and procedures of Euroclear and Clearstream, Luxembourg, as the case may be, to exercise any rights and obligations of a holder of Preferred Securities under the Partnership Agreement.

Payments

Each Accountholder must look solely to Euroclear, Clearstream, Luxembourg or such Alternative Clearing System, as the case may be, for its share of each payment made by the Issuer to the registered holder of the Preferred Securities and in relation to all other rights arising under the Global Certificate, subject to and in accordance with the respective rules and procedures of Euroclear, Clearstream, Luxembourg or such Alternative Clearing System, as the case may be. Such persons shall have no claim directly against the Issuer in respect of payments due on the Preferred Securities for so long as the Preferred Securities are evidenced by the Global Certificate and such obligations of the Issuer will be discharged by payment to the registered holder of the Preferred Securities in respect of each amount so paid.

Transfers of Interests

Accountholders will only be able to transfer their beneficial interests in the Preferred Securities in accordance with the rules and procedures of Euroclear, Clearstream, Luxembourg or the Alternative Clearing System, as the case may be.

DESCRIPTION OF THE GUARANTEE

The following is the form of the Guarantee to be executed by the Bank:

THIS DEED OF GUARANTEE (the "Guarantee"), dated 7 April 2004, is executed and delivered by HSBC Bank plc (the "Bank") for the benefit of the Holders (as defined below).

WHEREAS:

- (a) the Bank desires to issue this Guarantee for the benefit of the Holders, as provided herein; and
- (b) this Guarantee is intended to provide the Holders, on a dissolution or winding up of the Issuer (as defined below) or on a default by the Issuer in discharging its obligations in respect of the Preferred Securities (as defined below), with rights against the Bank in respect of the Guaranteed Payments (as defined below) which are as nearly as possible equivalent to those which they would have had if the Preferred Securities had been directly issued non-voting, non-cumulative, preference shares of the Bank (whether or not the Bank could in fact have issued such shares).

NOW, THEREFORE, the Bank executes and delivers this Guarantee as a deed poll for the benefit of the Holders.

1. Definitions

As used in this Guarantee, capitalised terms not defined herein shall have the meanings ascribed to them in the Partnership Agreement and otherwise the following terms shall, unless the context otherwise requires, have the following meanings:

"Guaranteed Payments" means collectively (i) all Distributions due on the Preferred Securities, (ii) any Distributions on the Preferred Securities which would have been due had the Issuer had sufficient legally available resources but only if, and to the extent that, the Issuer did not have such legally available resources solely due to a failure by the Bank to pay interest on the Subordinated Note or the Replacement Debt as and when due and payable under the terms thereof, (iii) any Liquidating Distribution, (iv) any amounts to which the Holders are entitled in respect of redemption of the Preferred Securities and (v) any Additional Amounts;

"Holder" means, in respect of each Preferred Security, the person registered on the Register as the limited partner holding such Preferred Security at the relevant time;

"Issuer" means HSBC Bank Capital Funding (Sterling 2) L.P.;

"Partnership Agreement" means the Limited Partnership Agreement dated 31 March 2004 between, the Bank, HSBC Bank (General Partner) Limited (the "General Partner"), HSBC Issuer Services Common Depositary Nominee (UK) Limited (the "Initial Partner") and HSBC Preferential LP (UK) (the "Preferential Limited Partner") establishing the Issuer;

"Preferred Securities" means collectively the £300,000,000 5.862% Non-cumulative Step-up Perpetual Preferred Securities of the Issuer, whether or not in issue on the date of this Guarantee, the Holders of which are entitled to the benefits of this Guarantee as evidenced by the execution of this Guarantee;

"Solvent" means, in relation to the Bank, that its Assets exceed its Liabilities (in each case, as defined below) excluding its Liabilities to persons in respect of Subordinated Indebtedness whose claims rank or are expressed to rank *pari passu* with, or junior to, the Guarantee or any other of its obligations which rank *pari passu* with, or junior to, the Guarantee; and "Insolvent" shall be construed accordingly, and for the purposes hereof, "Assets" means the unconsolidated gross assets (including contingencies) of the Bank

and “Liabilities” means the unconsolidated gross liabilities (including contingencies) of the Bank, all as shown in its latest published balance sheet having the benefit of an unqualified auditors’ report but with such adjustments as the auditors of the Bank or, if the Bank is in winding up, the liquidator shall determine in any report of such auditor issued on the request of the Bank or of such liquidator prepared in connection with the liquidation of the Bank and in either case relating to the solvency of the Bank; and

“Subordinated Indebtedness” means any liability of the Bank howsoever arising for the payment of money the right to payment of which by the Bank by the terms thereof is, or is expressed to be, subordinated in the event of a winding up of the Bank to the claims of all or any of the creditors of the Bank; provided that the term “Subordinated Indebtedness” shall include, without limitation, any liability of the Bank to any creditor of the Bank:

- (i) whose right to payment ranks or is expressed to rank postponed or subordinated to that of unsubordinated creditors (such unsubordinated creditors not being creditors whose right to payment is preferred by operation of law); or
- (ii) whose right to payment is made subject to a condition or is restricted (whether by operation of law or otherwise) or is expressed to be restricted in each case such that the amount which may be claimed for his own retention by such creditor in the event that the Bank is not Solvent is less than in the event that the Bank is Solvent.

2. Guarantee

2.1 Subject to the exceptions and limitations contained in the following provisions of this Clause 2, the Bank irrevocably guarantees to the Holders the payment in full of the Guaranteed Payments, as and when due, to the extent that such payments shall not have been paid when due and payable by the Issuer regardless of any defence, right of set-off or counterclaim which the Issuer may have or assert. This Guarantee is continuing, irrevocable and absolute. The rights of the Holders against the Bank under this Guarantee will, in the event of the winding up of the Bank, be subordinated in right of payment to the claims of all other creditors of the Bank other than creditors in respect of Subordinated Indebtedness whose claims rank or are expressed to rank *pari passu* with or junior to the Guarantee or any other of the Bank’s obligations which rank *pari passu* with or junior to the Guarantee.

2.2 Notwithstanding Clause 2.1, the Bank’s obligation to make any Guaranteed Payment is conditional upon it being able to make such payment and being Solvent immediately thereafter and, furthermore, the Bank will not, save to the extent provided in Clause 2.5, be obliged to make payment under the Guarantee of any Guaranteed Payment if the Bank is prevented by applicable UK banking regulations or other requirements from making such payment in full under this Guarantee. In addition, notwithstanding Clause 2.1, the Bank will not, save to the extent provided in Clause 2.5, be obliged to make payment under the Guarantee of any Guaranteed Payment in respect of Distributions on any Preferred Securities if, on the relevant Distribution Date:

- (a) the Bank is prevented by applicable UK banking regulations or other requirements from making payment in full of dividends or other distributions due and payable on its Parity Obligations or is unable to make such payment of dividends or other distributions on its Parity Obligations without causing a breach of the FSA’s capital adequacy requirements from time to time applicable to the Bank; or
- (b) the amount of the Distribution to which such Guaranteed Payment relates (if paid in full), together with the sum of any dividends and other distributions on the Bank’s Parity Obligations due and payable on the Distribution Date in respect of such Distribution, would exceed the Adjusted Distributable Reserves of the Bank

determined as of the Distribution Determination Date immediately preceding the relevant Distribution Date.

- 2.3 The Bank will determine whether, as of the Distribution Determination Date, sufficient Adjusted Distributable Reserves exist to allow a payment of some or all of the relevant Distribution. In the event that any Distribution cannot be paid in full, the Bank will notify or procure notification to the Stock Exchange, the General Partner, the Registrar and the Paying Agents, and to Holders in accordance with the Partnership Agreement, of the fact and of the amount, if any, to be paid in respect of that Distribution.
- 2.4 All payments under the Guarantee will be made without withholding or deduction for or on account of any present or future taxes, duties, assessments or governmental charges of whatever nature imposed or levied by or on behalf of the United Kingdom or any political sub-division thereof or by any authority therein or thereof having power to tax, unless the withholding or deduction of such taxes, duties, assessments or governmental charges is required by law. In that event, the Bank will, subject to permission (if required) being granted by the FSA, pay such additional amounts ("Guarantor Additional Amounts") as may be necessary in order that the net amounts received by the Holders after such withholding or deduction shall equal the amounts which would have been receivable under this Guarantee in the absence of such withholding or deduction; except that no such Guarantor Additional Amounts will be payable to a Holder (or a third party on his behalf) in respect of any Preferred Security:
- (a) where the Holder is liable to such tax, duty or charge by reason of such Holder having some connection with the jurisdiction by which such tax, duty or charge has been imposed other than the mere holding of the relevant Preferred Security; or
 - (b) if such withholding or deduction may be avoided by complying with any statutory requirement or by making a declaration of non-residence or other similar claim for exemption to any authority of or in the United Kingdom, unless such Holder proves that he is not entitled so to comply or to make such declaration or claim; or
 - (c) if the Holder (or the third party to whom payment is made on behalf of the Holder) is a partnership or is not the sole beneficial owner of the Preferred Security or holds the Preferred Security in a fiduciary capacity, to the extent that any of the members of the partnership, the beneficial owner or the settlor or beneficiary with respect to the fiduciary would not have been entitled to the payment of an additional amount had each of the members of the partnership, the beneficial owner, settlor or beneficiary (as the case may be) received directly his beneficial or distributive share of the payment; or
 - (d) where presentation is required presented for payment more than 30 days after the relevant Distribution Date, except to the extent that the Holder thereof would have been entitled to such additional amounts if it had presented the same for payment on the last day of such period of 30 days; or
 - (e) where presentation is required, if such withholding or deduction may be avoided by presenting the relevant Preferred Security to another Paying Agent; or
 - (f) if such withholding or deduction is imposed on or in respect of a payment to an individual Holder and is required to be made pursuant to Council Directive 2003/48/EC of 3 June 2003 on the taxation of savings income in the form of interest payments or any European Union Directive otherwise implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any law implementing, or complying with, or introduced in order to conform to, any such Directive,

provided that the Bank's obligation to pay any Guarantor Additional Amounts is subject to the conditions relating to payments under the Guarantee set out in Clauses 2.2 and 2.3.

- 2.5 In the event that the amounts described in Clauses 2.1 and 2.4 cannot be paid in full by reason of the condition referred to in Clause 2.2, such amount as is to be paid will be payable *pro rata* in the Relevant Proportion and the obligations of the Bank in respect of any such unpaid amount shall lapse.
- 2.6 The obligations, covenants, agreements and duties of the Bank under this Guarantee shall in no way be affected or impaired by reason of the happening from time to time of any of the following:
- (a) the release or waiver, by operation of law or otherwise, of the performance or observance by the Issuer of any express or implied agreement, covenant, term or condition relating to the Preferred Securities to be performed or observed by or on behalf of the Issuer; or
 - (b) the extension of time for the payment by or on behalf of the Issuer of all or any portion of any Distribution, the Optional Redemption Price, the Tax Redemption Price, the Regulatory Event Redemption Price, the Liquidating Distribution or any other sums payable under the terms of the Preferred Securities or the extension of time for the performance of any other obligation under, arising out of, or in connection with, the Preferred Securities; or
 - (c) any failure, omission, delay or lack of diligence on the part of Holders to enforce, assert or exercise any right, privilege, power or remedy conferred on the Holders pursuant to the terms of the Preferred Securities, or any action on the part of the Issuer granting indulgence or extension of any kind; or
 - (d) the voluntary or involuntary winding up, dissolution, amalgamation, reconstruction, sale of any collateral, receivership, insolvency, bankruptcy, assignment for the benefit of creditors, reorganisation, arrangement, composition or readjustment of debt of, or other similar proceedings affecting, the Issuer or any of the assets of the Issuer; or
 - (e) any invalidity of, or defect or deficiency in, the Preferred Securities; or
 - (f) the settlement or compromise of any obligation guaranteed hereby or hereby incurred.

There shall be no obligation on the Holders to give notice to, or obtain consent of, the Bank with respect to the happening of any of the foregoing.

- 2.7 This Guarantee shall be deposited with and held by the Registrar until all the obligations of the Bank have been discharged in full. The Bank hereby acknowledges the right of every Holder to the production of, and the right of every Holder to obtain a copy of, this Guarantee from the Registrar.
- 2.8 Subject to Clause 2.11 and Clause 2.12, a Holder may enforce this Guarantee directly against the Bank, and the Bank waives any right or remedy to require that any action be brought against the Issuer or any other person or entity before proceeding against the Bank. Subject to Clause 2.12, all waivers contained in this Guarantee shall be without prejudice to the right to proceed against the assets of the Issuer and the General Partner as permitted by the terms of the Preferred Securities. The Bank agrees that this Guarantee shall not be discharged except by complete performance of all obligations of the Bank under this Guarantee.
- 2.9 The Bank shall be subrogated to any and all rights of the Holders against the assets of the Issuer in respect of any amounts paid to the Holders by the Bank under this Guarantee. The Bank shall not (except to the extent required by mandatory provisions of

law) exercise any rights which it may acquire by way of subrogation or any indemnity, reimbursement or other agreement, in all cases as a result of a payment under this Guarantee if, at the time of any such payment, any amounts are due and unpaid under this Guarantee. If the Bank shall receive or be paid any amount with respect to the Preferred Securities in violation of the preceding sentence, the Bank agrees to pay the amount to the Holders.

- 2.10 The Bank acknowledges that its obligations hereunder are several and independent of the obligations of the Issuer with respect to the Preferred Securities and that the Bank shall be liable as principal and sole obligor hereunder to make the payments undertaken to be made by it pursuant to the terms of this Guarantee, notwithstanding the occurrence of any event referred to in Clause 2.6.
- 2.11 Following a failure by the Bank to make a payment under this Guarantee on the due date therefor, which failure continues for more than seven days, a Holder (or Holders) holding not less than one-fifth of the outstanding nominal amount of Preferred Securities may petition for the winding up of the Bank in England and claim in the liquidation of the Bank but no other remedy shall be available to the Holder.
- 2.12 No Holder shall following any breach by the Bank of any of its obligations under this Guarantee be entitled to exercise any right of set-off or counterclaim which may be available to it against amounts owing by the Bank to such Holder. Notwithstanding the provisions of the foregoing sentence, if any of the said rights and claims of any Holder against the Bank is discharged by set-off, such Holder will immediately pay an amount equal to the amount of such discharge to the Bank or, in the event of its winding-up, the trustee or liquidator of the Bank and until such time as payment is made will hold a sum equal to such amount in trust for the Bank, or the trustee or liquidator of the Bank and accordingly any such discharge will be deemed not to have taken place.

3. Undertakings

- 3.1 The Bank undertakes that if for any single Distribution Period ending on or before the First Optional Redemption Date or thereafter for any two consecutive Distribution Periods the Distribution is not paid in full to Holders by reason of the limitations set out in the terms of the Preferred Securities and in the Partnership Agreement, the Bank will not (a) declare or pay any dividends or other distributions in respect of its ordinary shares or (if permitted) effect any repurchase of its ordinary shares or any other securities or obligations of the Bank ranking junior to the Guarantee (or contribute any moneys to a sinking fund for the redemption of any such shares or securities) until after the next following Distribution Date on which a Distribution in respect of the Preferred Securities is paid in full (or an amount equivalent to the Distribution to be paid in respect of the next Distribution Period has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders) or (b) (if permitted) repurchase or redeem Parity Obligations which are securities until after the next following Distribution Date on which a Distribution in respect of the Preferred Securities is paid in full (or an amount equivalent to the Distribution to be paid in respect of the next Distribution Period has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders).
- 3.2 The Bank undertakes that, so long as any of the Preferred Securities are outstanding (a) unless the Bank is itself being wound up, it will not permit, or take any action that would or might cause, the liquidation, dissolution or winding up of the General Partner or the Issuer otherwise than (i) with the prior approval of the FSA (if then required) and (ii) if either (A) the Bank has sufficient Adjusted Distributable Reserves or (B) the Bank has proceeds available from an issue of Replacement Capital that has been made for the purpose of funding the Liquidating Distribution (in either of cases (ii)(A) or (B) in an amount at least equal to the aggregate Liquidating Distribution) and (b) the General

Partner will at all times be a directly or indirectly wholly owned subsidiary of the Bank, unless in the case of (a) or (b), otherwise approved by all Holders.

- 3.3 The Bank undertakes (a) to take all reasonable steps to ensure that it will at all times have a sufficient amount of authorised but unissued Substitute Preference Shares to permit the substitution thereof for all outstanding Preferred Securities and (b) to take all reasonable steps to ensure that all corporate authorisations will have been taken for the allotment and issue of the same free from pre-emptive rights, and that following the occurrence of a Substitution Event and subject to the terms of the Partnership Agreement and the necessary authorisations being in place, it will allot, issue and deliver Substitute Preference Shares in satisfaction of the rights of the Holders in the circumstances described in the Partnership Agreement, such Substitute Preference Shares having the rights and being subject to the conditions set out in the Partnership Agreement. The Bank further undertakes that (a) it will take all reasonable steps to procure that such Substitute Preference Shares will at the relevant time be listed on a Recognised Stock Exchange and (b) if (i) Substitute Preference Shares are issued upon a Substitution Event, the Bank will confer upon Holders the option (A) to receive such Substitute Preference Shares in certificated form or (B) subject to such Holders agreeing to pay any UK stamp duty or stamp duty reserve tax ("SDRT") which would arise on the issue of the Substitute Preference Shares and providing appropriate indemnities against any such stamp duty or SDRT, to require the Bank to issue such Substitute Preference Shares to a clearing system (or a nominee for such clearing system); or if (ii) Substitute Preference Shares are issued other than upon a Substitution Event, the Bank will (A) issue such Substitute Preference Shares to a clearing system (or a nominee for such clearing system) and (B) pay any UK stamp duty or SDRT payable on the issue of Substitute Preference Shares.
- 3.4 The Bank undertakes that neither it nor any other member of the Bank Group will make or procure any payment to Holders if such a payment could not lawfully have been made had Holders held shares of the Bank ranking *pari passu* with the Substitute Preference Shares instead of the Preferred Securities.
- 3.5 The Bank undertakes that it will procure that the Issuer will maintain at all times whilst the Preferred Securities are in issue (a) a Paying Agent outside the European Union and Jersey or in a Member State of the European Union that will not be obliged to withhold or deduct for or on account of tax pursuant to Council Directive 2003/48/EC of 3 June 2003 on the taxation of savings income in the form of interest payments or any European Union Directive otherwise implementing the conclusions of the ECOFIN Council meeting of 26 and 27 November 2000 or any law implementing or complying with, or introduced in order to conform to, any such Directive, (b) for so long as the Preferred Securities are listed on the Luxembourg Stock Exchange and the rules thereof so require, a Paying Agent in Luxembourg, and (c) a Registrar having its office outside the United Kingdom.
- 3.6 The Bank undertakes that it will not redeem the Subordinated Note pursuant to the Terms and Conditions of the Subordinated Note other than in circumstances where (i) the proceeds of redemption will be invested in Replacement Debt, or (ii) the corresponding Preferred Securities are also being redeemed.

4. Termination

With respect to the Preferred Securities, this Guarantee shall terminate and be of no further force and effect upon (i) payment of the Optional Redemption Price, the Tax Redemption Price, or the Regulatory Event Redemption Price, as the case may be, on all Preferred Securities, (ii) purchase and cancellation of all Preferred Securities, (iii) payment of the Liquidating Distribution, or the Relevant Proportion thereof, or (iv) issue and allotment in full of Substitute Preference Shares, as the case may be, and dissolution of the Issuer, provided however that this Guarantee will continue to be effective or will be reinstated, as the case may be, if at any time payment of any sums paid in respect of

the Preferred Securities or under this Guarantee must be restored by a Holder for any reason whatsoever.

5. Transfer; Amendment; Notices

- 5.1 Subject to operation of law, all guarantees and agreements contained in this Guarantee shall bind the successors, assignees, receivers, trustees and representatives of the Bank and shall inure to the benefit of the Holders. The Bank shall not transfer its obligations hereunder without the prior approval of the Holders of not less than one-third by nominal amount of the Preferred Securities (excluding any Preferred Securities held by the Bank or any entity of which the Bank, either directly or indirectly, owns 20 per cent. or more of the voting shares or similar ownership interests), which approval shall be obtained in accordance with the procedures contained in the Partnership Agreement and the Law.
- 5.2 Except for those changes (a) required to correct any manifest errors or ambiguities; or (b) which do not materially adversely affect the rights of the Holders (in each of which cases no consent will be required), this Guarantee shall be changed only by the Bank with the consent in writing of the Holders of at least one-third of the outstanding Preferred Securities, or the sanction of a resolution of the Holders of the outstanding Preferred Securities, passed by a majority of at least three-quarters of those present in person or by proxy at a separate meeting of the Holders at which the quorum shall be one or more Holders holding at least one-third in nominal amount of the outstanding Preferred Securities, subject in each case to consent or sanction being obtained in accordance with the procedures contained in the Partnership Agreement and the Law.
- 5.3 Any notice, request or other communication required or permitted to be given hereunder to the Bank shall be given in writing by delivering the same against receipt therefor or by pre-paid post addressed to the Bank at:

HSBC Bank plc
8 Canada Square
London E14 5HQ

The address of the Bank may be changed at any time and from time to time and shall be the most recent such address furnished in writing by the Bank to the Registrar and notified to the Holders.

Any notice, request or other communication required or permitted to be given hereunder to the Holders shall be given by the Bank in the same manner as notices sent on behalf of the Issuer to Holders.

- 5.4 This Guarantee is solely for the benefit of the Holders and is not separately transferable from their interests in respect of the Preferred Securities.
- 5.5 The Bank will furnish any Holder, upon request of such Holder, with a copy of its annual report and any interim reports made generally available by the Bank to holders of the ordinary shares of the Bank.

6. Governing Law

This Guarantee shall be governed by, and construed in accordance with, English law.

IN WITNESS WHEREOF this Guarantee has been executed as a deed poll on behalf of HSBC Bank plc.

DESCRIPTION OF THE SUBSTITUTE PREFERENCE SHARES

It is intended that the Preference Shares to be issued upon substitution of the Preferred Securities (the "Preference Shares") will have the principal share rights described below.

The rights attaching to the Preference Shares are contained in the Bank's Articles of Association (the "Articles") and in the resolutions to be passed by the Board of Directors of the Bank or a duly constituted committee thereof at or before the time of issue of the Preference Shares. In addition, a detailed description of the rights attaching to the Preference Shares is included in the Partnership Agreement.

Denomination

The par value of each Preference Share will be £1.00 which together with the premium on issue will aggregate to £1,000 or such lesser amount as is equal to the nominal amount of one Preferred Security (the "Principal Amount"). The premium applicable to each Preference Share will be determined by the Board of Directors of the Bank or a duly constituted committee thereof at or before the issue of the Preference Shares. The Preference Shares will be issued credited as fully paid.

Dividends

- (a) Subject to sub-paragraphs (e) and (f) below, each Preference Share will entitle the holder thereof to receive a non-cumulative preferential dividend on the Principal Amount thereon calculated on the bases set out in sub-paragraphs (b) and (c) below. The dividend will be payable annually in arrear on 7 April in each year up to and including the relevant Dividend Re-set Date and thereafter semi-annually in arrear on 7 April and 7 October in each year (each a "Dividend Payment Date") when, as and if declared by the Board of Directors, provided that the first dividend will be paid on a *pro rata* basis in respect of the period from, and including, the date of the Distribution Date (as defined in the Partnership Agreement) immediately preceding the date on which the Preference Shares are substituted for the Preferred Securities (the "Substitution Date") to, but excluding, the first such Dividend Payment Date after issue. If any Dividend Payment Date after the Dividend Re-set Date (as defined below) would otherwise fall on a day which is not a Business Day payment of the Dividend otherwise payable on such date will be postponed to the next day which is a Business Day.

"Dividend Re-set Date" means 7 April 2020.

Such dividends will only be payable to the extent that payment of the same can be made out of profits available for distribution (the "Distributable Profits") under the provisions of the United Kingdom Companies Act as at each Dividend Payment Date.

The Preference Shares will rank as regards participation in profits *pari passu inter se* and *pari passu* with any other shares to the extent that they are expressed to rank *pari passu* therewith and in priority to the Bank's ordinary shares and to any other class of shares of the Bank issued after the date of issue of the Preference Shares.

For the purposes of this Description of the Preference Shares, "Dividend Period" means the period from the date of the Distribution Date immediately preceding the Substitution Date to the first Dividend Payment Date and each successive period from, and including, a Dividend Payment Date to, but excluding, the next succeeding Dividend Payment Date and "Business Day" means a day other than a Saturday or a Sunday on which commercial banks and foreign exchange markets settle payments in pounds sterling and are open for general business in London.

- (b) Each Preference Share in issue prior to the Dividend Re-set Date will entitle the holder thereof to receive on each Dividend Payment Date falling on or prior to the Dividend Re-set Date dividends payable in pounds sterling at a fixed rate per annum of 5.862% in

respect of the Preference Shares of the Principal Amount thereof calculated on the basis of the actual number of days in the period from and including the date from which the relevant dividend begins to accrue for the relevant period of calculation to but excluding the date on which it falls due divided by the actual number of days in the Dividend Period in which such period of calculation falls.

- (c) Each Preference Share in issue on or after the Dividend Re-set Date will entitle the holder thereof to receive dividends payable in pounds sterling at the rate equal to the Reference Rate in effect during the relevant Dividend Period, applied to the Principal Amount thereof calculated on the basis of the actual number of days in the relevant period divided by 365.

“Reference Rate” means the rate from time to time in respect of each Preference Share, determined in the manner and on the same basis as the Distribution Rate applicable to the Preferred Securities for such period provided, however, that all calculations relating to the Reference Rate will be made by the Bank.

- (d) Any decision regarding the declaration or payment of any dividend on the Preference Shares will be at the sole discretion of the Directors of the Bank and nothing herein contained will impose on the Directors of the Bank any requirement or duty to resolve to distribute in respect of any financial year or period the whole or any part of the profits of the Bank available for distribution.
- (e) Without prejudice to paragraph (d) above, if, in the opinion of the Directors of the Bank, the distributable profits of the Bank are insufficient to cover both the payment in full of dividends payable on the Preference Shares on any Dividend Payment Date and on all other dividends stated to be payable on such date on any other shares expressed to rank *pari passu* with the Preference Shares as regards participation in profits, then, subject to paragraph (f) below, dividends may be declared by the Directors *pro rata* on such Preference Shares and on such other shares to the extent of the available distributable profits (if any) to the extent that the amount of dividend declared per share on each such Preference Share and on each such other share will bear to each other the same ratio as the dividends payable on each such Preference Share and on each such other share bear to each other.
- (f) If, in the opinion of the Directors of the Bank, the declaration or payment of any dividend on any Preference Shares would breach or cause a breach of the FSA’s capital adequacy requirements from time to time applicable to the Bank and/or any of its subsidiary undertakings, then no such dividend will be declared or paid.
- (g) Payments of preferential dividends shall be made to holders on the register at any date selected by the directors up to 42 days prior to the relevant Dividend Payment Date. The Preference Shares will carry no further right as regards participation in the profits of the Bank.
- (h) If for any single Dividend Period ending on or before the Dividend Re-set Date, or for any two consecutive Dividend Periods thereafter the dividend is not paid in full the Bank will not (a) declare or pay any dividends or other distributions in respect of its ordinary stock or any other security of the Bank ranking junior to the Preference Shares or (if permitted) effect any repurchase or redemption of its ordinary stock or any other preference shares of the Bank ranking junior to the Preference Shares (or contribute any moneys to a sinking fund for the redemption of such stock or preference shares) until after the next following Dividend Payment Date on which a dividend in respect of the Preference Shares is paid in full (or an amount equivalent to the dividend to be paid in respect of the next Dividend Payment Period has been paid or set aside for payment to the holders of the Preference Shares) or (b) (if permitted) repurchase or redeem any other preference shares which rank *pari passu* with the Preference Shares until after the next following Dividend Payment Date on which a dividend in respect of the Preference Shares is paid

in full (or an amount equivalent to the dividend to be paid in respect of the next Dividend Period has been paid or set aside for payment to the holders).

- (i) Any dividend unclaimed after a period of 12 years from the date of declaration of such dividend will be forfeited and revert to the Bank. No dividends or other moneys payable on or in respect of a Preference Share shall bear interest against the Bank.

Return of Capital

- (a) On a return of capital in a winding up (but not on a redemption, reduction of capital or purchase of any shares by the Bank), the Preference Shares will rank *pari passu* inter se and *pari passu* with any other shares of the Bank that are expressed to rank *pari passu* therewith as regards participation in the capital, and otherwise in priority to the Bank's ordinary shares and any other class of shares of the Bank ranking junior to the Preference Shares. On such a return of capital, each holder of a Preference Share will be entitled to receive in pounds sterling an amount equal to the Principal Amount of that Preference Share together with, subject to the restrictions in paragraphs (e) and (f) under "Dividends" above, the amount of (i) any unpaid dividend for any Dividend Period ending on or before the date of commencement of the winding up or other return of capital (the "relevant date") and (ii) a pro rated dividend (calculated on the basis mentioned in (c) under "Dividends" above) in respect of the period, if any, from and including the last Dividend Payment Date prior to the relevant date down to but excluding the relevant date.
- (b) If, upon any such return of capital, the amounts available for payment are insufficient to cover the amounts payable in full on the Preference Shares and on any other shares expressed to rank *pari passu* therewith as regards participation in assets, then the holders of the Preference Shares and such other shares will share rateably and proportionately in such return of capital.
- (c) No Preference Share will confer any further right to participate on a return of capital of the Bank.

Redemption

- (a) Subject to paragraph (f) below, the Bank may, at its option, redeem all, but not some, of the Preference Shares for the time being issued and outstanding on the Dividend Re-set Date, and, on each Dividend Payment Date thereafter (each a "Redemption Date") provided that if either of the restrictions mentioned in paragraphs (e) and (f) under "Dividends" above applies to the dividend on the selected Redemption Date, the Bank may not redeem any of the Preference Shares on that Redemption Date.
- (b) Any redemption of the Preference Shares will be for cash.
- (c) If the Preference Shares are to be redeemed, a notice of redemption (a "Redemption Notice") will be mailed to each holder of Preference Shares, not less than 30 Business Days nor more than 60 Business Days prior to the relevant Redemption Date. Each Redemption Notice will specify, *inter alia*, (i) the Redemption Date, (ii) the particular Preference Shares to be redeemed on the Redemption Date, (iii) the Redemption Price and (iv) the place or places where holders may surrender share certificates (if applicable) in respect of such Preference Shares and obtain payment of the Redemption Price. No defect in the Redemption Notice or in its mailing will affect the validity of the redemption proceedings.

The cash amount payable on Redemption (the "Redemption Price") will equal the Principal Amount of such Preference Share. Any such Redemption will not prejudice the rights of the holder of any Preference Share to be so redeemed to receive any accrued but unpaid dividend on that Preference Share payable on the Redemption Date.

- (d) Payments in respect of the amount due on redemption of a Preference Share will be made by cheque or upon the written request of the holder or all joint holders not later than the date specified for the purpose in the Redemption Notice by transfer to a pounds sterling account maintained by the payee with a bank in London or such other method as the Directors of the Bank may specify in the Redemption Notice. Payment will be made against presentation and surrender of the relative share certificate (if any) at the place or one of the places specified in the Redemption Notice.
- (e) A receipt given by the holder for the time being of any Preference Share (or in the case of joint holders by the first-named joint holder) in respect of the amount payable on redemption of such Preference Share will constitute an absolute discharge to the Bank.
- (f) Any redemption of the Preference Shares will be made in compliance with the provisions of the United Kingdom Companies Act, the Uncertificated Securities Regulations and every other statute for the time being in force concerning bodies corporate and affecting the Bank (the "Statutes") and the Articles. No redemption of any Preference Shares may be made by the Bank without the prior consent of the FSA (for so long as the Bank is required to obtain such consent) and subject to such conditions as the FSA may impose at the time of any consent.

Voting

Except as provided below, holders of Preference Shares will not be entitled to attend and vote at general meetings of the Bank. Holders will be entitled to attend and vote at a class meeting of holders of Preference Shares. Every holder of Preference Shares who is present in person at a class meeting of holders of Preference Shares will have one vote on a show of hands and on a poll every holder of Preference Shares who is present in person or by proxy will have one vote for every Preference Share of which he is the holder.

If prior to any general meeting of shareholders of the Bank, dividends in respect of any single Dividend Period prior to the Dividend Re-set Date or for two consecutive Dividend Periods thereafter have not been paid in full, then the holders of the Preference Shares shall have the right to receive notice of, attend, speak and vote at such general meeting on all matters and such right shall continue until after the next following Dividend Payment Date on which a dividend in respect of the Preference Shares is paid in full (or an amount equivalent to the dividend to be paid in respect of the next Dividend Payment Period has been paid or set aside for payment to the holders of the Preference Shares).

Purchases

The Bank may at any time and from time to time exercise any powers conferred by the Statutes in purchasing the Preference Shares. No repurchase of any Preference Shares will be made without the prior consent of the FSA (for so long as the Bank is required to obtain such consent).

Variations of Rights and Further Issues

Subject to the provisions of the Statutes, the special rights attached to any class of shares may be varied or abrogated with the consent in writing of the holders of three-quarters in nominal value of the issued shares of that class or with the sanction of an extraordinary resolution passed at a separate meeting of the holders of shares of that class. At any such separate meeting, the provisions of the Articles relating to general meetings will apply, but the necessary quorum at any such meeting will be two persons at least holding or representing by proxy at least one-third in nominal value of the issued shares of that class (but so that at any adjourned meeting any holders of shares of the class present in person or by proxy shall be a quorum) and any such person may demand a poll.

The special rights or privileges attached to the Preference Shares will not be deemed to be varied, modified or abrogated by the creation or issue of further shares ranking *pari passu* therewith, or by the purchase or redemption by the Bank of its own shares.

Transfer of Shares

An instrument of transfer of a share which is in certificated form must be in writing in any usual form or other form approved by the directors of the Bank and must be executed by or on behalf of the transferor and (except in the case of fully-paid shares) by or on behalf of the transferee. The transferor will remain the holder of the shares transferred until the name of the transferee is entered in the register of members of the Bank in respect thereof.

The Directors of the Bank may in the case of shares in certificated form, in their absolute discretion and without assigning any reason therefor, refuse to register any transfer of a share (not being a fully paid share) provided that, where any such shares are traded on the London Stock Exchange, such discretion may not be exercised in such a way as to prevent dealings in the shares of that class from taking place on an open and proper basis, and any transfer of a share on which the Bank has a lien. The Directors of the Bank may also decline to register a transfer unless (i) the instrument of transfer is duly stamped (if so required), (ii) the transfer is in respect of only one class of shares and (iii) the transfer is in favour of not more than four persons as the transferee.

The Bank shares are in registered form. The registration of share transfers may be suspended at such times and for such periods as the Directors of the Bank may determine not exceeding 30 days in any year.

Notices or Other Documents

- (a) Any notice or other document may be served by the Bank upon any holder of the Preference Shares, *inter alia*, personally, by sending it through the post in a prepaid envelope to such holder at its registered address, by leaving it at that address in accordance with the Articles or by advertisement in one leading daily newspaper published in the United Kingdom and one leading English language daily newspaper and one leading Chinese language daily newspaper printed and circulated in Hong Kong. Holders who (having no registered address within the United Kingdom or Hong Kong) have not supplied to the Bank an address within the United Kingdom or Hong Kong for the service of notices shall not be entitled to receive notices from the Bank.
- (b) Holders of the Preference Shares with a registered address or address for correspondence within the United Kingdom will have the right to have sent to them (at the same time as the same are sent to the holders of Ordinary Shares) all notices of general meetings of the Bank and a copy of every circular or other like document sent out by the Bank to the holders of Ordinary Shares.

TAXATION

General

Prospective investors should inform themselves as to the tax consequences within the countries of their residence and domicile of the acquisition, holding or disposal of Preferred Securities. The comments below are of a general nature based on law and published practice as at the date hereof in each jurisdiction referred to and do not constitute tax or legal advice and should be treated with appropriate caution. They relate only to the position of persons who are the absolute beneficial owners of their Preferred Securities and hold their Preferred Securities as an investment (unless otherwise specified). Any investors who are in doubt as to their personal tax position should consult their professional advisers. Investors who may be liable to taxation in jurisdictions other than Jersey or the United Kingdom in respect of their acquisition, holding or disposal of the Preferred Securities are particularly advised to consult their professional advisers as to whether they are so liable and if so under the laws of which jurisdiction, since the following comments relate only to certain United Kingdom or Jersey taxation aspects of payments in respect of the Preferred Securities. In assessing their tax position, investors should note that the Issuer is a Jersey limited partnership and not a legal entity separate from its partners.

Jersey Taxation

Investors in Preferred Securities (other than residents of Jersey) are not subject to any tax in Jersey in respect of the holding, exchange, sale or other disposal of the Preferred Securities. Distribution payments may be made by the Issuer without withholding or deduction for, or on account of, and without, any payment of Jersey income tax.

No stamp duties are payable in Jersey on the acquisition, ownership, exchange, sale or other disposal of Preferred Securities. Probate or letters of administration may be required to be obtained in Jersey on the death of a holder of a Preferred Security with an estate in Jersey, including Preferred Securities. Stamp duty is payable in Jersey on the registration of such probate or such letters of administration on the value of the deceased's estate in Jersey.

As a limited partnership, the Issuer is not itself a subject for assessment to Jersey income tax since it is not a legal entity separate from its partners.

On 3 June 2003, the European Union ("EU") Council of Economic and Finance Ministers adopted a directive on the taxation of savings income in the form of interest payments (Council Directive 2003/48/EC) (the "EU Savings Tax Directive"). It is proposed that, subject to a number of important conditions being met, each EU Member State will, from 1 January 2005, be required to provide to the tax authorities of another EU Member State details of payments of interest (or other similar income) paid by a person within its jurisdiction to or for the benefit of an individual resident in that other EU Member State; however, Austria, Belgium and Luxembourg will instead apply a withholding tax system for a transitional period in relation to such payments.

Jersey is not a member of the European Union and therefore is not required to implement the EU Savings Tax Directive. However, the Policy & Resources Committee of the States of Jersey has announced that, in keeping with Jersey's policy of constructive international engagement, Jersey, in line with steps proposed by other relevant third countries, proposes to introduce a withholding tax system in respect of payments of interest, or other similar income, made to an individual beneficial owner resident in an EU Member State by a paying agent situate in Jersey (the terms "beneficial owner" and "paying agent" for this purpose are as defined in the EU Savings Tax Directive). The withholding tax system would apply for a transitional period prior to the implementation of a system of automatic communication to EU Member States of information regarding such payments. During this transitional period, such an individual beneficial owner resident in an EU Member State will be entitled to request a paying agent not to withhold tax from such payments but instead to apply a system by which the details of such

payments are communicated to the tax authorities of the EU Member State in which the beneficial owner is resident.

The States of Jersey has not yet adopted measures to implement these proposals but is expected to adopt such measures on the same timetable as EU Member States and other relevant third countries.

United Kingdom Taxation

In this section, the term “UK Investors” means persons who are resident (or in the case of individuals, ordinarily resident) in the United Kingdom for taxation purposes.

(a) Position of UK Investors

Classification of the Issuer

HSBC has been advised that the Issuer should be classified as a partnership for UK tax purposes. Accordingly, UK Investors in Preferred Securities should be subject to UK tax in respect of their investment in the Preferred Securities. UK Investors should be taxed on the basis that they are partners in the Issuer, and that the limited partnership interests are held on their behalf by the common depository for Euroclear and Clearstream, Luxembourg as bare trustee. This treatment should, broadly, result in UK Investors being taxed as if they hold their proportionate share of the Issuer’s assets. It is possible, however, that the Inland Revenue may seek to treat UK Investors in the Issuer as holding interests in a “unit trust scheme” and/or apply the “offshore fund” rules. This may have disadvantages for certain UK Investors. UK Investors who are in any doubt as to their tax position in respect of the Preferred Securities (or on exchange of Preferred Securities for Substitute Preference Shares) are strongly recommended to take independent professional advice.

(b) UK Withholding Tax on Distributions on the Preferred Securities

Payments of Distributions on the Preferred Securities may be made without withholding or deduction for or on account of UK tax.

(c) UK Withholding Tax on Interest on the Subordinated Note

The Subordinated Note issued by the Bank will constitute a “quoted Eurobond” provided it is and continues to be listed on a recognised stock exchange. The London Stock Exchange is a recognised stock exchange for these purposes. Accordingly, while the Subordinated Note is and continues to be a quoted Eurobond payments of interest on the Subordinated Note may be made without withholding or deduction for or on account of United Kingdom income tax.

(d) Stamp Duty and Stamp Duty Reserve Tax (“SDRT”)

No UK stamp duty will be chargeable in respect of the issue of the Preferred Securities. Transfers of the Preferred Securities within a clearing system that has not made an election under section 97A Finance Act 1986 should not be chargeable to UK stamp duty unless such transfer is effected by means of a written instrument. Although a liability to UK stamp duty may arise on an agreement to transfer, or a transfer of, Preferred Securities which is executed in the United Kingdom or which relates, wherever executed, to any property situate in, or to any matter or thing done or to be done in, the United Kingdom, it is not likely that any such duty will need to be paid in practice.

No liability to SDRT should arise in respect of the issue or subsequent transfer of the Preferred Securities.

No liability to UK stamp duty or SDRT will arise on issue of the Substitute Preference Shares unless they are issued either:

- (i) to a clearing system (or to a nominee for a clearing system) and the clearing system has not made an election under section 97A of the Finance Act 1986; or
- (ii) to a depository (or to a nominee or agent for a depository) who has issued or is to issue depository receipts for the Substitute Preference Shares.

In either case, on issue of the Substitute Preference Shares there will be an SDRT entry charge at the rate of 1.5% of the value of the Substitute Preference Shares.

If the Substitute Preference Shares are issued to a clearing system (or to its nominee) which has not made an election under section 97A of the Finance Act 1986, there will be no SDRT on any subsequent agreement to transfer the Substitute Preference Shares and no stamp duty on any subsequent transfer of the Substitute Preference Shares so long as they are held in the clearing system and provided that any instrument of transfer or written agreement to transfer the Substitute Preference Shares is executed outside the UK and remains at all times outside the UK.

If the Substitute Preference Shares are issued to a clearing system (or to its nominee) which has made an election under section 97A of the Finance Act 1986, there will be no stamp duty or SDRT entry charge on the issue to the clearing system, but there will be a SDRT charge at the rate of 0.5% of the amount or value of the consideration on any subsequent agreement to transfer the Substitute Preference Shares so long as they are held in the clearing system. If the Substitute Preference Shares are held by a clearing system which has made a section 97A election and that election is subsequently terminated (whether at the instigation of the clearing system or the Inland Revenue or otherwise) an SDRT charge of 1.5% will arise as if, immediately after such termination, the Substitute Preference Shares had been transferred to a clearing system that had not made a section 97A election.

If the Substitute Preference Shares are issued to a depository (or to its nominee or agent), there will be no SDRT on any subsequent agreement to transfer the depository receipts representing interests in the Substitute Preference Shares and no stamp duty on any subsequent transfer of the depository receipts provided that any instrument of transfer or written agreement to transfer the depository receipts is executed outside the UK and remains at all times outside the UK.

SUBSCRIPTION AND SALE

Under a Subscription Agreement (the "Subscription Agreement") dated 1 April 2004, HSBC Bank plc, Credit Suisse First Boston (Europe) Limited, Goldman Sachs International, Landesbank Baden-Württemberg, Morgan Stanley & Co. International Limited and Royal Bank of Canada Europe Limited (the "Managers") have agreed to subscribe for the Preferred Securities at a price of £1,000 per Preferred Security. The Managers will receive a combined selling, management and underwriting commission of £10 per Preferred Security and will be indemnified against certain liabilities by the Bank. The Managers are entitled to terminate the Subscription Agreement in certain circumstances before the issue of the Preferred Securities. The offering price and other selling terms may be changed at any time without notice.

United States of America

The Preferred Securities have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, US persons. Terms used in this paragraph have the meanings given to them by Regulation S.

Each Manager has agreed that, except as permitted by the Subscription Agreement, it will not offer or sell the Preferred Securities, (a) as part of their distribution at any time or (b) otherwise, until 40 days after the later of the commencement of the offering and the issue date of the Preferred Securities, within the United States or to, or for the account or benefit of, US persons, and that it will have sent to each dealer to which it sells Preferred Securities during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Preferred Securities within the United States or to, or for the account or benefit of, US persons.

In addition, until 40 days after commencement of the offering, an offer or sale of Preferred Securities within the United States by a dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act.

United Kingdom

Each Manager has further represented, warranted and agreed that:

- (a) *No offer to public:* It has not offered or sold and will not offer or sell any Preferred Securities to persons in the United Kingdom prior to the expiry of a period of six months from the issue date of such Preferred Securities except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995;
- (b) *Financial Promotion:* It has only communicated or caused to be communicated, and will only communicate or cause to be communicated, any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (the "FSMA")) received by it in connection with the issue or sale of any Preferred Securities in circumstances in which section 21(1) of the FSMA does not apply to the Issuer or the Bank;
- (c) *General compliance:* It has complied with and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Preferred Securities in, from or otherwise involving the United Kingdom;
- (d) *Collective Investment Schemes:* It has only offered or sold and will only offer or sell Preferred Securities to (a) investment professionals falling within article 14(5) of the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (the "Promotion of Collective Investment Schemes Order") and article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order

2001 (the "Financial Promotion Order"), who have professional experience of participating in unregulated schemes and matters relating to investments, or (b) persons falling within article 22(2) of the Promotion of Collective Investment Schemes Order and article 49(2) of the Financial Promotion Order; and

- (e) *Proper Systems*: It has in place and will have in place proper systems and procedures to prevent any person other than those persons described in paragraph (d) above from participating in the Preferred Securities.

General

No action has been or will be taken in any jurisdiction by the Issuer, the General Partner, the Bank or any Manager that would, or is intended to, permit a public offering of the Preferred Securities, or possession or distribution of this Offering Circular or any other offering material, in any country or jurisdiction where action for that purpose is required. Persons into whose hands this Offering Circular comes are required by the Issuer, the Bank and the Managers to comply with all applicable laws and regulations in each country or jurisdiction in which they purchase, offer, sell or deliver Preferred Securities or have in their possession, distribute or publish this Offering Circular or any other offering material relating to the Preferred Securities, in all cases at their own expense.

GENERAL INFORMATION

1. Application has been made to list the Preferred Securities on the Luxembourg Stock Exchange. In connection therewith, a legal notice relating to the issue of the Preferred Securities and the Partnership Agreement will be filed with the Register of Commerce and Companies in Luxembourg (*Registre de Commerce et des Sociétés à Luxembourg*), where the document may be examined and copies thereof may be obtained. The quotation on the Luxembourg Stock Exchange of the Preferred Securities will be expressed in pounds sterling as a percentage of the nominal amount per Preferred Security. For listing purposes, the Preferred Securities will be considered as debt securities. At the date hereof it is not intended to list the Preferred Securities on any other stock exchange.
2. The General Partner has obtained all necessary consents, approvals and authorisations in the United Kingdom and Jersey in connection with the issue of the Preferred Securities. The creation of the Preferred Securities was authorised by a resolution of the board of directors of the General Partner (acting in its capacity as general partner of, and on behalf of, the Issuer) on 11 March 2004. The issue of the Guarantee was authorised by resolutions of the Board of Directors of the Bank passed on 25 February 2004 and the resolutions of a committee of the Board of Directors of the Bank passed on 31 March 2004.
3. There has been no significant change in the financial or trading position of HSBC Bank Capital Funding (Sterling 2) L.P. and no material adverse change in the financial position or prospects of HSBC Bank Capital Funding (Sterling 2) L.P. since its establishment.
4. HSBC Bank Capital Funding (Sterling 2) L.P. is not, nor has been, involved in any legal or arbitration proceedings that may have, or have had since its establishment, a significant effect on the financial position of HSBC Bank Capital Funding (Sterling 2) L.P. nor is the General Partner aware that any such proceedings are pending or threatened.
5. There are no legal or arbitration proceedings against or affecting the Bank, or any of its subsidiaries or any of their respective assets, nor is the Bank aware of any pending or threatened proceedings, which are or might be material in the context of the issue of the Preferred Securities.
6. Save as disclosed in this Offering Circular, there has been no significant change in the financial or trading position of the Bank or the Bank Group since 31 December 2003 and no material adverse change in the financial position or prospects of the Bank or the Bank Group since 31 December 2003.
7. The Preferred Securities have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The following security codes have been assigned:

ISIN: XS0189704140
Common Code: 018970414
8. Copies of the following documents will be available for inspection at (and, in the case of 7(c), 7(d) and 7(g) for collection (free of charge) from) the offices of the listing agent, Kredietbank S.A. Luxembourgeoise, and at the registered offices of the Bank, the Issuer and of the Paying Agents whose addresses are shown elsewhere in this Offering Circular during normal business hours for so long as the Preferred Securities are outstanding:
 - (a) the Partnership Agreement (which includes the form of the Global Certificate);
 - (b) the memorandum and articles of association of the Bank;
 - (c) the audited financial statements of the Bank for the years ended 31 December 2001, 31 December 2002 and 31 December 2003;
 - (d) the consents and authorisations referred to in paragraph 2 above;

- (e) the Guarantee;
- (f) the Subscription Agreement; and
- (g) a copy of this Offering Circular together with any supplemental offering circular.

For so long as the Preferred Securities are listed on the Luxembourg Stock Exchange, the most recently published audited annual financial statements and any consolidated unaudited semi-annual financial statements of the Bank, and the most recently published audited annual accounts of the Issuer, will also be available at the offices of Kredietbank S.A. Luxembourggeoise in Luxembourg. The Bank does not publish non-consolidated interim financial statements. The first annual accounts of the Issuer are expected to be prepared for the period commencing on 31 March 2004 and ending on 31 December 2004. The Issuer does not publish semi-annual interim accounts.

9. KPMG Audit Plc, Chartered Accountants and Registered Auditor of 1 Canada Square, London E14 5AG, have been auditors to the Bank for the financial years ended 31 December 2001, 2002 and 2003. The auditors have issued unqualified reports in respect of the Bank's financial statements for the financial years ended 31 December 2001, 2002 and 2003, without any statements under Section 237(2) or (3) of the UK Companies Act 1985 and statutory accounts for the financial years ended 31 December 2001, 2002 and 2003 have been or, in the case of the statutory accounts for the financial years ended 31 December 2003, will be delivered to the Registrar of Companies.
10. No redemption of the Preferred Securities (optional or otherwise) and no purchase and cancellation of the Preferred Securities will be made by the Issuer, the General Partner or the Bank without such prior consent of the FSA as may for the time being be required. These requirements and restrictions do not affect the ability of the Bank's subsidiaries and affiliates to engage in market-making activities in relation to the Preferred Securities.

ANNEX A

HSBC BANK PLC

ANNUAL REPORT AND ACCOUNTS 2003

Annual Report and Accounts 2003

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Presentation of Information

This document comprises the *Annual Report and Accounts 2003* for HSBC Bank plc (the 'bank') and its subsidiary undertakings (together the 'group'). It contains the Directors' Report and Accounts, together with the Auditors' report, as required by the UK Companies Act 1985.

The bank's obligation to file annual reports with the US Securities and Exchange Commission has been suspended following, among other things, the re-listing of two issues of the bank's subordinated notes to London from New York. As a consequence, an *Annual Report on Form 20-F* for 2003 has not been prepared.

Annual Report and Accounts 2003

Business Highlights 2003

- Underlying* operating income up £610 million, 8 per cent
- Underlying* profit before tax in line with last year

Personal Banking – profits up £47 million, or 8 per cent

- Strong growth in mortgages and personal lending, particularly in the UK
 - 25 per cent rise in Mortgages, First Direct's Offset mortgage up 53 per cent
 - Winner of several major mortgage awards
- Strong growth in credit cards
- Strong growth in savings and current account balances
- Difficult equity markets reflected in fall in sales of investment products
- 19 per cent growth in repayment protection premiums in the UK

Commercial Banking – profits down £88 million, or 14 per cent

- Competition Commission ruling cost £83 million in the year
 - HSBC increased share of business start-ups attracting more than 102,000 new customers
 - 21 per cent rise in business current account balances

Corporate, Investment Banking and Markets – profit down £32 million, or 4 per cent

- Inclusion of full year figures for Investment Banking
- Underlying* increase of £48 million, 6 per cent
 - Dealing profits up – expansion of product range, successful interest rate positioning and currency volatility
 - Lower benefit from surplus funds in low interest rate environment
 - Business restructured under co-heads

CCF – profit up £17 million, or 5 per cent, in a subdued market

- Mortgage lending up 11 per cent and personal lending 9 per cent
- Number of structured products launched for corporate clients
- Growth in trade services and payments and cash management offset decline in equity related income.
- Costs held flat

HSBC Private Banking – profit up £65 million, or 29 per cent

- Higher volumes of brokerage income
- Higher sales of structured products, trustee and safekeeping services as equity markets began to recover.
- Strong growth in discretionary asset management mandates
- Rising equity markets contributed to growth in fee and commission income
- 59 per cent increase in dealing profits as clients took advantage of upturn in markets in second half of the year

Costs

- Overall costs up £863m, or 17 per cent, reflecting:
 - costs of other HSBC entities transferred into the group
 - increased pension and national insurance costs
 - new headquarters costs
 - restructuring costs
 - salary increments and performance related bonuses (particularly in Corporate, Investment Banking and Markets)

Bad debts

- £59 million, or 16 per cent, rise in bad debts mainly reflects provision for a single corporate customer
- Credit environment remains stable in both personal and commercial sectors.

Goodwill amortisation cost up £78m reflecting the impairment of goodwill on a UK Fund management company acquired in 2000 as part of CCF.

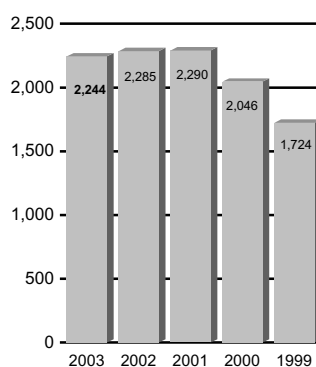
* The term 'underlying' reflects performance excluding business combinations made in 2002, the most significant of which was the divisionalisation of the Investment Banking activities of HSBC Investment Bank plc into HSBC Bank plc on 30 November 2002

Annual Report and Accounts 2003

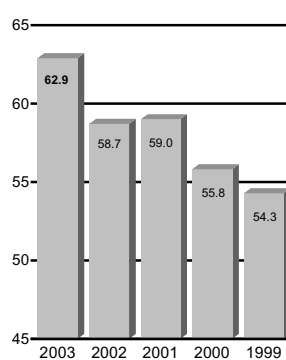
Financial Highlights

| | 2003 | 2002 | 2001 | 2000 | 1999 |
|--|---------|---------|---------|---------|---------|
| For the year (excluding goodwill amortisation) (£m) | | | | | |
| Profit on ordinary activities before tax | 2,810 | 2,773 | 2,757 | 2,163 | 1,727 |
| Profit attributable | 2,046 | 1,867 | 1,937 | 1,503 | 1,204 |
| For the year (as reported) (£m) | | | | | |
| Profit on ordinary activities before tax | 2,244 | 2,285 | 2,290 | 2,046 | 1,724 |
| Profit attributable | 1,480 | 1,379 | 1,470 | 1,386 | 1,201 |
| At year-end (£m) | | | | | |
| Shareholders' funds | 17,064 | 16,455 | 15,648 | 14,873 | 5,016 |
| Capital resources | 14,603 | 12,768 | 12,209 | 11,527 | 8,121 |
| Customer accounts and deposits by banks | 175,390 | 155,234 | 147,665 | 131,329 | 77,874 |
| Total assets | 246,104 | 218,378 | 202,309 | 185,426 | 106,468 |
| Ratios (%) | | | | | |
| Return on average shareholders' funds (equity) | 8.5 | 8.5 | 9.3 | 18.7 | 25.9 |
| Capital ratios | | | | | |
| — total capital | 10.7 | 10.3 | 10.7 | 10.7 | 11.3 |
| — tier 1 capital | 7.4 | 7.1 | 6.8 | 6.5 | 6.8 |
| Cost:income ratio (excluding goodwill amortisation) | 62.9 | 58.7 | 59.0 | 55.8 | 54.3 |

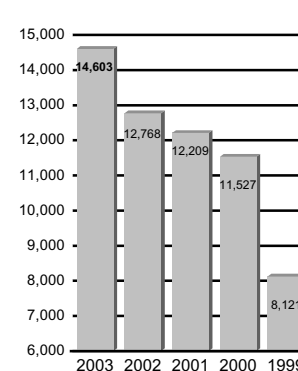
Profit on ordinary activities before tax (as reported) (£m)



Cost:income ratio (%)



Capital resources (£m)



The financial highlights are influenced by changes in the group structure over the five years. The most significant acquisitions are as follows: in 2000, HSBC Private Banking Holdings (Suisse) SA, CCF S.A. (formerly Crédit Commercial de France S.A.); in 2001, HSBC Investment Bank Asia Limited, Banque Herve, Demirbank TAS, HSBC Guyerzeller Bank AG; in 2002, HSBC Trinkaus & Burkhardt KGaA, HSBC Republic Bank (UK) Limited and activities of HSBC Investment Bank plc

Financial Review

Summary of Financial Performance

Consolidated Profit and Loss Account

| | 2003 £m | 2002 £m |
|--|--------------|--------------|
| Net interest income | 4,272 | 4,039 |
| Other operating income | 4,276 | 3,653 |
| Operating income | 8,548 | 7,692 |
| Administrative expenses | (4,886) | (4,060) |
| Depreciation | (491) | (455) |
| Amortisation of goodwill | (483) | (482) |
| Operating profit before provisions | 2,688 | 2,695 |
| Provisions | | |
| — provisions for bad and doubtful debts | (436) | (377) |
| — provisions for contingent liabilities and commitments | (45) | (27) |
| Amounts written off fixed asset investments | (28) | (146) |
| Operating profit | 2,179 | 2,145 |
| Share of operating (loss) in joint ventures and associates | (57) | (4) |
| Gains/(losses) on disposal of | | |
| — interests in joint ventures and associates | 1 | 32 |
| — investments | 137 | 122 |
| — tangible fixed assets | (16) | (10) |
| Profit on ordinary activities before tax | 2,244 | 2,285 |
| Tax on profit on ordinary activities | (641) | (808) |
| Profit on ordinary activities after tax | 1,603 | 1,477 |
| Minority interests | | |
| — equity | (43) | (30) |
| — non-equity | (80) | (68) |
| Profit attributable to shareholders | 1,480 | 1,379 |

Profit/(loss) on ordinary activities before tax

| | 2003 £m | 2002 £m |
|---|--------------|--------------|
| UK Personal Banking | 602 | 555 |
| UK Commercial Banking | 539 | 627 |
| UK Corporate and Institutional Banking | 369 | 312 |
| Global Markets UK | 458 | 467 |
| Investment Banking | (82) | (2) |
| International Banking | 202 | 208 |
| CCF | 382 | 365 |
| Private Banking | 290 | 225 |
| HSBC Trinkaus & Burkhardt | 50 | 16 |
| Amortisation of goodwill including goodwill on joint ventures | (566) | (488) |
| | 2,244 | 2,285 |

The UK economy expanded by 2.3 per cent in 2003. After a slow first half of the year, growth accelerated in the third quarter and that momentum continued into the final months of the year. Growth in consumer spending slowed during the course of the year but it nevertheless remained robust and in particular the housing market and household appetite to borrow remained strong. However, low real income growth, together with the expectation of

rising interest rates, are expected to dampen household activity in the forthcoming months. Elsewhere, there are a few encouraging signs that industrial activity in particular and corporate confidence in general is starting to improve from a low base. Going forward, stronger global demand, if maintained, should provide a boost to the corporate sector.

Having slipped into recession in the first half of the year, the euro-zone economies returned to growth in the second half, expanding by 0.4 per cent quarter-on-quarter in the third quarter and by 0.3 per cent in the fourth quarter. Once again, however, it was stronger exports that drove the third quarter improvement, while the domestic economies remained subdued. Consumer spending was flat and investment contracted for the third consecutive quarter. The pick-up in exports occurred despite the appreciating euro, which rose more than 15 per cent against the dollar during the course of the year. In the fourth quarter, growth seemed to have been largely the result of inventory build-up, with exports falling back after the strength of the third quarter, and with limited growth in consumer spending. Interest rates were cut twice during 2003, with the European Central Bank's repo rate dropping by 75 basis points to just 2 per cent. By contrast, however, longer-term interest rates have moved higher, rising by about 80 basis points between June and the end of December, as the bond market anticipated economic recovery.

In 2003, personal credit expansion in the UK was the major growth area as consumers took advantage of historically low interest rates, enabling HSBC to generate strong growth in mortgages and consumer lending. Conversely, investment sales were low because of a lack of confidence in equity markets, and sales of pensions and investment products fell. In this environment HSBC grew its deposit base as customers sought flexibility and security for their savings, notwithstanding the low interest rates available. The low interest rate environment also meant that the value of HSBC's maturing liquidity reduced as it was redeployed in lower yielding assets.

The same factors, low interest rates and weak equity markets, increased the cost of pension provision by £59 million in the UK. Employment costs also grew, notably in the UK, as social taxes were raised. In order to adjust for this higher cost environment, the bank took steps to reduce its staff costs, announcing both 1,400 redundancies in the UK and the shift, over the next three years, of 4,000 jobs to the Group's global service centres. In the short term these actions incurred both redundancy and excess property provisions totalling £107 million.

The results in 2003 reflect the full year impact of a number of business combinations in the latter stages of 2002, the most significant of which was the divisionalisation of the investment banking activities of HSBC Investment Bank plc into HSBC Bank plc on 30 November 2002. The term 'underlying'

reflects performance excluding these significant changes.

Profit on ordinary activities before tax decreased by £41 million, or 2 per cent compared to last year, as the impact of the UK Competition Commission ruling, lower investment sales, higher costs and specific bad debt charges in the corporate sector offset Global Markets' performance and growth in mortgages, personal lending and insurance income. Excluding the impact of business combinations, the underlying net profit before tax was in line with last year.

Net interest income at £4,272 million increased by 6 per cent, or 4 per cent excluding the effect of business transfers and acquisitions. Average interest-earning assets increased by £13 billion, or 7 per cent, driven by strong growth in mortgages and personal lending in the UK and to a lesser extent France. UK Mortgage balances increased by 25 per cent, as borrowers continued to take advantage of the low interest rate environment to re-mortgage. First Direct made a significant contribution to this growth with a 53 per cent increase on last year, reflecting the continuing success of its Offset mortgage product. Both HSBC and First Direct won a number of major awards for their mortgage products during the year.

Personal lending balances, excluding mortgages, increased by 15 per cent in the UK and 9 per cent in France reflecting the success of targeted marketing campaigns and improved utilisation of customer relationship management systems. Card balances in the UK grew by 18 per cent, due to the continued strength of consumer expenditure and a record number of competitor balance transfers following the introduction in July of a '0%' balance transfer promotion. Lending growth was funded through significant growth in savings and current account balances as customers preferred to hold cash in the uncertain investment climate.

The UK Competition Commission ruling on payment of interest on Small Business accounts had an adverse impact on UK margins and cost £83 million during the year. In response, HSBC committed more resource to advertising and marketing the broad advantages of its small business product, leading to a 21 per cent increase in business current account balances. The bank also increased its share of business start-ups and opened more than 102,000 new business accounts, while the new small business loan, launched in October, attracted nearly £10 million of new lending in its first two months of operation.

Financial Review (continued)

The current subdued economic climate resulted in a slight fall in corporate sector account balances in both the UK and France as corporate activity slowed and customers focused more actively on cash management. In Global Markets, earnings from deploying the excess liquidity of the bank declined as long-term assets matured and proceeds were reinvested at lower rates. While funding costs continued to benefit from the low interest rate environment and positive yield curves, the benefit was less significant than in 2002 as yield curves flattened during the first half of 2003.

Overall interest spread increased by 6 basis points to 2.02 per cent as spreads on personal customer lending and savings products widened. The value of free funds declined by 10 basis points as small business accounts changed to interest bearing and interest rates fell further during the period. As a result the margin fell by 4 basis points to 2.23 per cent.

Other operating income increased by 17 per cent, with underlying growth of 13 per cent. Debt capital markets saw strong performance as both refinancing activity and currency volatility afforded exceptional opportunities to generate sales of interest rate and foreign exchange products. Elsewhere, higher corporate banking fee income reflected restructuring within the telecommunications and transport sectors.

Sales of investment products fell, reflecting continued uncertainty in investment markets, while subdued equity markets reduced the value of long-term assurance business. However, the strong growth in mortgages and personal loans boosted sales of repayment protection products in the UK producing a 19 per cent increase in premiums. In France the launch of a number of structured products and growth in trade services, cash management and regional treasury activities partly offset a decline in equity related income. Private Banking benefited from higher volumes of brokerage activity and sales of tailored structured products, trustee and safekeeping services. Growth in discretionary asset management mandates and the rise in client portfolio values also contributed to the 32 per cent increase in Private Banking net fees and commissions income.

Other operating income in Global Markets of £400 million was £133 million, or 50 per cent, higher than in 2002, largely reflecting growth in dealing profits. Fixed income earnings increased as customers sought long-term financing at low interest

rates and investors purchased bonds for enhanced yield. Advantage was also taken of the narrowing of credit spreads. Foreign exchange revenues remained strong, aided by increased volatility in the major currency pairs and by the existence of a clear trend in the markets, in the form of a weakening U.S. dollar. Volumes increased sharply as customers sought to hedge their currency exposure in volatile markets. Income from interest rate derivatives increased in line with the expansion of the bank's product range. There was continued growth in mandates from corporate customers with an increasing number taking advantage of HSBC's geographic reach.

In Private Banking dealing profits increased by 59 per cent on the back of higher client driven volumes in foreign exchange and investment security sales.

Operating expenses increased by £863 million, or 17 per cent. Excluding the impact of acquisitions and business transfers, costs grew by £508 million, or 10 per cent. Underlying staff costs rose by 15 per cent, with two thirds of this increase accounted for by higher pension expense of £59 million, as the deficit reported at the end of 2002 was amortised; redundancy costs of £63 million; discretionary bonuses of £131 million; and annual pay awards. In Global Markets UK, staff costs were 53 per cent higher than in 2002 reflecting higher bonus accruals in line with increased profitability in specific product lines, while performance-related bonuses and recruitment to support business growth contributed to a 29 per cent increase in Private Banking staff costs.

Non-staff costs, on an underlying basis, were £125 million, or 5 per cent, higher than in 2002. The relocation of the bank's headquarters to Canary Wharf added £69 million to costs as equipment and infrastructure were upgraded and a number of buildings in the City were vacated. Provision of £23 million was also made for vacant space that will arise as a number of processing centres in the UK are closed.

The **charge for bad and doubtful debts** was £59 million or 16 per cent higher than in 2002 largely reflecting provisions for a single corporate customer, partly offset by a number of recoveries and the release of general provisions. Low interest rates, stable employment and improved stock markets provided the economic environment for continuing stability in credit charges in the personal and commercial business sectors.

Amounts written off fixed asset investments in 2002 included a provision for the permanent diminution in value in respect of a life insurance company, which was not repeated in 2003.

Income from joint ventures and associates included a provision for impairment of goodwill on a UK fund management company acquired in 2000 as part of CCF.

Capital Management

Capital measurement and allocation

The Financial Services Authority (FSA) is the supervisor of the bank and the group and, in this capacity, receives information on capital adequacy and sets minimum capital requirements. Individual banking subsidiaries are directly regulated by the appropriate local banking supervisors, which set and monitor capital adequacy requirements for them.

Under the European Union's Banking Consolidation and Amending Directive (Directive 98/31/EC) to the Capital Adequacy Directive (CAD2), the FSA requires each bank and banking group to maintain an individually prescribed ratio of total capital to risk-weighted assets.

The group's capital resources policy is to maintain its capital base through the diversification of its sources of capital and the efficient allocation of capital. It seeks to maintain at all times a prudent relationship between its total capital, as measured according to the criteria used by the FSA for supervisory purposes, and the varied risks of its business.

Capital adequacy is measured by the ratio of capital to risk-weighted assets, taking into account balance sheet assets and off-balance-sheet transactions, calculated for both the bank and the group on a consolidated basis.

The group's capital is divided into two tiers: tier 1, comprising shareholders' funds, innovative tier 1 securities and minority interests in tier 1 capital, but excluding revaluation reserves; and tier 2, comprising general loan loss provisions, property revaluation reserves, qualifying subordinated loan capital and minority and other interests in tier 2 capital. The amount of innovative tier 1 securities cannot exceed 15 per cent of overall tier 1 capital, qualifying tier 2 capital cannot exceed tier 1 capital, and term subordinated loan capital may not exceed 50 per cent of tier 1 capital. There are also limitations on the amount of general provisions which may be included in tier 2 capital. The book values of goodwill, own shares held and intangible assets are deducted in arriving at tier 1 capital. Total capital is calculated by deducting the book values of unconsolidated investments, investments in the capital of banks, and certain regulatory items from the total of tier 1 and tier 2 capital.

Financial Review (continued)

The table below sets out the analysis of regulatory capital.

Regulatory capital position

| Composition of capital | 2003 | 2002 |
|---|----------------|-------------|
| | £m | £m |
| Tier 1: | | |
| Shareholders' funds | 17,064 | 16,455 |
| Minority interests | 460 | 334 |
| Innovative tier 1 securities | 1,335 | 586 |
| Less: property revaluation reserves | (69) | (121) |
| goodwill capitalised and intangible assets | (8,688) | (8,490) |
| Total qualifying tier 1 capital | 10,102 | 8,764 |
| Tier 2: | | |
| Property revaluation reserves | 69 | 121 |
| General provisions | 464 | 480 |
| Perpetual subordinated loan | 1,247 | 1,354 |
| Term subordinated loan | 3,407 | 2,389 |
| Minority and other interests in tier 2 capital | 716 | 704 |
| Total qualifying tier 2 capital | 5,903 | 5,048 |
| Unconsolidated investments | (901) | (782) |
| Investments in other banks and other financial institutions | (462) | (226) |
| Other deductions | (39) | (36) |
| Total capital | 14,603 | 12,768 |
| Total risk-weighted assets | 136,305 | 123,864 |
| Capital ratios (per cent): | | |
| Total capital: | 10.7 | 10.3 |
| Tier 1 capital: | 7.4 | 7.1 |

The figures were computed in accordance with the EU Banking Consolidation Directive.

The increase of £1.3 billion in tier 1 capital was largely due to the issue of innovative tier 1 capital of £0.7 billion, net exchange rate movements of £0.2 billion and goodwill amortisation of £0.6 billion. Exchange rate movements increased shareholder's funds by £0.6 billion, but also increased the goodwill deduction by £0.4 billion. The payment to the HSBC Bank (UK) pension Scheme is deducted from tier 1

capital within goodwill capitalised and intangible assets.

The increase of £0.9 billion in tier 2 capital in 2003 mainly reflects new capital issues, net of maturities, redemptions and regulatory amortisation.

Total risk-weighted assets increased by £12 billion mainly due to growth in customer lending. Exchange rate changes were broadly neutral with the impact of the euro strengthening almost offset by the US dollar weakening.

Board of Directors

Directors

Sir John Bond, *Chairman*

Age 62. A Director since 1993 and Chairman from 1998. Group Chairman of HSBC Holdings plc. Joined HSBC in 1961. An executive Director of The Hongkong and Shanghai Banking Corporation Limited from 1988 to 1992. Chairman of HSBC Bank Middle East Limited and a Director of The Hongkong and Shanghai Banking Corporation Limited. A Director of Ford Motor Company and a member of the Court of the Bank of England.

S K Green, *Deputy Chairman*

Age 55. A Director since 1995 and Deputy Chairman since May 2003. Joined HSBC in 1982. Group Chief Executive of HSBC Holdings plc since May 2003. Executive Director, Corporate, Investment Banking and Markets from 1998 to May 2003. Group Treasurer, HSBC Holdings plc from 1992 to 1998. Chairman of HSBC Asset Management Limited. A Director of CCF S.A., Grupo Financiero HSBC, S.A. de C.V., HSBC Bank Canada, HSBC Bank Middle East Limited, HSBC Bank USA, HSBC North America Holdings Inc., HSBC North America Inc., HSBC Private Banking Holdings (Suisse) S.A., HSBC Trinkaus & Burkhardt KgaA, HSBC USA Inc. and The Hongkong and Shanghai Banking Corporation Limited.

M F Geoghegan CBE, *Chief Executive*

Age 50. A Director and Chief Executive since January 2004. An executive Director of HSBC Holdings plc since 1 March 2004. Joined HSBC in 1973. Group General Manager and President and Chief Executive Officer of HSBC Bank Brasil S.A. - Banco Múltiplo from 1997 to 2003. General Manager and Head of International HSBC Bank plc from 1994 to 1997. Senior Executive Vice President USA Area Management Office from 1992 to 1994. A non-executive Director and Chairman of Young Enterprise.

D D J John, *Chief Operating Officer*

Age 53. A Director and Chief Operating Officer since 2003. HSBC Holdings plc Group General Manager. Joined HSBC in 1972. Deputy Chairman and Chief Executive of HSBC Bank Malaysia Berhad from 1999 to 2002. Chief Executive Officer, The Hongkong and Shanghai Banking Corporation Limited in India from 1997 to 1999. General Manager for Wales from 1993 to 1997. A Director of HSBC Bank Malta p.l.c.

C-H Filippi

Age 51. A Director since 2000. HSBC Holdings plc Group Managing Director since 1 March 2004. Chairman and Chief Executive Officer of CCF S.A. since 1 March 2004. Joined CCF S.A. in 1987. Appointed a Group General Manager and Global Head of Corporate and Institutional Banking in 2001, having been Administrateur Directeur Général of CCF S.A. from 1998 until 2001.

J D Fishburn*

Age 57. A Director since May 2003. Chairman of HFC Bank Limited and an independent non-executive Director of Household International Inc.

C M S Jones*

Age 60. A Director since 2001. Chairman and Managing Director, James Beattie PLC.

A R D Monro-Davies*

Age 63. A Director since January 2004. Formerly Chief Executive Officer, Fitch Ratings.

A C Reed (Mrs) *

Age 47. A Director since 1996. Finance Director, Marks and Spencer Group plc. Non-executive Director of British Airways Plc.

H A Rose*

Age 63. A Director since 1997. Formerly Deputy Chairman of The Rover Group Limited.

J Singh*

Age 52. A Director since 2001. Chairman and Chief Executive Officer of Edwardian Group Limited. Member of the Board of Warwick Business School.

*Independent non-executive Director.

Secretary

I B Marshall

Age 54. Joined HSBC in 1995.

Registered Office: 8 Canada Square, London E14 5HQ

Senior Executives

A J Ashford

Age 54. General Manager, Personal Banking. Joined HSBC in 1979.

I M Dorner

Age 49. General Manager, Northern, Scotland and Northern Ireland Division. Joined HSBC in 1986.

R J Duke

Age 53. Group General Manager and General Manager, Banking Services. Joined HSBC in 1971.

G D Harvey-Samuel

Age 46. General Manager, Midlands Division. Joined HSBC in 1978.

A R Hill

Age 45. Chief Executive Officer and Managing Director, HFC Bank Limited. Joined HFC in 1989.

A R F Hughes

Age 52. Chief Executive, First Direct. Joined HSBC in 1969.

A M Keir

Age 45. General Manager, Commercial. Joined HSBC in 1981.

C G F Laughton-Scott

Age 47. Global Head of Corporate and Institutional Banking. Joined HSBC in 1986.

A M Mahoney

Age 41. General Manager, Western and Wales Division. Joined HSBC in 1983.

I D F Ogilvie

Age 44. Head of Human Resources. Joined HSBC in 1981.

M J Powell

Age 42. Treasurer. Joined HSBC in 1984.

J Ranaldi

Age 55. General Manager, Operations. Joined HSBC in 1982.

G A Ronning

Age 56. Chief Financial Officer. Joined HSBC in 1991.

R G Spence

Age 44. General Manager, Southern Division. Joined HSBC in 1978.

P E Stringham

Age 54. Group General Manager, Marketing. Joined HSBC in 2001.

R M Walker

Age 51. Head of Credit and Risk. Joined HSBC in 1975.

C S O'N Wallis

Age 48. General Manager, International. Joined HSBC in 1978.

G F Williams

Age 55. Head of Information Technology - Europe. Joined HSBC in 1986.

C P M Wills

Age 46. General Manager, Strategy and Support Services. Joined HSBC in 1978.

Report of the Directors

Results for 2003

The consolidated profit for the year attributable to the shareholders of the bank was £1,480 million.

First and second interim dividends of £400 million and £300 million were paid on the ordinary share capital during the year and the Directors have

resolved to pay a third interim dividend for 2003 of £700 million.

Further information about the results is given in the consolidated profit and loss account on page 29.

Principal Activities and Business Review

The group provides a comprehensive range of banking and related financial services.

The bank divides its activities into the following business segments: UK Personal Banking; UK Commercial Banking; UK Corporate, Investment Banking and Markets; International Banking; CCF; HSBC Private Banking; and HSBC Trinkaus & Burkhardt.

UK Personal Banking provides current accounts, savings, personal lending, mortgages, cards and wealth management services to customers through a number of channels under the HSBC and First Direct Brands.

UK Commercial Banking provides products and services to a broad range of commercial organisations from sole proprietors to major companies.

Corporate, Investment Banking and Markets, formed out of the alignment of Corporate and Institutional Banking, Global Markets UK and Investment Banking, provides tailored financial solutions to major government, corporate and institutional clients.

International Banking provides a range of retail financial services, primarily across Europe, to local and expatriate customers and wholesale banking to corporate and institutional clients.

CCF offers a wide range of retail, commercial and asset management products to individuals, companies and institutional customers through a network of regional banks in France.

HSBC Private Banking offers an array of client services to high net worth customers, including advisory portfolio management, discretionary asset management, tax, trust and estate planning, mutual funds and currency and securities transactions.

HSBC Trinkaus & Burkhardt, based in Düsseldorf, Germany, offers a comprehensive range of services to wealthy private clients and medium sized companies, institutional investors, public corporations and financial institutions.

The bank has 1,602 branches in the United Kingdom. Outside the United Kingdom, it has branches in Australia, Belgium, Cyprus, the Czech Republic, France, Greece, Guernsey, the Hong Kong Special Administrative Region, Ireland, the Isle of Man, Israel, Italy, Jersey, the Netherlands, South Africa, Spain and Sweden; it has representative offices in Argentina, Côte d'Ivoire, Ghana, Mexico, Singapore, Uganda and Venezuela; and it has subsidiaries in Armenia, France, Germany, Greece, Kazakhstan, Malta, Poland, Russia, Spain, Switzerland and Turkey. Through these undertakings, the bank provides a comprehensive range of banking and related financial services.

In February 2003, the bank acquired the remaining 40 per cent of Equator Holdings Limited it did not already own, for a cash consideration of £4 million, from Nedbank Africa Investments Limited. This, together with the transfer of the majority of the assets and liabilities of HSBC Equator Bank plc to a new branch of the bank in South Africa in February 2004, forms part of the Group's strategy to build its business in South Africa. The transfer was effected by means of an Order of the Court sanctioning a banking business transfer scheme under Part VII of the Financial Services and Markets Act 2000.

In October 2003, the bank acquired Polski Kredyt Bank S.A. for a cash consideration of £5 million. The bank has been re-named HSBC Bank Polska S.A. and focuses on consumer finance business and corporate, investment banking and markets and treasury business.

During 2003, the CCF group increased its interest in Banque Eurofin from 59.84 per cent to 83.94 per cent for a consideration of £21 million. As part of the CCF group's reorganisation of its private banking business, Banque Eurofin was subsequently merged into HSBC Private Bank France. In November 2003, the CCF group acquired the remaining 49 per cent of Elysées-Fonds not already owned, for a consideration of £10 million.

The Financial Review is given on pages 4 to 8.

Report of the Directors (continued)

Share Capital

There have been no changes to the authorised or issued share capital of the bank in the year ended 31 December 2003.

Valuation of Freehold and Leasehold Land and Buildings

Freehold and long leasehold properties were revalued in September 2003 in accordance with the HSBC Group's policy of annual valuation. As a result of this revaluation, the net book value of land and

buildings has decreased by £59 million. Further details are included in Note 22 'Tangible fixed assets' in the Notes on the Accounts.

Board of Directors

The objectives of the management structures within the bank, headed by the Board of Directors and led by the Chairman, are to deliver sustainable value to shareholders. Implementation of the strategy set by the Board is delegated to the bank's Executive Committee under the leadership of the Chief Executive.

The Board meets regularly and Directors receive information between meetings about the activities of committees and developments in the bank's business. All Directors have full and timely access to all relevant information and may take independent professional advice if necessary.

The names of Directors serving at the date of this report and brief biographical particulars for each of them are set out on page 9.

Sir Keith Whitson retired as a Director and Deputy Chairman on 28 May 2003 and S K Green was appointed as Deputy Chairman. R Emerson retired as a non-executive Director on 28 May 2003, W R P Dalton retired as a Director and Chief

Executive on 31 December 2003 and C F W de Croisset retired as a Director on 25 February 2004.

D D J John was appointed a Director and Chief Operating Officer on 1 January 2003 and J D Fishburn was appointed non-executive Director on 28 May 2003. On 1 January 2004, M F Geoghegan was appointed a Director and Chief Executive and A R D Monro-Davies was appointed a non-executive Director. Having been appointed since the last Annual General Meeting, J D Fishburn, M F Geoghegan and A R D Monro-Davies will retire at the forthcoming Annual General Meeting and offer themselves for election.

Mrs A C Reed, H A Rose and J Singh will retire by rotation at the forthcoming Annual General Meeting. With the exception of Mrs A C Reed, who will retire, they will offer themselves for re-election.

None of the Directors had, during the year or at the end of the year, a material interest, directly or indirectly, in any contract of significance with the bank or any of its subsidiary undertakings.

Board Committees

The Board has appointed a number of committees consisting of certain Directors and senior executives. The following are the principal committees:

Executive Committee

The Executive Committee meets regularly and operates as a general management committee under the direct authority of the Board. The members of the Executive Committee are M F Geoghegan (Chairman), D D J John, both of whom are executive Directors and A J Ashford, R J Duke, A R Hill, A M Keir, C G F Loughton-Scott, M J Powell, G A Ronning and R M Walker, all of whom are senior executives.

Audit Committee

The Audit Committee meets regularly with the bank's senior financial, internal audit and compliance management and the external auditor to consider the bank's financial reporting, the nature and scope of audit reviews and the effectiveness of the systems of internal control and compliance. The members of the Audit Committee are H A Rose (Chairman), Mrs A C Reed and A R D Monro-Davies, all of whom are independent non-executive Directors.

Corporate Governance

The HSBC Group is committed to high standards of corporate governance. The bank has complied throughout the year with the relevant best practice

provisions of the Combined Code on corporate governance appended to the Listing Rules of the Financial Services Authority.

Internal Control

The Directors are responsible for internal control in the group and for reviewing its effectiveness. Procedures have been designed for safeguarding assets against unauthorised use or disposition; for maintaining proper accounting records; and for the reliability of financial information used within the business or for publication. Such procedures are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material errors, losses or fraud. The procedures also enable the bank to discharge its obligations under the Handbook of Rules and Guidance issued by the Financial Services Authority, the bank's lead regulator.

The key procedures that the Directors have established are designed to provide effective internal control within the HSBC Group and accord with the Internal Control Guidance for Directors on the Combined Code issued by the Institute of Chartered Accountants in England and Wales. Such procedures have been in place throughout the year and up to 1 March 2004, the date of approval of the *Annual Report and Accounts*. In the case of companies acquired during the year, the internal controls in place are being reviewed against the HSBC Group's benchmarks and they are being integrated into the HSBC Group's systems. The HSBC Group's key internal control procedures include the following:

- Authority to operate the bank is delegated to the Chief Executive who has responsibility for overseeing the establishment and maintenance of appropriate systems and controls and has authority to delegate such duties and responsibilities as he deems fit among the Directors and senior management. The appointment of executives to the most senior positions within the group requires the approval of the Board of Directors.
- Functional, operating, financial reporting and certain management reporting standards are established by HSBC Holdings' management for application across the whole HSBC Group. These are supplemented by operating standards set by the bank's management, as required.
- Systems and procedures are in place in the group to identify, control and report on the major risks including credit, changes in the market prices of

financial instruments, liquidity, operational error, unauthorised activities and fraud. Exposure to these risks is monitored by the bank's or major subsidiaries' executive committees and the asset and liability management committees.

- Comprehensive annual financial plans are prepared, reviewed and approved by the Board of Directors. Results are monitored regularly and reports on progress as compared with the related plan are prepared monthly.
- Centralised functional control is exercised over all computer system developments and operations. Common systems are employed where possible for similar business processes. Credit and market risks are measured and reported on in the bank and major subsidiaries and aggregated for review of risk concentrations on an HSBC Group-wide basis.
- Responsibilities for financial performance against plans and for capital expenditure, credit exposures and market risk exposures are delegated with limits to line management. In addition, functional management in HSBC Holdings has been given responsibility to set policies, procedures and standards in the areas of: finance; legal and regulatory compliance; internal audit; human resources; credit; market risk; operational risk; computer systems and operations; property management; and for certain global product lines.
- Policies and procedures have been established to guide the bank, subsidiary companies and management at all levels in the conduct of business to avoid reputational risk which can arise from social, ethical or environmental issues, or as a consequence of operational risk events. As a banking group, the HSBC Group's good reputation depends upon the way in which it conducts its business but it can also be affected by the way in which clients, to which it provides financial services, conduct their business.
- The internal audit function, which is centrally controlled, monitors compliance with policies and standards and the effectiveness of internal

Report of the Directors (continued)

control structures across the HSBC Group. The work of the internal audit function is focused on areas of greatest risk to the HSBC Group as determined by a risk management approach. The head of this function reports to the Group Chairman and the HSBC Group Audit Committee.

The Audit Committee has kept under review the effectiveness of this system of internal control and has reported regularly to the Board of Directors. The key processes used by the Committee in carrying out its reviews include: regular reports from the heads of key risk functions; the production and regular

updating of summaries of key controls measured against HSBC Group benchmarks which cover all internal controls, both financial and non-financial; annual confirmations from senior executives that there have been no material losses, contingencies or uncertainties caused by weaknesses in internal controls; internal audit reports; external audit reports; prudential reviews; and regulatory reports.

The Directors, through the Audit Committee, have conducted an annual review of the effectiveness of the bank's system of internal control covering all controls, including financial, operational and compliance and risk management.

Reputational, Strategic and Operational Risk

The HSBC Group regularly updates its policies and procedures for safeguarding against reputational, strategic and operational risks. This is an evolutionary process.

The safeguarding of the HSBC Group's reputation is of paramount importance to its continued prosperity and is the responsibility of every member of staff. The HSBC Group has always aspired to the highest standards of conduct and, as a matter of routine, takes account of reputational risks to its business.

Reputational risks are considered and assessed by the Board, its committees and senior management in adherence with the HSBC Group standards. Standards on all major aspects of business are set for the HSBC Group and for individual subsidiary companies, businesses and functions. These policies, which form an integral part of the internal control systems, are communicated through manuals and statements of policy and are promulgated through internal communications. The policies cover social, ethical and environmental issues and set out

operational procedures in all areas of reputational risk, including money laundering deterrence, environmental impact, anti-corruption measures and employee relations. The policy manuals address risk issues in detail and co-operation between head office departments and businesses is required to ensure a strong adherence to the HSBC Group's risk management system and its corporate social responsibility practices.

Internal controls are an integral part of how the HSBC Group conducts its business. The HSBC Group's manuals and statements of policy are the foundation of these internal controls. There is a strong process in place to ensure controls operate effectively. Any significant failings are reported through the control mechanisms, internal audit and compliance functions to the Audit Committee, which keeps under review the effectiveness of the system of internal controls and reports regularly to the Board.

KPMG continues to advise the HSBC Group in respect of environmental systems.

Health and Safety

The maintenance of appropriate health and safety standards throughout the bank remains a key responsibility of all managers and the bank is committed actively to managing all health and safety risks associated with its business. The bank's objectives are to identify, remove, reduce or control material risks of fires and of accidents or injuries to employees and visitors.

Health and safety policies and Group standards and procedures are set by the bank's Fire and Safety Department and are implemented by Coordinators based in each location in which the bank operates.

The HSBC Group faces a range of threats from terrorists and criminals across the world. In particular, over the past year the threat from international terrorism has become significant in a number of areas where the HSBC Group operates. This threat has mainly manifested itself in bomb attacks such as the one in Istanbul last year in which HSBC's Turkish headquarters building was attacked. Despite suffering tragic loss of life and major damage, existing security measures and well-managed contingency procedures enabled the

business to be up and running again the following day.

HSBC Group Security provides regular risk assessments in areas of increased risk to assist

management in judging the level of terrorist threat and regular security reviews are conducted to ensure measures to protect HSBC Group staff, buildings, assets and information are appropriate for the level of threat.

Directors' Interests

According to the register of Directors' interests maintained by the bank pursuant to section 325 of the Companies Act 1985, the Directors of the bank

at the year-end had the following beneficial interests in the shares and loan capital of HSBC Holdings plc:

Ordinary shares of US\$0.50

| | At 1 January 2003 | At 31 December 2003 |
|--------------------------------|-----------------------|----------------------|
| Sir John Bond ¹ | 274,369 | 404,602 |
| C F W de Croisset ¹ | 35,664 | 37,441 |
| W R P Dalton ¹ | 22,624 | 36,441 |
| C-H Filippi ¹ | 276,000 | 386,000 |
| J D Fishburn | 19,732 ^{2,3} | 19,732 ³ |
| S K Green ¹ | 173,608 | 198,758 ⁴ |
| D D J John ¹ | 9,377 | 5,882 |

1 Details of additional interests in ordinary shares of US\$0.50 each under the Share Option Plans and Restricted Share Plan are set out in the Directors' Remuneration Report on pages 24 to 26.

2 Interests at 28 May 2003 - date of appointment.

3 Includes 4,054 shares held in the Deferred Phantom Stock Plan operated by Household International Inc. and which will be released to J D Fishburn when he retires as a Director of that company, which will be no later than May 2017.

4 Includes 45,000 shares as beneficiary of a trust holding these shares.

Sir John Bond has an interest as beneficial owner in £290,000 of HSBC Capital Funding (Sterling 1) L.P. 8.208 per cent Non-cumulative Step-up Perpetual Preferred Securities, which he held throughout the year.

S K Green has an interest as beneficial owner in €75,000 of HSBC Holdings plc 5½ per cent Subordinated Notes 2009 and in £100,000 of HSBC Bank plc 9 per cent Subordinated Notes 2005, which he held throughout the year.

As Directors of CCF S.A. ('CCF'), C F W de Croisset, W R P Dalton, C-H Filippi and S K Green each have an interest as beneficial owner in one share of €5 each in that company, which they held throughout the year. The Directors have waived their rights to receive dividends on these shares and have undertaken to transfer these shares to the bank on ceasing to be Directors of CCF.

Following the acquisition of CCF in 2000, CCF shares issued following the exercise of options over CCF shares became exchangeable for HSBC Holdings plc ordinary shares of US\$0.50 each in the same ratio as the exchange offer for CCF (13 HSBC Holdings plc ordinary shares of US\$0.50 each for each CCF share). HSBC Holdings plc ordinary shares of US\$0.50 each, which may be used to

satisfy the exchange of CCF shares for HSBC Holdings plc ordinary shares of US\$0.50 each following exercise of these options, were purchased by The HSBC Holdings Employee Benefit Trust 2001 (No.1). C F W de Croisset and C-H Filippi have options over CCF shares that are exchangeable for 2,418,000 and 598,000 HSBC Holdings plc ordinary shares of US\$0.50 each respectively, further details of which are set out in the section headed 'share options' in the Directors' Remuneration Report. However, as potential beneficiaries of the Trust, C F W de Croisset and C-H Filippi and are deemed to have a technical interest in all 32,775,055 HSBC Holdings plc ordinary shares of US\$0.50 each held by the Trust at 31 December 2003.

Save as stated above, and in the Directors' Remuneration Report, none of the Directors had an interest in any shares or debentures of HSBC Holdings plc or any of its subsidiary undertakings at the beginning or at the end of the year and none of the Directors, or members of their immediate families, was awarded or exercised any right to subscribe for any shares or debentures during the year.

Since the end of the year, the beneficial interests of Sir John Bond, W R P Dalton and S K Green each

Report of the Directors (continued)

increased by 17 HSBC Holdings plc ordinary shares of US\$0.50 each, which were acquired by Computershare Trustees Limited using monthly contributions to the HSBC UK Share Ownership Plan and the reinvestment of dividend income.

The reinvestment of dividend income by an Individual Savings Account and Personal Equity Plan Manager has resulted in the total interests of Sir John Bond increasing by 56 HSBC Holdings plc ordinary shares of US\$0.50 each.

The scrip dividend paid on 20 January 2004 has increased the total beneficial interests in HSBC Holdings plc ordinary shares of US\$0.50 each of the

following Directors: Sir John Bond 587 shares as beneficiary of a trust holding these shares; C F W de Croisset 296 shares; W R P Dalton 283 shares; and S K Green 1,565 shares, including 355 shares as beneficiary of a trust holding these shares.

Apart from the increases in the interests of Directors as beneficiaries of the trust holding awards of HSBC Holdings plc ordinary shares of US\$0.50 each under the HSBC Restricted Share Plan, as a result of the scrip dividend on 20 January 2004, as detailed in the Directors' Remuneration Report on page 26, there have been no other changes in Directors' interests from 31 December 2003 to the date of this report.

Employee Involvement

HSBC believes that its employees help to differentiate it from the competition. Success in delivering the HSBC brand to the bank's customers is based on the premise that one of the most important factors in differentiating the bank from its competitors is the way the bank treats its employees. This involves understanding the importance of each individual's contribution to business success and maximising their potential. The bank creates an environment where the insights of diverse groups are sought and welcomed, and innovation and creativity are rewarded and recognised. The bank's policies promote communication, involvement and collegiate working, including consultative forums for managers,

agreed procedures with the recognised union and the bank's participation in the HSBC European Council.

The involvement of employees in the performance of the bank is further encouraged through participation in bonus and share option plans.

Many HSBC employees now participate in one or more of the HSBC Group's employee share plans. There are over 4,300 in the Share Ownership Plan and over 38,000 in Sharesave. Additionally, around 31,000 employees have discretionary options under the executive share option schemes.

Diversity Policy - Employees with Disabilities

By employing and managing diverse people, the bank is a more rounded and balanced organisation, better able to adapt to new situations. Diversity is not simply about gender, ethnicity, disability or age but also about keeping an open mind, embracing non-conformity and creating balanced teams. Respect for individuals of all types will inspire loyalty and this is why the bank is committed to developing effective policies to support its employees and customers with disabilities.

The bank's continued employment policy means that it will make every effort, if existing employees become disabled, to retain them within the workforce, making reasonable adjustments on an individual basis to ensure that they are not disadvantaged and can compete equally.

Community Involvement and Donations

During the year, the bank made charitable donations of £3 million, and made gifts in kind in support of community activities in the United Kingdom. Many staff also gave their time in voluntary activities for the benefit of others.

The bank continued to build its support for the communities in which it operates through activities focused on its commitment to education, particularly for under-privileged primary and secondary school

students, and the environment. This commitment to education is led by Dame Mary Richardson, whose primary role within the HSBC Group is as Chief Executive of the HSBC Education Trust in the United Kingdom.

The Trust will consider charitable payments relating to education. Among the initiatives the Trust will support are funding for business and enterprise, sports and language colleges and primary

and secondary school programmes for underprivileged children.

The bank's staff and customers made contributions through a number of events and raised more than £450,000 for BBC Children in Need, being named one of the largest corporate fundraisers for that event. Staff raised a further £111,000 for The Children's Heart Federation with sponsored walks, and £95,000 for research into women's cancers with Cancer Research UK's Race for Life.

In addition, the HSBC Group continued its policy of making donations to charities instead of sending Christmas cards. In 2003, this totalled £180,000, the beneficiaries being: Changing Faces, providing help for people with facial disfigurements; The Samaritans; John Grooms, a leading disability charity; Fundacion Amistad Britanico, a Mexican charity supporting illiterate children; and a project in Turkey supporting the educational needs of children bereaved in the Istanbul bombing.

HSBC's five year partnership 'Investing in Nature' with three charities: WWF; Botanic Gardens

Conservation International; and Earthwatch, under which US\$50 million will be donated to fund conservation projects around the world, continues. The programme has made progress on cleaning up three of the world's major rivers, benefitting 50 million people who depend upon them and helping to save 8,000 rare plant species from extinction (of a five year target of 20,000). By 2003, more than 500 HSBC employees (of a five year target of 2,000) had travelled to work on vital conservation research projects worldwide and 30 scientists had been trained, as a result of the programme.

In 2003, HSBC announced a five year partnership with the Outward Bound Trust over which period a £500,000 donation will be made. This project will enable 750 children from 5 schools in East London to benefit from residential outward bound experiences and ancillary activities. This project is being independently assessed by Loughborough University as to its impact on the young people involved.

No political donations were made during the year.

Supplier Payment Policy

The bank subscribes to the Better Payment Practice Code for all suppliers, the four principles of which are: to agree payment terms at the outset and stick to them; to explain payment procedures to suppliers; to pay bills in accordance with any contract agreed with the supplier or as required by law; and to tell suppliers without delay when an invoice is contested and settle disputes quickly.

Copies of, and information about, the Code are available from: The Department of Trade and Industry, 1 Victoria Street, London SW1H 0ET.

The amount due to the bank's trade creditors at 31 December 2003 represented 24 days' average daily purchases of goods and services received from those creditors, calculated in accordance with the Companies Act 1985, as amended by Statutory Instrument 1997/571.

Auditor

KPMG Audit Plc has expressed its willingness to continue in office and the Board recommends that it be reappointed. A resolution proposing the reappointment of KPMG Audit Plc as auditor of

the bank and giving authority to the Directors to determine its remuneration will be submitted to the forthcoming Annual General Meeting.

On behalf of the Board
I B Marshall, *Secretary*

1 March 2004

Directors' Remuneration Report

Remuneration Committee

The functions of the Remuneration Committee are fulfilled by the Remuneration Committee of the Board of the bank's parent company, HSBC Holdings plc. During 2003, the members of the Remuneration Committee were Sir Mark Moody-Stuart (Chairman), W K L Fung and Sir John Kemp-Welch, all of whom are independent non-executive Directors of HSBC Holdings plc and eight meetings were held. S Hintze, an independent non-executive Director of HSBC Holdings plc, was appointed a member of the Committee on 30 January 2004.

During 2003, the Committee conducted a review of external specialist remuneration consultants. After a rigorous selection process, the Committee retained the services of Towers Perrin, a firm of specialist human resources consultants, who provide independent advice on executive remuneration issues. A further selection process will take place in 2006. As a global firm, Towers Perrin also provide other remuneration, actuarial and retirement consulting services to various parts of the HSBC Group. Other than the provision of expert advice in these areas, to the Remuneration Committee and to HSBC, Towers Perrin have no connection with HSBC. Other consultants are used from time to time to validate their findings. The Remuneration Committee also receives advice from the Group General Manager, Group Human Resources and the Senior Executive, Group Reward Management.

General Policy on Employees

As with most businesses, the HSBC Group's performance depends on the quality and commitment of its people. Accordingly, the HSBC Group's stated strategy is to attract, retain and motivate the very best people.

In a business that is based on trust and relationships, the HSBC Group's broad policy is to look for people who want to make a long-term career with the organisation since trust and relationships are built over time.

Remuneration is an important component in people's decisions on which company to join, but it is not the only one: it is the HSBC Group's experience that people are attracted to an organisation with good values, fairness, the potential for success and the scope to develop a broad, interesting career.

The Remuneration Committee is responsible for determining the remuneration policy of the bank, including the terms of bonus plans, share option plans and other long-term incentive plans and for

agreeing the individual remuneration packages of the bank's executive Directors and other senior executives. No Directors are involved in deciding their own remuneration.

The Remuneration Committee applies the following key principles:

- to ensure that remuneration is competitive in relation to comparative organisations in each of the countries or regions in which the HSBC Group operates;
- to offer fair and realistic salaries with an important element of variable pay based on relative performance;
- to have as many top-performers as possible at all levels within HSBC participating in some form of long-term share plan; and
- since 1996, to follow a policy of moving progressively from defined benefit to defined contribution Group pension schemes for new employees only.

In line with these principles:

- employees' salaries are reviewed annually in the context of individual and business performance, market practice, internal relativities and competitive market pressures. Allowances and benefits are largely determined by local market practice;
- employees participate in various bonus arrangements. The level of performance-related variable pay depends upon the performance of the bank and the individual concerned. Key measures of success include: achievement of financial goals, encompassing both revenue generation and expense control; customer relationships; full utilisation of professional skills; and adherence to the HSBC Group's ethical standards. The HSBC Group has a long history of paying close attention to its customers in order to provide value for shareholders. This has been achieved by ensuring that the interests of the HSBC Group and its employees are aligned with those of its shareholders and that the HSBC Group's approach to risk management serves the interests of all. Closer alignment with the interests of shareholders continues to be achieved through the promotion and extension of employee participation in the existing share plans and the bank's 'Let's

Reward Success' initiative which seeks to incentivise all employees to deliver higher levels of customer-driven service. Bonus ranges are reviewed in the context of prevailing market practice and overall remuneration; and

- in order to align the interests of employees with those of shareholders, employees are generally eligible to be considered for discretionary awards of share options under the HSBC Holdings Group Share Option Plan. For the majority of employees, the vesting of share awards under the HSBC Holdings Group Share Option Plan is subject to the attainment of total shareholder return ('TSR') targets (full details are set out on pages 20 to 21). Separate transitional arrangements are currently in place for employees of CCF.

In addition, to allow more employees to participate in the success they help to create, employees may also participate in the HSBC Holdings savings related share option plans and in local share ownership and profit-sharing arrangements.

Executive Directors and Senior Management

Consistent with the principles applied by the Committee to employees generally, there are four key components to the executive Directors' remuneration:

- salary;
- annual cash bonus;
- long-term incentives; and
- pension.

The Committee generally provides, on a discretionary basis, long-term share incentives to executive Directors and members of senior management through conditional awards of Performance Shares under the HSBC Holdings Restricted Share Plan 2000 rather than through the HSBC Holdings Group Share Option Plan, as explained under "Long-Term Incentive Plan" below.

The level of awards available to the executive Directors under the annual cash bonus scheme and the HSBC Holdings Restricted Share Plan 2000 is entirely dependent on performance. Remuneration policy for executive Directors is intended to provide competitive rates of base salary but with the potential for the majority of the value of the remuneration package to be delivered in the form of both short and

long-term incentives.

The Committee has made the following modifications to the performance condition for future awards of Performance Shares under the HSBC Holdings Restricted Share Plan 2000 in order to make the condition more relevant and long-lasting:

- the elimination of any re-testing provision so that awards lapse if the performance condition is not satisfied after the initial three year performance period; and
- a change to the benchmark group (set out on page 20) to make it more relevant as a benchmark against which the HSBC Group's performance is measured.

Long-Term Incentive Plan

The HSBC Holdings Restricted Share Plan 2000 is the principal long-term incentive plan used to reward the delivery of sustained financial growth of the HSBC Group. So as to align the interests of the Directors and senior employees more closely with those of shareholders, the vesting of Performance Share awards is subject to the attainment of a predetermined TSR target.

Awards

The Remuneration Committee has proposed to the Trustee of the HSBC Holdings Restricted Share Plan 2000 that the following conditional awards should be made to Directors in 2004:

| | £000 |
|---------------|-------------------|
| Sir John Bond | 2,100 |
| M F Geoghegan | 780 |
| S K Green | 1,430 |
| D D J John | 325 |
| | <hr/> 4,635 <hr/> |

The Trustee to the Plan will be provided with funds to acquire HSBC Holdings plc ordinary shares of US\$0.50 each at an appropriate time after the announcement of the annual results.

Additionally, executive Directors and members of senior management who participate in the HSBC Holdings Restricted Share Plan 2000 have not received awards under the HSBC Holdings Group Share Option Plan.

Neither C F W de Croisset, who retired on 25 February 2004, nor C-H Filippi have received any awards of Performance Shares under the HSBC Holdings Restricted Share Plan 2000 since the acquisition of CCF in 2000. Rather, in accordance with the arrangements agreed with CCF in 2000, both received share option awards under the HSBC

Directors' Remuneration Report (continued)

Holdings Group Share Option Plan. The awards in 2001 and 2002 were not subject to performance conditions and 50 per cent of the award made in 2003 was subject to the TSR performance conditions set out below.

Performance Conditions

From 1999, the vesting of awards has been linked to the attainment of predetermined TSR targets as set out below.

Particulars of Directors' interests in shares held in the Restricted Share Plan are set out on page 26.

TSR is defined as the growth in share value and declared dividend income, measured in sterling, during the relevant period. In calculating TSR, dividend income is assumed to be reinvested in the underlying shares.

The TSR performance condition for awards of Performance Shares under the Restricted Share Plan remained the same from 1999 to 2003, the five years of the Managing for Value strategy. For awards made in 2004, changes have been made to the peer group (as described below) and re-testing provisions have been eliminated so that awards will lapse if the performance condition is not satisfied after the initial three-year performance period.

Having regard to the HSBC Group's size and status within the financial sector, a benchmark for the HSBC Group TSR has been established which takes account of the TSR performance of:

1. a peer group of nine banks weighted by market capitalisation which are considered most relevant to the HSBC Group in terms of size and international scope. For performance periods up to and including the one beginning in 2003, this group comprised ABN AMRO Holdings N.V., The Bank of East Asia Limited, Citigroup, Deutsche Bank, J P Morgan Chase & Co., Lloyds TSB Group plc, Mitsubishi Tokyo Financial Group Inc., Overseas-Chinese Banking Corporation Ltd. and Standard Chartered PLC. To be more relevant to the HSBC Group in terms of size and international scope, this peer group has been amended for conditional awards made in 2004 and onwards by the replacement of Lloyds TSB Group plc, Overseas-Chinese Banking Corporation Ltd., Mitsubishi Tokyo Financial Group Inc. and The Bank of East Asia Limited with Bank of America Corporation, The Royal Bank of Scotland plc, Banco Santander Central Hispano S.A. and UBS A.G.

2. the five largest banks from each of the US, the UK, continental Europe and the Far East, other than any within paragraph 1 above, weighted by market capitalisation; and
3. the banking sector of the Morgan Stanley Capital International World Index, excluding any within paragraphs 1 and 2 above, weighted by market capitalisation.

By combining the weighted average TSR for each of the above three groups and weighting that average so that 50 per cent is applied to paragraph 1, 25 per cent is applied to paragraph 2 and 25 per cent is applied to paragraph 3, an appropriate single TSR benchmark for market comparison is determined.

The extent to which awards will vest will be determined by reference to the HSBC Group's TSR measured against the TSR benchmark. The calculation of the share price component within the HSBC Group's TSR will be the average market price over the 20 trading days commencing on the day when the annual results are announced, which in 2004 is 1 March. The starting point will be, therefore, the average over the period 1 to 26 March inclusive. TSR for the benchmark constituents will be based on their published share prices on 26 March 2004.

If the HSBC Group's TSR over the performance period exceeds the benchmark TSR, awards with a value, at the date of grant, of up to 100 per cent of the individual's earnings will vest. For higher value awards, the greater of 50 per cent of the award or the number of shares, equating at the date of grant to 100 per cent of earnings, will vest at this level of performance. If HSBC Holdings' TSR over the performance period places it within the upper quartile in the ranked list against the benchmark, these higher value awards will vest in full. For performance between the median and the upper quartile, vesting will be on a straightline basis.

For awards made in 2004 and thereafter, under the HSBC Holdings Restricted Share Plan 2000 only, the initial performance period will be three years from the date of grant. As before, if the upper quartile performance target is achieved, an additional award equal to 20 per cent of the initial Performance Share award will be made and will vest at the same time as the original award to which it relates. However, regardless of whether the upper quartile is achieved, full vesting and transfer of the shares will not generally occur until the fifth anniversary of the date of grant. If the performance test is not passed at the third anniversary, the shares will be forfeited.

As a secondary condition, options and awards will only vest if the Remuneration Committee is satisfied that HSBC Holdings' financial performance has shown a sustained improvement in the period since the date of grant.

In determining whether the HSBC Group has achieved a sustained improvement in performance the Remuneration Committee will take account of, among other factors, the comparison against history and the peer group in the following areas:

1. revenue growth;
2. revenue mix;
3. cost efficiency;
4. credit performance as measured by risk-adjusted revenues; and
5. cash return on cash invested, dividend performance and total shareholder return.

Awards will vest immediately in cases of death. The Remuneration Committee retains discretion to recommend early release of the shares to the Plan Trustee in certain instances, e.g. in the event of redundancy, retirement on grounds of injury or ill health, early retirement, retirement on or after contractual retirement or if the business is no longer part of the HSBC Group. Awards will normally be forfeited if the participant is dismissed or resigns from the HSBC Group.

Where events occur which cause the Remuneration Committee to consider that the performance condition has become unfair or impractical, the right is reserved to the Remuneration Committee to make such adjustments as in its absolute discretion it deems appropriate to make.

Service contracts and terms of appointment

M F Geoghegan does not have a service contract with the bank or any of its subsidiaries with a notice period in excess of one year or with provisions for pre-determined compensation on termination which exceeds one year's salary and benefits in kind.

D D J John has a service contract with the bank with a notice period of two years. This contract was in force before he joined the board of the bank.

C F W de Croisset had and C-H Filippi has contracts of employment that were in force before they joined the board of CCF. In accordance with French legal requirements and practice, these contracts were suspended while they served as executive Directors of CCF. On 29 February 2004, Mr de Croisset took early retirement from the Group, relinquishing his role as Chairman and Chief Executive Officer of CCF. In light of French legal requirements, a review of market practice was undertaken and it was agreed that a one-off payment of €2,427,000 would be made to Mr de Croisset, which is considered appropriate in all the circumstances. He will also receive a pension as set out on page 23. In the case of Mr Filippi, who ceased to be an executive Director of CCF in 2001, his contract remained suspended while he served as an HSBC Group General Manager. On assuming the position of Chairman and Chief Executive Officer of CCF, the suspended contract of employment with CCF will terminate and will be replaced by an International Group contract.

Senior executives are employed on service contracts which generally provide for a term of service expiring at the end of a period of up to two years, or the individual's sixtieth birthday, whichever is earlier.

Non-executive Directors are appointed for three year terms, subject to their re-election by shareholders at the subsequent Annual General Meeting. Independent non-executive Directors have no service contract and are not eligible to participate in the HSBC Group's share plans. Independent non-executive Directors' terms of appointment will expire in: 2004 — Mrs A C Reed, H A Rose and J Singh; 2005 — C M S Jones; and 2007 — J D Fishburn and A R D Monro-Davies.

Other Directorships

Executive Directors, if so authorised by the Board, may accept appointments as non-executive Directors of suitable companies which are not part of the HSBC Group. Executive Directors normally would be permitted to take on no more than one such appointment. Any remuneration receivable in respect of this appointment is paid to the bank, unless otherwise approved by the Remuneration Committee.

Directors' Remuneration Report (continued)

Audited Information

Directors' emoluments

The emoluments of the Directors of the bank for 2003 were as follows:

| | Fees | Salary and other remuneration | Benefits in kind | Discretionary bonuses ¹ | Total 2003 | Total 2002 |
|--------------------------------|------------------|-------------------------------------|---------------------|---------------------------------------|---------------|---------------|
| | £000 | £000 | £000 | £000 | £000 | £000 |
| Executive Directors | | | | | | |
| W R P Dalton ² | — ³ | 582 | 14 | — ⁴ | 596 | 592 |
| D D J John | 25 | 294 | — | 193 | 512 | - |
| Non-executive Directors | | | | | | |
| C F W de Croisset | — ³ | 382 | — | 917 | 1,299 | 574 |
| R Emerson ⁵ | 13 ⁶ | — | — | — | 13 | 33 |
| C-H Filippi | 25 | 207 | 150 ⁷ | 400 ⁸ | 782 | 613 |
| J D Fishburn ⁹ | 15 | — | — | — | 15 | — |
| C M S Jones | 25 | — | — | — | 25 | 25 |
| A C Reed | 33 ⁶ | — | — | — | 33 | 33 |
| H A Rose | 35 ¹⁰ | — | — | — | 35 | 35 |
| J Singh | 25 | — | — | — | 25 | 25 |
| Total | 196 | 1,465 | 164 | 1,510 | 3,335 | 2,670 |

1 These discretionary bonuses are in respect of 2003 and will be paid in 2004.

2 Retired as a Director and Chief Executive on 31 December 2003.

3 It is the HSBC Group policy that each HSBC Group Executive may only retain one fee paid by the HSBC Group. As a consequence, neither W R P Dalton nor C F W de Croisset, as Directors of HSBC Holdings plc, received a fee in respect of their directorship of HSBC Bank plc.

4 In return for the prior waiver of bonus, the employer contribution into the pension scheme has been increased by the amount of £1,250,000 (2002: £400,000) which would otherwise have been paid.

5 Retired as a non-executive Director on 28 May 2003.

6 Member of the Audit Committee, for which a fee of £7,500 per annum is payable.

7 Includes a sum of £143,000 representing the benefit arising from the provision of accommodation for C-H Filippi in the UK.

8 In return for the prior waiver of part of the bonus, the employer contribution into the pension scheme has been increased by the amount of £400,000 (2002: £400,000) which would otherwise have been paid.

9 From 28 May 2003 - date of appointment.

10 Chairman of the Audit Committee, for which a fee of £10,000 per annum is payable.

Sir John Bond, S K Green, and Sir Keith Whitson who retired on 28 May 2003, received no

emoluments from the bank or from its subsidiary undertakings.

Audited Information

Pensions

Pension arrangements for bank employees are provided by the HSBC Bank (UK) Pension Scheme, the assets of which are held in a separate trust fund. The Pension Scheme is administered by HSBC Bank Pension Trust (UK) Limited, whose Board of 19 Directors (eight of whom are elected by employees and one by pensioners) meets quarterly. It has three committees that monitor and review investment performance, discretionary benefits and administration and communications. The Pension Scheme does not invest in shares of the bank's parent company or in any of its subsidiary undertakings.

Pension arrangements to contractual retirement age of 60 for D D J John are provided under the HSBC Bank (UK) Pension Scheme.

The pension arrangements for W R P Dalton to contractual retirement age of 60 are provided under the HSBC Holdings Overseas (No.1) Pension Plan on a defined contribution basis, with an employer contribution in respect of 2003 of £1,379,000 (including a bonus waiver of £1,250,000) (2002: £529,000 including a bonus waiver of £400,000).

Pension arrangements to contractual retirement age of 60 for C-H Filippi are provided under the HSBC Group International Contract Executive

Retirement Plan on a defined contribution basis, with an employer contribution by way of bonus waiver in respect of 2003 of £400,000 (2002: £400,000).

C F W de Croisset was, until his retirement from CCF on 29 February 2004, and C-H Filippi is, eligible for pension benefits which are supplementary to those accrued under the French State and compulsory arrangements. The amount of these supplementary pensions, payable from age 60, accrued at the rate of €6,098 and €4,574 per annum respectively for each year of service (maximum 18 years) as executive Directors of CCF. Consequent on Mr de Croisset's early retirement from CCF and following a review of market practice, it has been agreed to provide a total pension of €341,467 per annum (equivalent to 32.5 per cent of his average total cash compensation over a three-year period) payable from 1 March 2004. In the case of C-H Filippi, these arrangements applied up to 30 June 2001, when he ceased to be an executive Director of CCF. The whole cost of these benefits is met by CCF.

The pension entitlements earned by these Directors during the year are shown below:

| | Accrued annual pension at 31 December 2003 | Increase in accrued pension during 2003, excluding any increase for inflation | Transfer value of accrued pension at 1 January 2003 ¹ | Transfer value of accrued pension at 31 December 2003 ¹ | Change in transfer value of accrued pension 1 January – 31 December 2003 ¹ |
|--------------------------------|--|---|--|--|---|
| | £000 | £000 | £000 | £000 | £000 |
| Executive Director | | | | | |
| D D J John | 125 | 20 | 1,095 | 1,504 | 409 |
| Non-executive Directors | | | | | |
| C F W de Croisset | 64 | 7 | 626 | 860 | 234 |
| C-H Filippi | 14 ² | — | 83 | 105 | 22 |

¹ The transfer value represents a liability of the HSBC Group's pension funds and not a sum paid or due to the individual; it cannot therefore meaningfully be added to annual remuneration.

² The accrued annual pension payable under the supplementary arrangements from CCF S.A., membership of which ceased on 30 June 2001, being the date he ceased to be an executive Director of CCF S.A.

Only basic salary is pensionable. Neither of the executive Directors of the bank is subject to the earnings cap introduced by the 1989 Finance Act.

Pension payments totalling £379,000 (2002: £384,000) were made to seven (2002: seven) former Directors of the bank.

Directors' Remuneration Report (continued)

Audited Information

Share options

At 31 December 2003, the undernamed Directors held options to acquire the number of HSBC Holdings ordinary shares of US\$0.50 each set against their respective names. The options were awarded for nil consideration at exercise prices equivalent to the market value at the date of award, except that options awarded under the HSBC Holdings savings-related share option plans before 2001 are exercisable at a 15 per cent discount to the market value at the date of award and those awarded since 2001 at a 20 per

cent discount. Except as otherwise indicated, no options were exercised or lapsed during the year and there are no remaining performance criteria conditional upon which the outstanding options are exercisable. The market value of the ordinary shares at 31 December 2003 was £8.78. The highest and lowest market values of the ordinary shares during the year were £9.135 and £6.31. Market value is the mid-market price derived from the London Stock Exchange Daily Official List on the relevant date.

Options over ordinary shares of US\$0.50 each

| | Options held at 1 January 2003 | Options awarded during year | Options exercised during year | Options held at 31 December 2003 | Exercise price in £ | Date of award | Exercisable from ¹ | Exercisable until |
|--------------------------------|--------------------------------|-----------------------------|-------------------------------|----------------------------------|---------------------|---------------|-------------------------------|-------------------|
| Executive Directors | | | | | | | | |
| W R P Dalton | 22,704 | — | 22,704 ² | — | 2.4062 | 12 Oct 1993 | 12 Oct 1996 | 12 Oct 2003 |
| | 30,273 | — | 30,273 ² | — | 2.8376 | 8 Mar 1994 | 8 Mar 1997 | 8 Mar 2004 |
| | 36,000 | — | 36,000 ² | — | 2.1727 | 7 Mar 1995 | 7 Mar 1998 | 7 Mar 2005 |
| | 36,000 ³ | — | 36,000 ² | — | 3.3334 | 1 Apr 1996 | 1 Apr 1999 | 1 Apr 2006 |
| | 2,798 | — | — | 2,798 ⁴ | 6.0299 | 10 Apr 2000 | 1 Aug 2005 | 31 Jan 2006 |
| D D J John | 21,000 | — | — | 21,000 | 6.2767 | 16 Mar 1998 | 16 Mar 2001 | 16 Mar 2008 |
| | 1,248 | — | — | 1,248 ⁴ | 5.3980 | 1 Apr 1999 | 1 Aug 2004 | 31 Jan 2005 |
| | 1,119 | — | — | 1,119 ⁴ | 6.0299 | 10 Apr 2000 | 1 Aug 2005 | 31 Jan 2006 |
| | 499 | — | — | 499 ⁴ | 6.7536 | 11 Apr 2001 | 1 Aug 2006 | 31 Jan 2007 |
| Non-executive Directors | | | | | | | | |
| Sir John Bond | 75,000 ³ | — | 75,000 ⁵ | — | 3.3334 | 1 Apr 1996 | 1 Apr 1999 | 1 Apr 2006 |
| | 2,798 | — | — | 2,798 ⁴ | 6.0299 | 10 Apr 2000 | 1 Aug 2005 | 31 Jan 2006 |
| C F W de Croisset | 206,000 ⁶ | — | — | 206,000 | 8.7120 | 23 Apr 2001 | 23 Apr 2004 | 23 Apr 2011 |
| | 206,000 ⁶ | — | — | 206,000 | 8.4050 | 7 May 2002 | 7 May 2005 | 7 May 2012 |
| | — | 206,000 ⁷ | — | 206,000 | 6.9100 | 2 May 2003 | 2 May 2006 | 1 May 2013 |
| C-H Filippi | 202,000 ⁶ | — | — | 202,000 | 8.7120 | 23 Apr 2001 | 23 Apr 2004 | 23 Apr 2011 |
| | 202,000 ⁶ | — | — | 202,000 | 7.4550 | 30 Aug 2002 | 30 Aug 2005 | 30 Aug 2012 |
| | — | 202,000 ⁷ | — | 202,000 | 6.9100 | 2 May 2003 | 2 May 2006 | 1 May 2013 |
| S K Green | 2,498 ⁴ | — | — | — ⁸ | 6.7536 | 11 Apr 2001 | 1 Aug 2006 | 31 Jan 2007 |
| | — | 3,070 ⁴ | — | 3,070 | 5.3496 | 23 Apr 2003 | 1 Aug 2008 | 31 Jan 2009 |

¹ May be advanced to an earlier date in certain circumstances, e.g. retirement.

² At the date of exercise, 5 March 2003, the market value per share was £6.70.

³ The exercise of these options was conditional upon the growth in earnings per share over a three-year period being equal to or greater than a composite rate of inflation (comprising 50 per cent of the Hong Kong Composite Consumer Price Index, 35 per cent of the UK Retail Price Index and 15 per cent of the USA All Urban Consumer Price Index) plus 2 per cent per annum. This condition has been satisfied.

⁴ Options awarded under the HSBC Holdings Savings-Related Share Option Plan.

⁵ At the date of exercise, 31 March 2003, the market value per share was £6.49.

⁶ Options awarded under the HSBC Holdings Group Share Option Plan. In accordance with agreements made at the time of the acquisition, there are no performance criteria conditional upon which the outstanding options are exercisable.

⁷ Options awarded under the HSBC Holdings Group Share Option Plan. Vesting of 50 per cent of the award is subject to the performance tests applicable to the HSBC Holdings Restricted Share Plan as set out in the section headed "Performance Conditions" on pages 20 to 21.

⁸ Options lapsed on 9 April 2003 following closure of the associated savings-related account by the Director.

Audited Information

At 31 December 2003, C F W de Croisset and C-H Filippi held the following options to acquire CCF shares of €5 each. On exercise of these options, each CCF share will be exchanged for 13 HSBC Holdings plc ordinary shares of US\$0.50 each. The options were granted by CCF for nil consideration at a 5 per cent discount to the market value at the date

of award. There are no remaining performance criteria conditional upon which the outstanding options are exercisable. No options over CCF shares of €5 each were awarded to or exercised by either C F W de Croisset or C-H Filippi during the year, except as otherwise indicated.

Options over CCF S.A. shares of €5 each

| Options held at 1 January 2003 | Exercise price per share (€) | Options held at 31 December 2003 | Equivalent HSBC Holdings ordinary shares of US\$0.50 each at 31 December 2003 | Date of award | Exercisable from | Exercisable until |
|-----------------------------------|------------------------------------|---|---|---------------|------------------|-------------------|
| C F W de Croisset | | | | | | |
| 10,000 | 32.78 | 10,000 | 130,000 | 23 Jun 1994 | 23 Jun 1996 | 23 Jun 2004 |
| 30,000 | 34.00 | 30,000 | 390,000 | 22 Jun 1995 | 22 Jun 1997 | 22 Jun 2005 |
| 30,000 | 35.52 | 30,000 | 390,000 | 9 May 1996 | 9 May 1998 | 9 May 2006 |
| 30,000 | 37.05 | 30,000 | 390,000 | 7 May 1997 | 7 Jun 2000 | 7 May 2007 |
| 30,000 | 73.50 | 30,000 | 390,000 | 29 Apr 1998 | 7 Jun 2000 | 29 Apr 2008 |
| 28,000 | 81.71 | 28,000 | 364,000 | 7 Apr 1999 | 7 Jun 2000 | 7 Apr 2009 |
| 28,000 | 142.50 | 28,000 | 364,000 | 12 Apr 2000 | 1 Jan 2002 | 12 Apr 2010 |
| C-H Filippi | | | | | | |
| 20,000 | 73.50 | — ¹ | — | 29 Apr 1998 | 7 Jun 2000 | 29 Apr 2008 |
| 23,000 | 81.71 | 23,000 | 299,000 | 7 Apr 1999 | 7 Jun 2000 | 7 Apr 2009 |
| 23,000 | 142.50 | 23,000 | 299,000 | 12 Apr 2000 | 1 Jan 2002 | 12 Apr 2010 |

¹ At the date of exercise, 5 December 2003, the market value per HSBC share was £8.77.

Save as stated above, none of the Directors or members of their immediate families were awarded

or exercised any right to subscribe for any shares or debentures during the year.

Directors' Remuneration Report (continued)

Audited Information

Restricted Share Plan

HSBC Holdings Ordinary shares of US\$0.50

| | Awards held at 1 January 2003 | Awards made during year | Monetary value of awards made during year £000 | Awards vested during year | Awards held at 31 December 2003 ¹ | Date of award | Year in which awards may vest |
|---------------|-------------------------------|-------------------------|--|---------------------------|--|---------------|-------------------------------|
| Sir John Bond | 29,746 | — | — | 30,647 ² | — | 2 Mar 1998 | 2003 |
| | 67,996 | — | — | — | 71,386 | 4 Mar 1999 | 2004 |
| | 85,365 | — | — | — | 89,621 | 10 Mar 2000 | 2005 |
| | 80,001 | — | — | — | 83,988 | 12 Mar 2001 | 2006 |
| | 119,795 | — | — | — | 125,767 | 8 Mar 2002 | 2007 |
| | — | 159,873 ³ | 1,100 | — | 167,843 | 5 Mar 2003 | 2008 |
| W R P Dalton | 19,833 | — | — | 20,433 ² | — | 2 Mar 1998 | 2003 |
| | 39,665 | — | — | — | 41,643 | 4 Mar 1999 | 2004 |
| | 38,803 | — | — | — | 40,738 | 10 Mar 2000 | 2005 |
| | 45,715 | — | — | — | 47,994 | 12 Mar 2001 | 2006 |
| | 75,660 | — | — | — | 79,432 | 8 Mar 2002 | 2007 |
| | — | 109,004 ³ | 750 | — | 114,438 | 5 Mar 2003 | 2008 |
| S K Green | 23,796 | — | — | 24,516 ² | — | 2 Mar 1998 | 2003 |
| | 39,665 | — | — | — | 41,643 | 4 Mar 1999 | 2004 |
| | 38,803 | — | — | — | 40,738 | 10 Mar 2000 | 2005 |
| | 80,001 | — | — | — | 83,988 | 12 Mar 2001 | 2006 |
| | 94,575 | — | — | — | 99,290 | 8 Mar 2002 | 2007 |
| | — | 109,004 ³ | 750 | — | 114,438 | 5 Mar 2003 | 2008 |
| D D J John | 16,513 | — | — | — | 17,338 | 4 Mar 1999 | 2004 |
| | 12,554 | — | — | — | 13,179 | 10 Mar 2000 | 2005 |
| | 17,144 | — | — | — | 17,999 | 12 Mar 2001 | 2006 |
| | 25,220 | — | — | — | 26,478 | 8 Mar 2002 | 2007 |
| | — | 36,336 ³ | 250 | — | 38,148 | 5 Mar 2003 | 2008 |

Unless otherwise indicated, vesting of these shares is subject to the performance tests set out in the section headed "Performance Conditions" on pages 20 to 21.

¹ Includes additional shares arising from scrip dividends.

² At the date of vesting, 31 March 2003, the market value per share was £6.49. The market value per share (adjusted for the share capital reorganisation implemented on 2 July 1999) on 2 March 1998, the date of the award, was £6.22. The awards were subject to performance conditions of earnings per share to be achieved in whole or in part, as follows: (1) earnings per share in the year 2001 (the fourth year of the performance period) to be greater than earnings per share in 1997 (the base year for the calculation) by a factor equivalent to the composite rate of inflation (a weighted average of inflation in the UK, USA and the Hong Kong SAR) plus 2 per cent, compounded over each year of the performance period; (2) earnings per share to increase relative to the previous year in not less than three of the four years of the performance period; and (3) cumulative earnings per share over the four years of the performance period, 1998 to 2001 inclusive, must exceed an aggregate figure calculated by compounding 1997 earnings per share by a factor equivalent to the annual composite rate of inflation plus 2 per cent for each year of the performance period. On meeting all of these three primary tests, 50 per cent of the conditional awards would be released to each eligible participant. A secondary test would apply such that, if the cumulative earnings per share over the performance period exceeded an aggregate figure calculated by compounding 1997 earnings per share by a factor equivalent to the same annual composite rate of inflation as described above, plus 5 per cent or more, or 8 per cent or more, for each year of the performance period, 75 per cent or 100 per cent respectively of the conditional awards would be released. In accordance with the rules of the Plan, these conditions were re-tested over the years 1999 to 2002. The performance conditions were met in full and the shares were released.

³ The market value per share on 5 March 2003 was £6.70. The shares acquired by the Trustee of the Plan were purchased at an average price of £6.88.

Following the dividend paid on 20 January 2004, the awards held by Directors as beneficiaries of the Trust holding these shares have increased as follows:

Sir John Bond 4,253 shares; W R P Dalton 2,559 shares; S K Green 2,999 shares; and D D J John 892 shares.

On behalf of the Board
I B Marshall, *Secretary*

1 March 2004

Statement of Directors' Responsibilities in Relation to Financial Statements

The following statement, which should be read in conjunction with the Auditors' statement of their responsibilities set out in their report on the next page, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the Auditors in relation to the financial statements.

The Directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the bank and its subsidiary undertakings as at the end of the financial year and of the profit or loss for the financial year. The Directors are required to prepare these financial statements on the going concern basis unless it is not appropriate. Since the Directors are satisfied that the group and the bank have the resources to continue in business for the foreseeable future, the financial statements continue to be prepared on the going concern basis.

The Directors consider that, in preparing the financial statements (on pages 29 to 102), the bank has used appropriate accounting policies, consistently applied save as disclosed in the Notes on the Accounts and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider to be applicable have been followed.

The Directors have responsibility for ensuring that the bank keeps accounting records which disclose with reasonable accuracy, at any time, the financial position of the bank and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

On behalf of the Board
I B Marshall, *Secretary*

1 March 2004

Independent Auditors' Report to the Member of HSBC Bank plc

We have audited the financial statements on pages 29 to 102.

This report is made solely to the bank's member in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the bank's member those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the bank and the bank's member for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and Auditors

The Directors are responsible for preparing the Directors' report and, as described on page 27, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the bank has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the group is not disclosed.

We read the other information accompanying the financial statements and consider whether it is consistent with those statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the affairs of the bank and the group as at 31 December 2003 and of the profit of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London

1 March 2004

Consolidated Profit and Loss Account for the Year Ended 31 December 2003

| | <i>Note</i> | 2003 £m | 2002 £m |
|---|-------------|-----------------------|-----------------------|
| Interest receivable | | | |
| — interest receivable and similar income arising from debt securities | | 1,631 | 1,792 |
| — other interest receivable and similar income | | 6,636 | 6,492 |
| Interest payable | | (3,995) | (4,245) |
| Net interest income | | 4,272 | 4,039 |
| Dividend income | 3 | 88 | 114 |
| Fees and commissions receivable | | 3,657 | 3,161 |
| Fees and commissions payable | | (657) | (560) |
| Dealing profits | 4 | 680 | 388 |
| Other operating income | | 508 | 550 |
| Other income | | 4,276 | 3,653 |
| Operating income | | 8,548 | 7,692 |
| Administrative expenses | 5 | (4,886) | (4,060) |
| Depreciation and amortisation | | | |
| — tangible fixed assets | 22 | (491) | (455) |
| — goodwill | 21 | (483) | (482) |
| Operating expenses | | (5,860) | (4,997) |
| Operating profit before provisions | | 2,688 | 2,695 |
| Provisions | | | |
| — provisions for bad and doubtful debts | 14 | (436) | (377) |
| — provisions for contingent liabilities and commitments | 28 | (45) | (27) |
| Amounts written off fixed asset investments | | (28) | (146) |
| Operating profit | | 2,179 | 2,145 |
| Share of operating (loss) in joint ventures and associates | | (57) | (4) |
| Gains/(losses) on disposal of | | | |
| — interests in joint ventures and associates | | 1 | 32 |
| — investments | | 137 | 122 |
| — tangible fixed assets | | (16) | (10) |
| Profit on ordinary activities before tax | 6 | 2,244 | 2,285 |
| Tax on profit on ordinary activities | 7 | (641) | (808) |
| Profit on ordinary activities after tax | | 1,603 | 1,477 |
| Minority interests | | | |
| — equity | | (43) | (30) |
| — non-equity | | (80) | (68) |
| Profit for the financial year attributable to shareholders | | 1,480 | 1,379 |
| Dividends (including amounts attributable to non-equity shareholders) | 9 | (1,440) | (1,144) |
| Retained profit for the year | | 40 | 235 |
| Earnings per ordinary share (basic and diluted) | 10 | pence 180.7 | pence 167.5 |

Movements in reserves are set out in Note 32 'Reserves'. All of the above represents continuing operations.

Consolidated Balance Sheet at 31 December 2003

| | <i>Note</i> | 2003 £m | 2002 £m |
|---|-------------|-------------------|----------------|
| Assets | | | |
| Cash and balances at central banks | | 1,210 | 1,834 |
| Items in the course of collection from other banks | | 1,819 | 1,967 |
| Treasury bills and other eligible bills | 11 | 2,197 | 2,047 |
| Loans and advances to banks | 12 | 33,642 | 26,627 |
| Loans and advances to customers | 13 | 116,298 | 104,907 |
| Debt securities | 16 | 49,556 | 44,948 |
| Equity shares | 17 | 5,837 | 3,483 |
| Interests in joint ventures | | | |
| — gross assets | | 49 | 137 |
| — gross liabilities | | (43) | (48) |
| | 18 | 6 | 89 |
| Interests in associates | 19 | 125 | 109 |
| Intangible fixed assets | 21 | 8,315 | 8,338 |
| Tangible fixed assets | 22 | 4,916 | 4,790 |
| Other assets | 23 | 18,965 | 16,614 |
| Prepayments and accrued income | | 3,218 | 2,625 |
| Total assets | | 246,104 | 218,378 |
| Liabilities | | | |
| Deposits by banks | 24 | 29,287 | 24,399 |
| Customer accounts | 25 | 146,103 | 130,835 |
| Items in the course of transmission to other banks | | 1,144 | 1,545 |
| Debt securities in issue | 26 | 9,769 | 8,343 |
| Other liabilities | 27 | 30,168 | 26,789 |
| Accruals and deferred income | | 3,073 | 2,578 |
| Provisions for liabilities and charges | 28 | | |
| — deferred taxation | | 693 | 588 |
| — other provisions for liabilities and charges | | 1,151 | 1,037 |
| Subordinated liabilities | 29 | | |
| — undated loan capital | | 1,268 | 1,374 |
| — dated loan capital | | 3,991 | 2,856 |
| Minority interests | | | |
| — equity | | 351 | 342 |
| — non-equity | 30 | 2,042 | 1,237 |
| Called up share capital | 31 | 797 | 797 |
| Share premium account | 32 | 12,157 | 12,208 |
| Revaluation reserves | 32 | 69 | 121 |
| Profit and loss account | 32 | 4,041 | 3,329 |
| Shareholders' funds (including non-equity interests) | | 17,064 | 16,455 |
| Total liabilities | | 246,104 | 218,378 |
| Memorandum items | | | |
| Contingent liabilities | 36 | | |
| — acceptances and endorsements | | 455 | 742 |
| — guarantees and assets pledged as collateral security | | 15,368 | 14,359 |
| | | 15,823 | 15,101 |
| Commitments | 36 | 73,581 | 61,377 |

Sir John Bond, *Chairman*
M F Geoghegan, *Chief Executive and Director*
D D J John, *Chief Operating Officer and Director*
I B Marshall, *Secretary*

Balance Sheet of HSBC Bank plc at 31 December 2003

| | <i>Note</i> | 2003 £m | 2002 £m |
|---|-------------|-------------------|----------------|
| Assets | | | |
| Cash and balances at central banks | | 616 | 599 |
| Items in the course of collection from other banks | | 1,400 | 1,558 |
| Treasury bills and other eligible bills | 11 | 1,635 | 1,430 |
| Loans and advances to banks | 12 | 20,942 | 14,224 |
| Loans and advances to customers | 13 | 84,320 | 76,207 |
| Debt securities | 16 | 22,320 | 20,589 |
| Equity shares | 17 | 2,850 | 1,209 |
| Interests in associates | 19 | 7 | 5 |
| Investments in subsidiary undertakings | 20 | 15,369 | 14,372 |
| Intangible fixed assets | 21 | 33 | 38 |
| Tangible fixed assets | 22 | 1,650 | 1,704 |
| Other assets | 23 | 9,219 | 7,716 |
| Prepayments and accrued income | | 2,166 | 1,674 |
| Total assets | | 162,527 | 141,325 |
| Liabilities | | | |
| Deposits by banks | 24 | 22,237 | 20,062 |
| Customer accounts | 25 | 94,222 | 79,770 |
| Items in the course of transmission to other banks | | 901 | 1,063 |
| Debt securities in issue | 26 | 2,930 | 2,873 |
| Other liabilities | 27 | 16,524 | 14,604 |
| Accruals and deferred income | | 1,596 | 1,230 |
| Provisions for liabilities and charges | 28 | | |
| — deferred taxation | | 3 | 60 |
| — other provisions for liabilities and charges | | 270 | 313 |
| Subordinated liabilities | 29 | | |
| — undated loan capital | | 1,168 | 1,262 |
| — dated loan capital | | 5,612 | 3,633 |
| Called up share capital | 31 | 797 | 797 |
| Share premium account | 32 | 12,157 | 12,208 |
| Revaluation reserves | 32 | 1,115 | 685 |
| Profit and loss account | 32 | 2,995 | 2,765 |
| Shareholders' funds (including non-equity interests) | | 17,064 | 16,455 |
| Total liabilities | | 162,527 | 141,325 |
| Memorandum items | | | |
| Contingent liabilities | 36 | | |
| — acceptances and endorsements | | 328 | 631 |
| — guarantees and assets pledged as collateral security | | 9,242 | 8,423 |
| | | 9,570 | 9,054 |
| Commitments | 36 | 59,025 | 50,469 |

Sir John Bond, *Chairman*
M F Geoghegan, *Chief Executive and Director*
D D J John, *Chief Operating Officer and Director*
I B Marshall, *Secretary*

Statement of Total Consolidated Recognised Gains and Losses for the Year Ended 31 December 2003

| | 2003 £m | 2002 £m |
|--|--------------|--------------|
| Profit for the financial year attributable to shareholders | 1,480 | 1,379 |
| Unrealised deficit on revaluation of land and buildings | (56) | (44) |
| Exchange and other movements | 625 | 359 |
| Total recognised gains and losses for the year | <u>2,049</u> | <u>1,694</u> |

Reconciliation of Movements in Consolidated Shareholders' Funds for the Year Ended 31 December 2003

| | 2003 £m | 2002 £m |
|--|---------------|---------------|
| Profit for the financial year attributable to shareholders | 1,480 | 1,379 |
| Dividends | (1,440) | (1,144) |
| | <u>40</u> | <u>235</u> |
| Other recognised gains and losses relating to the year | 569 | 315 |
| New share capital subscribed | — | 292 |
| Share capital redeemed | — | (35) |
| Net addition to shareholders' funds | <u>609</u> | <u>807</u> |
| Shareholders' funds at 1 January | <u>16,455</u> | <u>15,648</u> |
| Shareholders' funds at 31 December | <u>17,064</u> | <u>16,455</u> |
| Shareholders' funds are analysed as follows: | | |
| Equity interests | 16,575 | 15,913 |
| Non-equity interests | 489 | 542 |
| | <u>17,064</u> | <u>16,455</u> |

Non-equity interests in shareholders' funds comprise proceeds of the issue of US\$ non-cumulative preference shares and the £ preferred ordinary share (Note 31), including share premium and after deducting unamortised issue costs.

No note of historical cost profits and losses has been presented as there is no material difference between the group's results as disclosed in the consolidated profit and loss account and the results on an unmodified historical cost basis.

Notes on the Accounts

1 Basis of preparation

- a** The accounts have been prepared under the historical cost convention, as modified by the revaluation of certain investments and land and buildings, and in accordance with applicable accounting standards.

The consolidated accounts are prepared in accordance with the special provisions of Part VII Chapter II of the Companies Act 1985 ('the Act') relating to banking groups.

As permitted by Section 230 of the Act, no profit and loss account is presented for the bank.

In accordance with Financial Reporting Standard ('FRS') 8, 'Related Party Disclosures', no disclosure is presented of transactions with entities that are part of the HSBC Group as all voting rights are controlled by HSBC Holdings plc which publishes its own publicly available accounts. The group has also taken advantage of the exemption under FRS 1 (revised), 'Cash flow statements', allowing wholly-owned subsidiary undertakings to be excluded from the requirement to prepare a cash flow statement.

The accounts have been prepared in accordance with the Statements of Recommended Practice ('SORPs') issued by the British Bankers' Association ('BBA') and Irish Bankers' Federation ('IBF') and with the SORP 'Accounting issues in the asset finance and leasing industry' issued by the Finance & Leasing Association ('FLA').

The SORP issued by the Association of British Insurers ('ABI'), 'Accounting for insurance business' contains recommendations on accounting for insurance business for insurance companies and insurance groups. The group is primarily a banking group, rather than an insurance group, and, consistent with previously established practice for such groups preparing consolidated financial statements complying with Schedule 9 to the Act, values its long-term assurance businesses using the Embedded Value method. This method includes a valuation of the discounted future earnings expected to emerge from business currently in force, taking into account factors such as recent experience and general economic conditions, together with the surplus retained in the long-term assurance funds.

- b** The preparation of financial information requires the use of estimates and assumptions about future conditions. This is particularly so in the development of provisions for bad and doubtful debts. Making reliable estimates of customers' and other counterparties' abilities to repay is often difficult even in periods of economic stability and becomes more difficult in periods of economic uncertainty such as exists in some the group's overseas exposures. Therefore, while management believes it has employed all available information to estimate adequate allowances for all identifiable risks in the current portfolios, there can be no assurance that the provisions for bad and doubtful debts or other provisions will prove adequate for all losses ultimately realised.

- c** The consolidated accounts of the group comprise the accounts of HSBC Bank plc ('the bank') and its subsidiary undertakings (together 'the group'). Accounts of subsidiary undertakings are made up to 31 December. The consolidated accounts include the attributable share of the results and reserves of joint ventures and associates, based on accounts made up to dates not earlier than six months prior to 31 December.

All significant intra-group transactions are eliminated on consolidation.

2 Principal accounting policies

- a** *Income recognition*

Interest income is recognised in the profit and loss account as it accrues, except in the case of doubtful debts (Note 2b).

Fee and commission income is accounted for in the period when receivable, except where it is charged to cover the costs of a continuing service to, or risk borne for, the customer, or is interest in nature. In these cases, it is recognised on an appropriate basis over the relevant period.

Notes on the Accounts (continued)

2 Principal accounting policies (continued)

b *Loans and advances and doubtful debts*

It is the HSBC Group's policy that each operating company will make provisions for bad and doubtful debts promptly where required and on a consistent basis.

Loans are designated as non-performing as soon as management has doubts as to the ultimate collectability of principal or interest, or when contractual payments of principal or interest are 90 days overdue. When a loan is designated as non-performing, interest will be suspended (see below) and a specific provision raised if required.

However, the suspension of interest may exceptionally be deferred for up to 12 months past due in the following situations:

- where cash collateral is held covering the total of principal and interest due and a legal right of set-off exists; or
- where the value of net realisable tangible security is considered more than sufficient to cover the full repayment of all principal and interest due and credit approval has been given to the rolling-up or capitalisation of interest payments.

There are two basic types of provision, specific and general, each of which is considered in terms of the charge and the amount outstanding.

Specific provisions

Specific provisions represent the quantification of actual and inherent losses from identified accounts and are deducted from loans and advances in the balance sheet.

Other than where provisions on smaller balance homogeneous loans are assessed on a portfolio basis, the amount of specific provision raised is assessed on a case-by-case basis. The amount of specific provision raised is the group's estimate of the amount needed to reduce the carrying value of the asset to the expected ultimate net realisable value, and in reaching a decision consideration is given, among other things, to the following factors:

- the financial standing of the customer, including a realistic assessment of the likelihood of repayment of the loan within an acceptable period and the extent of the group's other commitments to the same customer;
- the realisable value of any security for the loan;
- the costs associated with obtaining repayment and realisation of the security; and
- if loans are not in local currency, the ability of the borrower to obtain the relevant foreign currency.

Where specific provisions are raised on a portfolio basis, the level of provisioning takes into account management's assessment of the portfolio's structure, past and expected credit losses, business and economic conditions, and any other relevant factors. The principal portfolios evaluated on a portfolio basis are credit cards and other consumer lending products.

General provisions

General provisions augment specific provisions and provide cover for loans that are impaired at the balance sheet date but which will not be identified as such until some time in the future. The HSBC Group requires operating companies to maintain a general provision, which is determined taking into account the structure and risk characteristics of each company's loan portfolio. Historic levels of latent risk are regularly reviewed by each operating company to determine that the level of general provisioning continues to be appropriate. Where entities operate in a significantly higher risk environment, an increased level of general provisioning will apply, taking into account local market conditions and economic and political factors. General provisions are deducted from loans and advances to customers in the balance sheet.

2 Principal accounting policies (continued)

b *Loans and advances and doubtful debts (continued)*

Loans on which interest is being suspended

Provided that there is a realistic prospect of interest being paid at some future date, interest on non-performing loans is charged to the customer's account. However, the interest is not credited to the profit and loss account but to an interest suspense account in the balance sheet which is netted against the relevant loan. On receipt of cash (other than from the realisation of security), suspended interest is recovered and taken to the profit and loss account. A specific provision of the same amount as the interest receipt is then raised against the principal balance. Amounts received from the realisation of security are applied to the repayment of outstanding indebtedness, with any surplus used to recover any specific provisions and then suspended interest.

Non-accrual loans

Where the probability of receiving interest payments is remote, interest is no longer accrued and any suspended interest balance is written off.

Loans are not reclassified as accruing until interest and principal payments are up-to-date and future payments are reasonably assured.

Loan write-offs

Loans and suspended interest are written off, either partially or in full, when there is no prospect of recovery of these amounts.

Assets acquired in exchange for advances

Assets acquired in exchange for advances in order to achieve an orderly realisation continue to be reported as advances. The asset acquired is recorded at the carrying value of the advance disposed of at the date of the exchange and subsequent provisions are based on any further deterioration in its value.

c *Treasury bills, debt securities and equity shares*

Treasury bills, debt securities and equity shares intended to be held on a continuing basis are disclosed as investment securities and are included in the balance sheet at cost less provision for any permanent diminution in value.

Where dated investment securities have been purchased at a premium or discount, these premiums and discounts are amortised through the profit and loss account over the period from the date of purchase to the date of maturity so as to give a constant rate of return. If the maturity is at the borrowers' option within a specified range of years, the earliest maturity is adopted. These securities are included in the balance sheet at cost adjusted for the amortisation of premiums and discounts arising on acquisition. The amortisation of premiums and discounts is included in 'Interest receivable'. Any profit or loss on realisation of these securities is recognised in the profit and loss account as it arises and included in 'Gains on disposal of investments'.

Other treasury bills, debt securities, equity shares and short positions in securities are included in the balance sheet at market value. Changes in the market value of such assets and liabilities are recognised in the profit and loss account as 'Dealing profits' as they arise. For liquid portfolios market values are determined by reference to independently sourced mid-market prices. In certain less liquid portfolios securities are valued by reference to bid or offer prices as appropriate. Where independent prices are not available, market values may be determined by discounting the expected future cash flows using an appropriate interest rate adjusted for the credit risk of the counterparty. In addition, adjustments are made for illiquid positions where appropriate.

Notes on the Accounts (continued)

2 Principal accounting policies (continued)

c *Treasury bills, debt securities and equity shares (continued)*

Where securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the balance sheet and a liability is recorded in respect of the consideration received. Conversely, securities purchased under analogous commitments to resell are not recognised on the balance sheet and the consideration paid is recorded in 'Loans and advances to banks' or 'Loans and advances to customers'.

d *Subsidiary undertakings, joint ventures and associates*

The bank's investments in subsidiary undertakings are stated at net asset values including attributable goodwill, where this has been capitalised, with the exception of the group's interest in long-term assurance business as explained in Note 2(g). Changes in net assets of subsidiary undertakings are accounted for as movements in the revaluation reserve.

Interests in joint ventures are stated at the group's share of gross assets, including attributable goodwill, less the group's share of gross liabilities.

Interests in associates are stated at the group's share of net assets, including attributable goodwill.

Goodwill arises on the acquisition of subsidiary undertakings, joint ventures or associates when the cost of acquisition exceeds the fair value of the group's share of separable net assets acquired. Negative goodwill arises on the acquisition of subsidiary undertakings, joint ventures and associates when the fair value of the group's share of separable net assets acquired exceeds the cost of acquisition. For acquisitions made on or after 1 January 1998, goodwill is included in the balance sheet in 'Intangible fixed assets' in respect of subsidiary undertakings, in 'Interests in joint ventures' in respect of joint ventures and in 'Interests in associates' in respect of associates. Capitalised goodwill is amortised over its estimated life on a straight-line basis. For acquisitions prior to 1 January 1998, goodwill was charged against reserves in the year of acquisition. Capitalised goodwill is tested for impairment when necessary by comparing the present value of the expected future cash flows from an entity with the carrying value of its net assets, including attributable goodwill. Negative goodwill is credited in the profit and loss account in the periods expected to be benefited.

At the date of disposal of subsidiary undertakings, joint ventures or associates, any unamortised goodwill or goodwill charged directly to reserves is included in the group's share of net assets of the undertaking in the calculation of the gain or loss on disposal of the undertaking.

e *Tangible fixed assets*

Land and buildings are stated at valuation or cost less depreciation calculated to write off the assets over their estimated useful lives as follows:

- freehold land and land held on leases with more than 50 years to expiry are not depreciated;
- land held on leases with 50 years or less to expiry is depreciated over the unexpired terms of the leases; and
- buildings and improvements thereto are depreciated on cost or valuation at the greater of 2 per cent per annum on the straight-line basis or over the unexpired terms of the leases or over the remaining useful lives.

Equipment, fixtures and fittings are stated at cost less depreciation calculated on the straight-line basis to write off the assets over their estimated useful lives, which are generally between 5 and 20 years.

Operating lease assets (Note 2f) are depreciated over their useful economic lives such that, for each asset, rentals less depreciation are recognised at a constant periodic rate of return on the net cash invested in that asset.

2 Principal accounting policies (continued)

f *Finance and operating leases*

Assets leased to customers under agreements which transfer substantially all the risks and rewards associated with ownership, other than legal title, are classified as finance leases. Where the group is a lessor under finance leases the amounts due under the leases, and under hire purchase contracts that are in the nature of finance leases, after deduction of unearned charges, are included in 'Loans and advances to banks' or 'Loans and advances to customers'. Finance charges receivable are recognised over the periods of the leases so as to give a constant rate of return on the net cash investment in the leases, taking into account tax payments and receipts associated with the leases.

Where the group is a lessee under finance leases the leased assets are capitalised and included in 'Equipment, fixtures and fittings' and the corresponding liability to the lessor is included in 'Other liabilities'. Finance charges payable are recognised over the periods of the leases, based on the interest rates implicit in the leases.

All other leases are classified as operating leases and, where the group is the lessor, are included in 'Tangible fixed assets'. The residual values of equipment on operating leases are regularly monitored. Provision is made to the extent that the carrying value of equipment is impaired through residual values not being fully recoverable. Rentals payable and receivable under operating leases are accounted for on the straight-line basis over the periods of the leases and are included in 'Administrative expenses' and 'Other operating income' respectively.

g *Long-term assurance business*

The value placed on the group's interest in long-term assurance business includes a valuation of the discounted future earnings expected to emerge from business currently in force, using appropriate assumptions in assessing factors such as recent experience and general economic conditions, together with the surplus retained in the long-term assurance funds. These are determined annually in consultation with independent actuaries and are included in 'Other assets'.

Changes in the value placed on the group's interest in long-term assurance business are calculated on a post-tax basis and reported in the profit and loss account as part of 'Other operating income' after adjusting for taxation.

Long-term assurance assets and liabilities attributable to policyholders are recognised in the group's accounts in 'Other assets' and 'Other liabilities'.

h *Deferred taxation*

Deferred tax is recognised in full on timing differences between the accounting and taxation treatment of income and expenditure, subject to assessment of the recoverability of deferred tax assets. Deferred tax balances are not discounted.

i *Pension and other post-retirement benefits*

The group operates a number of pension and other post-retirement benefit schemes.

For UK defined benefit pension schemes, annual contributions are made, on the advice of qualified actuaries, for funding of retirement benefits in order to build up reserves for each scheme member during the employee's working life and used to pay a pension to the employee or dependant after retirement. The costs of providing these benefits are charged to the profit and loss account on a systematic basis.

Arrangements for staff retirement benefits in overseas locations vary from country to country and are made in accordance with local regulations and custom. The pension cost of the major overseas schemes is assessed in accordance with the advice of qualified actuaries so as to recognise the cost of pensions on a systematic basis over employees' service lives.

The cost of providing post-retirement health-care benefits, which is assessed in accordance with the advice of qualified actuaries, is recognised on a systematic basis over employees' service lives.

Notes on the Accounts (continued)

2 Principal accounting policies (continued)

j Foreign currencies

Assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the year-end. The results of overseas branches and subsidiary undertakings, joint ventures and associates are translated into sterling at the average rates of exchange for the year.

Exchange differences arising from the retranslation of opening foreign currency net investments and the related cost of hedging and exchange differences arising from retranslation of the result for the year from the average rate to the exchange rate ruling at the year-end are accounted for in reserves.

Other exchange differences are recognised in the profit and loss account.

k Off-balance-sheet financial instruments

Off-balance-sheet financial instruments comprise futures, forward, swap and option transactions undertaken by the group in the foreign exchange, interest rate, equity, credit derivative and commodity markets. Netting is applied where a legal right of set-off exists. Mark-to-market assets and liabilities are presented gross, with netting shown separately.

Accounting for these instruments is dependent upon whether the transactions are undertaken for trading or non-trading purposes.

Trading transactions

Trading transactions include transactions undertaken for market-making, to service customers' needs and for proprietary purposes, as well as any related hedges.

Transactions undertaken for trading purposes are marked-to-market and the net present value of any gain or loss arising is recognised in the profit and loss account as 'Dealing profits', after appropriate deferrals for unearned credit margin and future servicing costs. Off-balance-sheet trading transactions are valued by reference to an independent liquid price where this is available. For those transactions where there are no readily quoted prices, which predominately relates to over the counter transactions, market values are determined by reference to independently sourced rates, using valuation models. Adjustments are made for illiquid positions where appropriate.

Assets, including gains, resulting from off-balance-sheet exchange rate, interest rate, equities, credit derivative and commodity contracts that are marked-to-market are included in 'Other assets'. Liabilities, including losses, resulting from such contracts, are included in 'Other liabilities'.

Non-trading transactions

Non-trading transactions are those which are held for hedging purposes as part of the group's risk management strategy against assets, liabilities, positions or cash flows measured on an accruals basis. Non-trading transactions include qualifying hedges and positions that synthetically alter the characteristics of specified financial instruments.

Non-trading transactions are accounted for on an equivalent basis to the underlying assets, liabilities or net positions. Any profit or loss arising is recognised on the same basis as that arising from the related assets, liabilities or positions.

To qualify as a hedge, a derivative must effectively reduce the price, foreign exchange or interest rate risk of the asset, liability or anticipated transaction to which it is linked and be designated as a hedge at inception of the derivative contract. Accordingly, changes in the market value of the derivative must be highly correlated with changes in the market value of the underlying hedged item at inception of the hedge and over the life of the hedge contract. If these criteria are met, the derivative is accounted for on the same basis as the underlying hedged item. Derivatives used for hedging purposes include swaps, forwards and futures.

2 Principal accounting policies (continued)

k Off-balance-sheet financial instruments (continued)

Interest rate swaps are also used to alter synthetically the interest rate characteristics of financial instruments. In order to qualify for synthetic alteration, a derivative instrument must be linked to specific individual, or pools of similar, assets or liabilities by the notional principal and interest rate risks of the associated instruments, and must achieve a result that is consistent with defined risk management objectives. If these criteria are met, accruals based accounting is applied, i.e. income or expense is recognised and accrued to the next settlement date in accordance with the contractual terms of the agreement.

Any gain or loss arising on the termination of a qualifying derivative is deferred and amortised to earnings over the original life of the terminated contract. Where the underlying asset, liability or position is sold or terminated, the qualifying derivative is immediately marked-to-market and any profit or loss arising is taken to the profit and loss account.

3 Dividend income

| | 2003 £m | 2002 £m |
|---------------------------|------------|------------|
| Income from equity shares | <u>88</u> | <u>114</u> |

4 Dealing profits

| | 2003 £m | 2002 £m |
|----------------------------|------------|------------|
| Foreign exchange | 398 | 357 |
| Interest rate derivatives | 144 | 5 |
| Debt securities | 84 | 37 |
| Equities and other trading | 54 | (11) |
| | <u>680</u> | <u>388</u> |

5 Administrative expenses

a Analysis of expenses

| | 2003 £m | 2002 £m |
|---|--------------|--------------|
| Staff costs | | |
| — wages and salaries | 2,537 | 2,044 |
| — social security costs | 330 | 267 |
| — other pension costs (Note 5b below) | 274 | 196 |
| | <u>3,141</u> | <u>2,507</u> |
| Premises and equipment (excluding depreciation) | 582 | 545 |
| Other administrative expenses | 1,163 | 1,008 |
| | <u>4,886</u> | <u>4,060</u> |

Notes on the Accounts (continued)**5 Administrative expenses** (continued)**a Analysis of expenses** (continued)

The average number of persons employed by the group during the year was made up as follows:

| | 2003 | 2002 |
|--|---------------|--------|
| UK Personal, Commercial, Corporate and Institutional Banking | 46,609 | 47,752 |
| Global Markets UK | 964 | 939 |
| Investment Banking | 1,778 | 156 |
| International Banking | 7,116 | 6,352 |
| CCF | 14,162 | 14,185 |
| Private Banking | 3,587 | 2,835 |
| HSBC Trinkaus & Burkhardt | 1,578 | 630 |
| | 75,794 | 72,849 |

The average numbers of persons for acquisitions and transfers have been weighted in proportion to the time that they have been owned by the group.

b Retirement benefits

The group has continued to account for pensions in accordance with Statement of Standard Accounting Practice ('SSAP') 24, 'Accounting for pension costs' and the disclosures given in i) are those required by that standard. FRS 17, 'Retirement benefits' was issued in November 2000. Prior to full implementation, which has been deferred until accounting periods beginning on or after 1 January 2005, phased transitional disclosures are required from 31 December 2001. These disclosures, to the extent not given in i), are set out in ii).

i Pension schemes

Within the group, the HSBC Bank (UK) Pension Scheme, assets of which are held in a separate trust fund, covers 96 per cent of UK employees. The HSBC Bank (UK) Pension Scheme comprises a funded defined benefit scheme ('the Principal Scheme') and a defined contribution scheme which was established on 1 July 1996 for new employees.

Actuarial valuations of the assets and liabilities of the Principal Scheme are carried out triennially by professionally qualified actuaries to determine its financial position and to enable the bank to determine the level of contributions to be made to the Principal Scheme.

The latest valuation of the Principal Scheme was made at 31 December 2002 by C G Singer, Fellow of the Institute of Actuaries, of Watson Wyatt LLP. At that date, the market value of the Principal Scheme's assets was £5,772 million. The actuarial value of the assets represented 88 per cent of the benefits accrued to members, after allowing for expected future increases in earnings, and the resulting deficit amounted to £788 million. The method adopted for this valuation was the projected unit method and the main assumptions used were a long-term investment return of 6.85 per cent per annum, salary increases of 3.0 per cent per annum and post-retirement pension increases of 2.5 per cent per annum.

As previously advised, in anticipation of the above valuation result, HSBC made a payment into the scheme, in February 2003, amounting to £500 million. In addition, following receipt of the valuation results, a further payment of £84 million was made in August 2003 into the scheme. HSBC has decided to continue ongoing contributions to the scheme at the rate of 20.0 per cent of pensionable salaries, until completion of the next actuarial valuation, due as at 31 December 2005.

The deficit as at 31 December 2002 is being amortised over a thirteen year period, the average remaining service life of the existing employed members. The amortisation is net of the interest benefit from the £584 million payments made during the year.

5 Administrative expenses (continued)

b Retirement benefits (continued)

i Pension schemes (continued)

The group's total pension cost for the year ended 31 December 2003 was £272 million (2002: £184 million), which includes £174 million (2002: £106 million) in respect of the Principal Scheme. This comprises:

| | <i>Year ended</i> <i>31 December 2003</i> |
|-------------------------|--|
| | £m |
| Regular cost | 124 |
| Amortisation of deficit | 50 |
| Total cost for the year | 174 |

A prepayment of £502 million (2002: £nil) for the group entities participating in the Principal Scheme is included in Prepayments and accrued income.

For CCF, retirement provision for employees in France is provided via both State and compulsory supplementary pension funds founded (via Government decree) on agreements between Employer Organisations and Unions. These 'compulsory supplementary' arrangements cover some 14,411 employees.

ii FRS 17

The financial assumptions used to calculate scheme liabilities for the group's main defined benefit pension schemes under FRS 17 are:

| | <i>Discount</i> <i>rate</i> | <i>Inflation</i> <i>assumption</i> | <i>Rate</i> <i>of increase</i> <i>for pensions</i> <i>in payment</i> <i>and deferred</i> <i>pension</i> | <i>Rate of pay</i> <i>Increase</i> |
|-----------------|--------------------------------|---------------------------------------|--|---------------------------------------|
| 2003 | % | % | % | % |
| United Kingdom* | 5.5 | 2.5 | 2.5 | 3.0 |
| France | 5.25 | 2.0 | 2.0 | 3.5 |
| Switzerland | 3.5 | 1.5 | 0 - 1.5 | 2.5 |
| | <i>Discount</i> <i>rate</i> | <i>Inflation</i> <i>assumption</i> | <i>Rate</i> <i>of increase</i> <i>for pensions</i> <i>in payment</i> <i>and deferred</i> <i>pension</i> | <i>Rate of pay</i> <i>increase</i> |
| 2002 | % | % | % | % |
| United Kingdom* | 5.6 | 2.25 | 2.25 | 2.75 |
| France | 5.5 | 2.0 | 2.0 | 3.5 |
| Switzerland | 3.75 | 1.5 | 0 - 1.5 | 2.5 |

* United Kingdom disclosure in this section mostly relates to the bank.

Notes on the Accounts (continued)

5 Administrative expenses (continued)

b Retirement benefits (continued)

ii FRS 17 (continued)

| | <i>Discount rate</i> | <i>Inflation assumption</i> | <i>Rate of increase for pensions in payment and deferred pension</i> | <i>Rate of pay increase</i> |
|-----------------|--------------------------|---------------------------------|--|---------------------------------|
| 2001 | % | % | % | % |
| United Kingdom* | 5.9 | 2.5 | 2.5 | 3.75 |
| France | 5.5 | 2.0 | 2.0 | 3.5 |
| Switzerland | 4.5 | 1.5 | 1.5 | 2.5 |

* United Kingdom disclosure in this section mostly relates to the bank.

The assets in the defined benefit schemes and the expected rates of return are:

| | <i>Expected rate of return at 31 December 2003</i> | <i>Value at 31 December 2003</i> | <i>Expected rate of return at 31 December 2002</i> | <i>Value at 31 December 2002</i> | <i>Expected rate of return at 31 December 2001</i> | <i>Value at 31 December 2001</i> |
|--|--|--|--|--|--|--|
| | % | £m | % | £m | % | £m |
| Equities | 8.5 | 3,916 | 8.5 | 3,395 | 7.5 | 3,941 |
| Bonds | 4.9 | 1,992 | 4.9 | 1,293 | 5.1 | 848 |
| Property | 7.0 | 621 | 7.0 | 659 | 7.5 | 655 |
| Other | 3.84 | 515 | 3.65 | 263 | 4.0 | 535 |
| Total market value of assets | | 7,044 | | 5,610 | | 5,979 |
| Present value of scheme liabilities | | (9,066) | | (7,484) | | (6,816) |
| Deficit in the schemes* | | (2,022) | | (1,874) | | (837) |
| Related deferred tax asset | | 588 | | 540 | | 209 |
| Net pension liability | | (1,434) | | (1,334) | | (628) |
| * Analysis of the deficit is as follows: | | | | | | |
| The Principal Scheme | | (1,794) | | (1,636) | | (661) |
| Other schemes — unfunded | | (224) | | (199) | | (178) |
| Other schemes — funded | | (4) | | (39) | | 2 |
| | | (2,022) | | (1,874) | | (837) |

Of the deficit in unfunded schemes, £219 million has been provided (2002: fully provided).

The net pension liability will have a consequent effect on reserves when FRS 17 is fully implemented.

The Principal Scheme is closed to new entrants. For this scheme the current service cost will increase as the members of the scheme approach retirement under the projected unit credit method.

The Principal Scheme mostly relates to the bank.

5 Administrative expenses (continued)

b Retirement benefits (continued)

ii FRS 17 (continued)

The following amounts would be reflected in the consolidated profit and loss account and statement of total consolidated recognised gains and losses on implementation of FRS 17:

| | <i>Year ended 31 December 2003 £m</i> | <i>Year ended 31 December 2002 £m</i> |
|---|---|---|
| Amount that would be charged to operating profit | | |
| Current service cost | 169 | 166 |
| Past service cost | 9 | — |
| Total operating charge | <u>178</u> | <u>166</u> |
| Amount that would be credited to other finance income | | |
| Expected return on pension scheme assets | 424 | 405 |
| Interest on pension scheme liabilities | <u>(404)</u> | <u>(399)</u> |
| Net return | <u>20</u> | <u>6</u> |
| Amount that would be recognised in the statement of total consolidated recognised gains and losses | | |
| Actual return less expected return on pension scheme assets | 614 | (853) |
| Experience gains and losses arising on the scheme liabilities | (129) | (347) |
| Changes in assumptions underlying the present value of the scheme | <u>(1,168)</u> | <u>251</u> |
| Actuarial loss | <u>(683)</u> | <u>(949)</u> |
| Movement in pension schemes deficit during the year | | |
| Deficit in the pension schemes at 1 January | (1,874) | (837) |
| Movement in the year: | | |
| Total operating charge | (178) | (166) |
| Contributions | 711 | 147 |
| Other finance income | 20 | 6 |
| Actuarial loss | (683) | (949) |
| Acquisitions | — | (104) |
| Exchange and other movements | <u>(18)</u> | <u>29</u> |
| Deficit in the pension schemes at 31 December | <u>(2,022)</u> | <u>(1,874)</u> |
| History of experience gains and losses | | |
| Difference between expected and actual return on scheme assets: | | |
| amount | 614 | (853) |
| percentage of scheme assets | 9% | (15%) |
| Experience gains and losses arising on scheme liabilities: | | |
| amount | (129) | (347) |
| percentage of the present value of scheme liabilities | (1%) | (5%) |
| Total amount recognised in the statement of total consolidated recognised | | |
| amount | (683) | (949) |
| percentage of the present value of scheme liabilities | (8%) | (13%) |

Notes on the Accounts (continued)

5 Administrative expenses (continued)

b Retirement benefits (continued)

ii FRS 17 (continued)

The Principal Scheme covers both UK employees of the group and UK employees of other HSBC Group companies. The deficit is the group's share of the Principal Scheme's deficit although the group's share increased following the acquisition of the business of HSBC Investment Bank plc.

iii Post-retirement health-care benefits

The group also provides post-retirement health-care benefits for certain pensioners and employees together with their dependent relatives. An actuarial assessment of the liabilities of the scheme, which is unfunded, is carried out on a regular basis by qualified actuaries. The liabilities are evaluated by discounting the expected future claims to a net present value.

The charge relating to post-retirement health-care is £2 million for the year (2002: £12 million).

The latest actuarial assessment was carried out at 31 December 2000 and updated to 31 December 2003. At 31 December 2003, the estimated present value of the post-retirement benefit obligation was £121 million (2002: £120 million) for the group and £121 million (2002: £120 million) for the bank, of which £115 million (2002: £105 million) has been provided for by the group and £115 million (2002: £105 million) has been provided for by the bank. The main financial assumptions used to estimate the obligation at 31 December 2003 were price inflation of 2.5 per cent per annum (2002: 2.5 per cent), health-care claims cost escalation of 7.5 per cent per annum (2002: 7.5 per cent) and a discount rate of 5.3 per cent per annum (2002: 5.6 per cent). Under FRS 17, the deferred tax asset related to the unprovided liability of £6 million (2002: £15 million) would be £2 million (2002: £5 million).

The movement in the FRS 17 liability is as follows:

| | <i>Year ended</i> <i>31 December</i> <i>2003</i> £m | <i>Year ended</i> <i>31 December</i> <i>2002</i> £m |
|--|---|---|
| Deficit at 1 January | (120) | (147) |
| Current service cost | — | — |
| Interest cost on liabilities | (7) | (9) |
| Change in assumptions underlying the present value of scheme liabilities | 6 | 36 |
| Deficit at 31 December | (121) | (120) |

c Directors' emoluments

The aggregate emoluments of the Directors of the bank, computed in accordance with Part I of Schedule 6 of the Act were:

| | 2003 £000 | 2002 £000 |
|------------------------------------|----------------------------|--------------|
| Fees | 196 | 201 |
| Salaries and other emoluments | 1,629 | 1,487 |
| Discretionary bonuses | 1,510 | 982 |
| | 3,335 | 2,670 |
| Gains on exercise of share options | 735 | 229 |

In addition, there are annual commitments under retirement benefit agreements with former Directors of £460,980 (2002: £459,584).

5 Administrative expenses (continued)

c Directors' emoluments (continued)

Retirement benefits accrue to three Directors under defined benefit schemes and to two Directors under a money purchase scheme.

During the year, aggregate contributions to money purchase pension schemes were £1,779,000 (2002: £929,000).

Discretionary bonuses for Directors are based on a combination of individual and corporate performance and are determined by the Group Remuneration Committee of HSBC Holdings.

Details of individual Directors' remuneration are disclosed in the 'Directors' Remuneration Report' on page 22.

d Auditors' remuneration

Auditors' remuneration for statutory audit amounted to £7.3 million (2002: £5.6 million) including £2.9 million (2002: £1.5 million) which relates to the bank. The following remuneration was paid to the group's principal auditor (KPMG):

| | 2003 £m | 2002 £m |
|------------------------------------|-------------|------------|
| Audit services | | |
| Statutory audit | 6.9 | 5.1 |
| Audit-related regulatory reporting | 1.2 | 1.8 |
| | <u>8.1</u> | <u>6.9</u> |
| Further assurance services | 1.5 | 0.2 |
| Tax services | | |
| Advisory services | 0.4 | 0.5 |
| Other services | | |
| Other services | 0.5 | 1.1 |
| | <u>10.5</u> | <u>8.7</u> |

Fees paid in respect of auditors other than the principal auditor for audits were £0.4 million (2002: £0.5 million).

The following is a description of the type of services included within the categories listed above.

Audit-Related Services include services for assurance and other services that are reasonably related to the performance of the audit or review of the financial statements including comfort letters and interim reviews.

Further Assurance Services include services for advice on accounting matters, reporting on internal controls not connected with the financial statements (such as S166 reports), due diligence work, and environmental audits.

Tax Services include services for tax advice and tax planning.

Other Services include all other services.

The majority of the increase in auditors' remuneration relates to acquisitions.

Notes on the Accounts (continued)**6 Profit on ordinary activities before tax**

Profit on ordinary activities before tax is stated after:

a Income

| | 2003 | 2002 |
|---|-------------|------|
| | £m | £m |
| Aggregate rentals receivable, under | | |
| — finance leases | 230 | 226 |
| — hire purchase contracts | 656 | 552 |
| — operating leases | 335 | 327 |
| Increase in the value of long-term assurance business | 53 | 84 |
| Profits less losses on debt securities and equities dealing | 102 | (5) |
| Gain on disposal of investment securities | 119 | 104 |

b Charges on income

| | 2003 | 2002 |
|--|-------------|------|
| | £m | £m |
| Charges incurred with respect to subordinated liabilities | 262 | 245 |
| Finance charges in respect of finance leases and similar hire purchase contracts | 15 | 12 |
| Rentals payable on premises held under operating leases | 198 | 149 |

c Gains on disposal of investments and tangible fixed assets

Gains on disposal of investments and tangible fixed assets attracted a tax charge of £24 million (2002: £21 million).

7 Tax on profit on ordinary activities

The charge for taxation comprises:

| | 2003 | 2002 |
|---|--------------|-------|
| | £m | £m |
| United Kingdom corporation tax charge* | 590 | 670 |
| Adjustment in respect of prior periods | (123) | (44) |
| | 467 | 626 |
| Relief for overseas taxation* | (186) | (160) |
| | 281 | 466 |
| Overseas taxation (including £(15) million (2002: £(1) million) in respect of previous periods) | 275 | 234 |
| Joint ventures and associates | 6 | 3 |
| Current taxation | 562 | 703 |
| Origination and reversal of timing differences | 75 | 79 |
| Adjustment in respect of previous periods | 4 | 26 |
| Deferred taxation (Note 28a) | 79 | 105 |
| Total charge for taxation | 641 | 808 |

* Figures for 2002 have been restated to reflect in greater detail the effect of underlying taxes attributable to overseas group dividends receivable in the UK. This has no impact on the total tax charge for 2002.

During the year, the group provided for UK corporation tax at 30 per cent (2002: 30 per cent).

The tax charge includes £11 million (2002: £18 million) in respect of the tax attributable to the increase in the value of long-term assurance business attributable to shareholders.

7 Tax on profit on ordinary activities (continued)

Analysis of overall tax charge

| | 2003 £m | 2002 £m |
|---|------------|------------|
| Taxation at UK corporation tax rate of 30% (2002: 30%) | 673 | 685 |
| Other non-deductible items including unrelieved losses | 15 | 12 |
| Tax-free gains | (1) | (5) |
| Impact of differently taxed overseas profits in principal locations | (90) | (36) |
| Amortisation of goodwill | 164 | 141 |
| Prior year adjustments | (121) | (22) |
| Other items | 1 | 33 |
| Timing differences impact on current tax | (79) | (105) |
| Current tax charge | 562 | 703 |
| Deferred tax charge | 79 | 105 |
| Overall tax charge | 641 | 808 |

8 Profit of the bank

The profit of the bank for the year attributable to shareholders was £1,650 million (2002: £1,854 million)

9 Dividends

| | 2003 £m | 2002 £m |
|----------------------|------------|------------|
| Equity | | |
| Ordinary dividends | | |
| — paid | 700 | 600 |
| — proposed | 700 | 500 |
| | 1,400 | 1,100 |
| Non-equity | | |
| Preference dividends | 40 | 44 |
| | 1,440 | 1,144 |

10 Earnings per ordinary share

Basic and diluted earnings per ordinary share are calculated by dividing the profit for the financial year attributable to equity shareholders, after deducting preference dividends, of £1,440 million (2002: £1,335 million) by the weighted average number of ordinary shares in issue in 2003 of 797 million (2002: 797 million).

Notes on the Accounts (continued)

11 Treasury bills and other eligible bills

| | <i>group</i> | | | | <i>bank</i> | | | |
|---|-------------------|-------------------------|-------------------|-------------------------|-------------------|-------------------------|-------------------|-------------------------|
| | <i>Book value</i> | <i>Market valuation</i> | <i>Book value</i> | <i>Market valuation</i> | <i>Book value</i> | <i>Market valuation</i> | <i>Book value</i> | <i>Market valuation</i> |
| | 2003 | 2003 | 2002 | 2002 | 2003 | 2003 | 2002 | 2002 |
| | £m | £m | £m | £m | £m | £m | £m | £m |
| Investment securities | | | | | | | | |
| — treasury bills and similar securities | 1,560 | 1,562 | 948 | 952 | 1,045 | 1,047 | 367 | 367 |
| — other eligible bills | 438 | 438 | 630 | 630 | 438 | 438 | 630 | 630 |
| | 1,998 | 2,000 | 1,578 | 1,582 | 1,483 | 1,485 | 997 | 997 |
| Other securities | | | | | | | | |
| — treasury bills and similar securities | 199 | | 469 | | 152 | | 433 | |
| | 2,197 | | 2,047 | | 1,635 | | 1,430 | |

Investment securities:

| | <i>Cost and book value</i> |
|--|----------------------------|
| group | £m |
| At 1 January 2003 | 1,578 |
| Additions | 8,666 |
| Disposals and amounts repaid | (8,366) |
| Amortisation of discounts and premiums | 49 |
| Exchange and other movements | 71 |
| At 31 December 2003 | 1,998 |
| bank | £m |
| At 1 January 2003 | 997 |
| Additions | 7,915 |
| Disposals and amounts repaid | (7,515) |
| Amortisation of discounts and premiums | 39 |
| Exchange and other movements | 47 |
| At 31 December 2003 | 1,483 |

11 Treasury bills and other eligible bills (continued)

The maturities of investment treasury bills and other eligible bills at 31 December 2003 are analysed as follows:

| | <i>group</i> | | <i>bank</i> | |
|---------------------|-------------------|-------------------------|-------------------|-------------------------|
| | <i>Book value</i> | <i>Market valuation</i> | <i>Book value</i> | <i>Market valuation</i> |
| | £m | £m | £m | £m |
| Due within 1 year | 1,775 | 1,777 | 1,472 | 1,474 |
| Due 1 year and over | 223 | 223 | 11 | 11 |
| | 1,998 | 2,000 | 1,483 | 1,485 |

The net unamortised discounts on investment securities were:

| | <i>group</i> | <i>bank</i> |
|--|--------------|-------------|
| | 2003 | 2003 |
| | £m | £m |
| | 6 | 5 |

12 Loans and advances to banks

| | <i>group</i> | | <i>bank</i> | |
|---|---------------|--------|---------------|--------|
| | 2003 | 2002 | 2003 | 2002 |
| | £m | £m | £m | £m |
| Remaining maturity | | | | |
| — repayable on demand | 8,084 | 7,259 | 7,388 | 5,252 |
| — 3 months or less but not repayable on demand | 21,757 | 15,716 | 11,612 | 7,049 |
| — 1 year or less but over 3 months | 2,937 | 2,854 | 1,223 | 1,040 |
| — 5 years or less but over 1 year | 587 | 548 | 512 | 471 |
| — over 5 years | 288 | 264 | 211 | 415 |
| Specific bad and doubtful debt provisions (Note 14) | (11) | (14) | (4) | (3) |
| | 33,642 | 26,627 | 20,942 | 14,224 |
| Amounts include: | | | | |
| Subordinated | 61 | 45 | — | — |
| Due from subsidiary undertakings | | | | |
| — unsubordinated | | | 2,348 | 1,051 |
| Due from fellow subsidiary undertakings | | | | |
| — unsubordinated | 3,438 | 1,067 | 2,875 | 866 |

Notes on the Accounts (continued)**13 Loans and advances to customers**

| | <i>group</i> | | <i>bank</i> | |
|---|--------------------------|------------|--------------------------|------------|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Remaining maturity | | | | |
| — repayable on demand or at short notice | 20,199 | 18,413 | 20,388 | 12,954 |
| — 3 months or less but not repayable on demand or at short notice | 21,098 | 19,714 | 9,035 | 12,688 |
| — 1 year or less but over 3 months | 11,694 | 12,308 | 6,696 | 7,954 |
| — 5 years or less but over 1 year | 29,321 | 26,363 | 21,618 | 20,094 |
| — over 5 years | 36,366 | 30,361 | 27,929 | 23,839 |
| General and specific bad and doubtful debt provisions (Note 14) | (2,380) | (2,252) | (1,346) | (1,322) |
| | 116,298 | 104,907 | 84,320 | 76,207 |
| Amounts include: | | | | |
| Subordinated | 134 | 114 | 15 | 15 |
| Due from subsidiary undertakings | | | | |
| — unsubordinated | | | 6,882 | 6,043 |
| Due from fellow subsidiary undertakings | | | | |
| — unsubordinated | 864 | 440 | 831 | 439 |
| Due from joint ventures | | | | |
| — unsubordinated | 211 | 203 | 175 | 165 |

Securitisation transactions

Loans and advances to customers include balances that have been securitised. Certain of these balances meet the requirements for linked presentation under FRS 5, 'Reporting the substance of transactions'.

The non-recourse finance has been netted against loans and advances to customers as follows:

| | 2003 £m | 2002 £m |
|------------------------------|--------------------------|------------|
| Customer loans | 1,202 | 1,423 |
| Non-recourse finance | (1,054) | (1,271) |
| Funding provided by the bank | 148 | 152 |

13 Loans and advances to customers *(continued)*

The bank has securitised a designated portion of its corporate loan portfolio. The transaction was effected through a declaration of trust in favour of Clover Securitisation Limited. Clover Securitisation Limited holds its beneficial interest in the trust for Clover Funding No. 1 plc, Clover Funding No. 2 plc, Clover Funding No. 3 plc, Clover Funding No. 4 plc (collectively 'Clover Funding') and the bank.

To fund the acquisition of this beneficial interest, Clover Funding has issued £1,423 million (2002: £1,423 million) floating rate notes ('FRNs'). Clover Funding No.2 plc is in scheduled accumulation and has collected £221 million (2002: £nil) to repay its outstanding Notes in April 2004. The offering circulars for the FRNs stated that they are the obligations of Clover Funding only and are not guaranteed by, or the responsibility of, any other party.

Non-returnable proceeds of £1,054 million (2002: £1,271 million) received by the bank from Clover Funding have been deducted from 'Loans and advances to customers'. Clover Securitisation Limited has entered into swap agreements with the bank under which Clover Securitisation Limited pays the floating rate of interest on the loans and receives interest linked to three-month London Interbank Offered Rate ('LIBOR'). The proceeds generated from the loans are used in priority to meet the claims of the FRN holders, and amounts payable in respect of the interest rate swap arrangements after the payment of trustee and administration expenses.

There is no provision whatsoever, either in the financing arrangements or otherwise, whereby the bank or any part of the group has a right or obligation either to keep the loans and advances on repayment of the finance or to repurchase them at any time other than in certain circumstances where the bank is in breach of warranty.

The bank is not obliged to support any losses that may be suffered by the FRN holders and does not intend to provide such support.

The bank has taken up £41 million (2002: £41 million) of subordinated FRNs that are repayable after payments in respect of senior FRNs. The bank has made subordinated loans of £26 million (2002: £26 million) to Clover Funding that are repayable after all other payments. Interest is payable on the subordinated FRNs and subordinated loans conditional upon Clover Funding having funds available.

Clover Securitisation Limited's entire share capital is held by Clover Holdings Limited. Clover Funding's entire share capital is held by Clover Holdings Limited. Clover Holdings Limited's entire share capital is held by trustees under the terms of a trust for charitable purposes.

The bank recognised net income of £4 million (2002: £3 million) which comprised £66 million (2002: £64 million) interest receivable by Clover Funding and £62 million (2002: £61 million) of interest on FRNs and other third-party expenses payable by Clover Funding.

Notes on the Accounts (continued)

14 Provisions for bad and doubtful debts

a Movements on provisions for bad and doubtful debts

| | <i>Specific</i> | <i>General</i> | <i>Total</i> | <i>Specific</i> | <i>General</i> | <i>Total</i> |
|---|-----------------|----------------|--------------|-----------------|----------------|--------------|
| | 2003 | 2003 | 2003 | 2002 | 2002 | 2002 |
| | £m | £m | £m | £m | £m | £m |
| group | | | | | | |
| At 1 January | 1,739 | 527 | 2,266 | 1,502 | 546 | 2,048 |
| Amounts written off | (437) | — | (437) | (290) | — | (290) |
| Recoveries of amounts written off in previous years | 70 | — | 70 | 41 | — | 41 |
| Charge/(release) to the profit and loss account | 509 | (73) | 436 | 412 | (35) | 377 |
| Acquisitions | — | — | — | 37 | 15 | 52 |
| Exchange and other movements | 46 | 10 | 56 | 37 | 1 | 38 |
| At 31 December | 1,927 | 464 | 2,391 | 1,739 | 527 | 2,266 |
| bank | | | | | | |
| At 1 January | 991 | 334 | 1,325 | 804 | 366 | 1,170 |
| Amounts written off | (354) | — | (354) | (210) | — | (210) |
| Recoveries of amounts written off in previous years | 60 | — | 60 | 33 | — | 33 |
| Charge/(release) to the profit and loss account | 393 | (60) | 333 | 369 | (32) | 337 |
| Exchange and other movements | (14) | — | (14) | (5) | — | (5) |
| At 31 December | 1,076 | 274 | 1,350 | 991 | 334 | 1,325 |

| | <i>group</i> | | <i>bank</i> | |
|---|--------------|--------------|--------------|--------------|
| | 2003 | 2002 | 2003 | 2002 |
| | £m | £m | £m | £m |
| Included in: | | | | |
| Loans and advances to banks (Note 12) | 11 | 14 | 4 | 3 |
| Loans and advances to customers (Note 13) | 2,380 | 2,252 | 1,346 | 1,322 |
| | 2,391 | 2,266 | 1,350 | 1,325 |

b Movements on suspended interest account

| | <i>group</i> | | <i>bank</i> | |
|------------------------------------|--------------|-----------|-------------|-----------|
| | 2003 | 2002 | 2003 | 2002 |
| | £m | £m | £m | £m |
| At 1 January | 80 | 80 | 35 | 31 |
| Amounts written off | (13) | (12) | (10) | (8) |
| Interest suspended during the year | 27 | 44 | 17 | 22 |
| Suspended interest recovered | (17) | (23) | (9) | (7) |
| Exchange and other movements | 4 | (9) | (1) | (3) |
| At 31 December | 81 | 80 | 32 | 35 |

14 Provisions for bad and doubtful debts (continued)

c Non-performing loans

| | <i>group</i> | | <i>bank</i> | |
|--|----------------|---------|--------------|-------|
| | 2003 | 2002 | 2003 | 2002 |
| | £m | £m | £m | £m |
| Loans on which interest has been suspended (net of suspended interest) | 1,449 | 1,321 | 900 | 909 |
| Provisions | (793) | (626) | (486) | (364) |
| | 656 | 695 | 414 | 545 |
| Other non-performing loans | 1,594 | 1,502 | 898 | 887 |
| Provisions | (1,134) | (1,113) | (590) | (627) |
| | 460 | 389 | 308 | 260 |
| Total non-performing loans (net of provisions) | 1,116 | 1,084 | 722 | 805 |

15 Concentrations of exposure

The group has the following concentrations of loans and advances to customers:

| | 2003 | 2002 |
|--|----------------|---------|
| | £m | £m |
| Total gross advances to customers: | | |
| Residential mortgages | 29,028 | 24,061 |
| Other personal | 20,606 | 18,354 |
| Commercial, industrial and international trade | 27,517 | 27,622 |
| Commercial real estate | 8,751 | 7,377 |
| Other property related | 3,070 | 2,464 |
| Government | 1,430 | 1,382 |
| Other commercial | 15,630 | 16,109 |
| Non-bank financial institutions | 12,385 | 9,869 |
| | 118,417 | 107,238 |

The analysis of concentration of exposure is based on the categories used by the group to manage the associated risks. Of total loans and advances to customers gross of provisions, £83,939 million (2002: £75,299 million) was advanced by operations located in the United Kingdom.

Other commercial includes advances in respect of transport, energy and agriculture.

Notes on the Accounts (continued)

16 Debt securities

| | <i>group</i> | | | | <i>bank</i> | | | |
|---|-------------------|-------------------------|-------------------|-------------------------|-------------------|-------------------------|-------------------|-------------------------|
| | <i>Book value</i> | <i>Market valuation</i> | <i>Book value</i> | <i>Market valuation</i> | <i>Book value</i> | <i>Market valuation</i> | <i>Book value</i> | <i>Market valuation</i> |
| | 2003 | 2003 | 2002 | 2002 | 2003 | 2003 | 2002 | 2002 |
| | £m | £m | £m | £m | £m | £m | £m | £m |
| Issued by public bodies | | | | | | | | |
| Investment securities | | | | | | | | |
| — government securities and US government agencies | 7,276 | 7,377 | 6,077 | 6,215 | 2,609 | 2,610 | 1,564 | 1,570 |
| — other public sector securities | 785 | 845 | 806 | 870 | 105 | 108 | 61 | 62 |
| | 8,061 | 8,222 | 6,883 | 7,085 | 2,714 | 2,718 | 1,625 | 1,632 |
| Other debt securities | | | | | | | | |
| — government securities and US government agencies | 9,938 | | 8,898 | | 2,100 | | 2,229 | |
| — other public sector securities | 58 | | 67 | | 22 | | 41 | |
| | 9,996 | | 8,965 | | 2,122 | | 2,270 | |
| Issued by other bodies | | | | | | | | |
| Investment securities | | | | | | | | |
| — bank and building society certificates of deposit | 106 | 106 | 240 | 240 | 66 | 66 | 101 | 101 |
| — other securities | 14,042 | 14,348 | 13,448 | 13,728 | 3,327 | 3,374 | 3,173 | 3,237 |
| | 14,148 | 14,454 | 13,688 | 13,968 | 3,393 | 3,440 | 3,274 | 3,338 |
| Other debt securities | | | | | | | | |
| — bank and building society certificates of deposit | 3,882 | | 5,890 | | 3,748 | | 5,660 | |
| — other securities | 13,469 | | 9,522 | | 10,343 | | 7,760 | |
| | 17,351 | | 15,412 | | 14,091 | | 13,420 | |
| | 49,556 | | 44,948 | | 22,320 | | 20,589 | |
| Due within 1 year | 12,426 | | 15,532 | | 7,247 | | 10,310 | |
| Due 1 year and over | 37,130 | | 29,416 | | 15,073 | | 10,279 | |
| | 49,556 | | 44,948 | | 22,320 | | 20,589 | |
| Amounts include: | | | | | | | | |
| Subordinated debt securities | 145 | | 153 | | 107 | | 104 | |
| Unamortised net premiums on investment securities | 139 | | 167 | | 83 | | 171 | |
| Investment securities | | | | | | | | |
| — listed | 17,376 | 17,826 | 17,097 | 17,542 | 4,080 | 4,127 | 3,706 | 3,769 |
| — unlisted | 4,833 | 4,850 | 3,474 | 3,511 | 2,027 | 2,031 | 1,193 | 1,201 |
| | 22,209 | 22,676 | 20,571 | 21,053 | 6,107 | 6,158 | 4,899 | 4,970 |
| Other debt securities | | | | | | | | |
| — listed | 17,727 | | 13,698 | | 9,258 | | 8,324 | |
| — unlisted | 9,620 | | 10,679 | | 6,955 | | 7,366 | |
| | 27,347 | | 24,377 | | 16,213 | | 15,690 | |
| | 49,556 | | 44,948 | | 22,320 | | 20,589 | |

16 Debt securities (continued)

Where securities are carried at market valuation, and the market valuation is higher than cost, the difference between cost and market valuation is not disclosed as it cannot be determined without unreasonable expense.

The above market valuations do not take account of transactions entered into to hedge the value of the group's investment securities. If these transactions were included, the market valuation of investment securities would be £22,496 million for the group (2002: £20,782 million) and £6,158 million (2002: £4,970 million) for the bank.

Investment securities:

| | <i>Cost</i> | <i>Provisions</i> | <i>Book value</i> |
|--|---------------|-------------------|-------------------|
| | £m | £m | £m |
| group | | | |
| At 1 January 2003 | 20,598 | (27) | 20,571 |
| Additions | 18,796 | (4) | 18,792 |
| Disposals and amounts repaid | (17,071) | 21 | (17,050) |
| Amortisation of discounts and premiums | (191) | — | (191) |
| Exchange and other movements | 98 | (11) | 87 |
| At 31 December 2003 | 22,230 | (21) | 22,209 |
| bank | | | |
| At 1 January 2003 | 4,905 | (6) | 4,899 |
| Additions | 4,808 | — | 4,808 |
| Disposals and amounts repaid | (3,585) | 6 | (3,579) |
| Amortisation of discounts and premiums | (187) | — | (187) |
| Exchange and other movements | 166 | — | 166 |
| At 31 December 2003 | 6,107 | — | 6,107 |

17 Equity shares

| | <i>group</i> | | | | <i>bank</i> | | | |
|-----------------------|-------------------|-------------------------|-------------------|-------------------------|-------------------|-------------------------|-------------------|-------------------------|
| | <i>Book value</i> | <i>Market valuation</i> | <i>Book value</i> | <i>Market valuation</i> | <i>Book value</i> | <i>Market valuation</i> | <i>Book value</i> | <i>Market valuation</i> |
| | 2003 | 2003 | 2002 | 2002 | 2003 | 2003 | 2002 | 2002 |
| | £m | £m | £m | £m | £m | £m | £m | £m |
| Investment securities | | | | | | | | |
| — listed | 524 | 649 | 435 | 477 | 61 | 88 | 27 | 40 |
| — unlisted | 1,195 | 1,397 | 1,131 | 1,286 | 95 | 106 | 86 | 109 |
| | 1,719 | 2,046 | 1,566 | 1,763 | 156 | 194 | 113 | 149 |
| Other securities | | | | | | | | |
| — listed | 4,098 | | 1,843 | | 2,694 | | 1,095 | |
| — unlisted | 20 | | 74 | | — | | 1 | |
| | 4,118 | | 1,917 | | 2,694 | | 1,096 | |
| | 5,837 | | 3,483 | | 2,850 | | 1,209 | |

Notes on the Accounts (continued)**17 Equity shares** (continued)

Where securities are carried at market valuation, and the market valuation is higher than cost, the difference between cost and market valuation is not disclosed as it cannot be determined without unreasonable expense.

Investment securities:

| | <i>Cost</i> | <i>Provisions</i> | <i>Book value</i> |
|------------------------------|--------------|-------------------|-------------------|
| | £m | £m | £m |
| group | | | |
| At 1 January 2003 | 1,847 | (281) | 1,566 |
| Additions | 1,202 | — | 1,202 |
| Disposals | (1,221) | 54 | (1,167) |
| Provisions made | — | (40) | (40) |
| Exchange and other movements | 159 | (1) | 158 |
| At 31 December 2003 | 1,987 | (268) | 1,719 |
| bank | | | |
| At 1 January 2003 | 162 | (49) | 113 |
| Additions | 75 | — | 75 |
| Disposals | (44) | 9 | (35) |
| Provisions made | — | (9) | (9) |
| Exchange and other movements | (2) | 14 | 12 |
| At 31 December 2003 | 191 | (35) | 156 |

Included in investment securities is £2 million, after amortisation, of HSBC Holdings' shares (2002: £2 million) held in trust for the purposes of conditional awards under the Restricted Share Plan, details of which are provided in the 'Directors' Remuneration Report' on page 26. At 31 December 2003, the trust held 1,418,000 ordinary shares (2002: 974,815) of nominal value US\$0.50 each with a market value at that date of £13 million (2002: £7 million) in respect of these conditional awards.

Also included within investment securities is £24 million of HSBC Holdings' shares (2002: £13 million) held in trust which may be used in respect of the exercise of share options. At 31 December 2003, the trust held 2,719,256 ordinary shares (2002: 1,482,249) of US\$0.50 each with a market value of £24 million (2002: £10 million) in respect of these option holders.

18 Interests in joint ventures**a** *Movements in interests in joint ventures*

| | <i>group</i> |
|------------------------------|--------------|
| | £m |
| At 1 January 2003 | 89 |
| Additions | — |
| Retained profits and losses | 4 |
| Amortisation of goodwill | (83) |
| Exchange and other movements | (4) |
| At 31 December 2003 | 6 |

None of the joint ventures is listed or a bank.

18 Interests in joint ventures *(continued)*

b *Principal joint venture as at 31 December 2003*

| | <i>Country of incorporation</i> | <i>Principal activity</i> | <i>Interest in equity capital</i> |
|---------------------------|-------------------------------------|-------------------------------|---------------------------------------|
| Framlington Group Limited | UK | Asset management | 51% |

Framlington Group Limited prepares its financial statements up to 31 December and its principal country of operation is the United Kingdom.

The group's share of total operating income in joint ventures is £15 million (2002: £27 million).

The group's share of contingent liabilities in joint ventures is £nil (2002: £nil).

c *Goodwill*

Included within the group's share of gross assets of joint ventures is goodwill of £94m which has been fully written off in 2003 (2002: net book value £83m).

Notes on the Accounts (continued)**19 Interests in associates****a** *Movements in interests in associates*

| | <i>group</i> | <i>bank</i> |
|--|-------------------|-----------------|
| | <u>£m</u> | <u>£m</u> |
| At 1 January 2003 | 109 | 5 |
| Retained profits | 16 | — |
| Write-up of associates to net asset value, including attributable goodwill | — | 3 |
| Exchange and other movements | — | (1) |
| At 31 December 2003 | <u>125</u> | <u>7</u> |

| | <i>group</i> | | <i>bank</i> | |
|-----------------|-------------------|------------|-----------------|----------|
| | 2003 | 2002 | 2003 | 2002 |
| | £m | £m | £m | £m |
| Shares in banks | 9 | 7 | — | — |
| Other | 116 | 102 | 7 | 5 |
| | <u>125</u> | <u>109</u> | <u>7</u> | <u>5</u> |

None of the associates are listed.

On the historical cost basis, the bank's interests in associates would have been included as follows:

| | 2003 | 2002 |
|------------|-----------------|----------|
| | £m | £m |
| Cost | 15 | 15 |
| Provisions | (10) | (10) |
| | <u>5</u> | <u>5</u> |

b *Principal associate as at 31 December 2003*

| | <i>Country of incorporation</i> | <i>Principal activity</i> | <i>Interest in equity capital</i> |
|-------|-------------------------------------|-------------------------------|---------------------------------------|
| | <u></u> | <u></u> | <u></u> |
| Erisa | France | Insurance | 49.99% |

20 Investments in subsidiary undertakings

a *Movements in investments in subsidiary undertakings*

| | £m |
|---|---------------|
| At 1 January 2003 | 14,372 |
| Acquisitions | 38 |
| Increases in share capital | 555 |
| Disposals | (26) |
| Write-up to net asset value including attributable goodwill | 482 |
| Redemption of shares | (115) |
| Exchange and other movements | 63 |
| At 31 December 2003 | 15,369 |

The above amount represents the direct interests of the bank in its subsidiary undertakings. Interests in subsidiary undertakings include £8,019 million (2002: £7,892 million) representing interests in banks.

On the historical cost basis, the bank's interests in subsidiary undertakings would have been included as follows:

| | 2003 | 2002 |
|------------|---------------|--------|
| | £m | £m |
| Cost | 14,278 | 13,763 |
| Provisions | (1) | (1) |
| | 14,277 | 13,762 |

b *Principal subsidiary undertakings as at 31 December 2003*

| | <i>Country of incorporation</i> |
|--|-------------------------------------|
| CCF S.A. (99.99% owned) (directly owned) | France |
| HSBC Asset Finance (UK) Limited (directly owned) | England |
| HSBC Bank A.S. (directly owned) | Turkey |
| HSBC Bank International Limited | Jersey |
| HSBC Bank Malta p.l.c. (70.03% owned) | Malta |
| HSBC Guyerzeller Bank AG (83.99% owned) | Switzerland |
| HSBC Invoice Finance (UK) Limited | England |
| HSBC Life (UK) Limited (directly owned) | England |
| HSBC Rail (UK) Limited | England |
| HSBC Private Bank (Guernsey) Limited (formerly HSBC Republic Bank (Guernsey) Limited) (97.82% owned) | Guernsey |
| HSBC Private Bank (Suisse) S.A. (formerly HSBC Republic Bank (Suisse) S.A.) (97.82% owned) | Switzerland |
| HSBC Republic Bank (UK) Limited (97.82% owned) | England |
| HSBC Trinkaus & Burkhardt KGaA (73.47% owned) | Germany |
| HSBC Trust Company (UK) Limited (directly owned) | England |

Details of all subsidiary undertakings will be annexed to the next Annual Return of the bank. All of the above subsidiary undertakings are engaged in the business of banking or other financial services.

Except where indicated otherwise, the issued equity capital of the above undertakings is wholly owned by the group and is held by subsidiaries of the bank.

Notes on the Accounts (continued)

20 Investments in subsidiary undertakings (continued)

c Acquisitions

On 31 January 2003, the group acquired the business in respect of two branches of Banque Worms from Deutsche Bank Group for a cash consideration of £1 million. Goodwill of £1 million arose on this acquisition.

On 20 February 2003, the bank increased its stake in Equator Holdings Limited from 60 per cent to 100 per cent for a cash consideration of £4 million. Negative goodwill of £1 million arose on this acquisition.

On 31 March 2003, the group increased its stake in Banque Eurofin from 59.84 per cent to 61.43 per cent for a cash consideration of £2 million. Goodwill of £1 million arose on this acquisition. On 30 June 2003, the group increase its stake again to 77.56 per cent for a cash consideration of £13 million. Goodwill of £7 million arose on this acquisition. On 31 July 2003, the group increased its stake again to 83.94 per cent for a cash consideration of £6 million. Goodwill of £4 million arose on this acquisition. As part of the CCF group's reorganisation of its private banking business, Banque Eurofin was merged into HSBC Private Bank France.

On 1 September 2003, the group increased its stake in Banque de Savoie from 98.2 per cent to 99.94 per cent for a cash consideration of £1 million. Goodwill of £1 million arose on this acquisition.

On 24 October 2003, the bank acquired 100 per cent of Polski Kredyt Bank S.A. for a cash consideration of £5 million. Goodwill of £1m arose on this acquisition.

On 24 November 2003, the group increased its stake in Elysées-Fonds from 51 per cent to 100 per cent for a cash consideration of £10 million. Goodwill of £6m arose on the acquisition.

All acquisitions have been accounted for on an acquisitions basis. No fair value table has been disclosed as the acquisition is not considered significant.

21 Intangible fixed assets

| <i>Goodwill</i> | <i>group</i> | <i>bank</i> |
|---|--------------|-------------|
| | 2003 | 2003 |
| | £m | £m |
| Cost | | |
| At 1 January 2003 | 9,412 | 46 |
| Additions (group: positive goodwill of £21 million, negative goodwill of £1 million) | 20 | — |
| Exchange and other movements | 492 | (2) |
| At 31 December 2003 | 9,924 | 44 |
| Accumulated amortisation | | |
| At 1 January 2003 | 1,074 | 8 |
| Charge to the profit and loss account (group: net of negative goodwill of £46 million) | 483 | 3 |
| Exchange and other movements | 52 | — |
| At 31 December 2003 | 1,609 | 11 |
| Net book value at 31 December 2003 (group: net of negative goodwill of £8 million) | 8,315 | 33 |
| Net book value at 31 December 2002 (group: net of negative goodwill of £51 million) | 8,338 | 38 |

Additions represent goodwill arising on the acquisition of and increased holdings in subsidiaries during 2003.

Positive goodwill on the acquisition of CCF S.A. and HSBC Private Banking Holdings (Suisse) SA and their subsidiaries is being amortised over 20 years. Other positive goodwill is being amortised over periods of up to 15 years. Negative goodwill is being credited to the profit and loss account over 5 years, the period to benefit.

22 Tangible fixed assets

a Movements on tangible fixed assets

| group | <i>Freehold land and buildings</i> | <i>Long leasehold land and buildings</i> | <i>Short leasehold land and buildings</i> | <i>Equipment, fixtures and fittings</i> | <i>Equipment on operating leases</i> | <i>Total</i> |
|---|--|--|---|---|--|----------------|
| | £m | £m | £m | £m | £m | £m |
| Cost or valuation | | | | | | |
| At 1 January 2003 | 1,167 | 638 | 278 | 2,314 | 2,595 | 6,992 |
| Additions | 10 | — | 16 | 313 | 437 | 776 |
| Disposals | (105) | — | (29) | (110) | (192) | (436) |
| Reclassification | — | (81) | — | 81 | — | — |
| Deficit on revaluation taken to profit and loss | (3) | — | — | — | — | (3) |
| Transfer of accumulated depreciation arising on revaluation | (14) | (9) | — | — | — | (23) |
| Surplus/(deficit) on revaluation | 14 | (70) | — | — | — | (56) |
| Exchange and other movements | 50 | (9) | 4 | 110 | (2) | 153 |
| At 31 December 2003 | 1,119 | 469 | 269 | 2,708 | 2,838 | 7,403 |
| Accumulated depreciation | | | | | | |
| At 1 January 2003 | (32) | (2) | (174) | (1,425) | (569) | (2,202) |
| Disposals | — | — | 29 | 93 | 142 | 264 |
| Transfer of accumulated depreciation arising on revaluation | 14 | 9 | — | — | — | 23 |
| Charge to the profit and loss account | (26) | (10) | (10) | (285) | (157) | (488) |
| Exchange and other movements | (1) | (1) | (9) | (73) | — | (84) |
| At 31 December 2003 | (45) | (4) | (164) | (1,690) | (584) | (2,487) |
| Net book value | | | | | | |
| At 31 December 2003 | 1,074 | 465 | 105 | 1,018 | 2,254 | 4,916 |
| At 31 December 2002 | 1,135 | 636 | 104 | 889 | 2,026 | 4,790 |

Notes on the Accounts (continued)**22 Tangible fixed assets** (continued)**a** *Movements on tangible fixed assets (continued)*

| | <i>Freehold land and buildings</i> | <i>Long leasehold land and buildings</i> | <i>Short leasehold land and buildings</i> | <i>Equipment, fixtures and fittings</i> | <i>Total</i> |
|--|--|--|---|---|----------------|
| bank | £m | £m | £m | £m | £m |
| Cost or valuation | | | | | |
| At 1 January 2003 | 447 | 625 | 201 | 1,428 | 2,701 |
| Additions | 3 | — | 13 | 200 | 216 |
| Disposals | (4) | — | (4) | (64) | (72) |
| Acquisitions | 6 | — | — | 20 | 26 |
| Reclassification | — | (81) | — | 81 | — |
| Deficit on revaluation taken to profit and loss | (3) | — | — | — | (3) |
| Transfer of accumulated depreciation arising on revaluation | (5) | (9) | — | — | (14) |
| Surplus/(deficit) on revaluation | 23 | (72) | — | — | (49) |
| Exchange and other movements | 5 | (7) | — | 1 | (1) |
| At 31 December 2003 | 472 | 456 | 210 | 1,666 | 2,804 |
| Accumulated depreciation | | | | | |
| At 1 January 2003 | (23) | (3) | (135) | (836) | (997) |
| Disposals | — | — | 4 | 59 | 63 |
| Transfer of accumulated depreciation arising on revaluation | 5 | 9 | — | — | 14 |
| Charge to the profit and loss account | (14) | (10) | (8) | (184) | (216) |
| Exchange and other movements | (5) | (1) | (9) | (3) | (18) |
| At 31 December 2003 | (37) | (5) | (148) | (964) | (1,154) |
| Net book value | | | | | |
| At 31 December 2003 | 435 | 451 | 62 | 702 | 1,650 |
| At 31 December 2002 | 424 | 622 | 66 | 592 | 1,704 |

b *Assets held under finance leases*

The net book amount of equipment, fixtures and fittings included assets held under finance leases of £12 million (2002: £5 million) for the group and £nil (2002: £nil) for the bank, on which the depreciation charge was £6 million (2002: £2 million) for the group and £nil (2002: £2 million) for the bank. The net book amount of equipment on operating leases included assets held under finance leases of £111 million (2002: £117 million) for the group on which the depreciation charge was £5 million (2002: £3 million).

22 Tangible fixed assets (continued)

c Valuations

| | <i>group</i> | | <i>bank</i> | |
|---|-------------------|------------|-------------------|------------|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Cost or valuation of freehold and long leasehold land and buildings: | | | | |
| At valuation | 1,566 | 1,787 | 917 | 1,062 |
| At cost | 22 | 18 | 11 | 10 |
| | 1,588 | 1,805 | 928 | 1,072 |
| On the historical cost basis, freehold and long leasehold land and buildings would have been included as follows: | | | | |
| Cost | 1,652 | 1,900 | 1,009 | 1,087 |
| Accumulated depreciation | (275) | (267) | (139) | (119) |
| Net book value | 1,377 | 1,633 | 870 | 968 |

The group values its freehold and long leasehold properties on an annual basis. In September 2003, the group's freehold and long leasehold properties were revalued on an existing use basis or open market value as appropriate or, in the case of a few specialised properties, at depreciated replacement cost. The properties were revalued either by professional external valuers or by professionally qualified staff. The valuation has been updated for any material changes at 31 December 2003.

As a result of the revaluation, there was a deficit below the net book value of land and buildings of £59 million (bank: £52 million), of which £56 million, net of minority interests of £nil and deficits taken to the profit and loss account of £3 million, (bank: £ 49 million, net of deficits taken to the profit and loss account of £3 million) has been included in the revaluation reserve at 31 December 2003.

d Land and buildings occupied for own activities

| | <i>group</i> | | <i>bank</i> | |
|----------------|-------------------|------------|-------------------|------------|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Net book value | 1,586 | 1,642 | 925 | 936 |

Land and buildings with a net book value of £4 million (2002: £22 million) are occupied by HSBC Holdings plc and its subsidiaries other than the group.

Notes on the Accounts (continued)**22 Tangible fixed assets** (continued)**e Residual values of equipment on operating leases**

Included in the net book value of equipment on operating leases are residual values at the end of current lease terms, which will be recovered through re-letting or disposal in the following periods:

| | 2003 | 2002 |
|-----------------------|--------------|-------|
| | £m | £m |
| Within 1 year | 707 | 347 |
| Between 1 and 2 years | 68 | 687 |
| Between 2 and 5 years | 387 | 180 |
| Over 5 years | 652 | 443 |
| | 1,814 | 1,657 |

Residual value risk arises in relation to an operating lease transaction to the extent that the actual value of the leased asset at the end of the lease term (the residual value) recovered through disposing of or re-letting the asset at the end of the lease term, could be different to that projected at the inception of the lease. Residual value exposure is regularly monitored by the business through reviewing the recoverability of the residual value projected at lease inception. This entails considering the re-letability and projected disposal proceeds of operating lease assets at the end of their lease terms. Provision is made to the extent that the carrying values of leased assets are impaired through residual values not being fully recoverable.

23 Other assets

| | <i>group</i> | | <i>bank</i> | |
|--|---------------|--------|--------------|-------|
| | 2003 | 2002 | 2003 | 2002 |
| | £m | £m | £m | £m |
| Bullion | 8 | 5 | 1 | 1 |
| Assets, including gains, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked to market | 11,119 | 9,530 | 8,368 | 6,699 |
| Deferred taxation (Note 28a) | 98 | 55 | 88 | 167 |
| Long-term assurance assets attributable to policyholders (Note 27) | 3,714 | 3,263 | — | — |
| Other | 4,026 | 3,761 | 762 | 849 |
| | 18,965 | 16,614 | 9,219 | 7,716 |
| Assets, including gains, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked to market | | | | |
| Due from subsidiary undertakings | | | 1,429 | 738 |
| Due from fellow subsidiary undertakings | 1,171 | 1,212 | 1,014 | 1,142 |

23 Other assets (continued)

'Other' also includes the surplus retained in long-term assurance funds and the net present value of policies in force. These assets form part of the total value of the group's interest in long-term assurance business as follows:

| | 2003 | 2002 |
|--|-------------|------|
| | £m | £m |
| Net tangible assets of long-term assurance subsidiaries | 43 | 41 |
| Surplus retained in long-term assurance funds and net present value of policies in force | 659 | 559 |
| Total long-term assurance business attributable to shareholders | 702 | 600 |

The increase in the value of long-term assurance business attributable to shareholders which is included in the consolidated profit and loss account amounts to £53 million (2002: £84 million) before tax and £42 million (2002: £66 million) after tax.

The key assumptions used in determining the value of policies in force are:

| | 2003 | 2002 |
|--|-------------|------|
| | % | % |
| Risk discount rate (net of tax) | 8.0 | 10.0 |
| Economic assumptions (gross of tax) | | |
| Investment return on unit-linked funds | 6.6 | 6.8 |
| Investment return on non-linked funds | 4.5 | 5.0 |
| Expense inflation | 3.2 | 3.7 |

The group has changed the Risk discount rate used in the Embedded Value calculation from 10 per cent to 8 per cent to align the rate with expected market yields.

The composition of the net tangible assets relating to long-term assurance funds is analysed as follows:

| | 2003 | 2002 |
|--|--------------|-------|
| | £m | £m |
| Loans and advances to banks | 121 | 135 |
| Debt securities | 1,054 | 871 |
| Equity shares | 2,001 | 1,626 |
| Other assets | 578 | 694 |
| Prepayments and accrued income | 19 | 21 |
| Other liabilities | (59) | (84) |
| Long-term assurance net assets attributable to policyholders | 3,714 | 3,263 |

24 Deposits by banks

| | <i>group</i> | | <i>bank</i> | |
|---|---------------|--------|---------------|--------|
| | 2003 | 2002 | 2003 | 2002 |
| | £m | £m | £m | £m |
| Repayable on demand | 8,166 | 8,358 | 4,789 | 4,892 |
| With agreed maturity dates or periods of notice by remaining maturity | | | | |
| — 3 months or less but not repayable on demand | 16,750 | 12,901 | 15,061 | 13,123 |
| — 1 year or less but over 3 months | 2,180 | 2,317 | 1,803 | 941 |
| — 5 years or less but over 1 year | 1,386 | 387 | 356 | 273 |
| — over 5 years | 805 | 436 | 228 | 833 |
| | 29,287 | 24,399 | 22,237 | 20,062 |

Notes on the Accounts (continued)**24 Deposits by banks** (continued)

Amounts include:

| | | | | |
|---------------------------------------|--------------|-------|--------------|-------|
| Due to subsidiary undertakings | | | 7,984 | 8,022 |
| Due to fellow subsidiary undertakings | 2,960 | 3,042 | 1,778 | 643 |

25 Customer accounts

| | <i>group</i> | | <i>bank</i> | |
|---|----------------|---------|---------------|--------|
| | 2003 | 2002 | 2003 | 2002 |
| | £m | £m | £m | £m |
| Repayable on demand | 89,603 | 77,813 | 65,763 | 55,287 |
| With agreed maturity dates or periods of notice by remaining maturity | | | | |
| — 3 months or less but not repayable on demand | 49,454 | 45,972 | 24,884 | 21,128 |
| — 1 year or less but over 3 months | 3,651 | 3,750 | 1,849 | 1,366 |
| — 5 years or less but over 1 year | 2,938 | 2,608 | 1,375 | 1,565 |
| — over 5 years | 457 | 692 | 351 | 424 |
| | 146,103 | 130,835 | 94,222 | 79,770 |
| Amounts include: | | | | |
| Due to joint ventures | 246 | 261 | 232 | 248 |
| Due to associates | 3 | 3 | 3 | 3 |
| Due to subsidiary undertakings | | | 3,177 | 1,329 |
| Due to fellow subsidiary undertakings | 1,276 | 86 | 878 | 826 |
| Due to parent undertaking | 2,612 | 2,593 | 1,708 | 1,344 |

26 Debt securities in issue

| | <i>group</i> | | <i>bank</i> | |
|---|--------------|-------|--------------|-------|
| | 2003 | 2002 | 2003 | 2002 |
| | £m | £m | £m | £m |
| Bonds and medium-term notes, by remaining maturity | | | | |
| — within 1 year | 961 | 1,414 | 91 | 796 |
| — between 1 and 2 years | 673 | 508 | 613 | 5 |
| — between 2 and 5 years | 710 | 1,657 | 228 | 847 |
| — over 5 years | 588 | 199 | 39 | 20 |
| | 2,932 | 3,778 | 971 | 1,668 |
| Other debt securities in issue, by remaining maturity | | | | |
| — 3 months or less | 6,251 | 3,833 | 1,769 | 1,202 |
| — 1 year or less but over 3 months | 355 | 390 | 190 | 1 |
| — 5 years or less but over 1 year | 216 | 295 | — | 2 |
| — over 5 years | 15 | 47 | — | — |
| | 6,837 | 4,565 | 1,959 | 1,205 |
| | 9,769 | 8,343 | 2,930 | 2,873 |

27 Other liabilities

| | <i>group</i> | | <i>bank</i> | |
|--|---------------|------------|---------------|------------|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Short positions in securities: | | | | |
| Debt securities | | | | |
| — government securities | 7,735 | 5,769 | 4,420 | 3,368 |
| — other debt securities | 1,410 | 1,157 | 789 | 834 |
| Equity shares | 794 | 905 | 765 | 844 |
| | 9,939 | 7,831 | 5,974 | 5,046 |
| Liabilities, including losses, resulting from off-balance-sheet interest rate, exchange rate and equities contracts that are marked to market | 11,273 | 10,723 | 8,495 | 7,463 |
| Current taxation | 513 | 567 | 283 | 343 |
| Obligations under finance leases | 296 | 167 | — | — |
| Dividend payable | 706 | 507 | 706 | 507 |
| Long-term assurance liabilities attributable to policyholders (Note 23) | 3,714 | 3,263 | — | — |
| Other liabilities | 3,727 | 3,731 | 1,066 | 1,245 |
| | 30,168 | 26,789 | 16,524 | 14,604 |
| Liabilities, including losses, resulting from off-balance-sheet interest rate, exchange rate and equities contracts that are marked to market include amounts: | | | | |
| Due to subsidiary undertakings | | | 1,015 | 336 |
| Due to fellow subsidiary undertakings | 1,585 | 1,437 | 1,569 | 1,291 |
| Obligations under finance leases fall due as follows | | | | |
| — within 1 year | — | — | — | — |
| — between 1 and 5 years | — | — | — | — |
| — over 5 years | 635 | 367 | — | — |
| | 635 | 367 | — | — |
| — less future finance charges | (339) | (200) | — | — |
| | 296 | 167 | — | — |
| | | | | |
| | <i>group</i> | | <i>bank</i> | |
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Short positions in debt securities are in respect of securities | | | | |
| — due within 1 year | 411 | 683 | 353 | 347 |
| — due 1 year and over | 8,734 | 6,243 | 4,856 | 3,855 |
| | 9,145 | 6,926 | 5,209 | 4,202 |
| — listed | 7,403 | 2,670 | 3,784 | 2,667 |
| — unlisted | 1,742 | 4,256 | 1,425 | 1,535 |
| | 9,145 | 6,926 | 5,209 | 4,202 |

Notes on the Accounts (continued)**28 Provisions for liabilities and charges****a** *Deferred taxation*

| | <i>group</i> | <i>bank</i> |
|--|--------------|--------------|
| | £m | £m |
| At 1 January 2003 | 533 | (107) |
| Charge to the profit and loss account (Note 7) | 79 | 27 |
| Exchange and other movements | (17) | (5) |
| At 31 December 2003 | 595 | (85) |

| | <i>group</i> | | <i>bank</i> | |
|--|--------------|------|-------------|-------|
| | 2003 | 2002 | 2003 | 2002 |
| | £m | £m | £m | £m |
| Included in 'Provisions for liabilities and charges' | 693 | 588 | 3 | 60 |
| Included in 'Other assets' (Note 23) | (98) | (55) | (88) | (167) |
| | 595 | 533 | (85) | (107) |

| | <i>group</i> | | <i>bank</i> | |
|---------------------------------------|--------------|-------|-------------|-------|
| | 2003 | 2002 | 2003 | 2002 |
| | £m | £m | £m | £m |
| Short-term timing differences | (66) | (64) | (32) | (68) |
| Accelerated capital allowances | 70 | 85 | 71 | 86 |
| Leasing transactions | 772 | 678 | — | — |
| Provisions for bad and doubtful debts | (172) | (164) | (86) | (109) |
| Relief for tax losses | (10) | (17) | — | — |
| Other items | 1 | 15 | (38) | (16) |
| | 595 | 533 | (85) | (107) |

There is no material deferred taxation liability not provided for.

At 31 December 2003, there were potential future tax benefits of approximately £110 million (2002: £119 million) in respect of capital losses that have not been recognised because recoverability of the potential benefits is not considered likely.

No provision has been made for deferred taxation on gains recognised on revaluing property to its market value or on the sale of properties where potentially taxable gains will be covered by available tax losses.

28 Provisions for liabilities and charges (continued)

b Other provisions for liabilities and charges

| | <i>Provisions for pensions and other post-retirement obligations</i> | <i>Provisions for contingent liabilities and commitments</i> | <i>Premises- related provisions</i> | <i>Insurance and other provisions</i> | <i>Total</i> |
|--|--|--|---|---|--------------|
| | £m | £m | £m | £m | £m |
| group | | | | | |
| At 1 January 2003 | 339 | 178 | 117 | 403 | 1,037 |
| Additional provisions/increase in provisions | 15 | 95 | 51 | 171 | 332 |
| Provisions released | — | (50) | (9) | (32) | (91) |
| Provisions utilised | (18) | (23) | (89) | (62) | (192) |
| Exchange and other movements | 28 | — | 44 | (7) | 65 |
| At 31 December 2003 | 364 | 200 | 114 | 473 | 1,151 |
| bank | | | | | |
| At 1 January 2003 | 113 | 38 | 110 | 52 | 313 |
| Additional provisions/increase in provisions | 2 | 23 | 47 | 2 | 74 |
| Provisions released | — | (8) | (9) | (1) | (18) |
| Provisions utilised | (6) | (17) | (88) | (2) | (113) |
| Exchange and other movements | 10 | — | 46 | (42) | 14 |
| At 31 December 2003 | 119 | 36 | 106 | 9 | 270 |

Included within 'Provisions for contingent liabilities and commitments' are provisions:

- for the costs of possible redress relating to the sales of certain personal pension plans and endowments of £9 million (2002: £19 million); and
- against possible payments to be made under guarantee contracts of £56 million.

The personal pension provision is the result of an actuarial calculation extrapolated from a sample of cases and the timing of the expenditure depends on settlement of the individual claims.

The 'Premises-related provisions' relate to discounted future costs associated with vacant and sub-let short leasehold properties, including those that have or will become vacant as a consequence of the move of the group's head office and most of its London-based operations to Canary Wharf in 2002, and to discounted future costs to make good dilapidations upon the expiry of leases. The provisions cover rent voids while finding new tenants, shortfalls in expected rent receivable compared to rent payable and costs of refurbishing the building to attract tenants or make good dilapidations. Uncertainties relate to movements in market rents, the delay in finding new tenants, timing of rental reviews and the estimation of costs of refurbishment.

Included within 'Insurance and other provisions' are provisions of £415 million (2002: £271 million) relating to the general insurance business.

Notes on the Accounts (continued)**29 Subordinated liabilities**

| | 2003 £m | 2002 £m |
|---|--------------|--------------|
| Undated subordinated loan capital | | |
| — bank | 1,168 | 1,262 |
| — subsidiary undertakings | 100 | 112 |
| | 1,268 | 1,374 |
| Dated subordinated loan capital | | |
| — bank | 3,570 | 2,396 |
| — subsidiary undertakings | 421 | 460 |
| | 3,991 | 2,856 |
| Total subordinated liabilities | | |
| — bank | 4,738 | 3,658 |
| — subsidiary undertakings | 521 | 572 |
| | 5,259 | 4,230 |
| Dated subordinated loan capital is repayable | | |
| — within 1 year | 306 | 73 |
| — between 1 and 2 years | 278 | 328 |
| — between 2 and 5 years | 591 | 795 |
| — over 5 years | 2,816 | 1,660 |
| | 3,991 | 2,856 |
| Undated subordinated loan capital | | |
| | 2003 | 2002 |
| | £m | £m |
| bank | | |
| US\$750 million Undated Floating Rate Primary Capital Notes | 420 | 466 |
| US\$500 million Undated Floating Rate Primary Capital Notes | 280 | 310 |
| US\$300 million Undated Floating Rate Primary Capital Notes (Series 3) | 168 | 186 |
| £150 million 9.25% Step-up Undated Subordinated Notes | 150 | 150 |
| £150 million 8.625% Step-up Undated Subordinated Notes | 150 | 150 |
| | 1,168 | 1,262 |
| subsidiary undertakings | | |
| ¥10,000 million Undated Subordinated Variable Rate Medium Term Notes | 52 | 52 |
| Other undated subordinated liabilities individually less than £50 million | 48 | 60 |
| | 100 | 112 |

The undated subordinated loan capital of the bank has characteristics which render it similar in certain circumstances to preference shares. These borrowings are unsecured obligations of the bank. Claims in respect of principal and interest are subordinated to the claims of all creditors of the bank, other than claims of any creditors in respect of subordinated indebtedness ranking *pari passu* or junior to claims in respect of undated subordinated loan capital.

29 Subordinated liabilities (continued)

Dated subordinated loan capital

| | | 2003 | 2002 |
|---|--|--------------|--------------|
| | | £m | £m |
| bank | | | |
| US\$400 million | 8.625% Subordinated Notes 2004 | 223 | 248 |
| £200 million | 9% Subordinated Notes 2005 | 200 | 200 |
| US\$500 million | 7.625% Subordinated Notes 2006 | 280 | 310 |
| US\$375 million | Subordinated Step-up Coupon Floating Rate Notes 2009 | 209 | 232 |
| US\$300 million | 6.95% Subordinated Notes 2011 | 168 | 186 |
| €600 million | 4.25% Callable Subordinated Notes 2016 | 424 | — |
| £350 million | Callable Subordinated Variable Coupon Notes 2017 | 350 | 350 |
| £350 million | 5% Callable Subordinated Notes 2023 | 350 | — |
| £300 million | 6.5% Subordinated Notes 2023 | 298 | 298 |
| US\$300 million | 7.65% Subordinated Notes 2025 | 168 | 186 |
| £500 million | 5.375% Subordinated Notes 2033 | 500 | — |
| £225 million | 6.25% Subordinated Notes 2041 | 223 | 223 |
| | | 3,393 | 2,233 |
| Amounts owed to parent undertaking | | | |
| €250 million | Floating Rate Subordinated Loan 2015 | 177 | 163 |
| | | 3,570 | 2,396 |
| Amounts owed to subsidiary undertakings | | | |
| €1,000 million | Floating Rate Subordinated Loan 2012 | 707 | 651 |
| €900 million | 7.75% Non-cumulative Subordinated Notes 2040 | 635 | 586 |
| £700 million | 5.844% Fixed / Floating Rate Subordinated Note 2048 | 700 | — |
| | | 5,612 | 3,633 |
| subsidiary undertakings | | | |
| US\$81 million | Subordinated Floating Rate Notes 2005 | 45 | 50 |
| €152 million | Subordinated Callable Floating Rate Notes 2008 | 107 | 99 |
| Other dated subordinated liabilities individually less than £50 million | | 269 | 311 |
| | | 421 | 460 |

The dated subordinated loan capital of the bank represents unsecured obligations of the bank. Claims in respect of principal and interest are subordinated to the claims of all creditors of the bank, other than claims of any creditors in respect of subordinated indebtedness ranking *pari passu* or junior to claims in respect of dated subordinated loan capital.

Interest rates on floating rate subordinated loan capital are related to interbank offered rates. On the remaining subordinated loan capital, interest is payable at fixed rates up to 9.25 per cent.

Generally, subordinated loan capital is repayable at par on maturity, but some is repayable prior to maturity at the option of the borrower, subject to the prior consent of the Financial Services Authority. The US\$300 million 7.65% Subordinated Notes 2025 are repayable in May 2007 at par at the option of the holders.

Notes on the Accounts (continued)

29 Subordinated liabilities (continued)

The interest rate on the 9.25% Step-up Undated Subordinated Notes changes in December 2006 to become, for each successive five-year period, the rate per annum which is the sum of the yield on the then five-year benchmark UK gilt plus 2.15 per cent. The interest rate on the 8.625% Step-up Undated Subordinated Notes changes in December 2007 to become, for each successive five-year period, the rate per annum which is the sum of the yield on the then five-year benchmark UK gilt plus 1.87 per cent. In both cases, the issues are then repayable at the option of the borrower, subject to the prior consent of the Financial Services Authority.

The interest rates on the Subordinated Step-up Coupon Floating Rate Notes 2009 and the Floating Rate Subordinated Loan 2015 increase by 0.50 per cent five years prior to their maturity dates. In both cases, the issues are then repayable at the option of the borrower, subject to the prior consent of the Financial Services Authority.

The interest rates on the Callable Subordinated Variable Coupon Notes 2017 and the 5% Callable Subordinated Notes 2023 change five years prior to their maturity date to become the rate per annum which is the sum of the yield on the then five-year benchmark UK gilt plus 1.70 per cent and 1.80 per cent respectively. The issues are then repayable at the option of the borrower, subject to the prior consent of the Financial Services Authority.

The interest rate on the 4.25% Callable Subordinated Notes 2016 changes to a floating rate plus a margin of 1.05 per cent five years prior to its maturity date. The issue is then repayable at the option of the borrower, subject to the prior consent of the Financial Services Authority.

30 Minority interests — non-equity

| | | 2003 | 2002 |
|----------------|--|--------------|--------------|
| | | £m | £m |
| €900 million | First capital contribution | 635 | 586 |
| €1,000 million | Second capital contribution | 707 | 651 |
| £700 million | 5.844% Non-Cumulative Step-up Perpetual Preferred Securities | 700 | — |
| | | 2,042 | 1,237 |

Capital Contributions

HSBC Capital Funding 1 (UK) Limited Partnership was established by a subsidiary undertaking of the bank as General Partner, and a fellow subsidiary undertaking of HSBC Holdings plc, as Limited Partner.

The Limited Partner's first capital contribution of €900 million qualifies as innovative tier 1 capital for both the bank and the group on a consolidated basis. The proceeds of the first capital contribution were on-lent by the Limited Partnership to the bank's Paris branch by issue of 7.75% Non-cumulative Subordinated Notes 2040 (the 'Notes'). The Notes may be redeemed at the option of the bank's Paris branch on the interest payment date in October 2010, or any interest payment date thereafter, subject to the prior consent of the Financial Services Authority.

The Limited Partner made a second capital contribution to the Limited Partnership of €1,000 million by way of assignment to the Limited Partnership of a €1,000 million Floating Rate Subordinated Loan 2012 (the 'Loan') made by the Limited Partner to the bank's Paris branch. The Limited Partner's second capital contribution qualifies as tier 2 capital for both the bank and the group on a consolidated basis. The interest rate on the Loan is related to interbank offered rates and increases by 0.50 per cent from the interest payment date in October 2007. The Loan is repayable at par on maturity, and also at the option of the bank's Paris branch on the interest payment date in October 2007, or any interest payment date thereafter, subject to the prior consent of the Financial Services Authority.

The Limited Partner's profit share for each distribution period is calculated as i) the lower of a) the amount of interest received by the Limited Partnership in respect of the Loan and b) the profit of the Limited Partnership available for that distribution period, and ii) the lower of a) €69,750,000 and b) the profit of the Limited Partnership available for that distribution period less amounts paid under i).

30 Minority interests — non-equity (continued)

There are limitations on the payment of the Limited Partner's profit share if the bank is prohibited under UK banking regulations or other requirements from paying distributions on its Parity Obligations, or if the bank has insufficient distributable reserves.

The Limited Partnership will be dissolved only upon the occurrence of i) the redemption of the Notes, provided certain redemption conditions are satisfied, or ii) the passing of a resolution for the winding-up of the bank. In the event of a dissolution of the Limited Partnership, before any substitution event (see below), the Limited Partner shall be entitled to receive a) the Limited Partner's share of the Loan (if any) and b) the liquidating distribution to which the Limited Partner is entitled in respect of its €900 million capital contribution, which amount shall not exceed the amount per security that would have been paid as the liquidating distribution from the assets of the bank had the Limited Partner's interest in the Limited Partnership been substituted by the Substitute Securities (see below).

If i) the total capital ratio of the bank or the group on a consolidated basis has fallen below the regulatory minimum ratio required, or ii) in view of the bank's deteriorating financial condition, the bank's Board of Directors expect i) to occur in the near term, then the Limited Partner's interest in the Limited Partnership, in respect of its first €900 million capital contribution, shall be substituted with fully paid ordinary shares issued by the bank ('Substitute Securities') and, as to the remainder, with an appropriate portion of the Loan.

Step-up Perpetual Preferred Securities

The £700 million 5.844% Non-cumulative Step-up Perpetual Preferred Securities (the 'Preferred Securities') were issued by HSBC Bank Capital Funding (Sterling 1) L.P., a Jersey limited partnership, and are guaranteed, on a subordinated basis, by the bank. The proceeds of the issue were on-lent to the bank by the limited partnership by issue of a 5.844% fixed/floating subordinated note. The Preferred Securities qualify as innovative tier 1 capital for the bank and the group on a consolidated basis. The Preferred Securities, together with the guarantee, are intended to provide investors with rights to income and capital distributions and distributions upon liquidation of the bank that are equivalent to the rights they would have had if they had purchased non-cumulative perpetual preference shares of the bank.

The Preferred Securities are perpetual, but redeemable in November 2031 or on each distribution date thereafter at the option of the General Partner of the Limited Partnership. If not redeemed the distributions payable step-up and change to a floating rate plus a margin of 1.76%. There are limitations on the payment of distributions if the bank is prohibited under UK banking regulations or other requirements, if a payment would cause a breach of the bank's capital adequacy requirements, or if the bank has insufficient distributable reserves (as defined in the Limited Partnership Agreement).

The bank has covenanted that if it has been prevented under certain circumstances from paying distributions on the Preferred Securities in full, it will not pay dividends or other distributions in respect of its ordinary shares, or effect repurchase or redemption of its ordinary shares, until after a distribution has been paid in full.

If i) any Preferred Securities are outstanding in November 2048, or ii) the total capital ratio of the bank and the group on a consolidated basis falls below the regulatory minimum ratio required, or iii) in view of the deteriorating financial condition of the bank, the Directors expect (ii) to occur in the near term, then the Preferred Securities will be substituted by Preference Shares of the bank having economic terms which are in all material respects equivalent to those of the Preferred Securities and the guarantee taken together.

Notes on the Accounts (continued)**31 Called up share capital**

| | <i>Non-cumulative preference shares of £1 each</i> | <i>Non-cumulative preference shares of US\$0.01 each</i> | <i>Ordinary shares of £1 each</i> | <i>Total</i> |
|--|--|--|-----------------------------------|--------------|
| | £m | £m | £m | £m |
| At 31 December 2002 and 2003 | | | | |
| Authorised share capital | 150 | 1 | 1,000 | 1,151 |
| Allotted, called up and fully paid share capital | — | — | 797 | 797 |

The issued, allotted and fully paid share capital of the bank comprises 796,969,095 ordinary shares of nominal value £1 each; 35,000,000 Third US\$ non-cumulative preference shares of nominal value US\$0.01 each; and one preferred ordinary share of nominal value £1.

Third preference shares are redeemable at the option of the bank, at any time after 5 years and 1 day from date of issue, at a redemption price of US\$25 per share. Dividends on Third preference shares are payable annually on 31 October at a rate of 7.5 per cent per annum.

In the event of a winding-up, Third preference shareholders would receive, in priority to the ordinary shareholders of the bank, repayment of US\$25 per share, plus an amount equal to any dividends declared but unpaid in respect of the previous dividend for the period and any accrued and unpaid dividends for the period to the date of the commencement of winding-up. With the exception of the above, the preference shares do not carry any right to participate in any surplus of assets on a winding-up.

Holder of Third preference shares are not entitled to vote at general meetings of the shareholders, except in certain limited circumstances, such as the variation of the rights attaching to those shares, or in the event of a reduction of the preference share capital. In addition, Third preference shareholders are entitled to vote at general meetings of the shareholders if any resolution is proposed for a winding-up or sale of the whole business of the bank, or in the event of a failure to pay in full the dividend payable on the Third preference shares for the most recent dividend period.

32 Reserves

| | <i>group</i> | <i>bank</i> | <i>Joint ventures and associates</i> |
|---|---------------|---------------|--|
| | £m | £m | £m |
| Share premium account | | | |
| At 1 January 2003 | 12,208 | 12,208 | |
| Exchange movements | (51) | (51) | |
| At 31 December 2003 | 12,157 | 12,157 | |
| Revaluation reserves | | | |
| At 1 January 2003 | 121 | 685 | |
| Realisation on disposal of properties | (1) | — | |
| Unrealised deficit on revaluation of freehold and long leasehold properties | (56) | (49) | |
| Net increase in attributable net assets of subsidiaries and associates | — | 485 | |
| Exchange and other movements | 5 | (6) | |
| At 31 December 2003 | 69 | 1,115 | |
| Profit and loss account | | | |
| At 1 January 2003 | 3,329 | 2,765 | 8 |
| Retained profit for the year | 40 | 210 | 20 |
| Realisation on disposal of properties | 1 | — | — |
| Realisation on disposal of subsidiary and associates | — | — | — |
| Exchange and other movements | 671 | 20 | (4) |
| At 31 December 2003 | 4,041 | 2,995 | 24 |

Cumulative goodwill amounting to £84 million (2002: £84 million) has been charged against reserves in respect of acquisitions prior to 1 January 1998.

The reserves of the bank include distributable reserves of £2,980 million (2002: £2,750 million).

Some of the group's banking subsidiary undertakings operate under local regulatory jurisdictions which could potentially restrict the amount of reserves that can be remitted to the bank in order to maintain local regulatory capital ratios.

Advantage has been taken of the exemptions applicable to Inland Revenue approved SAYE share option schemes and equivalent overseas schemes under Urgent Issues Task Force Abstract 17 (revised 2003) 'Employee share schemes'.

Notes on the Accounts (continued)**33 Analysis of total assets and total liabilities****a** *Assets subject to sale and repurchase transactions*

| | <i>group</i> | | <i>bank</i> | |
|--|--------------------------|------------|--------------------------|------------|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Total assets subject to sale and repurchase transactions | 5,179 | 4,254 | 878 | 1,464 |

b *Assets leased to customers*

Amounts relating to assets leased to customers are included under the following balance sheet headings:

| | 2003 £m | 2002 £m |
|---------------------------------|--------------------------|------------|
| Loans and advances to customers | | |
| — finance leases | 2,719 | 2,525 |
| — hire purchase contracts | 1,010 | 984 |
| Tangible fixed assets | | |
| — equipment on operating leases | 2,255 | 2,026 |
| | 5,984 | 5,535 |

The cost of assets acquired during 2003 for letting under finance leases and hire purchase contracts by the group amounted to £410 million (2002: £466 million) and £449 million (2002: £475 million), respectively.

c *Assets charged as security for liabilities*

Assets have been pledged as security for liabilities included under the following headings:

| | <i>group</i> | | <i>bank</i> | |
|--------------------------|--------------------------|------------|--------------------------|------------|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Deposits by banks | 355 | 910 | 336 | 892 |
| Customer accounts | 932 | 1,396 | 932 | 1,395 |
| Debt securities in issue | 107 | 158 | 107 | 111 |
| Other liabilities | 480 | 695 | 347 | 503 |
| | 1,874 | 3,159 | 1,722 | 2,901 |

The total assets pledged to secure the above liabilities are as follows:

| | <i>group</i> | | <i>bank</i> | |
|--------------------------------------|--------------------------|------------|--------------------------|------------|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Assets pledged to secure liabilities | 12,441 | 11,320 | 11,488 | 10,431 |

The above amounts are mainly made up of items included in 'Debt securities' of £11,478 million (2002: £9,675 million) for the group and £10,551 million (2002: £8,859 million) for the bank.

34 Risk management

All of the group's activities involve analysis, evaluation and management of some degree of risk or combination of risks. The most important types of risk are market risk (which includes foreign exchange, interest rate, equity and commodity price risks), liquidity risk, operational risk and credit risk (which includes cross-border risk).

a *Market Risk Management*

Market risk is the risk that interest rates, credit spreads, foreign exchange rates or equity and commodity prices will move and result in profits or losses to the group. Market risk arises on financial instruments which are valued at current market prices (mark-to-market basis) and those valued at cost plus any accrued interest (accruals basis). The main valuation sources are securities prices, foreign exchange rates, and interest rate yield curves and volatilities.

The group makes markets in interest rate, exchange rate and equity derivative instruments, as well as in debt, equities and other securities. Trading risks arise either from customer-related business or from position taking. Trading positions are valued on a mark-to-market basis.

The group manages market risk through risk limits approved by the HSBC Bank Executive Committee. Traded Markets Development and Risks, an independent unit within the Corporate, Investment Banking and Markets operation, develops risk management policies and measurement techniques and reviews limit utilisation on a daily basis.

Risk limits are determined for each location and, within location, for each portfolio. Limits are set by product and risk type, with market liquidity being a principal factor in determining the level of limits set. Only those offices which management deem to have sufficient derivative product expertise and appropriate control systems are authorised to trade derivative products. Limits are set using a combination of risk measurement techniques, including position limits, sensitivity limits, as well as value at risk limits at a portfolio level. Similarly, option risks are controlled through full revaluation limits in conjunction with limits on the underlying variables that determine each option's value.

i *Trading Value at Risk (VAR)*

VAR is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. The group's VAR, predominantly calculated on a variance/co-variance basis, uses historical movements in market rates and prices, a 99 per cent confidence level, a 10-day holding period, generally takes account of correlations between different markets and rates, and is calculated daily. The movement in market prices is calculated by reference to market data from the last two years. Aggregation of VAR from different risk types is based upon the assumption of independence between risk types.

The group VAR should be viewed in the context of the limitations of the methodology used. These include:

- The model assumes that changes in risk factors follow a normal distribution. This may not be the case in reality and the probability of extreme market movements may be underestimated.
- The use of a 10-day holding period assumes that all positions can be liquidated or hedged in 10 days. This does not fully reflect the market risk arising from times of severe illiquidity, when a 10-day period may be insufficient to liquidate or hedge all positions fully.
- The use of a 99 per cent confidence level does not take account of any losses that might occur beyond this level of confidence.
- The use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature.
- The assumption of independence between risk types may not be accurate and VAR may not fully capture market risk where variables exhibit correlation.

Notes on the Accounts (continued)**34 Risk management** (continued)**a Market Risk Management** (continued)**i Trading Value at Risk (VAR)** (continued)

- VAR is calculated at the close of business with intra-day exposures not being subject to intra-day VAR calculations on a group basis.
- VAR does not necessarily capture all of the higher-order market risks and may underestimate real market risk exposure.

The group recognises these limitations by augmenting the VAR limits with other position and sensitivity limit structures, as well as with stress testing both on individual portfolios and on a consolidated basis. The group's stress testing regime provides senior management with an assessment of the impact of extreme events on the market risk exposures of the group.

Trading VAR for 2003 is set out below:

| | <i>At 31 December 2003</i> | <i>Minimum during the year</i> | <i>Maximum during the year</i> | <i>Average for the year</i> |
|------------------------------------|------------------------------------|--|--|-------------------------------------|
| | £m | £m | £m | £m |
| Total trading activities | 26.5 | 20.3 | 44.4 | 28.1 |
| Foreign exchange trading positions | 4.9 | 2.9 | 14.2 | 6.3 |
| Interest rate trading positions | 22.6 | 14.3 | 42.8 | 24.5 |
| Equities trading positions | 7.4 | 3.7 | 12.1 | 6.6 |

Trading VAR for 2002 is set out below:

| | <i>At 31 December 2002</i> | <i>Minimum during the year</i> | <i>Maximum during the year</i> | <i>Average for the year</i> |
|------------------------------------|------------------------------------|--|--|-------------------------------------|
| | £m | £m | £m | £m |
| Total trading activities | 25.5 | 17.0 | 41.9 | 28.1 |
| Foreign exchange trading positions | 7.0 | 3.5 | 22.4 | 9.9 |
| Interest rate trading positions | 22.9 | 15.9 | 36.4 | 22.7 |
| Equities trading positions | 3.8 | 0.8 | 5.3 | 2.1 |

The VAR noted for foreign exchange positions excludes structural foreign currency exposures, since related gains or losses are taken through reserves.

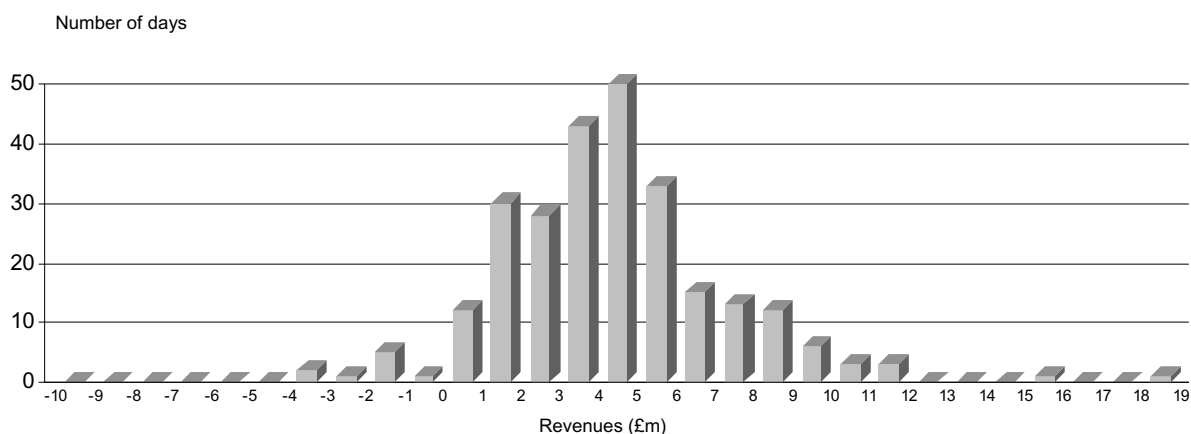
The group's equities exposure arises from equities and equity derivatives transactions.

34 Risk management (continued)

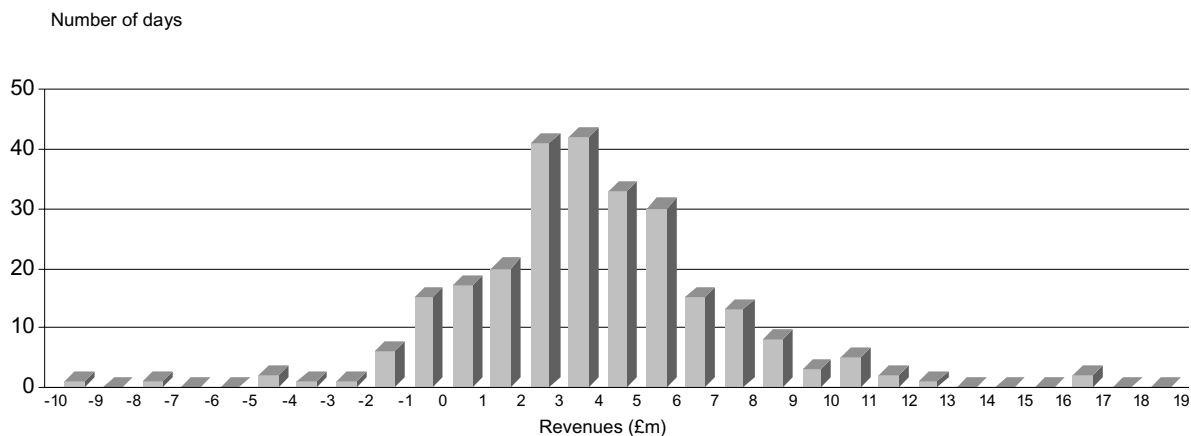
a Market Risk Management (continued)

i Trading Value at Risk (VAR) (continued)

Daily distribution of market risk revenues 2003



Daily distribution of market risk revenues 2002



The average daily revenue earned from market-risk-related treasury activities in 2003, including accrual book net interest income and funding related to dealing positions, was £4.3 million, (2002: £3.7 million). The standard deviation of this daily revenue was £2.9 million (2002: £3.3 million). An analysis of the frequency distribution of daily revenues shows that negative revenues were reported on only 9 days during 2003. The most frequent result was a daily revenue of between £4 million and £5 million, with 50 occurrences. The highest daily revenue was £18.6 million (2002: £16.7 million).

Foreign exchange exposure

The group's foreign exchange exposure comprises trading exposures and structural foreign currency translation exposure.

Notes on the Accounts (continued)

34 Risk management (continued)

a Market Risk Management (continued)

i Trading Value at Risk (VAR) (continued)

Trading value at risk

The foreign exchange exposures comprise those which arise from foreign exchange dealing within the group's treasury centres and currency exposures originated within the group's commercial banking businesses. The latter exposures are transferred to local treasury units where they are managed together with exposures which result from dealing within approved limits. VAR on foreign exchange trading positions is shown in the table on page 78.

ii Interest rate exposure

The group's interest rate exposures comprise those originating in its treasury trading activities and structural interest rate exposures; both are managed under limits described above. Interest rate risk arises on both trading positions and accrual books. The interest rate risk on interest rate trading positions is set out in the trading VAR table on page 78.

Structural interest rate risk

Structural interest rate risk arises from the differing repricing characteristics of commercial banking assets and liabilities, including non-interest-bearing liabilities such as shareholders' funds and some current accounts. The bank and each major subsidiary undertaking assess the structural interest rate risks which arise in their businesses and either transfer such risks to their local treasury unit for management or transfer the risks to separate books managed by their local Asset and Liability Management Committee (ALCO). ALCOs regularly monitor all such interest rate risk positions, subject to interest rate risk limits agreed with HSBC Holdings plc. In the course of managing interest rate risk, quantitative techniques and simulation models are used where appropriate to identify the potential net interest income and market value effects of these interest rate positions in different interest scenarios. The primary objective of such interest rate risk management is to limit potential adverse effects of interest rate movements on net interest income.

In accordance with FRS 13, 'Derivatives and Other Financial Instruments: Disclosures', the table below discloses the mismatching of the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rate on a contractual basis, or, if earlier, the dates on which the instruments mature. Actual reset dates may differ from contractual dates owing to prepayments and the exercise of options. In addition, contractual terms may not be representative of the behaviour of assets and liabilities. For these reasons, the group manages its interest rate risk on a different basis from that presented below, taking into account behavioural characteristics of the relevant assets and liabilities.

A positive interest rate sensitivity gap exists where more assets than liabilities re-price during a given period. Although a positive gap position tends to benefit net interest income in a rising interest rate environment, the actual effect will depend on a number of factors, including the extent to which repayments are made earlier or later than the contracted date and variations in interest rates within re-pricing periods and among currencies. Similarly, a negative interest rate sensitivity gap exists where more liabilities than assets re-price during a given period. In this case, a negative gap position tends to benefit net interest income in a declining interest rate environment, but again the actual effect will depend on the same factors as for positive interest rate gaps, as described above.

34 Risk management (continued)

a Market Risk Management (continued)

ii Interest rate sensitivity gap table

| | <i>Not more than three months</i> | <i>More than three months but not more than six months</i> | <i>More than six months but not more than one year</i> | <i>More than one year but not more than five years</i> | <i>More than five years</i> | <i>Non-interest bearing</i> | <i>Banking Book Total</i> | <i>Trading book</i> | <i>Total</i> |
|---|-----------------------------------|--|--|--|-----------------------------|-----------------------------|---------------------------|---------------------|------------------|
| | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| 2003 | | | | | | | | | |
| Assets | | | | | | | | | |
| Treasury bills and other eligible bills | 1,562 | 181 | 47 | 208 | — | — | 1,998 | 199 | 2,197 |
| Loans and advances to banks | 20,061 | 939 | 663 | 163 | 157 | 571 | 22,554 | 11,088 | 33,642 |
| Loans and advances to customers | 76,178 | 4,025 | 4,318 | 14,127 | 5,764 | 1,893 | 106,305 | 9,993 | 116,298 |
| Debt securities and equity shares | 6,785 | 777 | 1,085 | 9,438 | 4,106 | 1,737 | 23,928 | 31,465 | 55,393 |
| Other assets | 644 | — | — | — | — | 26,322 | 26,966 | 11,608 | 38,574 |
| Total assets | 105,230 | 5,922 | 6,113 | 23,936 | 10,027 | 30,523 | 181,751 | 64,353 | 246,104 |
| Liabilities | | | | | | | | | |
| Deposits by banks | (17,873) | (1,450) | (398) | (1,295) | (613) | (1,954) | (23,583) | (5,704) | (29,287) |
| Customer accounts | (120,363) | (1,784) | (824) | (1,530) | (421) | (13,438) | (138,360) | (7,743) | (146,103) |
| Debt securities in issue | (5,179) | (675) | (172) | (2,473) | (584) | (4) | (9,087) | (682) | (9,769) |
| Other liabilities | (133) | — | — | (144) | (19) | (14,610) | (14,906) | (21,323) | (36,229) |
| Loan capital and other subordinated liabilities | (887) | (630) | (332) | (552) | (2,858) | — | (5,259) | — | (5,259) |
| Minority interests and shareholders' funds | — | — | — | — | — | (19,457) | (19,457) | — | (19,457) |
| Internal funding of the trading book | 27,515 | 1,050 | 129 | 342 | (2) | (133) | 28,901 | (28,901) | — |
| Total liabilities | (116,920) | (3,489) | (1,597) | (5,652) | (4,497) | (49,596) | (181,751) | (64,353) | (246,104) |
| Net on-balance-sheet items | (11,690) | 2,433 | 4,516 | 18,284 | 5,530 | (19,073) | — | — | — |
| Off-balance-sheet items | (17,449) | 1,772 | 4,309 | 12,601 | (1,233) | — | — | — | — |
| Interest rate sensitivity gap | (29,139) | 4,205 | 8,825 | 30,885 | 4,297 | (19,073) | — | — | — |
| Cumulative interest rate sensitivity gap | (29,139) | (24,934) | (16,109) | 14,776 | 19,073 | — | — | — | — |

Notes on the Accounts (continued)**34 Risk management** (continued)**a Market Risk Management** (continued)*ii Interest rate sensitivity gap table* (continued)

| | <i>Not more than three months</i> | <i>More than three months but not more than six months</i> | <i>More than six months but not more than one year</i> | <i>More than one year but not more than five years</i> | <i>More than five years</i> | <i>Non-interest bearing</i> | <i>Banking Book Total</i> | <i>Trading book</i> | <i>Total</i> |
|---|-----------------------------------|--|--|--|-----------------------------|-----------------------------|---------------------------|---------------------|------------------|
| 2002 | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| Assets | | | | | | | | | |
| Treasury bills and other eligible bills | 1,257 | 93 | 60 | 168 | — | — | 1,578 | 469 | 2,047 |
| Loans and advances to banks | 16,037 | 960 | 956 | 202 | 157 | 326 | 18,638 | 7,989 | 26,627 |
| Loans and advances to customers | 74,940 | 3,665 | 3,633 | 10,812 | 3,863 | 1,843 | 98,756 | 6,151 | 104,907 |
| Debt securities and equity shares | 7,682 | 1,005 | 2,961 | 4,223 | 4,688 | 1,578 | 22,137 | 26,294 | 48,431 |
| Other assets | 1,377 | — | — | — | — | 25,083 | 26,460 | 9,906 | 36,366 |
| Total assets | 101,293 | 5,723 | 7,610 | 15,405 | 8,708 | 28,830 | 167,569 | 50,809 | 218,378 |
| Liabilities | | | | | | | | | |
| Deposits by banks | (16,144) | (513) | (1,041) | (165) | (150) | (1,839) | (19,852) | (4,547) | (24,399) |
| Customer accounts | (104,899) | (1,811) | (979) | (254) | (364) | (16,245) | (124,552) | (6,283) | (130,835) |
| Debt securities in issue | (3,493) | (482) | (45) | (3,010) | (245) | (987) | (8,262) | (81) | (8,343) |
| Other liabilities | (146) | — | — | (147) | (19) | (13,528) | (13,840) | (18,697) | (32,537) |
| Loan capital and other subordinated liabilities | (554) | (841) | (323) | (1,179) | (1,333) | — | (4,230) | — | (4,230) |
| Minority interests and shareholders' funds | — | — | — | — | — | (18,034) | (18,034) | — | (18,034) |
| Internal funding of the trading book | 17,764 | 1,817 | 546 | 1,234 | 37 | (197) | 21,201 | (21,201) | — |
| Total liabilities | (107,472) | (1,830) | (1,842) | (3,521) | (2,074) | (50,830) | (167,569) | (50,809) | (218,378) |
| Net on-balance-sheet items | (6,179) | 3,893 | 5,768 | 11,884 | 6,634 | (22,000) | — | — | — |
| Off-balance-sheet items | (14,440) | (730) | 3,260 | 13,049 | (1,139) | — | — | — | — |
| Interest rate sensitivity gap | (20,619) | 3,163 | 9,028 | 24,933 | 5,495 | (22,000) | — | — | — |
| Cumulative interest rate sensitivity gap | (20,619) | (17,456) | (8,428) | 16,505 | 22,000 | — | — | — | — |

34 Risk management (continued)

a Market Risk Management (continued)

iii Assets and liabilities denominated in foreign currency

| | <i>group</i> | | <i>bank</i> | |
|---|--------------------------|------------|--------------------------|------------|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Denominated in sterling | 104,981 | 94,820 | 98,344 | 90,152 |
| Denominated in currencies other than sterling | 141,123 | 123,558 | 64,183 | 51,173 |
| Total assets | 246,104 | 218,378 | 162,527 | 141,325 |
| Denominated in sterling | 112,619 | 101,134 | 97,709 | 89,224 |
| Denominated in currencies other than sterling | 133,485 | 117,244 | 64,818 | 52,101 |
| Total liabilities | 246,104 | 218,378 | 162,527 | 141,325 |

iv Structural currency exposures

The main operating (or functional) currencies of the group's subsidiaries are sterling, euros, US dollars, Swiss francs, Turkish lira and Maltese lira.

Since the currency in which the group prepares its consolidated financial statements is sterling, the group's consolidated balance sheet is affected by movements in the exchange rates between these functional currencies and sterling. These currency exposures are referred to as structural foreign currency exposures. Translation gains and losses arising from these exposures are recognised in the statement of total consolidated recognised gains and losses.

The group's structural foreign currency exposure is represented by the net asset value of its foreign currency equity and subordinated debt investments in its branches, subsidiary undertakings, joint ventures and associates. Gains or losses on structural foreign currency exposures are taken to reserves.

The group mitigates the effect of structural foreign currency exposures by financing a proportion of its net investment in its operations with borrowings in the same currencies as the functional currencies involved.

The group's structural foreign currency exposures are managed with the primary objective of ensuring, where practical, that the group's and individual banking subsidiaries' tier 1 capital ratios are protected from the effect of changes in exchange rates. This is usually achieved by denominating tier 1 capital broadly in proportion to the corresponding foreign-currency-denominated risk-weighted assets at a subsidiary bank level. The group considers hedging structural foreign currency exposures only in limited circumstances, to protect the tier 1 capital ratio or the value of capital invested. Such hedging would be undertaken using forward foreign exchange contracts or by financing with borrowings in the same currencies as the functional currencies involved.

As subsidiaries are generally able to balance adequately foreign currency tier 1 capital with foreign currency risk-weighted assets, the group's structural foreign currency exposures are usually unhedged, including exposures due to foreign-currency-denominated profits arising during the year. There were no material effects from foreign currency exchange rate movements on group or subsidiary tier 1 capital ratios during the year.

Notes on the Accounts (continued)**34 Risk management** (continued)**a Market Risk Management** (continued)iv *Structural currency exposure* (continued)

The group's structural currency exposures as at the year-end were as follows:

2003

| <i>Functional currency of the operation involved</i> | <i>Net investments in operations</i> | <i>Borrowing taken out in the functional currencies of operations in order to hedge the net investment in such operations</i> | <i>Remaining structural currency exposures</i> |
|--|--|---|--|
| | £m | £m | £m |
| Euro | 9,751 | 1,341 | 8,410 |
| US dollars | 1,468 | 490 | 978 |
| Swiss francs | 1,410 | 415 | 995 |
| Turkish lira | 307 | — | 307 |
| Maltese lira | 142 | — | 142 |
| Other | 44 | — | 44 |
| Total | 13,122 | (2,246) | 10,876 |

2002

| <i>Functional currency of the operation involved</i> | <i>Net investments in operations</i> | <i>Borrowing taken out in the functional currencies of operations in order to hedge the net investment in such operations</i> | <i>Remaining structural currency exposures</i> |
|--|--|---|--|
| | £m | £m | £m |
| Euro | 9,144 | 1,237 | 7,907 |
| US dollars | 1,555 | 549 | 1,006 |
| Swiss francs | 1,256 | 410 | 846 |
| Turkish lira | 274 | — | 274 |
| Maltese lira | 121 | — | 121 |
| Other | 38 | — | 38 |
| Total | 12,388 | 2,196 | 10,192 |

b Liquidity Management

The group's commercial banking operations generate a surplus of stable retail deposits over loans to its customers. Together with its capital resources, this surplus is placed with the treasury units where the group's funding and liquidity is managed by Global Markets in London, CCF in Paris and Private Banking in Geneva, ensuring this reflects the different local regulatory requirements. In addition, all sites operate within the HSBC Group's liquidity policy. This process includes:

- projecting cash flows by major currency and consideration of the level of liquid assets in relation thereto;
- maintenance of strong balance sheet liquidity ratios;
- monitoring of depositor concentration both in terms of the overall funding mix and to avoid undue reliance on large individual depositors; and
- maintenance of liquidity contingency plans.

34 Risk management (continued)

b Liquidity Management (continued)

Core retail deposits (current accounts and savings deposits payable on demand or at short notice) form a significant part of the group's overall funding. Considerable importance is attached to this core deposit base which, over the years, has been stable and predictable. The HSBC Group prefers to grow its balance sheet through increasing core retail deposits where possible.

Global Markets is an important player in the money markets and debt capital markets. As a leading market maker in loans and deposits, the group routinely accepts deposits, often of a short-term nature, from banks and other institutions and makes advances to similar organisations. In addition, the funding of capital markets activities, by repo arrangements for example, will often result in funding directly in the wholesale market.

Approximately two thirds of the bank's asset base is sterling-based with the remainder mostly denominated in euros and US dollars. The non-sterling asset base is partially funded through currency-denominated capital issues and loan stock, supplemented by time deposits taken from the eurocurrency interbank market, from central banks, corporate customers and other financial institutions.

The sources of such deposits, by type of institution and country, are monitored in order to avoid an undesirable dependence on any particular institution or category of depositor.

Global Markets in London has, for some years, operated a liquidity management policy based on consolidated net cash flows that conforms to the FSA's arrangements for the supervision of major UK banks' sterling liquidity. Central to these arrangements is the requirement for banks to be able to survive five working days without the renewal of any maturing net wholesale liabilities, and after the leakage of 5 per cent of the gross retail deposit base, for which purpose a minimum coverage ratio of specified liquid assets must be maintained. This ratio is computed daily, with the position being managed so as to exceed the minimum ratio. In addition to complying with these FSA requirements on sterling liquidity, the bank also adopts the same consolidated cash flow methodology for managing its all-currency 0-5 working day liquidity exposures.

It is, however, the HSBC Group's policy that on an all-currency basis all professional deposits with residual maturities up to 30 days, plus 5 per cent of deposit liabilities should be backed by liquid assets. This means that, in a crisis, the group would be able to meet its obligations as they fall due for at least 30 days without recourse to the wholesale markets. This requirement is significantly more stringent than the regulatory requirement.

In France, CCF complies with the regulatory liquidity ratio requirements of the Banque de France, overseen and monitored by the Commission Bancaire. Banks are required to submit quarterly returns which are used to compute a liquidity ratio for the coming month, and for the following two months. Banks simultaneously submit a future forecast of liquidity positions called 'observation ratios'. The ratios are derived by dividing liquid assets (which are subject to discount factors) by liabilities (which include a proportion of customer accounts, 5 per cent of off-balance-sheet commitments and all borrowings and subordinated loan stock maturing within one month). Banks are required to maintain, at all times, a ratio in excess of 100 per cent.

In Switzerland, Private Banking complies with the liquidity ratio requirements of the Swiss Federal Banking Commission. 'Liquidity I' applies to Swiss currency only and is calculated monthly, based on monthly averages. 'Liquidity II' embraces all currencies and requires that liquid and easily realisable assets are above one third of the difference between amounts due to banks/clients maturing within 30 days and amounts due from banks/clients maturing within 30 days. This ratio is calculated daily.

Other non-UK units maintain sufficient liquidity to meet their day-to-day needs and local regulatory requirements unless specific arrangements are made for Global Markets in London to provide the necessary support. Both CCF and Private Banking are required to maintain high-quality liquid assets at least equal to 0-30 days' cumulative refinancing exposures on an all-currency basis for HSBC Group liquidity management purposes.

Notes on the Accounts (continued)

34 Risk management (continued)

c Operational Risk Management

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

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

The HSBC Group codified its operational risk management process by issuing a high level standard in May 2002. This explains how the HSBC Group manages operational risk by identifying, assessing, monitoring, controlling and mitigating the risk, rectifying operational risk events, and implementing any additional procedures required for compliance with local regulatory requirements. The processes undertaken to manage operational risk are determined by reference to the scale and nature of each HSBC Group operation. The HSBC Group standard covers the following.

- Operational risk management responsibility is assigned at a senior management level within the business operation.
- Information systems are used to record the identification and assessment of operational risks and generate appropriate, regular management reporting.
- Operational risks are identified by risk assessments covering operational risks facing each business and risks inherent in processes, activities and products. Risk assessment incorporates a regular review of risks identified to monitor significant changes.
- Operational risk loss data is collected and reported to senior management. This report covers aggregate operational risk losses and details of incidents above a materiality threshold.
- Risk mitigation, including insurance, is considered where this is cost-effective.

Local management within the group is responsible for implementation of the HSBC Group standard on operational risk, throughout their operations, within a reasonable timeframe.

The HSBC Group maintains and tests contingency facilities to support operations in the event of disasters. Additional reviews and tests were conducted following the terrorist events of 11 September 2001 and more recently, the two bomb blasts in Istanbul, to incorporate lessons learned in the operational recovery from those circumstances.

d Credit Risk Management

Credit risk is the risk that a customer or counterparty of the group will be unable or unwilling to meet a commitment into which it has entered with a member of the group. It arises from lending, trade finance, treasury and other activities. The group has in place standards, policies and procedures for the control and monitoring of all such risks.

HSBC Holdings plc is responsible for the formulation of high-level credit policies. It also reviews the application of the HSBC Group's universal facility grading system. The HSBC Group's credit risk limits to counterparties in the financial and government sectors are managed centrally to optimise the use of credit availability and to avoid excessive risk concentration. Cross-border risk is controlled through the imposition of country limits, which are determined by taking into account economic and political factors, and local business knowledge, with sub-limits by maturity and type of business. Transactions with counterparties in higher risk countries are considered on a case-by-case basis.

34 Risk management (continued)

d Credit Risk Management (continued)

Within the overall framework of the HSBC Group policy, the bank has an established risk management process encompassing credit approvals, the control of exposures (including those to borrowers in financial difficulty), credit policy direction to business units and the monitoring and reporting of exposures both on an individual and a portfolio basis. Local management is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality. Regular reviews are undertaken to assess and evaluate levels of risk concentration, including those to individual industry sectors and products.

Special attention is paid to the management of problem loans. Where deemed appropriate, specialist units are established to provide intensive management and control to maximise recoveries of doubtful debts.

Geographical concentrations of credit risk

The group restricts its exposure to the risk of payment difficulties arising with respect to individual countries and regions through a central HSBC Group system of internally determined country limits that relate to both economic and political risks. Exposures to individual countries and cross-border exposures in aggregate are kept under continuous review.

The following table shows total outstandings to counterparties in countries and regions which individually represent in excess of 5 per cent of total outstandings. Classification is based upon the country of residence of the borrower but recognises the transfer of country risk in respect of third party guarantees or residence of the head office where the borrower is a branch. In accordance with the Bank of England Country Exposure Report (Form C1) guidelines, outstandings comprise loans and advances (excluding settlement accounts), amounts receivable under finance leases, acceptances, commercial bills, certificates of deposit, and debt and equity securities (net of short positions), and exclude accrued interest and intra group exposures. Outstandings to counterparties in the United Kingdom, the bank's country of domicile, are not recorded on Form C1 but, for 2003, were collected separately on a comparable basis. In 2002, these amounts were computed on the basis of total group outstandings for classes of asset specified in the Form C1 guidelines less amounts reported on Form C1.

As shown in the table below, the group's credit risk exposures are predominantly with countries and regions with developed economies.

| | 2003 | 2002 |
|----------------------------|-------------|------|
| | % | % |
| United Kingdom | 47 | 45 |
| France | 15 | 18 |
| Germany | 8 | 7 |
| Rest of Continental Europe | 16 | 16 |
| Continental Europe | 39 | 41 |
| United States | 5 | 5 |
| Rest of world | 9 | 9 |
| | 100 | 100 |

Concentrations of credit risk

Information relating to industry concentrations, gross of specific provisions, is given within Note 15 'Concentrations of exposure' in the Notes on the Accounts.

The group provides a diverse range of financial services both in the United Kingdom and internationally. As a result, its portfolio of financial instruments with credit risk is highly diversified with no exposures to individual industries or economic groupings totalling more than 10 per cent of consolidated total assets, except as follows:

Notes on the Accounts (continued)

34 Risk management (continued)

d Credit Risk Management (continued)

- the bank's position as one of the principal UK clearing banks means that the majority of the group's exposure to credit risk is concentrated in the United Kingdom. Within the United Kingdom, the group's credit risk is diversified over a wide range of industrial and economic groupings; and
- the group's position as part of a major international banking group means, that it has a significant concentration of exposure to banking counterparties. The majority of credit risk to the banking industry at 31 December 2003 and 31 December 2002 was concentrated in Europe (including the United Kingdom). Concentrations of credit risk arising from off-balance-sheet transactions are discussed in note 35a.

There are no special collateral requirements relating to industrial concentrations, with the exception of exposures to the property sector. The majority of exposures to the property and construction industry and the residential mortgage market are secured on the underlying property.

35 Financial instruments

a Derivatives

Off-balance-sheet financial instruments, commonly referred to as derivatives, are contracts the characteristics of which are derived from those of the underlying assets, interest and exchange rates, credit spreads, equity indices or commodity prices. They include futures, forwards, swap and options transactions in the foreign exchange, interest rate, equity, credit and commodity markets. Transactions are negotiated directly with customers, with the group acting as a counterparty, or can be dealt through exchanges.

Users of derivatives typically want to convert an unwanted risk generated by their business to a more acceptable risk, or cash. Derivatives provide an effective tool for companies to manage the financial risks associated with their business and, as a consequence, there has been a significant growth in derivatives transactions in recent years.

The group, through its dealing operations, takes positions in the market and acts as an intermediary between a broad range of users, structuring deals to produce risk management products to suit individual customer needs. As a result, the group can accumulate significant open positions in derivatives portfolios. These positions are managed constantly to ensure that they are within acceptable risk levels, with offsetting deals being undertaken to achieve this where necessary. As well as acting as a dealer, the group also uses derivatives (principally interest rate swaps) in the management of its own asset and liability portfolios and structural positions.

Risks associated with derivatives

Derivative instruments are subject to both market risk and credit risk, discussed in note 34.

The market risk associated with derivatives can be significant since large positions can be accumulated with a substantially smaller initial outlay than required in cash markets. Recognising this, only certain offices with sufficient derivative product expertise and appropriate control systems are authorised to trade derivative products. The management of market risk arising from derivatives business is monitored daily by the market risk control unit in each office and on a regular basis by Traded Markets Development and Risk, in combination with market risks arising from on-balance-sheet instruments, discussed in note 34a.

Unlike assets recorded on the balance sheet, where the credit risk is typically the full amount of the principal value, together with any unrealised interest accrued or mark-to-market gain ('Credit risk management' in the note 34d), the credit risk relative to a derivative is principally the replacement cost of any contract with a positive mark-to-market gain and an estimate for the potential future change in value, reflecting the volatilities affecting the contract. Credit risk on contracts having a negative mark-to-market value is restricted to the potential future change in value. Credit risk on derivatives is, therefore, small in relation to a comparable balance sheet risk. In addition, credit exposure with individual counterparties can be reduced by the receipt of collateral and close-out netting agreements, which allow for positive and negative mark-to-market values on different transactions to be offset and settled by a single payment in the event of default by either party. Such agreements are enforceable in the jurisdictions of the major market makers and the group has executed close-out netting agreements with the majority of its significant counterparties, notwithstanding the fact that the group deals only with the most creditworthy counterparties.

35 Financial instruments (continued)

a Derivatives (continued)

To reduce credit risk, management may deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on management's credit evaluation of the customer. Collateral held varies but will generally be in the form of liquid securities or cash.

The credit risk profile generated by the use of credit derivatives has an additional dimension. Where the group purchases protection, credit risk arises through the cost of replacing the contract and it is managed and reduced in the same way as for other derivative contracts. Selling protection through credit derivatives gives rise to additional credit risk. This credit risk arises as a direct consequence of the obligation of the group as the protection seller to make a payment to the protection buyer following a credit event on a reference name. The group manages the credit risk with regards to reference names by including any such exposures arising from credit derivatives with its overall credit limits structure. In addition the trading of credit derivatives is restricted to a number of small offices within the major centres which have the control infrastructure and market skills to manage effectively the credit risk inherent in the products.

The following table analyses the replacement cost of all third-party exchange rate, interest rate and equities contracts with positive mark-to-market gains, after netting where available, by maturity and by category of counterparty at 31 December 2003 and 31 December 2002. The table shows that the replacement cost of derivatives is predominately with banks and under five years.

| <i>Replacement cost</i> | <i>Residual maturity</i> | | | | | |
|---------------------------------|---------------------------|--------------------------|------------------------|----------------|-------------------|-------------------|
| | <i>Less than one year</i> | <i>One to five years</i> | <i>Over five years</i> | <i>Netting</i> | <i>Total 2003</i> | <i>Total 2002</i> |
| | £m | £m | £m | £m | £m | £m |
| Government | 22 | 50 | 93 | (150) | 15 | 20 |
| Banks | 6,196 | 5,734 | 3,011 | (7,496) | 7,445 | 6,577 |
| Non-bank financial institutions | | | | | | |
| Exchanges* | 46 | 83 | — | — | 129 | 141 |
| Other | 1,123 | 903 | 502 | (593) | 1,935 | 1,837 |
| Other sectors | 896 | 924 | 269 | (771) | 1,318 | 823 |
| Total 2003 | 8,283 | 7,694 | 3,875 | (9,010) | 10,842 | |
| Total 2002 | 6,123 | 8,532 | 4,065 | (9,322) | | 9,398 |

* Exchanges with margining requirement

The following table analyses the maturity profile of the contract amounts of third-party derivative contracts outstanding at 31 December 2003 and 31 December 2002. This shows that the majority of contracts are executed over the counter and mature within one year.

| <i>Contract amount</i> | <i>Residual maturity</i> | | | | |
|---|---------------------------|--------------------------|------------------------|-------------------|-------------------|
| | <i>Less than one year</i> | <i>One to five years</i> | <i>Over five years</i> | <i>Total 2003</i> | <i>Total 2002</i> |
| | £m | £m | £m | £m | £m |
| Exchange rate, interest rate and equities contracts | | | | | |
| Exchanges* | 99,537 | 47,489 | — | 147,026 | 75,914 |
| Other | 627,067 | 353,708 | 193,495 | 1,174,270 | 971,327 |
| Total 2003 | 726,604 | 401,197 | 193,495 | 1,321,296 | |
| Total 2002 | 604,454 | 324,213 | 118,574 | | 1,047,241 |

* Exchanges with margining requirement

Notes on the Accounts (continued)

35 Financial instruments (continued)

a Derivatives (continued)

i Derivatives used for trading purposes

Contracts for trading purposes are undertaken both for the group's own account and to service its corporate customer base, including designing structured products to meet the specific requirements of customers. Derivatives are used for trading purposes in order to generate income from customer-driven business and dealing income from market fluctuations.

Trading positions are valued on a mark-to-market basis.

In liquid portfolios, the market values are determined by reference to independently sourced mid-market prices where it is reasonable to assume the positions could be sold at that price. In those instances where markets are less liquid and/or where positions have been held for extended periods, portfolios will be valued by reference to bid or offer prices as appropriate.

In relation to certain products, such as over-the-counter derivative instruments, there are no independent prices quoted in the markets. In these circumstances market values are determined by reference to standard industry models, which typically utilise discounted cash flow techniques to derive the market value. The models may be in-house developed or software vendor packages.

In valuing transactions, prices may be amended in respect of those positions considered illiquid, having recognition of the size of the position vis à vis the normal market trading volumes in that product.

The main valuation sources are volatilities, securities prices, foreign exchange rates, and interest rate yield curves.

The group's derivative transactions are predominantly in plain vanilla instruments, primarily comprising interest rate and foreign exchange contracts, where the marked to market values are readily determinable by reference to independent prices and valuation quotes, as described above.

There are a limited number of structured transactions which have been performed, primarily to meet specific customer demand, where standard industry models are not routinely available, and where there is no market quotation. For these products, the group has developed its own proprietary models for the purposes of performing valuations. These models are rigorously checked by Finance and Operations departments on an ongoing basis to ensure that the model assumptions are, and remain, valid over the transaction life, which is generally less than five years.

The average mark-to-market values for the years ended 31 December 2003 and 31 December 2002 are analysed in the following table. Positive amounts represent replacement cost values, while negative amounts represent current mark-to-market losses.

| | <u>2003</u> | <u>2002</u> |
|-------------------------|---|---|
| | <i>Average Mark-to- market values</i> | <i>Average Mark-to- market values</i> |
| | £m | £m |
| Exchange rate contracts | | |
| — assets | 7,473 | 5,495 |
| — liabilities | (7,869) | (5,700) |
| Interest rate contracts | | |
| — assets | 12,301 | 8,363 |
| — liabilities | (11,914) | (8,442) |
| Equities | | |
| — assets | 1,142 | 897 |
| — liabilities | (1,498) | (1,011) |

Asset and liability balances arising from derivative contracts are not netted, except where a legal right of set-off exists.

35 Financial instruments (continued)

a Derivatives (continued)

i Derivatives used for trading purposes (continued)

Assets, including gains, resulting from derivatives that are marked to market, are included within 'Other assets' in the consolidated balance sheet. Liabilities, including losses, resulting from such contracts, are included in 'Other liabilities'.

The following tables summarise the contract amount, replacement cost and mark-to-market values of third-party and internal trading derivatives by product type. The replacement cost shown is the positive mark-to-market value and represents the accounting loss the group would incur if the counterparty to a derivative contract failed to perform according to the terms of the contract and the collateral, if any, for the amount due proved to be of no value.

Because all derivative instruments used for trading purposes are marked to market, carrying values are equal to market values. Mark-to-market values are determined by reference to market rates prevailing on the date of valuation or by discounting future cash flows and include netted internal positions, except where otherwise indicated.

The notional or contractual amounts of these instruments indicate the volume of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Netting is applied where a legal right of set-off exists. Mark-to-market assets and liabilities are presented gross, with allowable netting shown separately.

| | 2003 | | 2002 | |
|---|------------------------|--------------------------------------|------------------------|--------------------------------------|
| | <i>Contract amount</i> | <i>Replacement cost</i> ¹ | <i>Contract amount</i> | <i>Replacement cost</i> ¹ |
| | £m | £m | £m | £m |
| Spot and forward foreign exchange | 235,702 | 5,823 | 217,951 | 4,455 |
| Currency swaps, futures and options purchased | 98,499 | 3,036 | 72,079 | 1,729 |
| Currency options written | 49,622 | — | 33,122 | — |
| Credit derivatives | 10,846 | 102 | 3,850 | 70 |
| Commodity contracts | 521 | 3 | 120 | 1 |
| Total exchange rate contracts | 395,190 | 8,964 | 327,122 | 6,255 |
| Interest rate swaps | 734,452 | 7,957 | 590,756 | 10,358 |
| Interest rate futures, forward rate agreements, and options purchased | 186,155 | 1,104 | 126,446 | 761 |
| Interest rate options written | 64,956 | — | 42,448 | — |
| Total interest rate contracts | 985,563 | 9,061 | 759,650 | 11,119 |
| Equities, futures and options purchased | 17,302 | 1,507 | 16,764 | 1,007 |
| Equities options written | 7,837 | — | 11,741 | — |
| Total equities contracts | 25,139 | 1,507 | 28,505 | 1,007 |
| Netting | | (9,010) | | (9,322) |
| Total | 1,405,892 | 10,522 | 1,115,277 | 9,059 |

¹ Third-party contracts only

Notes on the Accounts (continued)**35 Financial instruments** (continued)**a Derivatives** (continued)*i Derivatives used for trading purposes* (continued)

| | 2003 | 2002 |
|---------------|------------------------------|------------------------------|
| | <i>Mark-to-market values</i> | <i>Mark-to-market values</i> |
| | £m | £m |
| Exchange rate | | |
| — assets | 9,556 | 6,646 |
| — liabilities | (9,908) | (6,987) |
| Interest rate | | |
| — assets | 9,066 | 11,199 |
| — liabilities | (9,164) | (11,716) |
| Equities | | |
| — assets | 1,507 | 1,007 |
| — liabilities | (1,211) | (1,342) |
| Total | | |
| — assets | 20,129 | 18,852 |
| — liabilities | (20,283) | (20,045) |
| Netting | (9,010) | (9,322) |

Included in the amounts in the previous table is cash collateral meeting the offset criteria of FRS 5 as follows:

| | 2003 | 2002 |
|----------------------------|-------------|------|
| | £m | £m |
| Offset against assets | 427 | 709 |
| Offset against liabilities | 281 | 28 |

ii Derivatives used for risk management purposes

The majority of the transactions undertaken for risk management purposes are between business units within the group, one of which is a trading desk, which may then lay off the resulting position by trading in the external market. Internal positions are integral to the group's asset and liability management and are included within analyses of non-trading positions in the tables below.

The table below summarises the contract amount and replacement cost of derivatives used for risk management purposes by product type. The replacement cost shown represents the accounting loss the group would incur if the counterparty to a derivative contract failed to perform according to the terms of the contract and the collateral, if any, for the amount due proved to be of no value.

35 Financial instruments (continued)

a Derivatives (continued)

ii Derivatives used for risk management purposes (continued)

| | 2003 | | 2002 | |
|--|------------------------|--------------------------------------|------------------------|--------------------------------------|
| | <i>Contract amount</i> | <i>Replacement cost</i> ¹ | <i>Contract amount</i> | <i>Replacement cost</i> ¹ |
| | £m | £m | £m | £m |
| Spot and forward foreign exchange | 3,961 | 3 | 11,913 | 1 |
| Currency swaps, futures and options purchased | 6,676 | 111 | 4,772 | 24 |
| Total exchange rate contracts | 10,637 | 114 | 16,685 | 25 |
| Interest rate swaps | 137,226 | 206 | 125,381 | 313 |
| Interest rate futures, forward rate agreements and options purchased | 1,141 | — | 1,355 | 1 |
| Total interest rate contracts | 138,367 | 206 | 126,736 | 314 |

¹ *Third-party contracts only*

The table below summarises the carrying value and mark-to-market value of derivative contracts held for risk management purposes. Mark-to-market values for assets and liabilities arising from derivatives held for non-trading purposes are determined in the same way as those set out for trading derivatives above including internal positions.

| | 2003 | | 2002 | |
|----------------------|-----------------------|------------------------------|-----------------------|------------------------------|
| | <i>Carrying value</i> | <i>Mark-to-market values</i> | <i>Carrying value</i> | <i>Mark-to-market values</i> |
| | £m | £m | £m | £m |
| Exchange rate | | | | |
| — assets | 87 | 164 | 7 | 40 |
| — liabilities | (792) | (1,078) | (298) | (558) |
| Interest rate | | | | |
| — assets | 528 | 2,298 | 610 | 2,710 |
| — liabilities | (138) | (1,671) | (268) | (1,900) |

Notes on the Accounts (continued)**35 Financial instruments** (continued)**b Other financial instruments***i Financial instruments held for trading purposes*

| | 2003 | 2002 |
|---|------------------------------|------------------------------|
| | <i>Mark-to-market values</i> | <i>Mark-to-market values</i> |
| | £m | £m |
| Assets | | |
| Treasury bills and other eligible bills | 199 | 469 |
| Loans and advances to banks and customers | 21,081 | 14,140 |
| Debt securities | 27,347 | 24,377 |
| Equity shares | 4,118 | 1,917 |
| | 52,745 | 40,903 |
| Liabilities | | |
| Short positions in securities | 9,939 | 7,831 |
| Debt securities in issue | 682 | 81 |
| Deposits by banks and customer accounts | 13,447 | 10,830 |
| | 24,068 | 18,742 |

The net trading assets above are funded by liabilities whose fair value is not materially different from their carrying value.

ii Financial instruments not held for trading purposes and for which a liquid and active market exists

| | 2003 | | 2002 | |
|---|-----------------------|------------------------------|-----------------------|------------------------------|
| | <i>Carrying value</i> | <i>Mark-to-market values</i> | <i>Carrying value</i> | <i>Mark-to-market values</i> |
| | £m | £m | £m | £m |
| Assets | | | | |
| Treasury bills and other eligible bills | 1,998 | 2,000 | 1,578 | 1,582 |
| Debt securities | 22,209 | 22,676 | 20,571 | 21,053 |
| Equity shares | 1,719 | 2,046 | 1,566 | 1,763 |
| | 25,926 | 26,722 | 23,715 | 24,398 |
| Liabilities | | | | |
| Debt securities in issue | 4,356 | 4,362 | 3,223 | 3,202 |
| Subordinated liabilities | 4,765 | 4,856 | 3,847 | 3,903 |
| Non-equity minority interest | 700 | 700 | — | — |
| | 9,821 | 9,918 | 7,070 | 7,105 |

35 Financial instruments (continued)

b Other financial instruments (continued)

ii Financial instruments not held for trading purposes and for which a liquid and active market exists (continued)

Where possible, mark-to-market values have been estimated using market prices for these financial instruments. Where market prices are not available, values have been estimated using quoted prices for financial instruments with similar characteristics, or otherwise using a suitable valuation technique where practicable to do so.

The valuation techniques used are:

— Treasury bills and other eligible bills

The mark-to-market value approximates to carrying value because these are mainly short-term in maturity with a carrying value not materially different from mark-to-market value.

— Loans and advances to banks and customers

For variable rate loans and advances with no significant change in credit risk, the carrying value is considered to represent mark-to-market value. The mark-to-market values of other loans and advances are estimated by discounting future cash flows using market interest rates.

— Debt securities and equity shares

Listed securities are valued at middle-market prices and unlisted securities at management's valuation, which takes into consideration future earnings streams, valuations of equivalent quoted securities and other relevant techniques.

— Debt securities in issue, short positions in securities, subordinated liabilities and preference shares

Mark-to-market values are estimated using quoted market prices at the balance sheet date.

— Deposits by banks and customer accounts

Deposits by banks and customer accounts that mature or re-price after six months are grouped by residual maturity. Fair value is estimated using discounted cash flows, applying either market rates, where applicable, or current rates offered for deposits of similar repricing maturities.

c Gains and losses on hedges

Gains and losses on instruments used for hedging are recognised in line with the underlying items that are being hedged. The unrecognised gains on instruments used for hedging as at 31 December 2003 were £1,638 million (2002: £1,814 million) and the unrecognised losses were £1,610 million (2002: £1,573 million).

Unrecognised gains of £799 million and unrecognised losses of £703 million are expected to be recognised in 2004.

Of the gains and losses included in the profit and loss account in 2003, £784 million gains and £648 million losses were unrecognised at 1 January 2003.

Notes on the Accounts (continued)**36 Memorandum items****a** *Contingent liabilities and commitments*

| group | 2003 | | | 2002 | | |
|--|------------------------|---------------------------------|-----------------------------|------------------------|---------------------------------|-----------------------------|
| | <i>Contract amount</i> | <i>Credit equivalent amount</i> | <i>Risk-weighted amount</i> | <i>Contract amount</i> | <i>Credit equivalent amount</i> | <i>Risk-weighted amount</i> |
| | £m | £m | £m | £m | £m | £m |
| Contingent liabilities | | | | | | |
| Acceptances and endorsements | 455 | 197 | 137 | 742 | 502 | 391 |
| Guarantees and assets pledged as collateral security | | | | | | |
| — guarantees and irrevocable letters of credit | 15,364 | 11,338 | 9,374 | 14,353 | 10,477 | 8,774 |
| — other | 4 | 4 | 4 | 6 | 6 | 6 |
| | 15,823 | 11,539 | 9,515 | 15,101 | 10,985 | 9,171 |
| Commitments | | | | | | |
| Documentary credits and short-term trade-related transactions | 1,550 | 730 | 379 | 1,515 | 782 | 293 |
| Forward asset purchases and forward deposits placed | 130 | 130 | 116 | 70 | 70 | 77 |
| Undrawn note issuance and revolving underwriting facilities | 59 | 30 | 30 | 36 | 18 | 18 |
| Undrawn formal standby facilities, credit lines and other commitments to lend | | | | | | |
| — over 1 year | 19,568 | 9,781 | 8,710 | 14,825 | 7,412 | 6,609 |
| — 1 year or less | 52,274 | — | — | 44,931 | — | — |
| | 73,581 | 10,671 | 9,235 | 61,377 | 8,282 | 6,997 |
| | | | | | 2003 | 2002 |
| | | | | | £m | £m |
| Incurring on behalf of parent and fellow subsidiary undertakings (contract amount) | | | | | | |
| — contingent liabilities | | | | | 147 | 158 |

36 Memorandum items (continued)

a Contingent liabilities and commitments (continued)

| | 2003 | | | 2002 | | |
|--|------------------------|---------------------------------|-----------------------------|------------------------|---------------------------------|-----------------------------|
| | <i>Contract amount</i> | <i>Credit equivalent amount</i> | <i>Risk-weighted amount</i> | <i>Contract amount</i> | <i>Credit equivalent amount</i> | <i>Risk-weighted amount</i> |
| | £m | £m | £m | £m | £m | £m |
| bank | | | | | | |
| Contingent liabilities | | | | | | |
| Acceptances and endorsements | 328 | 67 | 44 | 631 | 387 | 307 |
| Guarantees and assets pledged as collateral security | | | | | | |
| — guarantees and irrevocable letters of credit | 9,242 | 7,326 | 5,574 | 8,423 | 6,500 | 5,073 |
| | 9,570 | 7,393 | 5,618 | 9,054 | 6,887 | 5,380 |
| Commitments | | | | | | |
| Documentary credits and short-term trade-related transactions | 1,006 | 433 | 214 | 1,081 | 590 | 213 |
| Forward asset purchases and forward forward deposits placed | 23 | 23 | 19 | 16 | 16 | 12 |
| Undrawn note issuance and revolving underwriting facilities | 21 | 10 | 10 | — | — | — |
| Undrawn formal standby facilities, credit lines and other commitments to lend | | | | | | |
| — over 1 year | 11,961 | 5,978 | 5,133 | 9,938 | 4,969 | 4,366 |
| — 1 year or less | 46,014 | — | — | 39,434 | — | — |
| | 59,025 | 6,444 | 5,376 | 50,469 | 5,575 | 4,591 |
| | | | | | 2003 | 2002 |
| | | | | | £m | £m |
| Incurring on behalf of subsidiary undertakings (contract amount) | | | | | | |
| — contingent liabilities | | | | | 7 | 46 |
| Incurring on behalf of parent and fellow subsidiary undertakings (contract amount) | | | | | | |
| — contingent liabilities | | | | | — | 19 |

The preceding tables give the nominal principal amounts, credit equivalent amounts and risk-weighted amounts of off-balance-sheet transactions. The credit equivalent amounts are calculated for the purposes of deriving the risk-weighted amounts. These are assessed in accordance with the Financial Services Authority's guidelines, which implement the 1988 Basel Capital Accord on capital adequacy and depend on the status of the counterparty and the maturity characteristics.

Contingent liabilities and commitments are credit-related instruments that include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements.

Notes on the Accounts (continued)**36 Memorandum items** (continued)**b Concentrations of contingent liabilities and commitments**

The group has the following concentration of exposure to contingent liabilities and commitments, based on the location of the office recording the transaction:

| | <i>United Kingdom</i> | <i>Continental Europe</i> | <i>Rest of the world</i> | <i>Total</i> |
|-------------------------|---------------------------|-------------------------------|------------------------------|---------------|
| | £m | £m | £m | £m |
| Contract amounts | | | | |
| Contingent liabilities | | | | |
| 2003 | 8,216 | 7,259 | 348 | 15,823 |
| 2002 | 7,602 | 7,204 | 295 | 15,101 |
| Commitments | | | | |
| 2003 | 55,871 | 13,288 | 4,422 | 73,581 |
| 2002 | 47,891 | 9,219 | 4,267 | 61,377 |

37 Litigation

The bank and certain subsidiary undertakings are named in, and are defending, legal actions in various jurisdictions arising from their normal business. No material adverse impact on the financial position of the group is expected to arise from these proceedings.

38 Capital commitments

| | <i>group</i> | | <i>bank</i> | |
|----------------------------|--------------|------|-------------|------|
| | 2003 | 2002 | 2003 | 2002 |
| | £m | £m | £m | £m |
| Expenditure contracted for | 708 | 662 | 131 | 117 |

39 Lease commitments

The group was committed to various non-cancellable operating leases on Leasehold land and buildings, which require aggregate future rental payments as follows:

| | 2003 | 2002 |
|-------------------------------|-------------|------|
| | £m | £m |
| Payable within 1 year | 86 | 98 |
| Payable between 1 and 2 years | 79 | 90 |
| Payable between 2 and 3 years | 75 | 84 |
| Payable between 3 and 4 years | 69 | 80 |
| Payable between 4 and 5 years | 63 | 74 |
| Payable in over 5 years | 372 | 568 |
| | 744 | 994 |

At the year-end, annual commitments under non-cancellable operating leases were:

| | <i>group</i> | | <i>bank</i> | |
|-------------------------------|--------------|------|-------------|------|
| | 2003 | 2002 | 2003 | 2002 |
| | £m | £m | £m | £m |
| Leasehold land and buildings | | | | |
| Operating leases which expire | | | | |
| — within 1 year | 3 | 2 | 2 | 1 |
| — between 1 and 5 years | 20 | 19 | 13 | 12 |
| — in over 5 years | 62 | 77 | 57 | 74 |
| | 85 | 98 | 72 | 87 |

Notes on the Accounts (continued)

40 Segmental analysis

As the group is not required to disclose turnover, no segmental analysis of turnover is included. Turnover of non-banking businesses is included in other operating income in the table below. The allocation of earnings reflects the benefit of shareholders' funds to the extent that these costs are actually allocated to businesses in the segment by way of intra-group capital and funding structures. Common costs are included in segments on the basis of the actual recharges made.

a By geographical region

In the analysis set out below, net assets include an appropriate amount of shareholders' funds, based on the proportion of risk-weighted assets in each segment. Geographical information has been classified by the location of the principal operations of the subsidiary undertaking or, in the case of the bank, by the location of the branch responsible for reporting the results or for advancing the funds.

| | <i>United Kingdom</i> | <i>Continental Europe</i> | <i>Rest of the world</i> | <i>Total</i> |
|--|---------------------------|-------------------------------|------------------------------|----------------|
| 2003 | £m | £m | £m | £m |
| Gross income | | | | |
| Interest receivable | 5,395 | 2,636 | 236 | 8,267 |
| Dividend income | 60 | 28 | — | 88 |
| Fees and commissions receivable | 2,338 | 1,241 | 78 | 3,657 |
| Dealing profits | 374 | 219 | 87 | 680 |
| Other operating income | 446 | 56 | 6 | 508 |
| Total gross income | 8,613 | 4,180 | 407 | 13,200 |
| Profit on ordinary activities before tax | 1,896 | 304 | 44 | 2,244 |
| Attributable profit/(loss) | 1,469 | (17) | 28 | 1,480 |
| Net assets | 10,804 | 5,699 | 561 | 17,064 |
| Total assets | 145,869 | 90,552 | 9,683 | 246,104 |
| 2002 | £m | £m | £m | £m |
| Gross income | | | | |
| Interest receivable | 5,366 | 2,539 | 379 | 8,284 |
| Dividend income | 94 | 20 | — | 114 |
| Fees and commissions receivable | 2,075 | 1,034 | 52 | 3,161 |
| Dealing profits | 191 | 135 | 62 | 388 |
| Other operating income | 464 | 68 | 18 | 550 |
| Total gross income | 8,190 | 3,796 | 511 | 12,497 |
| Profit/(loss) on ordinary activities before tax | 2,190 | (52) | 147 | 2,285 |
| Attributable profit/(loss) | 1,551 | (309) | 137 | 1,379 |
| Net assets | 10,393 | 5,895 | 167 | 16,455 |
| Total assets | 123,799 | 86,356 | 8,223 | 218,378 |

40 Segmental analysis (continued)

b By class of business

| | 2003 £m | 2002 £m |
|--|----------------|----------------|
| Profit/(loss) on ordinary activities before tax | | |
| UK Personal Banking | 602 | 555 |
| UK Commercial Banking | 539 | 627 |
| UK Corporate and Institutional Banking | 369 | 312 |
| Global Markets UK | 458 | 467 |
| Investment Banking | (82) | (2) |
| International Banking | 202 | 208 |
| CCF | 382 | 365 |
| Private Banking | 290 | 225 |
| HSBC Trinkaus & Burkhardt | 50 | 16 |
| Amortisation of goodwill | (566) | (488) |
| | <u>2,244</u> | <u>2,285</u> |
| Net assets | | |
| UK Personal Banking | 1,287 | 1,366 |
| UK Commercial Banking | 1,025 | 1,081 |
| UK Corporate and Institutional Banking | 1,161 | 1,307 |
| Global Markets UK | 566 | 509 |
| Investment Banking | 509 | 346 |
| International Banking | 846 | 969 |
| CCF | 7,732 | 6,822 |
| Private Banking | 3,707 | 3,882 |
| HSBC Trinkaus & Burkhardt | 231 | 173 |
| | <u>17,064</u> | <u>16,455</u> |
| Total assets | | |
| UK Personal Banking | 40,863 | 35,579 |
| UK Commercial Banking | 21,900 | 19,272 |
| UK Corporate and Institutional Banking | 17,685 | 19,107 |
| Global Markets UK | 56,393 | 45,681 |
| Investment Banking | 2,249 | 2,798 |
| International Banking | 16,633 | 13,489 |
| CCF | 55,667 | 49,220 |
| Private Banking | 26,980 | 26,122 |
| HSBC Trinkaus & Burkhardt | 7,734 | 7,110 |
| | <u>246,104</u> | <u>218,378</u> |

The amortisation of goodwill includes £417 million (2002: £309 million) in respect of CCF of which £83 million relates to goodwill on joint ventures (2002: £6 million) and £173 million (2002: £169 million) in respect of Private Banking.

Notes on the Accounts (continued)**41 Related party transactions****a** *Transactions, arrangements and agreements involving Directors and others*

Particulars of transactions, arrangements and agreements entered into by subsidiary undertakings of the bank with Directors and connected persons and companies controlled by them and with officers of the bank disclosed pursuant to section 232 of the Companies Act 1985 are as follows:

| | 2003 | | 2002 | |
|---|---------------|-------------|---------------|-------------|
| | <i>Number</i> | <i>£000</i> | <i>Number</i> | <i>£000</i> |
| Directors and connected persons and companies controlled by them: | | | | |
| Loans and credit card transactions (including £94,000 in credit card transactions (2002: £64,000)) | 19 | 210,457 | 18 | 91,465 |
| Officers: | | | | |
| Loans and credit card transactions (including £136,000 in credit card transactions (2002: £78,000)) | 27 | 7,823 | 22 | 6,986 |

b *Joint ventures and associates*

Information relating to joint ventures and associates can be found in the Notes on the Accounts, where the following are disclosed:

- Note 13: amounts due from joint ventures
- Note 18: interests in joint ventures
- Note 19: interests in associates
- Note 25: amounts due to joint ventures and associates

c *Transactions with other related parties of the group**Pension funds*

At 31 December 2003, the HSBC Bank (UK) Pension Scheme had deposits of £103 million (2002: £150 million) with the bank.

42 Approval of the accounts

These accounts were approved by the Board of Directors on 1 March 2004.

43 Ultimate parent company

The ultimate parent company of the group is HSBC Holdings plc, which is incorporated in England.

HSBC Holdings plc is the only undertaking for which consolidated accounts that include the consolidated accounts of the group are drawn up.

HSBC Holdings plc is HSBC Bank plc's direct and ultimate controlling party as defined under Financial Reporting Standard 8, 'Related Party Disclosures'.

Copies of HSBC Holdings plc's *Annual Review 2003* and *Annual Report and Accounts 2003* can be obtained from its registered office at 8 Canada Square, London E14 5HQ, or on the HSBC Group's web site, www.hsbc.com.

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