

**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 20-F

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934

Or

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2010

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Or

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report _____

For the transition period from N/A to N/A

Commission file number: 1-14930

HSBC Holdings plc

(Exact name of Registrant as specified in its charter)

N/A

(Translation of Registrant's name into English)

United Kingdom

(Jurisdiction of incorporation or organisation)

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Securities registered or to be registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Ordinary Shares, nominal value US\$0.50 each.	London Stock Exchange Hong Kong Stock Exchange Euronext Paris
American Depositary Shares, each representing 5 Ordinary Shares of nominal value US\$0.50 each.	Bermuda Stock Exchange New York Stock Exchange*
6.20% Non-Cumulative Dollar Preference Shares, Series A	New York Stock Exchange*
American Depositary Shares, each representing one-fortieth of a Share of 6.20% Non-Cumulative Dollar Preference Shares, Series A	New York Stock Exchange
5.25% Subordinated Notes 2012	New York Stock Exchange
6.5% Subordinated Notes 2036	New York Stock Exchange
6.5% Subordinated Notes 2037	New York Stock Exchange
6.8% Subordinated Notes Due 2038	New York Stock Exchange
8.125% Perpetual Subordinated Capital Securities Exchangeable at the Issuer's Option into Non-Cumulative Dollar Preference Shares	New York Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Securities Exchange Act of 1934: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Securities Exchange Act of 1934: None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by

the annual report:

Ordinary Shares, nominal value US\$0.50 each

17,686,155,902

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934.

Yes No.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP

International Financial Reporting Standards as issued by the
International Accounting Standards Board

Other

If "Other" has been checked in response to the previous question indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

* Not for trading, but only in connection with the registration of American Depositary Shares.

Annual Report and Accounts 2010

Certain defined terms

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

Financial statements

The consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the European Union ('EU'). EU-endorsed IFRSs may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2010, there were no unendorsed standards effective for the year ended 31 December 2010 affecting these consolidated and separate financial statements, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to HSBC. Accordingly, HSBC's financial statements for the year ended 31 December 2010 are prepared in accordance with IFRSs as issued by the IASB.

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

When reference to 'underlying' or 'underlying basis' is made in tables or commentaries, comparative information has been expressed at constant currency (see page 14), eliminating the impact of fair value movements in respect of credit spread changes on HSBC's own debt and adjusting for the effects of acquisitions and disposals. A reconciliation of reported and underlying profit before tax is presented on page 15.

Report of the Directors

The information set out in the Report of the Directors on pages 2 to 219 does not constitute the directors' report included in the Company's Annual Report and Accounts for the year ended 31 December 2010 under Section 415 of the Companies Act 2006 as it includes certain supplementary information and explanations.

Contents

Report of the Directors

Overview	2
Financial highlights	2
Cautionary statement regarding forward-looking statements	3(a)
Group Chairman's Statement	4
Group Chief Executive's Business Review	7
Principal activities	10
Strategic direction	10
Top and emerging risks	10
Key performance indicators	11

Operating and Financial Review

Financial summary¹	14
Customer groups and global businesses¹	37
Products and services	38
Geographical regions¹	50
Other information	81
Disclosure controls	80(h)
Management's assessment of internal controls over financial reporting	80(h)
Regulation and supervision	85(b)
Risk¹	86
Capital	177

Governance¹

Corporate Governance Report	183
Biographies of Directors and senior management	183
Board of Directors	189
Board committees	194
Employees	206
Corporate sustainability	212
Share capital	214
Dividends, shareholders and meetings	217

Directors' Remuneration Report¹	220
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Financial Statements and Other Information

Report of Independent Registered Public Accounting Firm	235
Financial Statements¹	
Financial statements	237
Notes on the financial statements	250
Shareholder Information¹	
Shareholder information	371
Glossary of accounting terms and US equivalents	379
Glossary	380
Index	389

¹ Detailed contents are provided on the referenced pages.

Report of the Directors: Overview



Headquartered in London, HSBC is one of the world's largest banking and financial services organisations and one of the industry's most valuable brands. We provide a comprehensive range of financial services to around 95 million customers through two customer groups, Personal Financial Services (including consumer finance), and Commercial Banking, and two global businesses, Global Banking and Markets, and Global Private Banking.

Our international network covers 87 countries and territories in six geographical regions; Europe, Hong Kong, Rest of Asia-Pacific, the Middle East, North America and Latin America.

With listings on the London, Hong Kong, New York, Paris and Bermuda stock exchanges, shares in HSBC Holdings plc are held by over 221,000 shareholders in 127 countries and territories.

Highlights

- Pre-tax profit more than doubled to US\$19bn on a reported basis.
- Underlying pre-tax profit up by almost US\$5bn or 36% to US\$18.4bn.
- Profitable in every customer group and region, including North America, for the first time since 2006.
- Dividends declared in respect of 2010 totalled US\$6.3bn, or US\$0.36 per ordinary share, with a fourth interim dividend for 2010 of US\$0.12 per ordinary share.
- Continued capital generation – core tier 1 ratio increased to 10.5% from 9.4%.
- Customer lending up 8% to US\$958bn; deposits up 7% to US\$1.2 trillion on an underlying basis.

Cover theme

An evening view of the Central Elevated Walkway in Hong Kong's business district. Used by tens of thousands of commuters every day, this walkway forms a vital artery through the heart of Asia's pre-eminent financial centre, which hosts over 190 banks and deposit-taking companies from all over the world.

Report of the Directors: Overview (continued)**Financial highlights****For the year****Profit before taxation****US\$19,037m** – up 169%2009: US\$7,079m
2008: US\$9,307m**Underlying profit before taxation****US\$18,366m** – up 36%

2009: US\$13,482m

Total operating income**US\$80,014m** – up 2%2009: US\$78,631m
2008: US\$88,571m**Net operating income before loan impairment charges and other credit risk provisions****US\$68,247m** – up 3%2009: US\$66,181m
2008: US\$81,682m**Profit attributable to shareholders of the parent company****US\$13,159m** – up 126%2009: US\$5,834m
2008: US\$5,728m**Earnings per share and dividends per share****Earnings per share****US\$0.73** – up 115%2009: US\$0.34
2008: US\$0.41**Dividends per share¹****US\$0.34**2009: US\$0.34
2008: US\$0.93**At the year-end****Loans and advances to customers****US\$958bn** – up 7%2009: US\$896bn
2008: US\$933bn**Customer accounts****US\$1,228bn** – up 6%2009: US\$1,159bn
2008: US\$1,115bn**Ratio of customer advances to customer accounts****78.1%**2009: 77.3%
2008: 83.6%**Total equity****US\$155bn** – up 14%2009: US\$136bn
2008: US\$100bn**Average total shareholders' equity to average total assets****5.5%**2009: 4.7%
2008: 4.9%**Risk-weighted assets****US\$1,103bn** – down 3%2009: US\$1,133bn
2008: US\$1,148bn**Capital ratios****Core tier 1 ratio****10.5%**2009: 9.4%
2008: 7.0%**Tier 1 ratio****12.1%**2009: 10.8%
2008: 8.3%**Total capital ratio****15.2%**2009: 13.7%
2008: 11.4%

Report of the Directors: Overview (continued)**Performance ratios**

Credit coverage ratios

Loan impairment charges to total operating income**16.9%**2009: 31.7%
2008: 27.2%**Loan impairment charges to average gross customer advances****1.5%**2009: 2.8%
2008: 2.5%**Total impairment allowances to impaired loans at year-end****71.6%**2009: 83.2%
2008: 94.3%

Return ratios

Return on average invested capital²**8.7%**2009: 4.1%
2008: 4.0%**Return on average shareholders' equity³,****9.5%**2009: 5.1%
2008: 4.7%**Post-tax return on average total assets****0.6%**2009: 0.3%
2008: 0.3%**Post-tax return on average risk-weighted assets****1.3%**2009: 0.6%
2008: 0.6%

Efficiency and revenue mix ratios

Cost efficiency ratio⁴**55.2%**2009: 52.0%
2008: 60.1%**Net interest income to total operating income****49.3%**2009: 51.8%
2008: 48.1%**Net fee income to total operating income****21.7%**2009: 22.5%
2008: 22.6%**Net trading income to total operating income****9.0%**2009: 12.5%
2008: 7.4%**Share information at the year-end**

US\$0.50 ordinary shares in issue	Market capitalisation	Closing market price		
		London	Hong Kong	American Depositary Share ⁵
17,686m	US\$180bn	£6.51	HK\$79.70	US\$51.04
2009: 17,408m 2008: 12,105m	2009: US\$199bn 2008: US\$114bn	2009: £7.09 2008: £5.77	2009: HK\$89.40 2008: HK\$67.81	2009: US\$57.09 2008: US\$44.15

	Total shareholder return ⁶		
	Over 1 year	Over 3 years	Over 5 years
To 31 December 2010	95.3	103.4	103.4
Benchmarks:			
– FTSE 100 ⁷	112.6	102.8	126.3
– MSCI World ⁷	115.9	111.0	127.0
– MSCI Banks ⁷	103.7	81.9	79.0

For footnotes, see page 83.

Report of the Directors: Overview (continued)

Cautionary statement regarding forward-looking statements

The *Annual Report and Accounts 2010* contains certain forward-looking statements with respect to HSBC's financial condition, results of operations and business.

Statements that are not historical facts, including statements about HSBC's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential' and 'reasonably possible', variations of these words and similar expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made, and it should not be assumed that they have been revised or updated in the light of new information or future events.

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

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

- changes in general economic conditions in the markets in which we operate, such as continuing or deepening recessions and fluctuations in employment beyond those factored into consensus forecasts; changes in foreign exchange rates and interest rates; volatility in equity markets; lack of liquidity in wholesale funding markets; illiquidity and downward price pressure in national real estate markets; adverse changes in central banks' policies with respect to the provision of liquidity support to financial markets; heightened market concerns over sovereign creditworthiness in over-indebted countries; adverse changes in the funding status

of public or private defined benefit pensions; and consumer perception as to the continuing availability of credit and price competition in the market segments we serve;

- changes in government policy and regulation, including the monetary, interest rate and other policies of central banks and other regulatory authorities; initiatives to change the size, scope of activities and interconnectedness of financial institutions in connection with the implementation of stricter regulation of financial institutions in key markets worldwide; revised capital and liquidity benchmarks which could serve to deleverage bank balance sheets and lower returns available from the current business model and portfolio mix; imposition of levies or taxes designed to change business mix and risk appetite; the practices, pricing or responsibilities of financial institutions serving their consumer markets; expropriation, nationalisation, confiscation of assets and changes in legislation relating to foreign ownership; changes in bankruptcy legislation in the principal markets in which we operate and the consequences thereof; general changes in government policy that may significantly influence investor decisions; extraordinary government actions as a result of current market turmoil; other unfavourable political or diplomatic developments producing social instability or legal uncertainty which in turn may affect demand for our products and services; the costs, effects and outcomes of product regulatory reviews, actions or litigation, including any additional compliance requirements; and the effects of competition in the markets where we operate including increased competition from non-bank financial services companies, including securities firms; and
- factors specific to HSBC, including our success in adequately identifying the risks we face, such as the incidence of loan losses or delinquency, and managing those risks (through account management, hedging and other techniques). Effective risk management depends on, among other things, our ability through stress testing and other techniques to prepare for events that cannot be captured by the statistical models it uses; and our success in addressing operational, legal and regulatory, and litigation challenges.

Report of the Directors: Overview (continued)

Group Chairman's Statement



When I took on the role of Chairman less than 90 days ago, I was acutely aware of the challenges facing our industry. I was conscious too of the need to demonstrate to all of our stakeholders that HSBC understands the responsibilities that accompany the systemic significance which continued success has built for HSBC in many of the markets in which we operate, not least those in Asia, given their historical significance to the Group. 145 years after we were founded, Hong Kong and the rest of Asia remain at the heart of HSBC's strength and identity and our commitment to the region is unwavering.

I fully acknowledge that our scale, the trust that our depositors place in us and our relevance to our personal and corporate clients – for their financing, banking, investment and risk management needs – all depend upon our maintaining our reputation and our integrity.

I also understand how important it is for you, our shareholders, that HSBC builds sustainable long-term value that is reflected through the share price and rebuilds, as quickly as competing regulatory demands allow, the dividend that was reduced during the financial crisis.

I firmly believe that HSBC has the people, the financial strength and the organisational structure best able to deliver all of the above and it is a privilege to have the opportunity to serve as Group Chairman as we enter a fresh chapter in our history.

Before I go any further, I want to pay tribute to both Stephen Green and Michael Geoghegan, who stepped down at the end of last year from their roles as Group Chairman and Group Chief Executive after, respectively, 28 and 37 years' service to HSBC. It fell to them to be at the helm as HSBC

navigated its way through the worst financial crisis since the 1930s. Mike led from the front in addressing the problems in our consumer finance subsidiary in the United States and in reshaping HSBC's organisational structure and operational practices in order to better and more efficiently serve an increasingly interconnected world. Stephen's personal reputation for integrity and probity stood out and distinguished HSBC during a period of intense disaffection with the banking industry. For their contribution over many years we owe them a deep debt of gratitude and wish them both well.

Our performance in 2010

The Group Chief Executive's Business Review sets out clearly how HSBC delivered a much improved balance of profits in 2010. It is reassuring to see our Personal Financial Services businesses returning to profitability in aggregate and Commercial Banking growing significantly, largely in emerging markets. These achievements augmented another year of strong performance in Global Banking and Markets.

Earnings per share improved strongly, rising by 115% to reach US\$0.73 per share.

The Group's capital position also strengthened with the core tier 1 ratio, the ratio most favoured by regulators as it comprises equity capital after regulatory adjustments and deductions, increasing from 9.4% to 10.5%, largely due to profit retention throughout the year.

As a consequence of this strong capital generation, together with greater clarity on the direction of regulatory reform of capital requirements and an improving economic backdrop in the developed world – particularly in the United States – the Board has approved increases in both the final dividend payment in respect of 2010 and the planned quarterly dividends for 2011. The final dividend for 2010, payable on 5 May 2011 to shareholders on the register on 17 March 2011, will be 12 cents per ordinary share, up from 10 cents at the same point last year. For the remainder of 2011 we plan to pay quarterly dividends of nine cents for each of the first three quarters compared with eight cents in respect of the equivalent quarters of 2010.

A new leadership team

We enter 2011 with a new leadership team, but only in the sense of changed roles. Everyone has worked together over many years and there is immense experience to draw on both from within HSBC and from earlier careers at peer organisations. Stuart Gulliver is leading the management team as Group Chief Executive. His clear objective is to deliver

Report of the Directors: Overview (continued)

sustainable long-term value for shareholders consistently in a manner that maintains the confidence of all other key stakeholders in our businesses including depositors, counterparties, long-term creditors, customers, employees, regulators and governments. His review on pages 7 to 9 gives an insight into his immediate priorities.

Everything we do is governed by the imperative of upholding HSBC's corporate reputation and character at the highest level and adding further strength to our brand; we deeply regret that a number of weaknesses in regulatory compliance were highlighted in 2010 and we are resolved to remedy these and reinforce the high standards we demand of ourselves.

For my part, I shall be focusing on engaging at the highest level in the regulatory reform debates that will, in large part, shape our future. I shall also lead the Board in the stewardship and review of performance of our financial and human resources.

In the interest of full transparency, we have today published on our website the respective roles and responsibilities of the Group Chairman, the Deputy Chairman and Senior Independent Director and the Group Chief Executive.

Board changes

I have already paid tribute to the contributions of Stephen Green and Michael Geoghegan. Vincent Cheng has indicated that he will step down at the next AGM and on behalf of the Board I want to thank him for his immense contribution in many roles over 33 years. Vincent will retain an association with the Group by taking on an advisory role to the Group Chief Executive on regional matters. Laura Cha will join the Board on 1 March; Laura has been Deputy Chair of The Hongkong and Shanghai Banking Corporation Limited for four years and brings a wealth of experience of China; fuller details of her background and experience are set out in the Directors' Report.

Regulatory update

There was much progress made during 2010 on the regulatory reform agenda. Although there is still a great deal to do, the shape of capital requirements was broadly clarified and an implementation timetable stretching out to 2019 was agreed to allow time for the industry to adjust progressively. A minimum common equity tier 1 ratio of 7%, including a capital conservation buffer, has been agreed. HSBC already meets this threshold requirement. The Group Chief Executive's Business Review addresses how these revised requirements

will impact our targeted return on equity.

During 2011, the debate will be dominated by consideration of the calibration of minimum liquidity standards. Although it is clear that liquidity and funding weaknesses were key elements contributing to the crisis, HSBC agrees with the industry consensus that the revised requirements in these areas are overly conservative and could lead to unnecessary deleveraging at a time of fragile economic recovery in much of the developed world. It will be a near impossibility for the industry to expand business lending at the same time as increasing the amount of deposits deployed in government bonds while, for many banks but not HSBC, reducing dependency on central bank liquidity support arrangements. It is to be hoped that the observation period, which starts this year and precedes the formal introduction of the new requirements, will inform a recalibration of these minimum liquidity standards.

A second debate of importance to HSBC's shareholders in 2011 will concern the designation of 'Systemically Important Financial Institutions' ('SIFI's). Consideration is being given in the regulatory community to mandating higher capital requirements, together with more intense supervision, for institutions classified as SIFIs. We agree with heightened supervision but it is not clear that the reduced shareholder returns that would follow the imposition of incremental capital would be compensated for by improved stability. Classification as a SIFI with a requirement to hold incremental capital would, however, probably lead others to favour SIFIs as counterparties, and may therefore have the unintended consequence of further concentrating the industry.

HSBC's position is that systemic importance should not be determined by size alone. It is clear, however, that, on almost any basis, HSBC would be classified as systemically important. For this reason we are engaging fully in the debate around the consequences of designation as a SIFI. In particular, we draw attention to the benefits of our corporate organisation through separate subsidiaries in mitigation against the imposition of incremental capital for SIFIs based on size alone.

In October 2010, the UK government confirmed its intention to raise the sum of £2.5bn (US\$3.9bn) through a levy on bank balance sheets, and recently announced it will accelerate the full impact of this levy to 2011. We take no issue with the right of the UK government to raise a levy on the banking industry, particularly when having had to risk taxpayers' money to rescue a number of important UK institutions. However, as the proposed levy is to

Report of the Directors: Overview (continued)

be applied to the consolidated balance sheet, it applies beyond the legal boundary of the domestic institution to include overseas operations conducted through separately capitalised subsidiaries. This therefore constitutes an additional cost of basing a growing multinational banking group in the UK.

We intend to clarify in each set of results going forward the impact of the levy, split between UK and overseas operations, and Stuart Gulliver covers this in more detail in his review. We regard the levy, which is not tax deductible, as akin to a distribution of profits. For this reason, we intend to add to future shareholder dividends that would otherwise be paid, any amount saved in the event that the levy is restructured or relieved in due course.

The role of banks in society

The recent crisis has caused a proper introspection as to the role that banks play in society and at HSBC we welcome this. Banking is not simply about money. It is about helping individuals and organisations within society to meet personal and corporate objectives by facilitating access to financial capital and protecting value for those who make capital available. Payment mechanisms, the provision of long-term credit, trade finance, hedging and other risk management products, deposit, investment and retirement services are but a few of the activities through which banking groups contribute to today's financial system. Society cannot function without an effective financial system that delivers value to those it serves at an intermediation cost that is proportionate to the value created. Somehow, many participants and not just banks, lost sight of this basic principle in the run-up to the recent financial crisis and the consequences for all have, inevitably, been far reaching. There is no doubt that the scale of regulatory reform will bring many challenges, but it will also open new opportunities.

At HSBC, we shall not forget what happened to precipitate the scale of reform now underway. Although the financial turmoil arising from the events of 2007-2008 has largely moderated, in large part as a result of co-ordinated government action and support to the financial system, we enter 2011 with humility, ready to apply right across HSBC all of the lessons learned, notwithstanding that HSBC itself neither sought nor received support from any government.

Society has a right to ask if banks 'get it'. At HSBC, we do – and we are focused on embedding the necessary changes in our business model for long-term sustainable value creation. But we also do not forget that value creation depends upon HSBC recruiting, training and retaining the right talent in

order to manage the risks we accept through intermediating customer flows; design solutions to address complex financial problems; build enduring relationships with core customers; build confidence in the Group's financial strength; and create the strategic options that offer the next generation fresh opportunities to continue building sustainable value.

In this globalised world, there is intense competition for the best people and, given our long history within and connections into the faster-growing developing markets, our best people are highly marketable. It would be irresponsible to allow our comparative advantages to wither by ignoring the market forces that exist around compensation, even though we understand how sensitive this subject is. Reform in this area can only be achieved if there is concerted international agreement on limiting the quantum of pay as well as harmonising pay structures but there appears to be no appetite to take the initiative on this. Our duty to shareholders is to build sustainable value in the economic and competitive environment in which we operate and our principal resource for achieving this is human talent. Under the governance of the Board, we will continue to operate and apply remuneration policies and practices that take full recognition of best practice and are aligned with the long-term interests of shareholders.

HSBC's people

Finally, I want to pay tribute to my 307,000 colleagues. So many of HSBC's people have exemplified commitment and endeavour again in 2010, helping our customers and clients to meet their financial objectives while taking on the additional burden of preparing for regulatory change. This has been done against a backdrop of continuing broad-based fiscal support to many economies, with public opinion consistently and highly critical of our industry. As I look forward, it is the combination of the capabilities of HSBC's people, their determination to do the right thing for our customers and their deep sense of responsibility to the communities they serve that makes me confident that HSBC will play a leading role in rebuilding the trust that our industry has lost and, by doing so, will build sustainable value for you, our shareholders.



D J Flint, *Group Chairman*
28 February 2011

Report of the Directors: Overview (continued)

Group Chief Executive's Business Review



Underlying financial performance continued to improve in 2010 and shareholders continued to benefit from HSBC's universal banking model. All regions and customer groups were profitable, as Personal Financial Services and North America returned to profit. Commercial Banking made an increased contribution to underlying earnings and Global Banking and Markets also remained strongly profitable, albeit behind 2009's record performance, reflecting a well-balanced and diversified business.

Credit experience continued to improve, as a result of a stronger global economy and our actions to reduce balance sheet risk. As a globally-connected bank with a growing presence across the world's faster-growing regions, HSBC also benefited from higher trade volumes and strong momentum in emerging economies, especially in Asia. Asia contributed the largest proportion to underlying pre-tax profits, while the contributions made by Latin America and the Middle East also increased. Together with our conservative management of the balance sheet, this improved performance allowed us to concentrate on serving our customers and to further strengthen our capital position.

Group performance headlines¹

- Profit before tax improved year on year. On a reported basis, profits increased by nearly US\$12bn from US\$7.1bn to US\$19bn. On an underlying basis, profits increased by 36%, or almost US\$5bn, from US\$13.5bn to US\$18.4bn.

¹ All figures are discussed on a reported basis and all references to profits are profits before tax unless otherwise stated.

- In a period of sustained low interest rates, revenues remained constrained, reflecting four principal factors: reducing loan balances in our US business; lower trading income in Global Banking and Markets resulting from lower client activity; adverse fair value movements on non-qualifying hedges; and a reduced contribution from Balance Sheet Management in line with earlier guidance.
- Strong asset growth in Commercial Banking, particularly in Asia, higher trade-related revenues generally, and expansion of our wealth management business, again most notably in Asia, partially offset these revenue pressures.
- Loan impairment charges reduced by almost half to US\$14.0bn. All regions and customer groups improved. The US experienced the greatest improvement, largely in the cards and consumer finance portfolios. Loan impairment charges also declined significantly in Latin America and the Middle East.
- In Global Banking and Markets, loan impairment charges fell significantly, notably in Europe as economic conditions improved. Credit risk provisions reduced by US\$1bn to US\$0.4bn in the available-for-sale asset-backed-securities portfolios due to a slowing in the rate of anticipated losses on underlying assets, in line with previous guidance. The associated available for sale reserve declined to US\$6.4bn from US\$12.2bn.
- The cost efficiency ratio rose to 55.2%, which is above our target range and unacceptable to me. The causes were constrained revenues and, in part, investment in strategic growth initiatives across the business together with higher staff costs. It additionally reflected one-off payroll taxes of US\$0.3bn paid in 2010 in respect of the previous year and a pension accounting credit of US\$0.5bn in 2009 and US\$0.1bn in 2010. However, it is also clear that we need to re-engineer the business to remove inefficiencies.
- Return on average total shareholders' equity rose from 5.1% to 9.5%, reflecting increased profit generation during the year.
- HSBC continued to grow its capital base and strengthen its capital ratios further. The core tier 1 ratio increased from 9.4% to 10.5%, as a result of capital generation and lower risk weighted assets.

Report of the Directors: Overview (continued)

- Total loans and advances to customers increased by 7% to US\$958bn while deposits rose by 6% to US\$1.2 trillion.

Impact of the evolving regulatory environment on the business

Much of the detail around the potential impact of change for banks remains uncertain. However, analysis of what we know confirms that our ability to generate capital and manage our risk-weighted assets positions HSBC strongly – and competitively – within the industry as the pace of change intensifies.

HSBC fully supports the rationale of the Basel III proposals which require banks to hold more capital. This is absolutely core to ensuring that governments and taxpayers are better protected in future than they have been in the past.

Certain aspects of the Basel III rules remain uncertain as to interpretation and application by national regulators. Notably, this includes any capital requirements which may be imposed on the Group over the implementation period in respect of the countercyclical capital buffer and any additional regulatory requirements for SIFIs. However, we believe that ultimately the level for the common equity tier 1 ratio of the Group may lie in the range 9.5 to 10.5%. This exceeds the minimum requirement for common equity tier 1 capital plus the capital conservation buffer.

We have estimated the pro forma common equity tier 1 ratio of the Group based on our interpretation of the new Basel III rules as they will apply from 1 January 2019, based on the position of the Group at year-end 2010. The rules will be phased in from 2013 with a gradual impact and we have estimated that their full application, on a proforma basis, would result in a common equity tier 1 ratio which is lower than the Basel II core tier 1 ratio by some 250–300 basis points. The changes relate to increased capital deductions, new regulatory adjustments and increases in risk-weighted assets. However, as the changes will progressively take effect over six years leading up to 2019 and as HSBC has a strong track record of capital generation and actively manages its risk-weighted assets, we are confident in our ability to mitigate the effect of the new rules before they come into force.

Last year, HSBC committed to reviewing its target shareholder return on equity once the effects of new regulation became clearer. Now that we have better visibility on the impact of increased capital requirements, we believe that higher costs of the

evolving regulatory framework will, all other things being equal, depress returns for shareholders of banks. We will therefore target a return on average shareholders' equity of 12-15% in the future.

As Group Chief Executive, it is right that, in managing the business and developing Group strategy, my principal office should be in Hong Kong – a global financial hub of growing importance at the centre of HSBC's strategically most important region. However, the company is headquartered in London and we hope to remain there. London's pre-eminence as an international financial services centre is widely recognised and well-deserved and reflects successful government policy over decades to build that position. It is therefore important to us that the UK's competitive position is protected and sustained. Appropriate supervision is an important part of the larger equation. Policymakers should continue to legislate and regulate, but they must not destroy London's competitive position in the process.

As the Group Chairman has outlined, new legislation is expected to be enacted in the UK, effective from the start of 2011, one curious consequence of which is an explicit incremental cost of being headquartered in the UK for any global bank. Had this been applied for 2010, this annual charge would have amounted to approximately US\$0.6bn in HSBC's case. Moreover, the overseas balance sheet would account for the majority of the annual charge, with the UK balance sheet accounting for approximately one third of the total.

Outlook

We have been closely watching events unfold in parts of the Middle East and North Africa. Our primary concern is for the security of our 12,000 staff across the region and we continue to work to ensure their safety. We have also activated robust continuity plans so that we can also stay open for business and support the needs of our customers. As a strongly capitalised global bank, HSBC's financial performance has not been materially affected by events to date. HSBC has been present in the Middle East for more than 50 years and we remain absolutely committed to its future. We also believe that the region's economies have a number of structural strengths which leave us positive on the longer-term outlook.

In the short term, risks to global growth remain, not least from an elevated oil price. We therefore expect cyclical volatility to continue – including in emerging markets – and progress is unlikely to be linear. In the longer term, we believe that growth

Report of the Directors: Overview (continued)

rates in many Western markets will continue to significantly underperform those of the emerging world. Emerging markets are no longer simply leading the recovery from a Western crisis; the growth gap has become a sustained secular trend.

The global economy's structural position also requires fundamental readjustment. Many Western economies must still deal with a large overhang of household and government debt and weak growth and high unemployment will make this a slow and painful process. As faster-growing nations seek to limit the effect of Western monetary policy on their own economies, we cannot discount the risk of increased tension over exchange rate and trade issues.

HSBC's balance sheet remains strongly positioned to benefit from future interest rate rises. We are realistic that, in many developed countries at least, historically low rates may continue to constrain income growth in the near-term. Nevertheless, maintaining a conservative liquidity position is core to our proposition and to our funding strength. In our risk appetite statement approved by the Board we have set a maximum advances-to-deposits ratio for the Group of 90%. This underlines our continuing commitment to a high level of liquidity and reflects our philosophy that HSBC should not be reliant on wholesale markets for funding. Even with a ratio currently slightly below 80%, we have capacity for further lending growth.

In the short-term, we expect the benefits of asset growth achieved in 2010 to continue to flow into revenues. In the medium-term, we will continue to target growth in the most strategically attractive markets for HSBC and build our capabilities in connectivity, one of our distinctive strengths as a globally-connected bank.

At the same time, with demand in many developed markets constrained and interest spreads

remaining compressed, we fully recognise the importance of ever more robust cost management discipline and the need to continue re-engineering the business to improve efficiency.

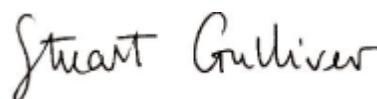
Furthermore, capital is becoming a scarcer resource and, as a new regulatory environment evolves, I am committed to making capital allocation a more disciplined and rigorous process at HSBC in order to drive the correct investment decisions for the future.

We will talk more to investors about each of these initiatives later in the spring. However, as a result of this focus, we are committed to delivering a cost efficiency ratio and a return on average shareholders' equity within our published target range.

We also recognise the importance of reliable dividend income for our shareholders and I believe it should be possible to benchmark a payout ratio of between 40-60% of attributable profits under normal market conditions.

In closing, I would like to acknowledge the huge contribution that my predecessor, Mike Geoghegan, made to HSBC in his five years as Group Chief Executive – not least during 2010 – and I wish him well for the future.

Finally, I am pleased to report that we have had a good start to the year, with continued momentum in lending, mainly in emerging markets and in respect of global trade.



S T Gulliver, *Group Chief Executive*
28 February 2011

Report of the Directors: Overview (continued)

Principal activities

HSBC is one of the largest banking and financial services organisations in the world, with a market capitalisation of US\$180bn at 31 December 2010. We are headquartered in London.

As 'The world's local bank', we combine the largest global emerging markets banking business and a uniquely cosmopolitan customer base with an extensive international network and substantial financial strength.

HSBC operates through long-established businesses and has an international network of some 7,500 offices in 87 countries and territories in six geographical regions; Europe, Hong Kong, Rest of Asia-Pacific, the Middle East, North America and Latin America.

Our products and services are delivered through two customer groups, Personal Financial Services ('PFS') and Commercial Banking ('CMB'), and two global businesses, Global Banking and Markets ('GB&M'), and Global Private Banking ('GPB'). PFS incorporates the Group's consumer finance businesses, the largest of which is HSBC Finance Corporation ('HSBC Finance').

Taken together, our five largest customers do not account for more than 1% of our income.

We have contractual and other arrangements with numerous third parties in support of our business activities. None of the arrangements is individually considered to be essential to the business of the Group.

There were no significant acquisitions during the year (for details of acquisitions see page 340).

Strategic direction

Our objective is to deliver sustainable long-term value to shareholders through consistent earnings and superior risk-adjusted returns.

Our strategy is to be the world's leading international bank, by:

- leveraging the HSBC brand and our network of businesses which covers the world's most relevant geographies. This network provides access to the world's fastest growing economies, for example Greater China. We serve companies as they grow and become more international and individuals as they become wealthier and require more sophisticated financial services, such as wealth management; and
- competing as a universal bank across the full financial services spectrum only where we have scale and can achieve appropriate returns. This implies building scale in attractive geographical regions and businesses where we can be competitive and reviewing businesses which do not meet our financial hurdles.

The strategy reflects the key trends which are shaping the global economy. In particular, we recognise that over the long term, developing markets are growing faster than mature economies and connectivity continues to increase as world trade is expanding at a greater rate than gross domestic product, generating increased demand for financial services. We are, therefore, continuing to direct incremental investment primarily to the faster growing markets and client segments which have international connectivity. In order to deliver this strategy we pursue a series of initiatives, reflected in the Group's key performance indicators:

- enhance efficiency by taking full advantage of local, regional and global economies of scale, in particular by adopting a common systems architecture wherever possible;
- maintain capital strength and a strong liquidity position. Capital and liquidity are critical for our strategy and are the foundation of decisions about the pace and direction of investment; and
- align objectives and incentives to motivate and reward staff for being fully engaged in delivering the strategy.

Report of the Directors: Overview (continued)

Top and emerging risks

All of our activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risk or combinations of risks. We classify risks as ‘top’ and ‘emerging’. A ‘top risk’ is a current, visible risk with the potential to have a material effect on our financial results or our reputation. An ‘emerging risk’ is one which has large unknown components which could have a material impact on our long-term strategy. Top and emerging risks are viewed as falling under the following four broad categories:

- challenges to our business operations;
- challenges to our governance and internal control systems;
- macro-economic and geopolitical risk; and
- macro-prudential and regulatory risks to our business model.

The top and emerging risks are summarised below:

Challenges to our business operations

- Challenges to our operating model in an economic downturn (in developed countries) and rapid growth (in emerging markets)
- Internet crime and fraud

Challenges to our governance and internal control systems

- Level of change creating operational complexity
- Information security risk

Macro-economic and geopolitical risk

- Potential emerging markets asset bubble
- Increased geopolitical risk in Asia-Pacific and Middle East regions

Macro-prudential and regulatory risks to our business model

- Regulatory change impacting our business model and Group profitability
- Regulatory requirements affecting conduct of business

Key performance indicators

The Board of Directors and the Group Management Board (‘GMB’) monitor HSBC’s progress against its strategic objectives. Progress is assessed by comparison with our strategy, our operating plan targets and our historical performance using both financial and non-financial measures.

Following a review of our high-level key performance indicators (‘KPI’s), the GMB decided to make the following changes to the Group’s published indicators in order to restrict their number to those which most accurately reflect its management priorities. The Group now has seven financial and three non-financial KPIs.

- the ratio of advances to core funding has been added to highlight the relationship between loans and advances to customers and core customer deposits in our principal banking entities;
- tier 1 capital has been added as a primary indicator of the strength of our capital base, and its ability to support the growth of the business and meet regulatory capital requirements;
- revenue growth, revenue mix factors and credit performance as measured by risk-adjusted margin have been replaced with risk-adjusted revenue growth;
- the GMB will prioritise return on average total shareholders’ equity in place of return on average invested capital, which has therefore been excluded; and
- customer transactions processed and percentage of information technology (‘IT’) services meeting targets form part of management information within our IT function. However, the GMB decided that these measures, which we have previously disclosed, were not appropriate proxies for assessing efficiencies and progress with implementing standard systems architecture.

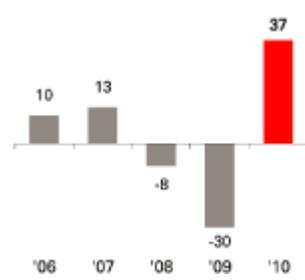
Report of the Directors: Overview (continued)

Strategic objectives

Deliver consistent earnings and superior risk-adjusted returns

Key Performance Indicators

Risk-adjusted revenue growth
(2010: underlying growth 15%)

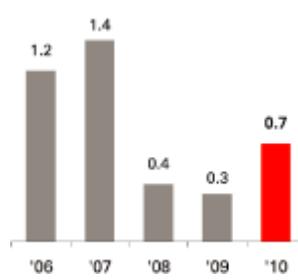


Measure: (percentage) increase in reported net operating income after loan impairment and other credit risk charges since last year.

Target: to deliver consistent growth in risk adjusted revenues.

Outcome: reported risk-adjusted revenue increased, primarily due to a reversal of adverse movements in previous years on the fair value of own debt designated at fair value and lower loan impairment charges. The latter also drove the increase in underlying risk-adjusted revenue.

Basic earnings per ordinary share

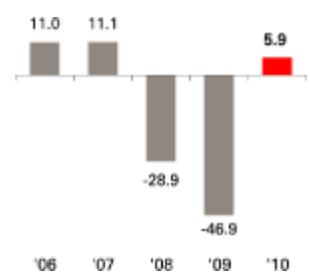


Measure: (US\$) level of basic earnings generated per ordinary share.

Target: to deliver consistent growth in basic earnings per share.

Outcome: Earnings per share ('EPS') increased in 2010, reflecting significantly lower adverse movements on the fair value of own debt due to credit spreads and lower loan impairment charges, which resulted in an increase in reported profit.

Dividends per share growth



Measure: (percentage) increase in dividends per share since last year, based on dividends paid in respect of the year to which the dividend relates.

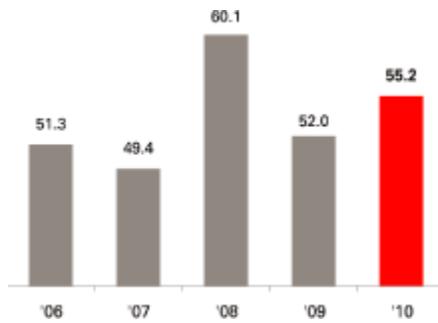
Target: to deliver sustained dividend per share growth.

Outcome: dividends per share increased by 5.9%.

Strategic objectives

Enhance efficiency using economies of scale

Cost efficiency



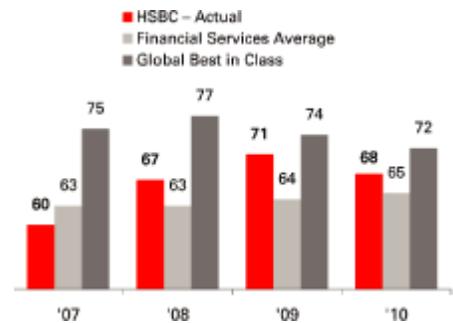
Measure: (percentage) total operating expenses divided by net operating income before loan impairment and other credit risk provisions.

Target: to be between 48% and 52%, a range within which business is expected to remain to accommodate both returns to shareholders and the need for continued investment in support of future business growth.

Outcome: the ratio was outside the target range in part due to one-off costs, but also increased investment in operational infrastructure and strategic initiatives.

Motivate staff to deliver strategy

Employee engagement



Measure: (percentage) measure of employee's emotional and rational attachment to HSBC, a combination of advocacy, satisfaction, commitment and pride.

Target: to achieve a 72% global rating in 2010, with progressive improvement to best in class by 2011.

Outcome: 68%, mirroring the fall in global best in class but remaining well above the financial services average.

Key Performance Indicators

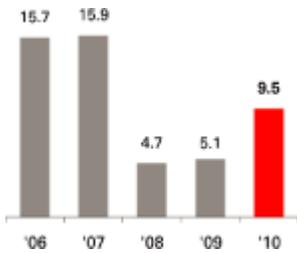
Report of the Directors: Overview (continued)

Maintain capital strength and strong liquidity

Strategic objectives

Key Performance Indicators

Return on average total shareholders' equity

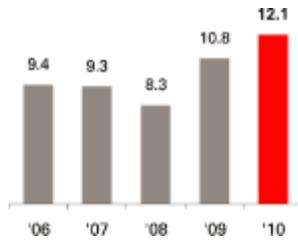


Measure: (percentage) profit attributable to ordinary shareholders divided by average total shareholders' equity.

Target: to maintain a return in the medium term of between 15% and 19%. In 2011, we intend to replace the target with one in the 12% to 15% range over the normal cycle.

Outcome: return on equity was below the target range, but 4.4 percentage points higher than in 2009.

Tier 1 capital

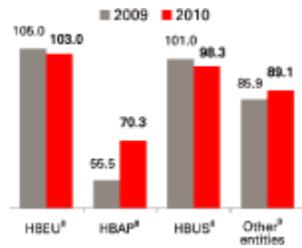


Measure: component of regulatory capital comprising core tier 1 and other tier 1 capital.

Target: to maintain a strong capital base to support the development of the business and meet regulatory capital requirements at all times.

Outcome: the increase in tier 1 capital to 12.1% reflected the contribution of profit to capital, the issue of hybrid capital securities during the year and careful management of RWAs.

Advances to core funding ratio



Measure: current loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year.

Target: to maintain an advances to core funding ratio below limits set for each entity.

Outcome: ratio within the limits set by the Risk Management Meeting for each site.

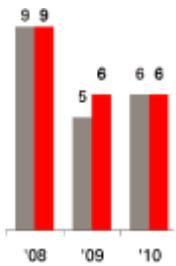
Reach new customers and expand services to existing customers using the HSBC brand and global network

Strategic objectives

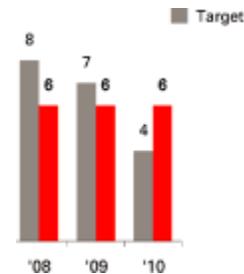
Key Performance Indicators

Brand perception

PFS



Business Banking



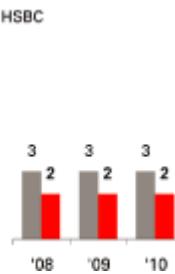
Measure: an independent survey of brands around the world which judges their relative strength. The results are used to form a brand perception index, where the industry average is zero.

Target: to meet or exceed targets based on performance against key competitors and the industry average.

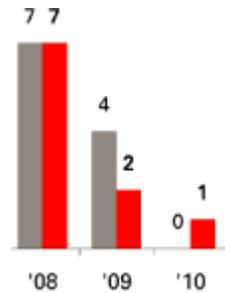
Outcome: PFS and Business Banking customers judged HSBC's brand to be six points stronger than the competitor average. Our ratings met or exceeded our targets in 2010.

Customer recommendation

PFS



Business Banking



Measure: an independent survey of customers in up to 15 countries which judges how likely they are to recommend a particular brand. The results are used to create a customer recommendation index, where the industry average is zero.

Target: to meet or exceed targets based on performance against key competitors and the industry average.

Outcome: Business Banking exceeded its target. Personal Financial Services fell short of its challenging target, but remained well above the competitor average.

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review

Financial summary

	Page
Reconciliation of reported and underlying profit before tax	14
Consolidated income statement	16
Group performance by income and expense item	18
Net interest income	18
Net fee income	19
Net trading income	20
Net income from financial instruments designated at fair value	21
Gains less losses from financial investments	22
Net earned insurance premiums	22
Other operating income	23
Net insurance claims incurred and movement in liabilities to policyholders	24
Loan impairment charges and other credit risk provisions	24
Operating expenses	26
Share of profit in associates and joint ventures	28
Tax expense	28
2009 compared with 2008	28(a)
Consolidated balance sheet	29
Movement in 2010	30
Average balance sheet	31(b)
Average balance sheet and net interest income	31(b)
Analysis of changes in net interest income and net interest expense	31(i)
Short-term borrowings	31(l)
Contractual obligations	31(l)
Ratios of earnings to combined fixed charges	31(l)
Loan maturity and interest sensitivity analysis	31(m)
Deposits	31(n)
Certificates of deposit and other time deposits	31(p)
Economic profit	32
Critical accounting policies	33

The management commentary included in the Report of the Directors: 'Overview' and 'Operating and Financial Review', together with the 'Employees' and 'Corporate sustainability' sections of 'Governance' and the 'Directors' Remuneration Report' is presented in compliance with the IFRS Practice Statement Management Commentary issued by the IASB.

Reconciliation of reported and underlying profit before tax

We measure our performance internally on a like-for-like basis by eliminating the effects of foreign currency translation differences, acquisitions and disposals of subsidiaries and businesses, and fair value movements on own debt attributable to credit spread where the net result of such movements will be zero upon maturity of the debt; all of which distort year-on-year comparisons. We refer to this as our underlying performance.

Reported results include the effects of the above items. They are excluded when monitoring progress against operating plans and past results because

management believes that the underlying basis more accurately reflects operating performance.

Constant currency

Constant currency comparatives for 2009 referred to in the commentaries are computed by retranslating into US dollars for non-US dollar branches, subsidiaries, joint ventures and associates:

- the income statements for 2009 at the average rates of exchange for 2010; and
- the balance sheet at 31 December 2009 at the prevailing rates of exchange on 31 December 2010.

Constant currency comparatives for 2008 referred to in the 2009 commentaries are computed on the same basis, by applying average rates of exchange for 2009 to the 2008 income statement and rates of exchange on 31 December 2009 to the balance sheet at 31 December 2008.

No adjustment has been made to the exchange rates used to translate foreign currency denominated assets and liabilities into the functional currencies of any HSBC branches, subsidiaries, joint ventures or associates. When reference is made to 'constant currency' in tables or commentaries, comparative data reported in the functional currencies of HSBC's operations have been translated at the appropriate exchange rates applied in the current period on the basis described above.

Underlying performance

The tables below compare our underlying performance in 2010 and 2009 with reported profits in those years.

The foreign currency translation differences reflect the relative strengthening of the US dollar against the euro and sterling, which offset its relative weakness against currencies in Asia, Mexico and Brazil during 2010.

The following acquisitions and disposals affected both comparisons:

- the acquisition of PT Bank Ekonomi Raharja Tbk ('Bank Ekonomi') in May 2009;
- the gain on sale of our 49% interest in a joint venture for a UK merchant acquiring business in June 2009 of US\$280m;
- the gain of US\$62m on reclassification of Bao Viet Holdings ('Bao Viet') from an available-for-sale asset to an associate in January 2010;
- the gain on sale of our stake in Wells Fargo HSBC Trade Bank in March 2010 of US\$66m;
- the gain on disposal of HSBC Insurance Brokers Limited of US\$107m in April 2010;
- the dilution gain of US\$188m which arose on our holding in Ping An Insurance (Group) Company of China, Limited ('Ping An Insurance') following the issue of shares by the company in May 2010;

Report of the Directors: Operating and Financial Review (continued)

- the loss of US\$42m on the completion of the sale of our investment in British Arab Commercial Bank plc in October 2010;
- the gain on sale of Eversholt Rail Group of US\$255m in December 2010; and
- the gain of US\$74m on the deconsolidation of private equity funds following the management buy-out of Headland Capital Partners Ltd (formally known as HSBC Private Equity (Asia) Ltd) in November 2010.

Reconciliation of reported and underlying profit before tax

	2010 compared with 2009								
	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2009 at 2010 exchange rates ¹² US\$m	2010 as reported US\$m	2010 adjust- ments ¹⁰ US\$m	2010 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
HSBC									
Net interest income	40,730	(1)	642	41,371	39,441	(31)	39,410	(3)	(5)
Net fee income	17,664	(210)	182	17,636	17,355	(3)	17,352	(2)	(2)
Changes in fair value ¹⁴	(6,533)	6,533	–	–	(63)	63	–	99	–
Other income	14,320	(283)	228	14,265	11,514	(719)	10,795	(20)	(24)
Net operating income¹⁵	66,181	6,039	1,052	73,272	68,247	(690)	67,557	3	(8)
Loan impairment charges and other credit risk provisions	(26,488)	–	(330)	(26,818)	(14,039)	–	(14,039)	47	48
Net operating income	39,693	6,039	722	46,454	54,208	(690)	53,518	37	15
Operating expenses	(34,395)	200	(568)	(34,763)	(37,688)	19	(37,669)	(10)	(8)
Operating profit	5,298	6,239	154	11,691	16,520	(671)	15,849	212	36
Income from associates	1,781	(1)	11	1,791	2,517	–	2,517	41	41
Profit before tax	7,079	6,238	165	13,482	19,037	(671)	18,366	169	36
By geographical region									
Europe	4,009	2,546	(152)	6,403	4,302	(164)	4,138	7	(35)
Hong Kong	5,029	1	(10)	5,020	5,692	(130)	5,562	13	11
Rest of Asia-Pacific	4,200	3	205	4,408	5,902	(211)	5,691	41	29
Middle East	455	–	(2)	453	892	42	934	96	106
North America	(7,738)	3,688	46	(4,004)	454	(208)	246		
Latin America	1,124	–	78	1,202	1,795	–	1,795	60	49
Profit before tax	7,079	6,238	165	13,482	19,037	(671)	18,366	169	36
By customer group and global business									
Personal Financial Services	(2,065)	(2)	(70)	(2,137)	3,518	(10)	3,508		
Commercial Banking	4,275	(306)	64	4,033	6,090	(133)	5,957	42	48
Global Banking and Markets	10,481	13	173	10,667	9,536	(342)	9,194	(9)	(14)
Global Private Banking	1,108	–	1	1,109	1,054	1	1,055	(5)	(5)
Other	(6,720)	6,533	(3)	(190)	(1,161)	(187)	(1,348)	83	(609)
Profit before tax	7,079	6,238	165	13,482	19,037	(671)	18,366	169	36

For footnotes, see page 83.

Additional information is available on pages 47(a) to 47(f) and 80(b) to 80(g).

Report of the Directors: Operating and Financial Review (continued)**Consolidated income statement***Five-year summary consolidated income statement*

	2010 US\$m	2009 US\$m	2008 US\$m	2007 US\$m	2006 US\$m
Net interest income	39,441	40,730	42,563	37,795	34,486
Net fee income	17,355	17,664	20,024	22,002	17,182
Net trading income	7,210	9,863	6,560	9,834	8,222
Net income/(expense) from financial instruments designated at fair value	1,220	(3,531)	3,852	4,083	657
Gains less losses from financial investments	968	520	197	1,956	969
Gains arising from dilution of interests in associates	188	–	–	1,092	–
Dividend income	112	126	272	324	340
Net earned insurance premiums	11,146	10,471	10,850	9,076	5,668
Gains on disposal of French regional banks	–	–	2,445	–	–
Other operating income	2,374	2,788	1,808	1,439	2,546
Total operating income	80,014	78,631	88,571	87,601	70,070
Net insurance claims incurred and movement in liabilities to policyholders	(11,767)	(12,450)	(6,889)	(8,608)	(4,704)
Net operating income before loan impairment charges and other credit risk provisions	68,247	66,181	81,682	78,993	65,366
Loan impairment charges and other credit risk provisions	(14,039)	(26,488)	(24,937)	(17,242)	(10,573)
Net operating income	54,208	39,693	56,745	61,751	54,793
Total operating expenses ¹⁷	(37,688)	(34,395)	(49,099)	(39,042)	(33,553)
Operating profit	16,520	5,298	7,646	22,709	21,240
Share of profit in associates and joint ventures	2,517	1,781	1,661	1,503	846
Profit before tax	19,037	7,079	9,307	24,212	22,086
Tax expense	(4,846)	(385)	(2,809)	(3,757)	(5,215)
Profit for the year	14,191	6,694	6,498	20,455	16,871
Profit attributable to shareholders of the parent company	13,159	5,834	5,728	19,133	15,789
Profit attributable to non-controlling interests	1,032	860	770	1,322	1,082
<i>Five-year financial information</i>					
	US\$	US\$	US\$	US\$	US\$
Basic earnings per share ¹⁸	0.73	0.34	0.41	1.44	1.22
Diluted earnings per share ¹⁸	0.72	0.34	0.41	1.42	1.21
Dividends per share ¹	0.34	0.34	0.93	0.87	0.76
	%	%	%	%	%
Dividend payout ratio ¹⁹	46.6	100.0	226.8	60.4	62.3
Post-tax return on average total assets	0.57	0.27	0.26	0.97	1.00
Return on average total shareholders' equity	9.5	5.1	4.7	15.9	15.7
Average foreign exchange translation rates to US\$: US\$1: £	0.648	0.641	0.545	0.500	0.543
US\$1: €	0.755	0.719	0.684	0.731	0.797

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Reported profit before tax of US\$19.0bn in 2010 was 169% higher than in 2009, and 36% higher on an underlying basis. The difference between reported and underlying results is explained on page 14. Except where stated otherwise, the commentaries in the Financial Summary are on an underlying basis and references to HSBC Finance and HSBC Bank USA are on a management basis, rather than a legal entity basis (for details see page 37).

Net operating income before loan impairment charges and other credit risk provisions ('revenue') was lower than in 2009, notably due to a decline in balances in North America, lower trading income from adverse movements on non-qualifying hedges and a fall in revenue from GB&M. In the former, we continued to reposition our core businesses and we remained focused on managing down our run-off portfolios. As a consequence, revenue fell, reflecting declining balances in the run-off portfolios and in the Card and Retail Services business, where revenue was also adversely affected by new regulations. In GB&M, lower revenue was generated in Balance Sheet Management as higher yielding positions matured and funds were invested in lower yielding assets. Trading income declined driven by increased competition and reduced margins across core products, and less favourable market conditions caused by the European sovereign debt crisis. These factors were partly offset by increased CMB revenue from balance sheet growth, particularly in Asia, and higher trade-related fees.

Loan impairment charges were significantly lower than in 2009, with decreases across all regions and customer groups as economic conditions improved. The most significant decline in loan impairment charges was in North America, reflecting lower balances due to increased repayments, an improvement in delinquency rates in Card and Retail Services, and the continued run-off of balances in the Consumer Finance business. There were also marked declines in the Middle East and in

Latin America, primarily in Mexico and Brazil, reflecting a reduction in personal lending balances as selected portfolios were managed down, and an improvement in credit quality as origination criteria were tightened and collection practices improved. In GB&M, loan impairment charges were significantly lower, reflecting the improvement in the credit environment which resulted in fewer significant charges than those taken in 2009 in relation to a small number of clients, notably in Europe and other credit risk provisions fell in the available-for-sale asset-backed securities ('ABS') portfolio due to a slowing in the rate of anticipated losses in the underlying collateral pools.

Underlying profit before tax rose by 36% as a significant fall in impairment charges offset a decline in revenue.

Operating expenses were higher than in 2009, in part due to specific one-off items such as a US\$0.3bn charge for UK bank payroll tax in 2010 and the non-recurrence of a pension accounting gain of US\$0.5bn in 2009 relating to the treatment of staff benefits. Excluding these items, operating expenses rose in support of strategic growth initiatives in our target markets to invest in operational infrastructure and the selective recruitment of customer-facing staff.

Income from associates increased, driven by strong results in Asia which reflected robust economic growth in mainland China.

In 2010, taxable profits were achieved in the US, principally as the result of a gain from an internal reorganisation that was not recognised for accounting purposes which increased the effective tax rate by 6.4 percentage points. If this were excluded, the effective tax rate would be 19.1% which is in line with our geographical range of business activities. Reported profit after tax was US\$7.5bn higher than in 2009.

Report of the Directors: Operating and Financial Review (continued)

Group performance by income and expense item

Net interest income

	2010 US\$m	2009 US\$m	2008 US\$m
Interest income	58,345	62,096	91,301
Interest expense	(18,904)	(21,366)	(48,738)
Net interest income ²⁰	39,441	40,730	42,563
Average interest-earning assets	1,472,294	1,384,705	1,466,622
Gross interest yield ²¹	3.96%	4.48%	6.23%
Net interest spread ²²	2.55%	2.90%	2.87%
Net interest margin ²³	2.68%	2.94%	2.90%

Summary of interest income by type of asset

	2010			2009			2008		
	Average balance US\$m	Interest income US\$m	Yield %	Average balance US\$m	Interest income US\$m	Yield %	Average balance US\$m	Interest income US\$m	Yield %
Short-term funds and loans and advances to banks	236,742	4,555	1.92	192,578	4,199	2.18	240,111	9,646	4.02
Loans and advances to customers	858,499	44,186	5.15	870,057	48,301	5.55	943,662	68,722	7.28
Financial investments	378,971	9,375	2.47	322,880	9,425	2.92	264,396	12,618	4.77
Other interest-earning assets ²⁴	(1,918)	229	(11.94)	(810)	171	(21.11)	18,453	315	1.71
Total interest-earning assets	1,472,294	58,345	3.96	1,384,705	62,096	4.48	1,466,622	91,301	6.23
Trading assets ²⁵	332,511	6,027	1.81	357,504	7,614	2.13	428,539	16,742	3.91
Financial assets designated at fair value ²⁶	52,692	1,033	1.96	62,143	1,032	1.66	37,303	1,108	2.97
Impairment provisions	(22,905)			(26,308)			(20,360)		
Non-interest-earning assets	664,308			667,942			596,885		
Total assets and interest income	2,498,900	65,405	2.62	2,445,986	70,742	2.89	2,508,989	109,151	4.35

Summary of interest expense by type of liability and equity

	2010			2009			2008		
	Average balance US\$m	Interest expense US\$m	Cost %	Average balance US\$m	Interest expense US\$m	Cost %	Average balance US\$m	Interest expense US\$m	Cost %
Deposits by banks ²⁷	111,443	1,136	1.02	117,847	1,659	1.41	135,747	4,959	3.65
Financial liabilities designated at fair value – own debt issued ²⁸	66,706	1,271	1.91	60,221	1,558	2.59	63,835	3,133	4.91
Customer accounts ²⁹	962,613	10,778	1.12	940,918	11,346	1.21	950,854	27,989	2.94
Debt securities in issue	189,898	4,931	2.60	225,657	5,901	2.62	286,827	11,982	4.18
Other interest-bearing liabilities	8,730	788	9.03	8,640	902	10.44	14,579	675	4.63
Total interest-bearing liabilities	1,339,390	18,904	1.41	1,353,283	21,366	1.58	1,451,842	48,738	3.36
Trading liabilities	258,348	3,497	1.35	205,670	3,987	1.94	277,940	11,029	3.97
Financial liabilities designated at fair value (excluding own debt issued)	17,456	283	1.62	15,688	293	1.87	21,266	345	1.62
Non-interest bearing current accounts	142,579			123,271			98,193		
Total equity and other non-interest bearing liabilities	741,127			748,074			659,747		
Total equity and liabilities	2,498,900	22,684	0.91	2,445,986	25,646	1.05	2,508,988	60,112	2.40

For footnotes, see page 83.

Reported net interest income fell by 3% to US\$39bn; the decline was 5% on an underlying basis. This was driven by the exceptionally low interest rate environment and by the effect of repositioning our customer assets towards secured lending as we reduced our higher risk and higher yielding portfolios.

Revenues in Balance Sheet Management decreased, as expected, from the strong levels of 2009 as higher yielding positions taken in prior years matured and opportunities for reinvestment at equivalent yields were limited by the prevailing low interest rates and flatter yield curves.

Report of the Directors: Operating and Financial Review (continued)

The fall in income from interest-earning assets was driven by declining yields on loans and advances to customers following the Group's decision to reposition the lending portfolio towards higher quality assets. Higher yielding unsecured lending balances decreased, particularly in North America, where the run-off portfolios continued to diminish and credit card balances fell as the number of active accounts declined and repayments by customers increased. Certain higher risk portfolios were also managed down in Latin America, Asia and the Middle East. This reduction was partly offset by commercial lending growth in CMB and GB&M, and growth in secured lending in the UK in residential mortgages.

The interest expense on debt issued by the Group fell, largely due to a decline in average balances in debt securities in issue as HSBC Finance's funding requirements continued to decrease in line with the run-off of the residual balances in Mortgage Services and Consumer

Lending and the sale of the vehicle finance portfolios.

Net interest income includes the expense of the internal funding of trading assets, while related revenue is reported in trading income. The cost of funding these assets declined as a result of the low interest rates. In reporting our customer group results, this cost is included within net trading income.

Net interest spread decreased due to lower yields on loans and advances to customers, partly as a result of the greater focus on secured lending. In addition, returns on financial investments and deposit spreads remained constrained due to low interest rates. Our net interest margin fell by a lesser amount due to the benefit from an increase in net free funds as customers held more funds in liquid non-interest bearing current accounts in the current low interest rate environment.

Net fee income

	2010 US\$m	2009 US\$m	2008 US\$m
Cards	3,801	4,625	5,844
Account services	3,632	3,592	4,353
Funds under management	2,511	2,172	2,757
Broking income	1,789	1,617	1,738
Credit facilities	1,635	1,479	1,313
Insurance	1,147	1,421	1,771
Imports/exports	991	897	1,014
Global custody	700	988	1,311
Remittances	680	613	610
Underwriting	623	746	325
Unit trusts	560	363	502
Corporate finance	440	396	381
Trust income	291	278	325
Mortgage servicing	118	124	120
Maintenance income on operating leases	99	111	130
Taxpayer financial services	73	87	168
Other	2,027	1,894	2,102
Fee income	21,117	21,403	24,764
Less: fee expense	(3,762)	(3,739)	(4,740)
Net fee income	17,355	17,664	20,024

Net fee income marginally decreased compared with 2009 on both a reported and an underlying basis. The significant decrease in fee income in North America, primarily in Card and Retail Services, was mostly offset by higher investment-related fees in Asia and Europe and an increase in trade-related fee income in Asia.

The significant fall in fee income from cards occurred primarily in North America, driven by lower volumes, improved delinquency rates and the revision to charging practices following the implementation of the Credit Card Accountability, Responsibility and Disclosure Act ('CARD Act').

Insurance fee income was markedly down. In the US, the decline resulted from lower sales of credit protection products associated with the cards business. In the UK, income was lower on a reported basis due to the sale of the insurance brokerage business in the first half of 2010.

Overall, underwriting fee income declined, particularly in Europe as a result of reduced capital market activity in the uncertain economic environment, although in Asia underwriting fees increased following several notable transactions.

Report of the Directors: Operating and Financial Review (continued)

Net fee income from sales of investment products in Asia and Europe increased, driven by a stronger investment performance in funds and improved customer sentiment which led to higher volumes.

Net trading income

Trading activities
 Net interest income on trading activities
 Other trading income – hedge ineffectiveness:
 – on cash flow hedges
 – on fair value hedges
 Non-qualifying hedges
 Losses on Bernard L. Madoff Investment Securities LLC fraud
 Net trading income^{30,31}

For footnotes, see page 83.

Reported net trading income was US\$7.2bn, 27% lower than in 2009. On an underlying basis, net trading income declined by 28% due to adverse movements on non-qualifying hedges and lower income from trading activities.

A US\$1.1bn adverse fair value movement was reported on non-qualifying hedges compared with a favourable fair value movement of US\$954m in 2009. These instruments are derivatives entered into as part of a documented interest rate management strategy for which hedge accounting was not, or could not be, applied. They are principally cross-currency and interest rate swaps used to economically hedge fixed rate debt issued by HSBC Holdings, floating rate debt issued by HSBC Finance and certain operating leased assets. The loss recognised on non-qualifying hedges was a result of fair value losses on these instruments, driven by the decrease in long-term US interest rates relative to sterling and euro rates. In HSBC Finance, the volume of non-qualifying hedge positions also increased as the duration of the mortgage book lengthened and swaps were used to align more closely the duration of the funding liabilities. The size and direction of the changes in fair value of non-qualifying hedges which are recognised in the income statement can be volatile from year to year, but do not alter the cash flows expected as part of the documented interest rate management strategy for both the instruments and the underlying economically hedged assets and liabilities.

The remaining decline in net trading income was driven by increased competition and reduced margins across core products. European sovereign debt concerns and increased economic uncertainty resulted in less favourable market conditions

Credit facilities fees also rose, notably in Asia, as a result of an increase in loan syndication transactions completed during the year.

Net fee income from trade finance also increased, particularly in Asia, reflecting a rise in trade activity.

2010 US\$m	2009 US\$m	2008 US\$m
5,708	5,312	2,988
2,530	3,627	5,713
(9)	90	(40)
38	(45)	5
(1,057)	951	(1,122)
–	(72)	(984)
7,210	9,863	6,560

compared with 2009.

In the Credit business, corporate bond trading volumes remained robust following investment in electronic trading capabilities, though revenues were affected as margins declined and credit spread movements were more favourable in 2009. This was partly offset by gains on the legacy portfolio which included a net release of write-downs on legacy positions and monoline credit exposures of US\$429m. This compared with a reported write-down of US\$331m in 2009.

Rates income decreased, reflecting reduced margins and increased risk aversion from customers due to economic uncertainty. Turmoil in the eurozone led to sovereign debt downgrades and falling asset prices in certain European countries, leading to lower revenues in the trading portfolio. These factors were partly offset by a small favourable fair value movement on structured liabilities, compared with an adverse movement in 2009.

Lower net trading income was driven by a US\$2.0bn adverse movement on non-qualifying hedges from 2009.

Performance in the Foreign Exchange business remained strong, although was affected by a competitive trading environment and tighter bid-offer spreads as competitors sought to rebuild their businesses. In addition, revenues fell as market volatility declined from the exceptional levels seen in early 2009.

The Equities business continued to increase market share in its target markets, following

Report of the Directors: Operating and Financial Review (continued)

investment in the equities platform. However, core revenues fell, as overall market volumes and margins declined.

Trading income benefited from foreign exchange gains on trading assets held as economic hedges of foreign currency debt designated at fair value compared with losses on these instruments in 2009. These gains were largely offset by

corresponding losses reported in 'Net income from financial instruments designated at fair value'.

Net interest income earned on trading activities decreased by 30%, driven by reduced holdings of debt securities. The cost of internally funding these assets also declined, but this interest expense is reported under 'Net interest income' and excluded from net trading income.

Net income/(expense) from financial instruments designated at fair value

	2010 US\$m	2009 US\$m	2008 US\$m
Net income/(expense) arising from:			
– financial assets held to meet liabilities under insurance and investment contracts	2,349	3,793	(5,064)
– liabilities to customers under investment contracts	(946)	(1,329)	1,751
– HSBC's long-term debt issued and related derivatives	(258)	(6,247)	6,679
Change in own credit spread on long-term debt	(63)	(6,533)	6,570
Other changes in fair value ³²	(195)	286	109
– other instruments designated at fair value and related derivatives	75	252	486
Net income/(expense) from financial instruments designated at fair value	1,220	(3,531)	3,852

Assets and liabilities from which net income/(expense) from financial instruments designated at fair value arose

	2010 US\$m	2009 US\$m	2008 US\$m
Financial assets designated at fair value at 31 December	37,011	37,181	28,533
Financial liabilities designated at fair value at 31 December	88,133	80,092	74,587
Including:			
Financial assets held to meet liabilities under:			
– insurance contracts and investment contracts with DPF ³³	7,167	6,097	5,556
– unit-linked insurance and other insurance and investment contracts	19,725	16,982	12,758
Long-term debt issues designated at fair value	69,906	62,641	58,686

For footnotes, see page 83.

The accounting policies for the designation of financial instruments at fair value and the treatment of the associated income and expenses are described in Notes 2i and 2b on the Financial Statements, respectively.

The majority of the financial liabilities designated at fair value relate to certain fixed-rate long-term debt issues whose rate profile has been changed to floating through interest rate swaps as part of a documented interest rate management strategy. The movement in fair value of these long-term debt issues includes the effect of our credit spread changes and any ineffectiveness in the economic relationship between the related swaps and own debt. As credit spreads widen or narrow, accounting profits or losses, respectively, are booked. The size and direction of the changes in the credit spread on our debt and ineffectiveness, which are recognised in the income statement, can be volatile from year to year, but do not alter the cash flows envisaged as part of the documented interest

rate management strategy. As a consequence, fair value movements arising from changes in our own credit spread on long-term debt and other fair value movements on the debt and related derivatives are not regarded internally as part of managed performance and are therefore not allocated to customer groups, but are reported in 'Other'. Credit spread movements on own debt are excluded from underlying results, and related fair value movements are not included in the calculation of regulatory capital.

We reported net income from financial instruments designated at fair value of US\$1.2bn in 2010 compared with a net expense of US\$3.5bn in 2009. On an underlying basis, the equivalent figures were income of US\$1.3bn in 2010 and US\$2.9bn in 2009. The difference between the reported and underlying results arises from the exclusion from the latter of the credit spread-related movements in the fair value of our own long-term debt, on which we reported adverse fair value movements of US\$63m

Report of the Directors: Operating and Financial Review (continued)

in 2010 and US\$6.5bn in 2009. In North America, a small favourable fair value movement was reported in 2010 as credit spreads widened marginally, in contrast with a significant adverse fair value movement in 2009. In Europe, significantly lower adverse fair value movements were reported in 2010 as credit spreads tightened, but to a lesser extent than in the previous year.

Income arising from financial assets held to meet liabilities under insurance and investment contracts reflected lower investment gains as the growth in equity markets was less than that of 2009. This predominantly affected the value of assets held to support unit-linked contracts in the UK, Hong Kong, Singapore and Brazil and participating contracts in France.

Gains less losses from financial investments

Net gains/(losses) from disposal of:

- debt securities
- equity securities
- other financial investments

Impairment of available-for-sale equity securities

Gains less losses from financial investments

Reported gains less losses from financial investments increased by US\$448m to US\$968m. On an underlying basis, excluding an accounting gain arising from the reclassification of Bao Viet as an associate following our purchase of additional shares, they increased by 69%. This was driven by a decrease in the level of impairments on available-for-sale equity investments as market values improved, along with an increase in gains on the disposal of equity and debt securities.

Impairments on equity investments declined markedly compared with 2009 as the improving economic situation resulted in a reduction in the level of write-downs required on private equity and other strategic equity investments.

Net earned insurance premiums

Gross insurance premium income

Reinsurance premiums

Net earned insurance premiums

Net earned insurance premiums increased by 6% to US\$11.1bn on both a reported and an underlying basis.

For investment gains or losses related to assets held to back investment contracts, the corresponding movement in liabilities to customers is also recorded under 'Net income from financial instruments designated at fair value'.

Investment gains or losses related to assets held to back insurance contracts or investment contracts with discretionary participation features ('DPF') are offset by a corresponding change in 'Net insurance claims incurred and movement in liabilities to policyholders' to reflect the extent to which unit-linked policyholders, in particular, participate in the investment performance of the associated asset portfolios.

2010 US\$m	2009 US\$m	2008 US\$m
564	463	19
516	407	1,216
(7)	8	4
1,073	878	1,239
(105)	(358)	(1,042)
968	520	197

Higher net gains were reported in Balance Sheet Management on disposals of available-for-sale debt securities, mainly in Europe and Asia. These were partly offset by a decrease in North America, where net gains realised from the sale of mortgage-backed securities and other ABSs in 2009 did not recur.

Net gains on the disposal of equity securities increased, primarily in our private equity portfolio in Europe, as the market offered greater opportunities for divestment. This was partly offset by the non-recurrence of the gain on disposal of our holdings of Visa Inc. shares in 2009.

2010 US\$m	2009 US\$m	2008 US\$m
11,609	10,991	12,547
(463)	(520)	(1,697)
11,146	10,471	10,850

Growth was largely attributable to the continued strong performance of life insurance products in Asia. Successful sales campaigns and the

Report of the Directors: Operating and Financial Review (continued)

recruitment of additional insurance sales managers increased net earned premiums in Hong Kong, particularly from deferred annuity and unit-linked products, and a life insurance product designed for high net worth individuals. Higher sales were also reported in Malaysia, Taiwan and mainland China, primarily from successful product launches and marketing campaigns.

Net earned premiums in Latin America increased marginally in the improved economic conditions, driven by higher sales in Brazil, Argentina and Mexico and repricing initiatives in Argentina.

In France, an increase in sales of investment

Other operating income

Rent received	
Losses recognised on assets held for sale	
Valuation gains/(losses) on investment properties	
Gain on disposal of property, plant and equipment, intangible assets and non-financial investments	
Change in present value of in-force long-term insurance business	
Other	
Other operating income	

Reported other operating income of US\$2.6bn was 8% lower than in 2009. Income in 2010 included gains of US\$188m following the dilution of our holding in Ping An Insurance, US\$107m from the sale of HSBC Insurance Brokers, US\$66m from the disposal of our interest in the Wells Fargo HSBC Trade Bank and US\$255m from the sale of Eversholt Rail Group. In addition, we reported a gain of US\$74m resulting from the sale of HSBC Private Equity (Asia) Ltd, partly offset by a loss of US\$42m on the disposal of our shareholding in British Arab Commercial Bank plc. Reported results in 2009 included a gain of US\$280m from the sale of the remaining stake in the card merchant-acquiring business in the UK.

On an underlying basis, excluding the items referred to above, other operating income decreased by 23%, primarily because gains on the sale of properties in London and Hong Kong in 2009 did not recur.

Net losses recognised on assets held for sale increased, reflecting a US\$207m loss on the sale of the US vehicle finance servicing operation and associated US\$5.3bn loan portfolio.

contracts with DPF drove higher net earned premiums. Strong sales activity also led to higher net earned premiums in our UK life insurance business.

This growth was partly offset by a reduction in non-life insurance premiums, primarily due to the run-off of the legacy motor book in the UK, which was closed during the second half of 2009, and the decision taken during 2010 not to renew certain contracts in the Irish business.

Net earned premiums in North America also decreased, reflecting a decline in sales of payment protection products following the discontinuation of mortgage originations in HSBC Finance.

2010 US\$m	2009 US\$m	2008 US\$m
535	547	606
(263)	(115)	(130)
93	(24)	(92)
889	1,033	881
705	605	286
603	742	257
2,562	2,788	1,808

Net investment valuation gains on investment properties contrasted with losses in 2009. This reflected improvements in the property markets in Hong Kong and the UK which led to net valuation gains on investment properties, compared with net valuation losses in 2009.

A loss on sale of the US vehicle finance business contributed to a fall in Other operating income.

We recognised gains of US\$194m and US\$56m in 2010 on the sale and leaseback of our Paris and New York headquarters buildings, respectively. These compared with more substantial underlying gains of US\$667m (US\$686m as reported) on the sale and leaseback of 8 Canada Square and the sale of a property in Hong Kong in 2009.

Strong sales of life insurance products, notably in Hong Kong, resulted in favourable movements in the present value of in-force ('PVIF') long-term insurance business. These were offset in part by the non-recurrence of gains recognised in 2009 following the refinement of the income recognition methodology in HSBC Finance.

Report of the Directors: Operating and Financial Review (continued)

Net insurance claims incurred and movement in liabilities to policyholders

	2010 US\$m	2009 US\$m	2008 US\$m
Insurance claims incurred and movement in liabilities to policyholders:			
– gross	11,969	12,560	9,206
– reinsurers' share	(202)	(110)	(2,317)
– net ³⁴	11,767	12,450	6,889

For footnote, see page 83.

Net insurance claims incurred and movement in liabilities to policyholders decreased by 5% and 4% on a reported and an underlying basis, respectively.

Lower investment returns than in 2009, particularly in Asia, Europe and Brazil, led to a decrease in the movement in liabilities to policyholders on unit-linked insurance contracts and, to a certain extent, participating contracts, whose policyholders share in the investment performance of the assets supporting their policies. The gains or losses experienced on the financial assets designated at fair value held to support insurance contract liabilities and investment contracts with DPF are reported in 'Net income from financial instruments designated at fair value'.

In Asia, the effect of the lower investment returns was more than offset by additional reserves established for new business written, consistent with the increase in net insurance premiums earned, particularly in Hong Kong, as a result of successful sales campaigns and the recruitment of additional insurance sales managers.

In addition, the increase in reserves in 2009 on the now closed UK motor insurance book, which reflected the rising incidence and severity of claims at that time, did not recur. The decision taken in 2010 not to renew certain contracts in our Irish business resulted in a further decrease in net insurance claims incurred and movement in liabilities to policyholders.

Loan impairment charges and other credit risk provisions

	2010 US\$m	2009 US\$m	2008 US\$m
Loan impairment charges			
– New allowances net of allowance releases	14,568	25,832	24,965
– Recoveries of amounts previously written off	(1,020)	(890)	(834)
	13,548	24,942	24,131
Individually assessed allowances	2,625	4,458	2,064
Collectively assessed allowances	10,923	20,484	22,067
Impairment of available-for-sale debt securities	472	1,474	737
Other credit risk provisions	19	72	69
Loan impairment charges and other credit risk provisions	14,039	26,488	24,937
	%	%	%
– as a percentage of net operating income excluding the effect of fair value movements in respect of credit spread on own debt and before loan impairment charges and other credit risk provisions	20.6	36.4	33.2
Impairment charges on loans and advances to customers as a percentage of gross average loans and advances to customers	1.5	2.8	2.5
	US\$m	US\$m	US\$m
Customer impaired loans	28,091	30,606	25,352
Customer loan impairment allowances	20,083	25,542	23,909

On a reported basis, loan impairment charges and other credit risk provisions were US\$14bn, a decline of 47% compared with 2009 and 48% on an underlying basis. There was improvement across all regions and in all customer groups.

At 31 December 2010, the aggregate balance of customer loan impairment allowances was US\$20.1bn. This represented 2.2% of gross loans and advances to customers (net of reverse repos and settlement accounts) compared with 3.0% at 31 December 2009.

Report of the Directors: Operating and Financial Review (continued)

We actively managed down some of our higher risk portfolios in all regions and enhanced credit quality through tighter underwriting and increased focus on the sale of secured products to customers where we already held a banking relationship. Loan impairment charges in our CMB and GB&M businesses fell as economic conditions improved and we recognised fewer large loan impairment charges against specific clients than in 2009.

Loan impairment charges and other credit risk provisions of US\$14bn were 48% or US\$12.8bn lower than in 2009.

Impairments on available-for-sale debt securities declined markedly to US\$472m from the US\$1.5bn reported in 2009, mainly reflecting a slowing in the rate of anticipated losses in the underlying collateral pools.

The most significant decline in loan impairment charges was in our HSBC Finance portfolios in **the US**, where lending balances reduced and delinquency levels improved.

Loan impairment charges and other credit risk provisions in the US declined by 48% to US\$7.9bn, the lowest level since 2006, representing 57% of the Group's total reduction compared with 2009. This mainly occurred in the US PFS business, where loan impairment charges declined by US\$6.1bn to US\$8.0bn, primarily in the Card and Retail Services business of HSBC Finance and, to a lesser extent, in the run-off consumer finance portfolios.

In Cards and Retail Services, loan impairment charges declined by 57% to US\$2.2bn. This improvement reflected the continuing effects of additional steps taken from the fourth quarter of 2007 to manage risk, including tightening underwriting criteria, lowering credit limits and reducing the number of active cards. An increased focus by our customers on reducing outstanding credit card debt helped improve delinquency levels.

Loan impairment charges in our Consumer Lending and Mortgage Services businesses declined by 29% to US\$5.7bn, due to the continued run-off of lending balances in these portfolios and lower delinquency balances. Total loss severities on foreclosed loans improved compared with 2009, reflecting an increase in the number of properties for which we accepted a deed in lieu of foreclosure or a short sale, both of which result in lower losses compared with loans which are subject to a formal foreclosure process.

During 2010, state and federal prosecutors announced investigations into foreclosure practices

of certain mortgage service providers. As a result, we expect that the scrutiny of documents will increase, and in some states additional verification of information will be required. If these trends continue there may be delays in their processing. See page 83 for more information on the investigation into US foreclosure practices.

In HSBC Bank USA, loan impairment charges in PFS fell by 92% to US\$50m, reflecting lower lending balances and improved credit quality in the residential mortgage portfolio.

In GB&M in the US, a net release of loan impairment charges and other credit risk provisions reflected the improved credit environment and a release of impairments of available-for-sale ABSs as mentioned previously. In CMB, loan impairment charges declined by US\$194m as the improved economic conditions resulted in credit upgrades on certain accounts, and fewer downgrades across all business lines.

In **the UK**, loan impairment charges in PFS and CMB declined as economic conditions improved and interest rates remained at low levels, resulting in an improvement in delinquency levels. In PFS, loan impairment charges fell by 35% to US\$1.1bn as we actively reduced our exposure to unsecured lending, while collections increased mainly due to programmes implemented to improve performance. In the UK secured lending book, credit quality continued to be high and loan impairment charges remained at low levels. In CMB, loan impairment charges declined by US\$159m due to strengthened credit risk management and improved collections, notably in the UK property, retail and service sectors.

Loan impairment charges and other credit provisions fell markedly in GB&M reflecting the improved credit outlook, loan restructuring activity and the non-recurrence of significant charges against a small number of clients in the financial and property sectors. Credit risk provisions on certain available-for-sale ABSs also reduced.

Loan impairment charges and other credit risk provisions in **Latin America** declined by 44% to US\$1.5bn. In PFS, loan impairment charges of US\$1.2bn were 45% lower, mainly in Mexico due to a reduction in balances and improved delinquency rates in our credit card portfolio. In Brazil, they also declined as we managed down the size of certain consumer finance portfolios and economic conditions improved. In 2010, initiatives taken in the region to improve the quality of the loan portfolios continued. These steps included the tightening of underwriting criteria, reducing and, in some

Report of the Directors: Operating and Financial Review (continued)

instances, eliminating the use of higher risk, non-branch sales channels, and continued investment in our collections infrastructure. In our CMB portfolios, loan impairment charges and other credit risk provisions declined by 50% to US\$293m, as improved economic conditions and credit quality resulted in lower specific impairment charges in all sectors.

In the **Middle East**, loan impairment charges and other credit risk provisions fell by 53% to US\$627m as lower loan impairment charges in both PFS and CMB were partly offset by an increase in GB&M following restructuring activities. In our PFS business, loan impairment charges declined by 61% to US\$227m, reflecting a marked decline in delinquency levels and lower lending balances, particularly in our credit card and unsecured personal lending book, as a result of managing down higher risk portfolios. Credit limits were tightened and our customer acquisition strategy was revised in the region to concentrate on Premier and Advance customers. This resulted in an improvement in credit quality. In CMB, lower loan impairment charges

Operating expenses

By expense category

Employee compensation and benefits	19,836	18,468	20,792
Premises and equipment (excluding depreciation and impairment)	4,348	4,099	4,305
General and administrative expenses	10,808	9,293	10,955
Administrative expenses	34,992	31,860	36,052
Depreciation and impairment of property, plant and equipment	1,713	1,725	1,750
Amortisation and impairment of intangible assets	983	810	733
Goodwill impairment	-	-	10,564
Operating expenses	37,688	34,395	49,099

Staff numbers (full time equivalents)

Europe	75,698	76,703	82,093
Hong Kong	29,171	27,614	29,330
Rest of Asia-Pacific	91,607	87,141	89,706
Middle East	8,676	8,281	8,453
North America	33,865	35,458	44,725
Latin America	56,044	54,288	58,559
Staff numbers	295,061	289,485	312,866

Operating expenses increased by 10% to US\$37.7bn on a reported basis and by 8% on an underlying basis. Significant one-off items included aggregate payroll taxes of US\$324m levied on 2009 bonuses in the UK and France, and the curtailment of certain benefits delivered through pension schemes, which generated accounting credits of US\$148m in the US and US\$480m (US\$499m as reported) in the UK in

reflected a reduction in collective impairment charges and fewer specific loan impairment charges as economic conditions improved.

In **Rest of Asia-Pacific**, loan impairment charges declined as the credit environment improved. In India, loan impairment charges fell by 83% to US\$82m, mainly in PFS as certain unsecured lending portfolios and the higher risk elements of the credit card portfolio were managed down, and economic conditions improved. Impairment charges also declined in CMB, due to the non-recurrence of charges against specific technology-related exposures in 2009. Partly offsetting these increases were higher specific loan impairment charges in GB&M.

In **Hong Kong**, loan impairment charges fell by 77% to US\$114m, as economic conditions improved and fewer large specific loan impairment charges were reported against the CMB and GB&M portfolios. Loan impairment charges fell in PFS too, mainly on unsecured lending as unemployment and bankruptcy levels reduced.

2010 US\$m	2009 US\$m	2008 US\$m
19,836	18,468	20,792
4,348	4,099	4,305
10,808	9,293	10,955
34,992	31,860	36,052
1,713	1,725	1,750
983	810	733
-	-	10,564
37,688	34,395	49,099

	At 31 December		
2010	2009	2008	
75,698	76,703	82,093	
29,171	27,614	29,330	
91,607	87,141	89,706	
8,676	8,281	8,453	
33,865	35,458	44,725	
56,044	54,288	58,559	
295,061	289,485	312,866	

2010 and 2009, respectively. Excluding these items, expenses grew by 6% as we continued to invest in our operational infrastructure, customer-facing and support staff, and GB&M's capabilities and platforms.

Employee compensation and benefits increased by 7%, partly due to the net effect of the curtailment gains and the payroll tax referred to above.

Report of the Directors: Operating and Financial Review (continued)

Excluding these items, staff costs rose by 3%. Performance-related costs increased, primarily in Asia, reflecting improved business performance and increased staff numbers. While year-end staff numbers increased as the pace of recruitment accelerated in the second half of the year, average staff numbers remained below 2009 levels. The growth in staff numbers in Asia encompassed both customer-facing and back-office staff supporting business growth and increased operational capacity. In Latin America, staff costs grew following union-agreed salary increases and the recruitment of customer-facing and regional support staff, primarily in the latter part of the year. We also increased resources in our Global Service Centres as we continued to move processes there.

Staff costs declined in the US due to the non-recurrence of restructuring costs associated with the closure of the Consumer Lending branch network in 2009. Also, headcount fell due to the sale of the vehicle finance portfolio and related servicing platform. Similarly, reported staff numbers fell in Europe due to the sale of the insurance broking business in the UK and business reorganisation in France, though this was partly offset by higher numbers of customer-facing staff in the UK and Turkey.

Premises and equipment costs increased as rental costs in the UK, the US and France rose

Cost efficiency ratios

HSBC

Personal Financial Services

Europe
Hong Kong
Rest of Asia-Pacific
Middle East
North America
Latin America

Commercial Banking

Europe
Hong Kong
Rest of Asia-Pacific
Middle East
North America
Latin America

Global Banking and Markets

Global Private Banking

Our cost efficiency ratio worsened by 3.2 percentage points on a reported basis and by 8.4 percentage points to 55.8% on an underlying basis.

following the sale and leaseback of 8 Canada Square, London and our headquarters buildings in the US and France, combined with business expansion in Asia and Europe and refurbishment costs in Europe and Latin America. This was partly offset by lower costs in the US following the closure of the Consumer Lending branch offices and the non-recurrence of the related restructuring costs.

General and administrative expenses rose, reflecting in part higher marketing and advertising costs. These grew in North America in Card and Retail Services, partly from complying with the CARD Act. Marketing costs also rose in Asia and Latin America in support of the launch of Advance and sales campaigns for credit cards and investment products. Project costs increased from various initiatives to enhance operational capabilities, in connection with which consultancy and contractors' fees rose, primarily in the UK as GB&M continued to invest in strategic initiatives to drive future revenue growth. These included the development of Prime Services and equity market capabilities, and the expansion of the Rates and foreign exchange e-commerce platforms.

Travel costs increased as we increased our focus on international connectivity and business growth. Costs also increased due to litigation provisions in North America and Europe.

	2010 %	2009 %	2008 %
HSBC	55.2	52.0	60.1
Personal Financial Services	57.7	51.7	76.4
Europe	67.4	68.7	62.7
Hong Kong	35.3	34.9	32.2
Rest of Asia-Pacific	85.1	81.2	81.5
Middle East	62.2	53.5	53.2
North America	46.9	38.1	106.8
Latin America	72.1	66.7	59.7
Commercial Banking	49.4	46.4	43.0
Europe	51.9	47.4	44.2
Hong Kong	32.2	33.7	26.2
Rest of Asia-Pacific	49.2	47.0	45.9
Middle East	36.4	33.8	32.0
North America	46.6	47.7	46.1
Latin America	65.7	57.0	55.0
Global Banking and Markets	49.9	39.1	67.3
Global Private Banking	65.8	60.5	58.3

In PFS, there was a deterioration of 5.7 percentage points in the cost efficiency ratio. Operating expenses remained broadly unchanged as a rise in costs in

Report of the Directors: Operating and Financial Review (continued)

Asia in support of business expansion was broadly offset by strict cost control across the Group and lower costs in the US. Revenue fell, largely in the run-off portfolio and in Card and Retail Services in North America.

In CMB, the cost efficiency ratio deteriorated by 2.9 percentage points as we continued to invest for future revenue growth in those markets that we see as central to international connectivity. Revenue grew in all regions, albeit at a slower pace, resulting in a deterioration in the cost efficiency ratio, with the exception of Hong Kong where strong revenue growth led to an improvement of 1.5 percentage points.

Share of profit in associates and joint ventures

	2010 US\$m	2009 US\$m	2008 US\$m
Associates			
Bank of Communications Co., Limited	987	754	741
Ping An Insurance (Group) Company of China, Limited	848	551	324
Industrial Bank Co., Limited	327	216	221
The Saudi British Bank	161	172	251
Other	156	42	63
Share of profit in associates	2,479	1,735	1,600
Share of profit in joint ventures	38	46	61
Share of profit in associates and joint ventures	2,517	1,781	1,661

The share of profit from associates and joint ventures increased by 41% to US\$2.5bn on both a reported and an underlying basis as our associates in mainland China capitalised on the improved economic conditions in region.

Our share of profits in Ping An Insurance increased due to strong insurance sales performance, while fee income and lending growth resulted in

Tax expense

	2010 US\$m	2009 US\$m	2008 US\$m
Profit before tax	19,037	7,079	9,307
Tax expense	(4,846)	(385)	(2,809)
Profit after tax	14,191	6,694	6,498
Effective tax rate	25.5%	5.4%	30.2%

The most significant factor influencing the year on year changes to the effective tax rate is the changing geographical split of profits, including the relative proportion of tax on the share of profits in associates and joint ventures included within profit before tax. The impact of the tax on profit on associates and joint ventures included within pre-tax profits was a reduction in the effective tax rate of 3.7% in 2010 and 7.1% in 2009.

In GB&M, the cost efficiency ratio deteriorated by 12.1 percentage points reflecting the one-off payroll and bonus taxes in the UK and France. Excluding them, the ratio deteriorated by 10.5 percentage points following a rise in costs related to higher support costs and continued investment in strategic initiatives being undertaken to drive future revenue growth. Revenue fell during 2010 mainly due to lower net interest income in Balance Sheet Management and lower trading income.

In GBP, the cost efficiency ratio deteriorated by 5.3 percentage points as costs increased, reflecting the hiring of front-line staff, investment in systems and higher compliance costs coupled with lower revenue in the low interest rate environment.

higher profits from the Bank of Communications Co., Limited ('Bank of Communications') and from Industrial Bank Co., Limited ('Industrial Bank').

These results were partly offset by a decrease in our share of profits from The Saudi British Bank as revenue declined amidst challenging economic conditions.

In 2010 HSBC's US operations achieved taxable profits, principally as a result of realising a taxable gain from an internal reorganisation which increased the effective tax rate by 6.4%. If this was excluded the effective tax rate would be 19.1% which is in line with the geographic profile of the Group.

Report of the Directors: Operating and Financial Review (continued)

2009 compared with 2008

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
	2008 as reported US\$m	2008 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2008 at 2009 exchange rates ¹⁶ US\$m	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	2009 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
HSBC									
Net interest income	42,563	(65)	(2,062)	40,436	40,730	(53)	40,677	(4)	1
Net fee income	20,024	(58)	(1,315)	18,651	17,664	(6)	17,658	(12)	(5)
Changes in fair value ¹⁴	6,570	(6,570)	–	–	(6,533)	6,533	–		
Gains on disposal of French regional banks	2,445	(2,445)	–	–	–	–	–	(100)	
Other income	10,080	(680)	(1,597)	7,803	14,320	(298)	14,022	42	80
Net operating income ¹⁵	81,682	(9,818)	(4,974)	66,890	66,181	6,176	72,357	(19)	8
Loan impairment charges and other credit risk provisions	(24,937)	6	709	(24,222)	(26,488)	–	(26,488)	(6)	(9)
Net operating income	56,745	(9,812)	(4,265)	42,668	39,693	6,176	45,869	(30)	8
Operating expenses (excluding goodwill impairment)	(38,535)	68	2,655	(35,812)	(34,395)	31	(34,364)	11	4
Goodwill impairment	(10,564)	–	–	(10,564)	–	–	–	100	100
Operating profit	7,646	(9,744)	(1,610)	(3,708)	5,298	6,207	11,505	(31)	
Income from associates	1,661	–	25	1,686	1,781	–	1,781	7	6
Profit before tax	9,307	(9,744)	(1,585)	(2,022)	7,079	6,207	13,286	(24)	
By geographical region									
Europe	10,869	(6,221)	(1,054)	3,594	4,009	2,561	6,570	(63)	83
Hong Kong	5,461	(5)	20	5,476	5,029	1	5,030	(8)	(8)
Rest of Asia-Pacific	4,722	(3)	(184)	4,535	4,200	(43)	4,157	(11)	(8)
Middle East	1,746	–	(7)	1,739	455	–	455	(74)	(74)
North America	(15,528)	(3,444)	(67)	(19,039)	(7,738)	3,688	(4,050)	50	79
Latin America	2,037	(71)	(293)	1,673	1,124	–	1,124	(45)	(33)
Profit before tax	9,307	(9,744)	(1,585)	(2,022)	7,079	6,207	13,286	(24)	
By customer group and global business									
Personal Financial Services	(10,974)	(148)	(457)	(11,579)	(2,065)	(3)	(2,068)	81	82
Commercial Banking	7,194	(486)	(665)	6,043	4,275	(318)	3,957	(41)	(35)
Global Banking and Markets	3,483	–	(479)	3,004	10,481	(5)	10,476	201	249
Global Private Banking	1,447	–	(48)	1,399	1,108	–	1,108	(23)	(21)
Other	8,157	(9,110)	64	(889)	(6,720)	6,533	(187)		79
Profit before tax	9,307	(9,744)	(1,585)	(2,022)	7,079	6,207	13,286	(24)	

Consolidated income statement

Our reported pre-tax profits in 2009 fell by 24% to US\$7.1bn and earnings per share declined to US\$0.34. Return on average shareholders' equity remained broadly at 2008 levels at 5.1% (2008: 4.7%).

On an underlying basis, our profit before tax increased by US\$15.3bn compared with 2008. The difference between reported and underlying results is

explained on page 14. Except where otherwise stated, the commentaries in the Financial Summary are on an underlying basis.

Profit before tax on an underlying basis and excluding the goodwill impairment charge of US\$10.6bn in 2008, was 56% or US\$4.7bn higher.

Report of the Directors: Operating and Financial Review (continued)

The increase in profit before tax was driven by strong growth in net operating income in GB&M, in part reflecting the absence of significant write-downs in securities and structured credit positions which had affected results in 2008. More significantly, the business benefited from market share gains in core activities and the effect of early positioning by Balance Sheet Management, in anticipation of the low interest rate environment. Results in 2009 also reflected lower loan impairment charges in North America, partly offset by an increase in loan impairment charges and other credit risk provisions elsewhere.

Although our business in North America continued to record a loss, performance improved as write-downs in GB&M reduced and loan impairment charges in PFS decreased. This resulted from steps taken to curtail origination in 2007 and 2008, which culminated in the closure of the Consumer Lending branch network in the second quarter of 2009, and from our decision to place all consumer finance portfolios other than credit cards into run-off. The closure of the branch network fed through to lower operating expenses during the remainder of the year.

In Hong Kong, economic performance remained robust despite continuing challenges, with our results underpinned by a market-leading share in deposits, residential mortgages, cards and insurance. Overall profitability declined, however, as revenue was driven lower by compressed deposit spreads in the low interest rate environment. Loan impairment charges improved on 2008, remaining low, and operating expenses reflected a disciplined approach to cost management.

In the Rest of Asia-Pacific region, the economic challenges faced were similar to those in Hong Kong and their impact was reflected in lower income and higher loan impairment charges. Income from associates, primarily in mainland China, made a significant positive contribution to the region's performance. We continued to expand our presence in Rest of Asia-Pacific through organic growth and strategic investment.

Our Middle East operations suffered from a combination of factors: a severe contraction in the economy of Dubai, a fall in oil revenues for much of the year and investment losses incurred by many regional investors. This led to a decline in profit before tax of 74%, primarily due to a significant increase in loan impairment charges. The regional economic downturn and continuing uncertainty affected both retail and corporate customers, particularly in the United Arab Emirates ('UAE') where the downturn was most pronounced.

In Europe, we reported an increase in profit before tax on an underlying basis, driven by GB&M in London and Paris. This resulted from a strong performance in Rates and Balance Sheet Management, coupled with the benefit of stabilisation of asset prices and general tightening of credit spreads and lower write-downs in the credit trading business. This was partly offset by a reduction in deposit spreads in PFS and CMB as interest rates fell, and an increase in loan impairment charges in Global Banking, reflecting a deterioration in the credit position of a small number of clients.

The increase in profit before tax was driven by strong growth in GB&M.

In Latin America, the decline in pre-tax profits was driven by an increase in loan impairment charges in PFS and CMB and lower revenues in PFS, partly offset by a strong performance in trading and Balance Sheet Management in GB&M. The lower revenues in PFS were in part due to the continued curtailment of personal unsecured credit exposures, following our adverse experience in 2008, with net interest income also adversely affected by declining interest rates and narrowing spreads.

With the exception of PFS, which continued to be heavily affected by the consumer finance losses in North America, all customer groups remained profitable.

The following items are significant to a comparison of reported results with 2008:

- the non-recurrence of the US\$10.6bn goodwill impairment charge in North America recorded in 2008;
- the non-recurrence of a US\$2.4bn gain on the sale of French regional banks in 2008;
- fair value losses relating to own credit spreads of US\$6.5bn in 2009 compared with gains of US\$6.6bn in 2008;
- a US\$72m fraud loss relating to Bernard L Madoff Investment Securities LLC ('Madoff Securities') in 2009, which was in addition to the US\$984m charge reported in 2008;
- loss from write-downs in legacy securities and structured credit positions amounting to US\$0.3bn in 2009 compared with US\$5.4bn in 2008;
- the acquisition in 2008 of the subsidiary, Project Maple II B.V., which owned our headquarters at 8 Canada Square, London E14 5HQ and the subsequent sale of the company and leaseback of

Report of the Directors: Operating and Financial Review (continued)

the property in 2009, resulting in gains of US\$0.6bn in 2009 and US\$0.4bn in 2008;

- the sale of the card merchant-acquiring business in the UK, resulting in gains of US\$0.3bn in 2009 and US\$0.4bn in 2008;
- the change in the basis of delivering long-term employee benefits in the UK, which generated a one-off accounting gain of US\$0.5bn in 2009; and
- the tax expense of US\$0.3bn in 2009, which was lower than in previous years as a result of the geographic distribution of income. We generated profits in low tax rate jurisdictions, principally Asia, and incurred losses in high tax rate jurisdictions, principally the US, which when mixed produced a low overall rate.

Group performance by income and expense item

Net interest income

Our reported net interest income of US\$40.7bn fell by 4% compared with 2008, but was marginally higher on an underlying basis.

Reported net interest income includes the expense of the internal funding of trading assets, while related revenue is reported in trading income. The cost of internally funding these assets declined significantly as a result of the low interest rate environment. In our customer group reporting, this cost is included within trading income.

Deposit spreads were squeezed by the exceptionally low interest rates, although this was partly offset by the reduced cost of funding trading activities. Strong revenues in Balance Sheet Management reflected positions taken in 2008 ahead of the reduction in major currency interest rates. As these positions began to mature, the revenue from Balance Sheet Management's activities reduced but remained strong in the second half of 2009.

Average interest-earning assets fell slightly due to a decline in term lending, mainly from the run-off portfolios in North America and the decline in consumer credit appetite globally.

Average interest-bearing liabilities also decreased, due to a decline in debt securities in issue as funding requirements for HSBC Finance fell as certain portfolios were managed down. This was largely offset by a rise in current account balances, driven by growth in customer demand for more liquid assets. The very low interest rates led to clients holding an increasing proportion of funds in liquid current accounts rather than in savings and deposit

accounts as they positioned for rising interest rates or prospective investment opportunities.

Competition for deposits and exceptionally low interest rates squeezed deposit margins.

The net interest spread rose slightly. As a result of continuing deposit inflows, we sourced an increasing proportion of our funding from customer accounts, and consequently reduced our reliance on relatively more expensive debt securities. The benefit of this was largely offset, however, by a decline in customer lending, particularly higher yielding personal lending, which reduced the average yield on assets.

Net fee income

Reported net fee income decreased by 12% to US\$17.7bn, 5% lower on an underlying basis.

Lower credit card fees and weaker equity markets led to a decline in net fee income.

Credit card fees fell significantly, mainly in North America, reflecting lower transaction volumes, a reduction in cards in issue and changes in customer behaviour which led to lower cash advance, interchange, late and overlimit fees. In the UK, the decrease primarily arose from the disposal of the card-acquiring business to a joint venture in June 2008.

Weaker equity markets and subdued investor sentiment for higher risk products led to a reduction in both the volume and the value of equity-related products. This resulted in a decrease in fees generated from funds under management, global custody and unit trusts, though fees grew from equity capital markets products in GB&M. The impact was particularly marked in the first half of 2009, though market-related fees recovered somewhat in the second half of the year as market values rose and investor appetite for equity products increased.

Account services fees fell, predominantly in North America as the result of a decline in credit card volumes and changes in customer behaviour, and in GPB due to a decrease in fiduciary deposit commissions as lower interest rates drove down balances.

Insurance broking fees also fell, mainly due to lower origination volumes of credit-related products, principally in the US consumer finance business, and reduced payment protection business in the UK.

Corporate credit facility and underwriting fees increased strongly on the back of higher debt originations in Europe and North America which

Report of the Directors: Operating and Financial Review (continued)

accompanied the considerable reconstruction and refinancing of corporate balance sheets in 2009.

Net trading income

Reported net trading income increased by 50% to US\$9.9bn, 83% higher on an underlying basis.

Reported trading income excludes the interest expense of the internal funding of trading assets. As noted in 'Net interest income', the cost of internally funding these assets declined significantly as a result of the low interest rate environment.

The Credit business benefited from a general tightening of credit spreads following a return of liquidity to much of the market, and the write-downs on legacy positions in Credit trading declined significantly following the stabilisation of asset prices.

Net trading income rose by 83% on an underlying basis.

An increase in Rates revenues, particularly in the first half of the year, reflected increased market share and client trading volumes, wider bid-offer spreads and early positioning for interest rate movements. Partly offsetting these gains, fair value losses were recorded on our structured liabilities as a result of credit spreads tightening, compared with gains in this area in 2008.

Equities benefited from the non-recurrence of the US\$984m charge reported in 2008 in respect of Madoff Securities. The core Equities business also took advantage of a changed competitive landscape to capture a greater share of business in strategic markets from key institutional clients.

Foreign exchange trading revenues were well ahead of 2007, but fell short of the record year in 2008. This reflected a combination of reduced customer volumes from lower trade flows and investment activity, and relatively lower market volatility.

Tightening credit spreads led to losses of US\$429m on credit default swap transactions in parts of the Global Banking portfolio. In 2008, gains of US\$912m were reported on these credit default swaps as a result of widening credit spreads.

A reduction in net interest income on trading activities reflected the sharp fall in interest rates at the end of 2008 but was partly compensated for by a reduction in the internal funding cost of trading activities, which is reported in 'Net interest income'.

Income from non-qualifying hedges related to mark-to-market gains on cross-currency swaps as the

US dollar depreciated against sterling, and on interest rate swaps as US dollar long and medium term interest rates increased over the year. In 2008, appreciation of the US dollar and a fall in interest rates led to mark-to-market losses on these instruments.

During the second half of 2008, we reclassified US\$17.9bn of assets from 'held for trading' to 'loans and receivables' and 'available for sale' following the IASB's amendment to International Accounting Standard ('IAS') 39. Had these reclassifications not taken place and the assets had continued to be accounted for on a fair value basis, we would have recorded additional gains of US\$1.5bn in 2009 (2008: losses of US\$3.5bn).

Net income from financial instruments designated at fair value

We designate certain financial instruments at fair value to remove or reduce accounting mismatches in measurement or recognition, or where financial instruments are managed and their performance is evaluated together on a fair value basis. All income and expense from financial instruments designated at fair value are included in this line except for interest arising from our issued debt securities and related derivatives managed in conjunction with those debt securities, which is recognised in 'Interest expense'.

We principally use the fair value designation in the following instances (for which all numbers are 'reported'):

- for certain fixed-rate long-term debt issues whose rate profile has been changed to floating through interest rate swaps as part of a documented interest rate management strategy. Approximately US\$63bn (2008: US\$59bn) of our debt issues have been accounted for using the fair value option.

The movement in fair value of these debt issues includes the effect of own credit spread changes and any ineffectiveness in the economic relationship between the related swaps and own debt. As credit spreads widen or narrow, accounting profits or losses, respectively, are booked. The size and direction of the accounting consequences of changes in own credit spread and ineffectiveness can be volatile from year to year, but do not alter the cash flows envisaged as part of the documented interest rate management strategy. As a consequence, gains and losses arising from changes in own credit spread on long-term debt are not regarded internally as part of managed performance and are excluded from underlying results. Similarly, such gains and

Report of the Directors: Operating and Financial Review (continued)

losses are ignored in the calculation of regulatory capital;

- for US\$15bn (2008: US\$11bn) of financial assets held to meet liabilities under insurance contracts, and certain liabilities under investment contracts with discretionary participation features; and
- for US\$8bn (2008: US\$7bn) of financial assets held to meet liabilities under unit-linked and other investment contracts, as well as the associated liabilities.

A net expense from financial instruments designated at fair value of US\$3.5bn was reported compared with income of US\$3.9bn in 2008.

A significant change in credit spread on our own debt in 2009 reversed the movement in 2008.

On an underlying basis, we reported income of US\$3.0bn in 2009 compared with an expense of US\$2.6bn in 2008. The large difference between the reported and underlying results is due to the exclusion of the effect of credit spread-related movements in the fair value of our own long-term debt from underlying performance.

Income of US\$3.8bn was recorded due to a fair value movement on assets held to back insurance and investment contracts, compared with an expense of US\$4.8bn in 2008. This reflected investment gains in the current year driven by improved market performance, predominantly affecting the value of assets held in unit-linked and participating funds in Hong Kong, the UK and France.

- To the extent that the investment gains related to assets held to back investment contracts, the expense associated with the corresponding increase in liabilities to customers was also recorded under net income from financial instruments designated at fair value. This expense amounted to US\$1.3bn in 2009 compared with an income of US\$1.5bn in 2008 when liabilities fell in line with declining asset markets.
- To the extent that the investment gains related to assets held to back insurance contracts, they were offset by a corresponding increase in 'Net insurance claims and movement in liabilities to policyholders' to reflect the extent to which unit-linked policyholders, in particular, participate in the investment performance experienced in the associated asset portfolios.

Gains less losses from financial investments

Reported gains less losses from financial investments increased by US\$323m to US\$520m. On an underlying basis, they increased by US\$546m.

Net gains on the disposal of debt securities increased significantly, due to gains recorded on the sale of mortgage-backed securities in North America. They were supplemented by smaller gains, principally on the disposal of available-for-sale bonds in Latin America and the UK.

Sales of Visa shares contributed significant gains during 2008, with additional gains from further sales in 2009. Other gains recognised during 2008, including those recorded on the sale of MasterCard shares, were not repeated in 2009.

A significantly lower level of impairments on equity investments was recognised in 2009 than in 2008 in Asia, Europe and North America, reflecting the improvement in the economic situation and equity markets. Of the investments on which material impairments were recognised in 2008, a significant amount reversed during 2009 due to share price appreciation, notably in India and, to a lesser extent, Vietnam; however, under IFRSs all subsequent increases in the fair value are treated as a revaluation and are recognised in other comprehensive income rather than the income statement.

Net earned insurance premiums

Reported net earned insurance premiums amounted to US\$10.5bn, a decrease of 3% compared with 2008. On an underlying basis, net earned insurance premiums increased by 3%. Growth was recorded in Asia, Brazil and France, but this was largely offset by significant declines in the UK and the US.

Net earned insurance premiums continued to grow in Asia, mainly from the launch of new products including a life insurance product designed for high net worth individuals and a guaranteed savings product. In Hong Kong, we retained our position as the leading bancassurer and increased net earned insurance premiums as a result of higher sales of unit-linked and whole life products.

Growth in insurance premiums in Asia, Brazil and France was largely offset by declines in the UK and US.

In Latin America, premium growth was driven by higher sales of pension and life products in Brazil, partly due to a number of customers switching their personal pension annuities to us.

Report of the Directors: Operating and Financial Review (continued)

In France, growth was significantly influenced by a large one-off reinsurance transaction in June 2008, which passed insurance premiums to a third-party reinsurance provider. Adjusting for this, net earned insurance premiums were ahead of 2008 despite a significant reduction in the distribution network following the disposal of the French regional banks in July 2008.

In the UK, demand for the Guaranteed Income Bond savings product declined as HSBC offered more favourable rates on an alternative deposit product. As the deposit product was a savings bond rather than an insurance contract, its income was recorded under net interest income, while the associated fall in sales of insurance products led to a US\$1.1bn reduction in insurance premium income with an equivalent decrease in 'Net insurance claims incurred and movement in liabilities to policyholders', as described below.

The reduction in origination volumes in the consumer finance business in North America also led to correspondingly lower sales of credit protection insurance as the consumer finance business was closed.

Other operating income

Reported other operating income of US\$2.8bn was 54% higher than in 2008. This included a US\$280m gain related to the sale of the remaining stake in the card merchant-acquiring business in the UK, compared with a US\$425m gain in 2008 from the sale of the first tranche. In 2008, results also included gains of US\$71m related to the sale of our stake in Financiera Independencia. On an underlying basis, other operating income rose by 163%, driven mainly by an increase in insurance-related income in Hong Kong, a rise in gains on property disposals and lower losses on foreclosed properties.

Increased insurance income in Hong Kong, higher gains on property disposals and lower losses on foreclosed properties in the US helped drive an underlying US\$1.5bn rise in other operating income.

Losses recognised on assets held for sale declined as losses on foreclosed properties in HSBC Finance decreased, partly due to lower inventory levels following delays in the foreclosure process and partly due to some stabilisation in real estate prices.

Property gains of US\$576m were recognised in respect of the sale and leaseback of 8 Canada Square, London which was effected through the disposal of our entire shareholding in Project Maple II B.V. ('PMII') to the National Pension Service of Korea.

In 2008, we reported a gain of US\$416m in respect of the purchase of PMII.

An increase in insurance sales to new customers in Hong Kong resulted in positive movements in the present value of in-force ('PVIF') long-term insurance business. Further positive movements arose from refining the income recognition methodology used in respect of long-term insurance contracts in HSBC Finance. In 2008, a similar refinement in Brazil and our introduction of enhanced benefits to existing pension products in the UK, resulted in favourable movements in PVIF.

In Hong Kong, a gain of US\$110m was recognised in respect of a property disposal, and in Argentina a gain was realised on the sale of the head office building.

Other operating income includes higher gains on the sale of prime residential mortgage portfolios in the US, gains from the extinguishment of certain debt issued by our mortgage securitisation vehicles in the UK and lower costs associated with the provision of support to certain money market funds.

Net insurance claims incurred and movement in liabilities to policyholders

Reported net insurance claims incurred and movement in liabilities to policyholders increased by 81% to US\$12.5bn. On an underlying basis, they increased by 94%.

The increase in net insurance claims incurred and movement in liabilities to policyholders mainly reflected the improvement in investment market performance compared with 2008 described above under 'Financial instruments designated at fair value'. Higher investment gains were broadly matched by movement in liabilities to policyholders on unit-linked and, to a certain extent, participating policies whose policyholders share in the investment performance of the supporting assets. The gains generated on the assets held to support insurance contract liabilities are reported in 'Net income from financial instruments designated at fair value'.

New business growth in a number of regions during 2009, particularly Hong Kong and Singapore, also contributed to an increase in the movement in liabilities to policyholders, as did the non-recurrence of a large one-off reinsurance transaction in France in 2008. The decline in sales of a Guaranteed Income Bond noted above had a corresponding effect on movement in liabilities to policyholders in the UK.

As a consequence of a rising incidence and severity of claims, aggregate charges of US\$310m were made to strengthen reserves in the UK motor

Report of the Directors: Operating and Financial Review (continued)

book and the Irish reinsurance business during 2009. The UK motor insurance business was placed into run-off in September 2009.

Loan impairment charges and other credit risk provisions

Reported loan impairment charges and other credit risk provisions were US\$26.5bn in 2009, an increase of 6% over 2008, 9% on an underlying basis. Within this, collectively assessed impairment allowances declined while individually assessed impairment allowances continued to increase.

Our aggregate outstanding customer loan impairment allowances at 31 December 2009 of US\$25.5bn represented 3% of gross customer advances (net of reverse repos and settlement accounts) compared with 2.6% at the end of 2008.

Loan impairment charges declined in certain businesses, notably PFS in North America and CMB in Hong Kong, but this was more than offset by increases elsewhere, primarily on individually significant loans within GB&M and more broadly on CMB exposures outside Hong Kong as the global economic downturn adversely affected the ability of many customers to service their loan commitments. As a consequence, loan impairment charges rose despite an underlying 9% decline in gross loans and advances to customers which was driven mainly by the run-off of the US consumer finance portfolios.

In our US PFS business, loan impairment charges declined by 11% to US\$14.2bn, as additional delinquencies due to the continued deterioration in the US economy were more than offset by the effect of lower balances in the run-off portfolios in HSBC Finance.

In HSBC Finance, loan impairment charges decreased by 12%. The reduction arose in most portfolios, but mainly in Mortgage Services as the portfolio continued to run off. In Consumer Lending, loan impairment charges increased, particularly in the unsecured personal lending portfolio, due to a deterioration in the 2006 and 2007 vintages and, to a lesser extent, first lien real estate secured loans, which was partly offset by lower loan impairment charges in the real estate secured portfolio. Loan impairment charges in the Card and Retail Services portfolio decreased despite the state of the US economy and higher levels of unemployment and personal bankruptcy. The main reason was the decline in card balances following actions taken to manage risk beginning in the fourth quarter of 2007 and continuing through 2009, and stable credit conditions.

In HSBC Bank USA, increased loan impairment charges in the personal lending portfolios were due to additional delinquencies which resulted in increased write-offs in the prime first lien mortgage loan portfolios as house prices continued to deteriorate in certain markets.

Loan impairment charges and other credit risk provisions increased significantly in GB&M. Loan impairment charges increased, reflecting the impairment of a small number of exposures in the financial and property sectors in Europe and the Middle East. Further impairments were also recognised in respect of certain asset-backed securities held in the available-for-sale portfolio, reflecting mark-to-market losses which we judged to be significantly in excess of the likely ultimate cash losses.

Loan impairment charges declined in PFS in the US but rose in CMB outside Hong Kong and in GB&M.

In the UK, loan impairment charges rose in both the CMB and PFS portfolios. However, despite the contraction in the economy, charges remained a low proportion of the portfolio. In CMB, loan impairment charges largely reflected economic weakness in a broad range of sectors.

In UK PFS, loan impairment charges also increased as unemployment rose. This was seen primarily in the credit card and unsecured personal loan portfolios. In the residential mortgage portfolios, delinquency rates decreased as we continued to benefit from very limited exposure to buy-to-let and self-certified mortgages. Our mortgage exposure continued to be well secured, with an average loan-to-value ratio for new UK business in HSBC Bank's mortgage portfolio, excluding First Direct, of under 55% in 2009, compared with 59% in 2008.

In the Middle East, our loan impairment charges increased markedly from US\$280m to US\$1.3bn as the region experienced a significant economic contraction in activity, predominantly in real estate and construction, which particularly affected the UAE. CMB recorded a number of specific loan impairment charges and a significant increase in collective loan impairment charges. Lower employment in the region, largely driven by the decline in construction activity, led to a rise in loan impairment charges in PFS, particularly in the credit card and personal lending portfolios.

In Latin America, our portfolios were affected by the weaker economic environment for much of the year. In PFS, loan impairment charges rose by 12% to US\$2.0bn, with increased delinquencies in

Report of the Directors: Operating and Financial Review (continued)

credit cards, mortgages, vehicle finance and payroll loans due to higher unemployment. In the Brazilian CMB portfolios, higher delinquencies were experienced primarily in the business banking and mid-market segments. In Mexico, action taken in 2008 to curtail originations and increase collection resources held loan impairment charges broadly unchanged notwithstanding the deterioration in the economy and the impact of the H1N1 virus.

In India, as in Mexico, curtailment of origination activity in unsecured personal lending slowed the increase in loan impairment charges in the unsecured credit card and personal lending portfolios in PFS. In CMB, a higher number of corporate failures including a number of fraud-related losses, led to increased loan impairment charges.

Loan impairment charges and other credit risk provisions in Hong Kong decreased by 35% to US\$500m as the economic environment improved in 2009, credit conditions recovered and international trade volumes improved.

In GBP, loan impairment charges increased from a very low level, largely attributable to a specific charge relating to a single client relationship in the US.

Operating expenses

Reported operating expenses fell by US\$14.7bn to US\$34.4bn, with the most significant feature being the non-recurrence of the goodwill impairment charge of US\$10.6bn in 2008 to fully write off goodwill in PFS in North America. Excluding this and on an underlying basis, operating expenses fell by 4%.

Underlying operating expenses excluding goodwill impairment fell by 4%.

Employee compensation and benefits fell by 4% as costs in the US declined following the closure of the branch-based consumer finance business in the first quarter of 2009. Average headcount in most regions was lower and this was reflected in lower costs. In the UK, a change in the basis of delivering death-in-service, ill health and early retirement benefits for some UK employees generated a one-off accounting gain of US\$499m which was partly offset by increased regular pension costs. There were higher performance-related costs in GB&M reflecting its results. The UK and French governments announced one-off taxes in late 2009 in respect of certain bonuses payable by banks and banking groups. In both countries there is uncertainty over the interpretation of the draft proposals, and detailed analysis of individual awards

in the context of the final legislation will be required to determine the precise effect of the taxes. The estimated tax payable under the proposals as currently drafted is US\$355m in the UK and US\$45m in France. The taxes will be payable and accounted for in 2010 once the legislation is enacted.

Premises and equipment costs increased marginally with higher rental costs reflecting the sale and leaseback of a number of properties in 2008. One-off costs incurred due to the closure of the Consumer Lending branch network in the US were partly offset by savings resulting from the closure.

General and administrative expenses fell as we focused on managing costs tightly and increasing efficiency. Marketing and advertising costs fell across the Group, most notably in Card and Retail Services in North America, and in the UK. Travel and entertainment costs, and expenditure related to services contracted to third parties, fell, primarily in Europe and North America. Better use of direct channels, increased automation of manual processes, enhanced utilisation of global service centres and elimination of redundant systems continued to be driven through our One HSBC programme. In North America, cost savings also resulted in the Consumer Lending Business from the discontinuation of loan originations and the closure of branches.

Share of profit in associates and joint ventures

The share of profit in associates and joint ventures was US\$1.8bn, an increase of 7% on 2008, and 6% on an underlying basis.

Our share of profits from Ping An Insurance increased by 62% as a result of the non-recurrence of its impairment of its investment in Fortis SA/NV and Fortis N.V. ('Fortis') in 2008 and an increase in new business sales and investment returns which were boosted by a recovery in equity markets during 2009. This was partly offset by the non-recurrence of favourable changes to investment assumptions in the first half of 2008.

6% underlying increase in share of profit in associates and joint ventures.

Our share of profits from the Bank of Communications remained in line with 2008 as higher fee and trading income and a lower tax charge were broadly offset by a decline in net interest income and higher loan impairment charges.

Profits from The Saudi British Bank were lower than in 2008 as an increase in loan impairment charges was only partly offset by increased operating income.

Report of the Directors: Operating and Financial Review (continued)

The share of profits from joint ventures fell due to a decline in the profitability of HSBC Saudi Arabia Ltd as a result of a slowdown in initial public offerings ('IPO's) and a decline in assets under management. This was partly offset by an increase in profits from HSBC Merchant Services UK Ltd in the first half of 2009 compared with the second half of 2008. HSBC Merchant Services UK Ltd was created in June 2008 and sold in June 2009.

Tax expense

The most significant factor influencing the year on year changes to the effective tax rate is the changing geographical split of profits, including the relative proportion of tax on the share of profits in associates and joint ventures included within profit before tax. The impact of the tax on profit on associates and joint ventures included within pre-tax profits was a reduction in the effective tax rate of 7.1% in 2009 and 5.1% in 2008.

In 2009 the losses in HSBC's US operations were tax effected at the local tax rate of 35.4%, while the profits in the rest of the HSBC Group were taxed at their local rates which averaged 18.8%. The combination of these two rates produced an overall tax effect of 5.44%.

The tax expense and effective tax rate also fell in 2009 due to the non-recurrence of the US\$10.6bn goodwill impairment charge in North America which, for tax purposes, was non-deductible and hence increased the effective tax rate by some 16% in 2008.

Report of the Directors: Operating and Financial Review (continued)**Consolidated balance sheet***Five-year summary consolidated balance sheet and selected financial information*

	At 31 December				
	2010 US\$m	2009 US\$m	2008 US\$m	2007 US\$m	2006 US\$m
ASSETS					
Cash and balances at central banks	57,383	60,655	52,396	21,765	12,732
Trading assets	385,052	421,381	427,329	445,968	328,147
Financial assets designated at fair value	37,011	37,181	28,533	41,564	20,573
Derivatives	260,757	250,886	494,876	187,854	103,702
Loans and advances to banks	208,271	179,781	153,766	237,366	185,205
Loans and advances to customers ³⁵	958,366	896,231	932,868	981,548	868,133
Financial investments	400,755	369,158	300,235	283,000	204,806
Other assets	147,094	149,179	137,462	155,201	137,460
Total assets	2,454,689	2,364,452	2,527,465	2,354,266	1,860,758
LIABILITIES AND EQUITY					
Liabilities					
Deposits by banks	110,584	124,872	130,084	132,181	99,694
Customer accounts	1,227,725	1,159,034	1,115,327	1,096,140	896,834
Trading liabilities	300,703	268,130	247,652	314,580	226,608
Financial liabilities designated at fair value	88,133	80,092	74,587	89,939	70,211
Derivatives	258,665	247,646	487,060	183,393	101,478
Debt securities in issue	145,401	146,896	179,693	246,579	230,325
Liabilities under insurance contracts	58,609	53,707	43,683	42,606	17,670
Other liabilities	109,954	148,414	149,150	113,432	103,010
Total liabilities	2,299,774	2,228,791	2,427,236	2,218,850	1,745,830
Equity					
Total shareholders' equity	147,667	128,299	93,591	128,160	108,352
Non-controlling interests	7,248	7,362	6,638	7,256	6,576
Total equity	154,915	135,661	100,229	135,416	114,928
Total equity and liabilities	2,454,689	2,364,452	2,527,465	2,354,266	1,860,758
<i>Five-year selected financial information</i>					
Called up share capital	8,843	8,705	6,053	5,915	5,786
Capital resources ^{36,37}	167,555	155,729	131,460	152,640	127,074
Undated subordinated loan capital	2,781	2,785	2,843	2,922	3,219
Preferred securities and dated subordinated loan capital ³⁸	54,421	52,126	50,307	49,472	42,642
Risk weighted assets and capital ratios³⁶	1,103,113	1,133,168	1,147,974	1,123,782	938,678
Risk weighted assets					
	%	%	%	%	%
Tier 1 ratio	12.1	10.8	8.3	9.3	9.4
Total capital ratio	15.2	13.7	11.4	13.6	13.5
Financial statistics					
Loans and advances to customers as a percentage of customer accounts	78.1	77.3	83.6	89.5	96.8
Average total shareholders' equity to average total assets	5.53	4.72	4.87	5.69	5.97
Net asset value per ordinary share at year-end ³⁹ (US\$)	7.94	7.17	7.44	10.72	9.24
Number of US\$0.50 ordinary shares in issue (millions)	17,686	17,408	12,105	11,829	11,572
Closing foreign exchange translation rates to US\$:					
US\$1: £	0.644	0.616	0.686	0.498	0.509
US\$1: €	0.748	0.694	0.717	0.679	0.759

*For footnotes, see page 83.**A more detailed consolidated balance sheet is contained in the Financial Statements on page 240.*

Report of the Directors: Operating and Financial Review (continued)

Movement in 2010

Total assets amounted to US\$2.5 trillion, 4% higher than at 31 December 2009. Excluding the effect of currency movements, underlying total assets increased by 5%. This reflected higher mortgage lending in Hong Kong and the UK, strong demand for commercial loans and a rise in trading assets in North America and Asia as a result of customer demand, supported by improved liquidity generated by higher deposits and our debt issuance programme.

The Group's reported tier 1 ratio increased from 10.8% to 12.1% due to the contribution from profits attributable to shareholders for the year net of dividends paid, the issue of hybrid capital securities net of redemptions, and a reduction in the reported level of risk-weighted assets ('RWA's). The latter was driven by a decline in some retail portfolio exposures in North America as a result of run-off, partly offset by the effect of lending growth in Asia. Market risk RWAs decreased as a result of reduced volatility and continuing exposure management. For more details of capital and RWAs, see page 177.

The following commentary is on an underlying basis.

Assets

Cash and balances at central banks decreased by 4% as a result of lower year-end cash balances in North America as excess liquidity was redeployed into highly-rated government debt securities. This was partly offset by higher year-end cash balances in Europe.

Trading assets fell by 6%, due to the deconsolidation of the Constant Net Asset Value ('CNAV') funds totalling US\$44bn (see Note 43 on the Financial Statements). This was offset, in part, by higher issuance of and customer demand for government and government agency debt securities, particularly in North America and Asia, and an increase in holdings of equities to hedge derivative positions arising from a rise in client trading activity. Higher customer-driven trading volumes also resulted in an increase in reverse repo balances in North America; this was partly offset by a reduction in reverse repo balances in Europe due to market uncertainty.

Strong increase in loans and advances to customers and customer accounts, notably in Asia, drove balance sheet growth.

Financial assets designated at fair value grew by 3% due to an increase in volumes in equity funds and a rise in the fair value of equity securities held

within the insurance business, particularly in Europe and Hong Kong, as market values recovered and client risk appetite returned. This was partly offset by the sale of European government debt securities by Balance Sheet Management.

Derivative assets rose by 8%. This was driven by increases in the fair value of interest rate contracts as a result of downward shifts of major yield curves, offset by higher netting from increased trading with clearing houses. The notional value of outstanding contracts also rose, reflecting an increase in the number of open transactions compared with 2009.

Loans and advances to banks increased by 16% due to higher placements with commercial and central banks in Europe and Latin America.

Loans and advances to customers grew by 8% as we targeted commercial loans and, in the improved economic conditions, demand grew from customers, notably in Asia. The increase in demand for credit, along with competitive pricing, also drove continued growth in mortgage lending in Hong Kong and the UK, though mortgage balances declined in North America as the Consumer Lending and Mortgage Services portfolios continued to run off and credit card lending fell.

Financial investments rose by 9%, mainly in North America and Europe, as Balance Sheet Management redeployed cash into available-for-sale treasury bills and government agency debt securities. This was partly offset by a decline in financial investments in Asia, as a result of disposals and debt securities that matured and were not replaced to support growth in commercial lending.

Liabilities

Deposits by banks decreased by 8%, reflecting a notable decline in central bank deposits in Europe which was partly offset by an increase in central bank deposits in Asia.

Customer accounts were 7% higher, driven by an overall increase in savings and current accounts across most regions, particularly in Asia and Europe. Growth in Premier and online savings contributed to a significant increase in current account balances as customers responded well to targeted promotional campaigns.

Trading liabilities increased by 16%. Higher repo balances in North America were reported as a result of increased trading volumes of treasury and corporate bonds driven by market volatility in the bond market. In Europe, short bond and equity

Report of the Directors: Operating and Financial Review (continued)

positions used to hedge derivative transactions increased, reflecting higher client demand.

Financial liabilities designated at fair value rose by 12% due to debt issuances by HSBC entities in Europe during 2010.

Derivative businesses are managed within market risk limits and, as a consequence, the increase in the value of *derivative liabilities* broadly matched that of derivative assets.

Debt securities in issue were in line with 2009, as new issuances of medium-term notes by HSBC entities in Europe during 2010 were offset by lower funding requirements in North America as the consumer finance portfolios in run-off declined.

Liabilities under insurance contracts grew by 12%. This was driven by strong life insurance sales

in Hong Kong following the launch of several new products, and gains on unit-linked products as investment market values improved.

Other liabilities were 26% lower than at 31 December 2009 due to the deconsolidation of the CNAV funds (see 'Trading assets' above).

Equity

Total shareholders' equity increased by 17%, driven by profits generated during the year and the issue of Perpetual Subordinated Capital Securities, a form of tier 1 hybrid capital securities, in June 2010. In addition, the negative balance on the available-for-sale reserve declined from US\$10.0bn at 31 December 2009 to US\$4.1bn at 31 December 2010, largely reflecting improvements in the market value of assets.

Reconciliation of reported and underlying assets and liabilities

31 December 2010 compared with 31 December 2009

	31 Dec 09 as reported US\$m	Currency Translation ⁴⁰ US\$m	31 Dec 09 at 31 Dec 10 exchange rates US\$m	Under- lying change US\$m	31 Dec 10 as reported US\$m	Reported change %	Under- lying change %
HSBC							
Cash and balances at central banks	60,655	(731)	59,924	(2,541)	57,383	(5)	(4)
Trading assets	421,381	(12,483)	408,898	(23,846)	385,052	(9)	(6)
Financial assets designated at fair value	37,181	(1,134)	36,047	964	37,011	–	3
Derivative assets	250,886	(9,285)	241,601	19,156	260,757	4	8
Loans and advances to banks	179,781	(5)	179,776	28,495	208,271	16	16
Loans and advances to customers	896,231	(10,788)	885,443	72,923	958,366	7	8
Financial investments	369,158	(268)	368,890	31,865	400,755	9	9
Other assets	149,179	(1,826)	147,353	(259)	147,094	(1)	–
Total assets	2,364,452	(36,520)	2,327,932	126,757	2,454,689	4	5
Deposits by banks	124,872	(4,182)	120,690	(10,106)	110,584	(11)	(8)
Customer accounts	1,159,034	(8,064)	1,150,970	76,755	1,227,725	6	7
Trading liabilities	268,130	(8,660)	259,470	41,233	300,703	12	16
Financial liabilities designated at fair value	80,092	(1,570)	78,522	9,611	88,133	10	12
Derivative liabilities	247,646	(9,262)	238,384	20,281	258,665	4	9
Debt securities in issue	146,896	(1,066)	145,830	(429)	145,401	(1)	–
Liabilities under insurance contracts	53,707	(1,593)	52,114	6,495	58,609	9	12
Other liabilities	148,414	(431)	147,983	(38,029)	109,954	(26)	(26)
Total liabilities	2,228,791	(34,828)	2,193,963	105,811	2,299,774	3	5
Total shareholders' equity	128,299	(1,679)	126,620	21,047	147,667	15	17
Non-controlling interests	7,362	(13)	7,349	(101)	7,248	(2)	(1)
Total equity	135,661	(1,692)	133,969	20,946	154,915	14	16
Total equity and liabilities	2,364,452	(36,520)	2,327,932	126,757	2,454,689	4	5

For footnote, see page 83.

In 2010, the effect of acquisitions was not material.

Report of the Directors: Operating and Financial Review (continued)*Reconciliation of reported and underlying loans and advances to customers and customer accounts by geographical region*

	31 December 2010 compared with 31 December 2009						
	31 Dec 09 as reported US\$m	Currency translation ¹¹ US\$m	31 Dec 09 at 31 Dec 10 exchange rates US\$m	Under- lying change US\$m	31 Dec 10 as reported US\$m	Reported change %	Under- lying change %
Loans and advances to customers (net)							
Europe	439,481	(20,778)	418,703	17,096	435,799	(1)	4
Hong Kong	99,381	(92)	99,289	41,402	140,691	42	42
Rest of Asia-Pacific	80,043	5,802	85,845	22,886	108,731	36	27
Middle East	22,844	(139)	22,705	1,921	24,626	8	8
North America	206,853	2,562	209,415	(18,883)	190,532	(8)	(9)
Latin America	47,629	1,857	49,486	8,501	57,987	22	17
	896,231	(10,788)	885,443	72,923	958,366	7	8
Customer accounts							
Europe	495,019	(21,560)	473,459	18,104	491,563	(1)	4
Hong Kong	275,441	(474)	274,967	22,517	297,484	8	8
Rest of Asia-Pacific	133,999	8,938	142,937	15,218	158,155	18	11
Middle East	32,529	(320)	32,209	1,302	33,511	3	4
North America	149,157	2,259	151,416	7,070	158,486	6	5
Latin America	72,889	3,093	75,982	12,544	88,526	21	17
	1,159,034	(8,064)	1,150,970	76,755	1,227,725	6	7

Reconciliation of reported and underlying loans and advances to customers and customer accounts by customer groups and global businesses

	31 December 2010 compared with 31 December 2009						
	31 Dec 09 as reported US\$m	Currency translation ¹¹ US\$m	31 Dec 09 at 31 Dec 10 exchange rates US\$m	Under- lying change US\$m	31 Dec 10 as reported US\$m	Reported change %	Under- lying change %
Loans and advances to customers (net)							
Personal Financial Services	399,460	(2,176)	397,284	(6,327)	390,957	(2)	(2)
Commercial Banking	199,674	(1,493)	198,181	41,105	239,286	20	21
Global Banking and Markets	256,956	(6,622)	250,334	34,169	284,503	11	14
Global Private Banking	37,031	(431)	36,600	4,065	40,665	10	11
Other	3,110	(66)	3,044	(89)	2,955	(5)	(3)
	896,231	(10,788)	885,443	72,923	958,366	7	8
Customer accounts							
Personal Financial Services	499,109	(1,710)	497,399	27,785	525,184	5	6
Commercial Banking	267,388	(1,537)	265,851	20,156	286,007	7	8
Global Banking and Markets	284,727	(4,711)	280,016	28,437	308,453	8	10
Global Private Banking	106,533	(108)	106,425	705	107,130	1	1
Other	1,277	2	1,279	(328)	951	(26)	(26)
	1,159,034	(8,064)	1,150,970	76,755	1,227,725	6	7

For footnote, see page 83.

In 2010, the effect of acquisitions was not material.

Report of the Directors: Operating and Financial Review (continued)

Average balance sheet

Average balance sheet and net interest income

Average balances and related interest are shown for the domestic operations of our principal commercial banks by geographical region. 'Other operations' comprise the operations of our principal commercial banking and consumer finance entities outside their domestic markets and all other banking operations, including investment banking balances and transactions.

Average balances are based on daily averages for the principal areas of our banking activities with monthly or less frequent averages used elsewhere.

Assets

Balances and transactions with fellow subsidiaries are reported gross in the principal commercial banking and consumer finance entities within 'Other interest-earning assets' and 'Other interest-bearing liabilities' as appropriate and the elimination entries are included within 'Other operations' in those two categories.

Net interest margin numbers are calculated by dividing net interest income as reported in the income statement by the average interest-earning assets from which interest income is reported within the 'Net interest income' line of the income statement. Interest income and interest expense arising from trading assets and liabilities and the funding thereof is included within 'Net trading income' in the income statement.

		2010			2009			2008		
		Average balance	Interest income	Yield	Average balance	Interest income	Yield	Average balance	Interest income	Yield
		US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%
Summary										
Total interest-earning assets (itemised below)		1,472,294	58,345	3.96	1,384,705	62,096	4.48	1,466,622	91,301	6.23
Trading assets ⁶³		332,511	6,027	1.81	357,504	7,614	2.13	428,539	16,742	3.91
Financial assets designated at fair value ⁶⁴		52,692	1,033	1.96	62,143	1,032	1.66	37,303	1,108	2.97
Impairment provisions		(22,905)			(26,308)			(20,360)		
Non-interest-earning assets		664,308			667,942			596,885		
Total assets and interest income		2,498,900	65,405	2.62	2,445,986	70,742	2.89	2,508,989	109,151	4.35
Short-term funds and loans and advances to banks										
Europe	HSBC Bank	47,741	1,290	2.70	38,455	1,379	3.59	46,703	2,187	4.68
	HSBC Private Banking Holdings (Suisse)	2,603	15	0.58	4,451	43	0.97	8,040	333	4.14
	HSBC France	47,094	337	0.72	37,239	440	1.18	35,801	1,495	4.18
Hong Kong	Hang Seng Bank	14,884	222	1.49	16,626	202	1.21	17,402	587	3.37
	The Hongkong and Shanghai Banking Corporation	16,544	117	0.71	27,903	182	0.65	47,244	1,344	2.84
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	30,288	464	1.53	23,107	326	1.41	27,907	881	3.16
	HSBC Bank Malaysia	5,113	126	2.46	3,776	81	2.15	4,659	165	3.54
Middle East	HSBC Bank Middle East	5,335	60	1.12	4,312	52	1.21	6,028	188	3.12
North America	HSBC Bank USA	28,653	103	0.36	2,338	94	4.02	9,595	328	3.42
	HSBC Bank Canada	3,823	16	0.42	2,934	10	0.34	3,354	107	3.19
Latin America	HSBC Mexico	3,238	129	3.98	3,722	149	4.00	3,682	247	6.71
	Brazilian operations ⁶⁵	16,102	1,525	9.47	10,490	1,003	9.56	7,959	951	11.95
	HSBC Bank Panama	959	8	0.83	1,187	10	0.84	1,133	30	2.65
	HSBC Bank Argentina	169	20	11.83	256	29	11.33	612	43	7.03
Other operations		14,196	123	0.87	15,782	199	1.26	19,992	760	3.80
		236,742	4,555	1.92	192,578	4,199	2.18	240,111	9,646	4.02

Report of the Directors: Operating and Financial Review (continued)

		2010			2009			2008		
		Average balance US\$m	Interest income US\$m	Yield %	Average balance US\$m	Interest income US\$m	Yield %	Average balance US\$m	Interest income US\$m	Yield %
Loans and advances to customers										
Europe	HSBC Bank	265,163	9,761	3.68	276,602	10,898	3.94	288,214	18,587	6.45
	HSBC Private Banking Holdings (Suisse)	11,987	191	1.59	9,993	176	1.76	12,355	494	4.00
	HSBC France	66,910	1,684	2.52	71,048	1,932	2.72	73,455	3,604	4.91
	HSBC Finance	2,251	198	8.80	3,094	319	10.31	4,808	505	10.50
Hong Kong	Hang Seng Bank	51,028	1,313	2.57	42,619	1,194	2.80	42,304	1,589	3.76
	The Hongkong and Shanghai Banking Corporation	65,226	1,755	2.69	55,287	1,757	3.18	54,628	2,291	4.19
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	81,080	3,928	4.84	66,262	3,668	5.54	77,741	5,163	6.64
	HSBC Bank Malaysia	9,614	531	5.52	8,113	455	5.61	8,407	553	6.58
Middle East	HSBC Bank Middle East	21,193	1,303	6.15	22,612	1,593	7.04	23,697	1,549	6.54
North America	HSBC Bank USA	78,556	4,582	5.83	98,422	5,541	5.63	93,088	5,758	6.19
	HSBC Finance	78,105	7,741	9.91	101,132	9,941	9.83	140,957	15,835	11.23
	HSBC Bank Canada	46,360	1,643	3.54	43,072	1,499	3.48	48,331	2,455	5.08
Latin America	HSBC Mexico	12,309	1,571	12.76	12,185	1,708	14.02	17,252	2,565	14.87
	Brazilian operations ⁶⁵	23,366	5,118	21.90	18,704	4,494	24.03	19,642	4,879	24.84
	HSBC Bank Panama	9,348	815	8.72	9,302	864	9.29	8,620	810	9.40
	HSBC Bank Argentina	2,460	367	14.92	1,940	357	18.40	2,136	378	17.70
Other operations		33,543	1,685	5.02	29,670	1,905	6.42	28,027	1,707	6.09
		858,499	44,186	5.15	870,057	48,301	5.55	943,662	68,722	7.28
Financial investments										
Europe	HSBC Bank	85,206	1,725	2.02	79,763	2,321	2.91	83,725	3,840	4.59
	HSBC Private Banking Holdings (Suisse)	17,013	287	1.69	15,602	363	2.33	12,018	553	4.60
	HSBC France	4,017	102	2.54	5,327	141	2.65	14,862	795	5.35
Hong Kong	Hang Seng Bank	30,334	541	1.78	24,594	630	2.56	24,031	1,063	4.42
	The Hongkong and Shanghai Banking Corporation	65,256	477	0.73	52,965	644	1.22	15,361	563	3.67
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	37,833	1,161	3.07	34,056	1,039	3.05	31,992	1,507	4.71
	HSBC Bank Malaysia	911	28	3.07	1,218	37	3.04	937	36	3.84
Middle East	HSBC Bank Middle East	8,086	126	1.56	6,996	118	1.69	5,671	144	2.54
North America	HSBC Bank USA	38,541	1,156	3.00	27,253	969	3.56	25,089	1,232	4.91
	HSBC Finance	2,834	116	4.09	2,426	120	4.95	2,908	143	4.92
	HSBC Bank Canada	14,310	257	1.80	10,282	205	1.99	7,037	197	2.80
Latin America	HSBC Mexico	7,177	388	5.41	3,916	227	5.80	3,470	244	7.03
	Brazilian operations ⁶⁵	9,564	1,089	11.39	6,930	820	11.83	6,758	853	12.62
	HSBC Bank Panama	996	38	3.82	604	39	6.46	618	47	7.61
	HSBC Bank Argentina	370	58	15.68	181	35	19.34	287	47	16.38
Other operations		56,523	1,826	3.23	50,767	1,717	3.38	29,632	1,354	4.57
		378,971	9,375	2.47	322,880	9,425	2.92	264,396	12,618	4.77

Report of the Directors: Operating and Financial Review (continued)

Assets (continued)

		2010			2009			2008		
		Average balance US\$m	Interest income US\$m	Yield %	Average balance US\$m	Interest income US\$m	Yield %	Average balance US\$m	Interest income US\$m	Yield %
Other interest-earning assets										
Europe	HSBC Bank	14,255	100	0.70	17,406	188	1.08	25,885	630	2.43
	HSBC Private Banking Holdings (Suisse)	17,738	241	1.36	21,450	360	1.68	21,189	875	4.13
	HSBC France	9,954	93	0.93	11,867	172	1.45	23,414	630	2.69
Hong Kong	Hang Seng Bank	1,077	13	1.21	2,618	32	1.22	1,629	48	2.95
	The Hongkong and Shanghai Banking Corporation	27,112	260	0.96	26,657	214	0.80	33,571	949	2.83
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	18,476	55	0.30	19,917	106	0.53	24,492	352	1.44
	HSBC Bank Malaysia	745	14	1.88	407	6	1.47	212	7	3.30
Middle East	HSBC Bank Middle East	1,272	46	3.62	541	46	8.50	843	63	7.47
North America	HSBC Bank USA	3,467	58	1.67	3,327	71	2.13	3,091	188	6.08
	HSBC Finance	2,895	7	0.24	2,995	6	0.20	2,638	63	2.39
	HSBC Bank Canada	1,287	20	1.55	773	9	1.16	1,025	25	2.44
Latin America	HSBC Mexico	158	9	5.70	138	–	–	193	2	1.04
	Brazilian operations ⁶⁵	1,170	80	6.84	1,074	46	4.28	1,438	147	10.22
	HSBC Bank Panama	1,234	12	0.97	1,372	9	0.66	1,807	23	1.27
	HSBC Bank Argentina	87	–	–	51	–	–	58	1	1.72
Other operations		(102,845)	(779)		(111,403)	(1,094)		(123,032)	(3,688)	
		(1,918)	229	(11.94)	(810)	171	(21.11)	18,453	315	1.71
Total interest-earning assets										
Europe	HSBC Bank	412,365	12,876	3.12	412,226	14,786	3.59	444,527	25,244	5.68
	HSBC Private Banking Holdings (Suisse)	49,341	734	1.49	51,496	942	1.83	53,602	2,255	4.21
	HSBC France	127,975	2,216	1.73	125,481	2,685	2.14	147,532	6,524	4.42
	HSBC Finance	2,251	198	8.80	3,094	319	10.31	4,808	505	10.50
Hong Kong	Hang Seng Bank	97,323	2,089	2.15	86,457	2,058	2.38	85,366	3,287	3.85
	The Hongkong and Shanghai Banking Corporation	174,138	2,609	1.50	162,812	2,797	1.72	150,804	5,147	3.41
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	167,677	5,608	3.34	143,342	5,139	3.59	162,132	7,903	4.87
	HSBC Bank Malaysia	16,383	699	4.27	13,514	579	4.28	14,215	761	5.35
Middle East	HSBC Bank Middle East	35,886	1,535	4.28	34,461	1,809	5.25	36,239	1,944	5.36
North America	HSBC Bank USA	149,217	5,899	3.95	131,340	6,675	5.08	130,863	7,506	5.74
	HSBC Finance	83,834	7,864	9.38	106,553	10,067	9.45	146,503	16,041	10.95
	HSBC Bank Canada	65,780	1,936	2.94	57,061	1,723	3.02	59,747	2,784	4.66
Latin America	HSBC Mexico	22,882	2,097	9.16	19,961	2,084	10.44	24,597	3,058	12.43
	Brazilian operations ⁶⁵	50,202	7,812	15.56	37,198	6,363	17.11	35,797	6,830	19.08
	HSBC Bank Panama	12,537	873	6.96	12,465	922	7.40	12,178	910	7.47
	HSBC Bank Argentina	3,086	445	14.42	2,428	421	17.34	3,093	469	15.16
Other operations		1,417	2,855		(15,184)	2,727		(45,381)	133	
		1,472,294	58,345	3.96	1,384,705	62,096	4.48	1,466,622	91,301	6.23

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Equity and liabilities

	2010			2009			2008			
	Average balance US\$m	Interest expense US\$m	Cost %	Average balance US\$m	Interest expense US\$m	Cost %	Average balance US\$m	Interest expense US\$m	Cost %	
Summary										
Total interest-bearing liabilities (itemised below)	1,339,390	18,904	1.41	1,353,283	21,366	1.58	1,451,842	48,738	3.36	
Trading liabilities	258,348	3,497	1.35	205,670	3,987	1.94	277,940	11,029	3.97	
Financial liabilities designated at fair value (excluding own debt issued)	17,456	283	1.62	15,688	293	1.87	21,266	345	1.62	
Non-interest bearing current accounts	142,579			123,271			98,193			
Total equity and other non-interest bearing liabilities	741,127			748,074			659,747			
Total equity and liabilities	2,498,900	22,684	0.91	2,445,986	25,646	1.05	2,508,988	60,112	2.40	
Deposits by banks⁶⁶										
Europe	HSBC Bank	32,850	260	0.79	35,207	553	1.57	48,167	1,875	3.89
	HSBC Private Banking Holdings (Suisse)	964	2	0.21	1,063	1	0.09	4,493	105	2.34
	HSBC France	42,399	340	0.80	43,682	536	1.23	37,851	1,672	4.42
Hong Kong	Hang Seng Bank	1,456	4	0.27	1,051	5	0.48	1,696	55	3.24
	The Hongkong and Shanghai Banking Corporation	5,691	10	0.18	6,892	9	0.13	3,665	70	1.91
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	9,540	131	1.37	10,710	165	1.54	16,232	450	2.77
	HSBC Bank Malaysia	164	4	2.44	110	2	1.82	338	10	2.96
Middle East	HSBC Bank Middle East	762	6	0.79	773	9	1.16	1,680	29	1.73
North America	HSBC Bank USA	8,693	26	0.30	8,381	9	0.11	11,015	220	2.00
	HSBC Bank Canada	946	5	0.53	1,405	8	0.57	1,391	41	2.95
Latin America	HSBC Mexico	1,002	51	5.09	1,462	49	3.35	822	32	3.89
	Brazilian operations ⁶⁵	3,610	247	6.84	3,292	241	7.32	2,790	190	6.81
	HSBC Bank Panama	612	18	2.94	908	26	2.86	1,016	43	4.23
	HSBC Bank Argentina	17	1	5.88	12	1	8.33	27	1	3.70
Other operations		2,737	31	1.13	2,899	45	1.55	4,564	166	3.64
		111,443	1,136	1.02	117,847	1,659	1.41	135,747	4,959	3.65
Financial liabilities designated at fair value – own debt issued⁶⁷										
Europe	HSBC Holdings	16,577	308	1.86	17,887	369	2.06	18,675	721	3.86
	HSBC Bank	15,169	270	1.78	7,932	196	2.47	8,805	529	6.01
	HSBC France	7,154	113	1.58	5,108	128	2.51	1,515	79	5.21
Hong Kong	Hang Seng Bank	63	–	–	130	2	1.54	127	6	4.72
North America	HSBC Bank USA	1,721	25	1.45	1,615	30	1.86	1,504	67	4.45
	HSBC Finance	24,740	528	2.13	26,628	871	3.27	32,126	1,563	4.87
Other operations		1,282	27	2.11	921	(38)	(4.13)	1,083	168	15.51
		66,706	1,271	1.91	60,221	1,558	2.59	63,835	3,133	4.91

Report of the Directors: Operating and Financial Review (continued)

Equity and liabilities (continued)

		2010			2009			2008		
		Average balance US\$m	Interest expense US\$m	Cost %	Average Balance US\$m	Interest expense US\$m	Cost %	Average balance US\$m	Interest expense US\$m	Cost %
Customer accounts⁶⁸										
Europe	HSBC Bank	275,153	2,042	0.74	274,949	2,407	0.88	305,702	10,092	3.30
	HSBC Private Banking Holdings (Suisse)	20,530	144	0.70	27,250	256	0.94	37,778	1,349	3.57
	HSBC France	50,096	377	0.75	61,465	645	1.05	39,428	1,583	4.01
Hong Kong	Hang Seng Bank	76,708	205	0.27	71,140	200	0.28	66,142	914	1.38
	The Hongkong and Shanghai Banking Corporation	160,794	146	0.09	150,520	211	0.14	139,169	1,365	0.98
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	104,648	1,696	1.62	92,305	1,494	1.62	96,476	2,869	2.97
	HSBC Bank Malaysia	11,213	220	1.96	9,658	191	1.98	10,266	295	2.87
Middle East	HSBC Bank Middle East	15,906	284	1.79	18,726	432	2.31	19,922	422	2.12
North America	HSBC Bank USA	85,946	540	0.63	85,007	975	1.15	86,701	2,069	2.39
	HSBC Bank Canada	41,153	304	0.74	35,051	385	1.10	34,090	967	2.84
Latin America	HSBC Mexico	14,127	398	2.82	11,636	391	3.36	14,612	561	3.84
	Brazilian operations ⁶⁵	36,727	3,502	9.54	28,605	2,946	10.30	26,288	3,110	11.83
	HSBC Bank Panama	8,771	321	3.66	8,592	353	4.11	7,761	296	3.81
	HSBC Bank Argentina	2,538	97	3.82	2,151	99	4.60	2,266	145	6.40
Other operations		58,303	502	0.86	63,863	361	0.57	64,253	1,952	3.04
		962,613	10,778	1.12	940,918	11,346	1.21	950,854	27,989	2.94
Debt securities in issue										
Europe	HSBC Bank	62,735	1,130	1.80	72,955	1,305	1.79	86,216	4,001	4.64
	HSBC France	20,686	160	0.77	25,065	330	1.32	30,815	1,447	4.70
	HSBC Finance	–	–	–	–	–	–	215	8	3.72
Hong Kong	Hang Seng Bank	1,034	13	1.26	1,220	21	1.72	1,685	57	3.38
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	5,558	218	3.92	5,409	218	4.03	8,995	640	7.12
	HSBC Bank Malaysia	389	15	3.86	403	16	3.97	475	20	4.21
Middle East	HSBC Bank Middle East	3,940	63	1.60	2,988	62	2.07	2,650	90	3.40
North America	HSBC Bank USA	12,680	375	2.96	20,968	590	2.81	21,922	852	3.89
	HSBC Finance	48,561	1,766	3.64	63,563	2,510	3.95	98,096	3,765	3.84
	HSBC Bank Canada	13,205	343	2.60	12,825	322	2.51	16,957	604	3.56
Latin America	HSBC Mexico	922	51	5.53	1,460	67	4.59	2,693	243	9.02
	Brazilian operations ⁶⁵	2,112	151	7.15	1,568	86	5.48	1,859	156	8.39
	HSBC Bank Panama	771	40	5.19	487	34	6.98	556	33	5.94
	HSBC Bank Argentina	4	–	–	1	–	–	2	–	–
Other operations		17,301	606	3.50	16,745	340	2.03	13,691	66	0.48
		189,898	4,931	2.60	225,657	5,901	2.62	286,827	11,982	4.18

Report of the Directors: Operating and Financial Review (continued)

		2010			2009			2008		
		Average balance US\$m	Interest expense US\$m	Cost %	Average balance US\$m	Interest expense US\$m	Cost %	Average balance US\$m	Interest expense US\$m	Cost %
Other interest-bearing liabilities										
Europe	HSBC Bank	28,269	434	1.54	50,247	655	1.30	38,906	1,134	2.91
	HSBC Private Banking Holdings (Suisse)	2,921	7	0.24	3,892	18	0.46	4,203	135	3.21
	HSBC France	16,668	78	0.47	24,699	187	0.76	33,920	1,361	4.01
	HSBC Finance	1,595	15	0.94	2,363	59	2.50	3,712	191	5.15
Hong Kong	Hang Seng Bank	829	5	0.60	789	5	0.63	1,258	41	3.26
	The Hongkong and Shanghai Banking Corporation	8,580	55	0.64	12,815	105	0.82	10,557	288	2.73
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	34,027	248	0.73	19,447	177	0.91	23,685	466	1.97
	HSBC Bank Malaysia	706	8	1.13	266	2	0.75	338	7	2.07
Middle East	HSBC Bank Middle East	1,496	63	4.21	1,748	68	3.89	1,918	89	4.64
North America	HSBC Bank USA	14,669	609	4.15	9,754	368	3.77	10,490	468	4.46
	HSBC Finance	3,487	102	2.93	4,051	102	2.52	4,670	141	3.02
	HSBC Bank Canada	1,806	3	0.17	1,149	6	0.52	1,306	19	1.45
	HSBC Markets Inc	1,266	25	1.97	1,716	36	2.10	10,349	78	0.75
Latin America	HSBC Mexico	804	13	1.62	301	11	3.65	187	20	10.70
	Brazilian operations ⁶⁵	2,803	316	11.27	1,496	130	8.69	2,340	207	8.85
	HSBC Bank Panama	108	1	0.93	192	2	1.04	917	3	0.33
	HSBC Bank Argentina	4	-	-	36	1	2.78	92	6	6.52
Other operations		(111,308)	(1,194)		(126,321)	(1,030)		(134,269)	(3,979)	
		8,730	788	9.03	8,640	902	10.44	14,579	675	4.63
Total interest-bearing liabilities										
Europe	HSBC Bank	414,176	4,136	1.00	441,290	5,116	1.16	487,796	17,631	3.61
	HSBC Private Banking Holdings (Suisse)	24,415	153	0.63	32,205	275	0.85	46,474	1,589	3.42
	HSBC France	137,003	1,068	0.78	160,019	1,826	1.14	143,529	6,142	4.28
	HSBC Finance	1,595	15	0.94	2,363	59	2.50	3,927	199	5.07
Hong Kong	Hang Seng Bank	80,090	227	0.28	74,330	233	0.31	70,908	1,073	1.51
	The Hongkong and Shanghai Banking Corporation	175,065	211	0.12	170,227	325	0.19	153,391	1,723	1.12
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	153,773	2,293	1.49	127,871	2,054	1.61	145,388	4,425	3.04
	HSBC Bank Malaysia	12,472	247	1.98	10,437	211	2.02	11,417	332	2.91
Middle East	HSBC Bank Middle East	22,104	416	1.88	24,235	571	2.36	26,170	630	2.41
North America	HSBC Bank USA	123,709	1,575	1.27	125,725	1,972	1.57	131,632	3,676	2.79
	HSBC Finance	76,788	2,396	3.12	94,242	3,483	3.70	134,892	5,469	4.05
	HSBC Bank Canada	57,110	655	1.15	50,430	721	1.43	53,744	1,631	3.03
	HSBC Markets Inc	1,266	25	1.97	1,716	36	2.10	10,349	78	0.75
Latin America	HSBC Mexico	16,855	513	3.04	14,859	518	3.49	18,314	856	4.67
	Brazilian operations ⁶⁵	45,252	4,216	9.32	34,961	3,403	9.73	33,277	3,663	11.01
	HSBC Bank Panama	10,262	379	3.69	10,179	415	4.08	10,250	375	3.66
	HSBC Bank Argentina	2,563	98	3.82	2,200	101	4.59	2,387	152	6.37
Other operations		(15,108)	281		(24,006)	47		(32,003)	(906)	
		1,339,390	18,904	1.41	1,353,283	21,366	1.58	1,451,842	48,738	3.36

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)*Net interest margin*⁶⁹

		2010 %	2009 %	2008 %
Total		2.68	2.94	2.90
Europe	HSBC Bank	2.12	2.35	1.71
	HSBC Private Banking Holdings (Suisse)	1.18	1.30	1.24
	HSBC France	0.90	0.68	0.26
	HSBC Finance	8.13	8.40	6.36
Hong Kong	Hang Seng Bank	1.91	2.11	2.59
	The Hongkong and Shanghai Banking Corporation	1.38	1.52	2.27
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	1.98	2.15	2.15
	HSBC Bank Malaysia	2.76	2.72	3.02
Middle East	HSBC Bank Middle East	3.12	3.59	3.63
North America	HSBC Bank USA	2.90	3.58	2.93
	HSBC Finance	6.52	6.18	7.22
	HSBC Bank Canada	1.95	1.76	1.93
Latin America	HSBC Mexico	6.92	7.85	8.95
	Brazilian operations ⁶⁵	7.16	7.96	8.85
	HSBC Bank Panama	3.94	4.07	4.39
	HSBC Bank Argentina	11.24	13.18	10.25

Distribution of average total assets

		2010 %	2009 %	2008 %
Europe	HSBC Bank	37.5	36.7	36.7
	HSBC Private Banking Holdings (Suisse)	2.2	2.3	2.3
	HSBC France	12.9	15.0	13.8
	HSBC Finance	0.1	–	0.2
Hong Kong	Hang Seng Bank	4.5	4.2	3.9
	The Hongkong and Shanghai Banking Corporation	10.7	10.5	9.5
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	9.4	8.5	8.8
	HSBC Bank Malaysia	0.7	0.6	0.6
Middle East	HSBC Bank Middle East	1.6	1.6	1.8
North America	HSBC Bank USA	9.7	11.0	11.2
	HSBC Finance	3.6	4.5	6.2
	HSBC Bank Canada	3.0	2.7	2.9
Latin America	HSBC Mexico	1.4	1.4	1.5
	Brazilian operations ⁶⁵	2.6	2.1	2.1
	HSBC Bank Panama	0.6	0.6	0.6
	HSBC Bank Argentina	0.2	0.2	0.2
Other operations (including consolidation adjustments)		(0.7)	(1.9)	(2.3)
		100.0	100.0	100.0

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)**Analysis of changes in net interest income and net interest expense**

The following tables allocate changes in net interest income and net interest expense between volume and rate for 2010 compared with 2009, and for 2009 compared with 2008.

Interest income

		2010 US\$m	Increase/(decrease) in 2010 compared with 2009		2009 US\$m	Increase/(decrease) in 2009 compared with 2008		2008 US\$m
			Volume US\$m	Rate US\$m		Volume US\$m	Rate US\$m	
Short-term funds and loans and advances to banks								
Europe	HSBC Bank	1,290	333	(422)	1,379	(386)	(422)	2,187
	HSBC Private Banking Holdings (Suisse)	15	(18)	(10)	43	(149)	(141)	333
	HSBC France	337	116	(219)	440	60	(1,115)	1,495
Hong Kong	Hang Seng Bank	222	(21)	41	202	(26)	(359)	587
	The Hongkong and Shanghai Banking Corporation	117	(74)	9	182	(549)	(613)	1,344
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	464	101	37	326	(152)	(403)	881
	HSBC Bank Malaysia	126	29	16	81	(31)	(53)	165
Middle East	HSBC Bank Middle East	60	12	(4)	52	(54)	(82)	188
North America	HSBC Bank USA	103	1,058	(1,049)	94	(248)	14	328
	HSBC Bank Canada	16	3	3	10	(13)	(84)	107
Latin America	HSBC Mexico	129	(19)	(1)	149	3	(101)	247
	Brazilian operations ⁶⁵	1,525	537	(15)	1,003	302	(250)	951
	HSBC Bank Panama	8	(2)	-	10	1	(21)	30
	HSBC Bank Argentina	20	(10)	1	29	(25)	11	43
Other operations		123	(20)	(56)	199	(160)	(401)	760
		<u>4,555</u>	<u>963</u>	<u>(607)</u>	<u>4,199</u>	<u>(1,911)</u>	<u>(3,536)</u>	<u>9,646</u>
Loans and advances to customers								
Europe	HSBC Bank	9,761	(451)	(686)	10,898	(749)	(6,940)	18,587
	HSBC Private Banking Holdings (Suisse)	191	35	(20)	176	(94)	(224)	494
	HSBC France	1,684	(113)	(135)	1,932	(118)	(1,554)	3,604
	HSBC Finance	198	(87)	(34)	319	(180)	(6)	505
Hong Kong	Hang Seng Bank	1,313	235	(116)	1,194	12	(407)	1,589
	The Hongkong and Shanghai Banking Corporation	1,755	316	(318)	1,757	28	(562)	2,291
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	3,928	821	(561)	3,668	(762)	(733)	5,163
	HSBC Bank Malaysia	531	84	(8)	455	(19)	(79)	553
Middle East	HSBC Bank Middle East	1,303	(100)	(190)	1,593	(71)	115	1,549
North America	HSBC Bank USA	4,582	(1,118)	159	5,541	330	(547)	5,758
	HSBC Finance	7,741	(2,264)	64	9,941	(4,472)	(1,422)	15,835
	HSBC Bank Canada	1,643	114	30	1,499	(267)	(689)	2,455
Latin America	HSBC Mexico	1,571	17	(154)	1,708	(753)	(104)	2,565
	Brazilian operations ⁶⁵	5,118	1,120	(496)	4,494	(233)	(152)	4,879
	HSBC Bank Panama	815	4	(53)	864	64	(10)	810
	HSBC Bank Argentina	367	96	(86)	357	(35)	14	378
Other operations		<u>1,685</u>	<u>249</u>	<u>(469)</u>	<u>1,905</u>	<u>100</u>	<u>98</u>	<u>1,707</u>
		<u>44,186</u>	<u>(641)</u>	<u>(3,474)</u>	<u>48,301</u>	<u>(5,358)</u>	<u>(15,063)</u>	<u>68,722</u>

Report of the Directors: Operating and Financial Review (continued)*Interest income (continued)*

	2010 US\$m	Increase/(decrease) in 2010 compared with 2009		2009 US\$m	Increase/(decrease) in 2009 compared with 2008		2008 US\$m	
		Volume US\$m	Rate US\$m		Volume US\$m	Rate US\$m		
Financial investments								
Europe	HSBC Bank	1,725	158	(754)	2,321	(182)	(1,337)	3,840
	HSBC Private Banking Holdings (Suisse)	287	33	(109)	363	165	(355)	553
	HSBC France	102	(35)	(4)	141	(510)	(144)	795
Hong Kong	Hang Seng Bank	541	147	(236)	630	25	(458)	1,063
	The Hongkong and Shanghai Banking Corporation	477	150	(317)	644	1,380	(1,299)	563
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	1,161	115	7	1,039	97	(565)	1,507
	HSBC Bank Malaysia	28	(9)	–	37	11	(10)	36
Middle East	HSBC Bank Middle East	126	18	(10)	118	34	(60)	144
North America	HSBC Bank USA	1,156	402	(215)	969	106	(369)	1,232
	HSBC Finance	116	20	(24)	120	(24)	1	143
	HSBC Bank Canada	257	80	(28)	205	91	(83)	197
Latin America	HSBC Mexico	388	189	(28)	227	31	(48)	244
	Brazilian operations ⁶⁵	1,089	312	(43)	820	22	(55)	853
	HSBC Bank Panama	38	25	(26)	39	(1)	(7)	47
	HSBC Bank Argentina	58	37	(14)	35	(17)	5	47
Other operations		1,826	195	(86)	1,717	966	(603)	1,354
		<u>9,375</u>	<u>1,638</u>	<u>(1,688)</u>	<u>9,425</u>	<u>2,790</u>	<u>(5,983)</u>	<u>12,618</u>

For footnotes, see page 83.

Interest expense

	2010 US\$m	Increase/(decrease) in 2010 compared with 2009		2009 US\$m	Increase/(decrease) in 2009 compared with 2008		2008 US\$m	
		Volume US\$m	Rate US\$m		Volume US\$m	Rate US\$m		
Deposits by banks								
Europe	HSBC Bank	260	(37)	(256)	553	(504)	(818)	1,875
	HSBC Private Banking Holdings (Suisse)	2	–	1	1	(80)	(24)	105
	HSBC France	340	(16)	(180)	536	258	(1,394)	1,672
Hong Kong	Hang Seng Bank	4	2	(3)	5	(21)	(29)	55
	The Hongkong and Shanghai Banking Corporation	10	(2)	3	9	62	(123)	70
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	131	(18)	(16)	165	(153)	(132)	450
	HSBC Bank Malaysia	4	1	1	2	(7)	(1)	10
Middle East	HSBC Bank Middle East	6	–	(3)	9	(16)	(4)	29
North America	HSBC Bank USA	26	–	17	9	(53)	(158)	220
	HSBC Bank Canada	5	(3)	–	8	–	(33)	41
Latin America	HSBC Mexico	51	(15)	17	49	25	(8)	32
	Brazilian operations ⁶⁵	247	23	(17)	241	34	17	190
	HSBC Bank Panama	18	(8)	–	26	(5)	(12)	43
	HSBC Bank Argentina	1	–	–	1	(1)	1	1
Other operations		31	(3)	(11)	45	(61)	(60)	166
		<u>1,136</u>	<u>(90)</u>	<u>(433)</u>	<u>1,659</u>	<u>(653)</u>	<u>(2,647)</u>	<u>4,959</u>

Report of the Directors: Operating and Financial Review (continued)

		Increase/(decrease) in 2010 compared with 2009			Increase/(decrease) in 2009 compared with 2008			
		2010 US\$m	Volume US\$m	Rate US\$m	2009 US\$m	Volume US\$m	Rate US\$m	2008 US\$m
Customer accounts								
Europe	HSBC Bank	2,042	2	(367)	2,407	(1,015)	(6,670)	10,092
	HSBC Private Banking Holdings (Suisse)	144	(63)	(49)	256	(376)	(717)	1,349
	HSBC France	377	(119)	(149)	645	884	(1,822)	1,583
Hong Kong	Hang Seng Bank	205	16	(11)	200	69	(783)	914
	The Hongkong and Shanghai Banking Corporation	146	14	(79)	211	111	(1,265)	1,365
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	1,696	200	2	1,494	(124)	(1,251)	2,869
	HSBC Bank Malaysia	220	31	(2)	191	(17)	(87)	295
Middle East	HSBC Bank Middle East	284	(65)	(83)	432	(25)	35	422
North America	HSBC Bank USA	540	11	(446)	975	(40)	(1,054)	2,069
	HSBC Bank Canada	304	67	(148)	385	27	(609)	967
Latin America	HSBC Mexico	398	84	(77)	391	(114)	(56)	561
	Brazilian operations ⁶⁵	3,502	837	(281)	2,946	274	(438)	3,110
	HSBC Bank Panama	321	7	(39)	353	32	25	296
	HSBC Bank Argentina	97	18	(20)	99	(7)	(39)	145
Other operations		502	(32)	173	361	(12)	(1,579)	1,952
		<u>10,778</u>	<u>263</u>	<u>(831)</u>	<u>11,346</u>	<u>(292)</u>	<u>(16,351)</u>	<u>27,989</u>
Financial liabilities designated at fair value – own debt issued		<u>1,271</u>	<u>168</u>	<u>(455)</u>	<u>1,558</u>	<u>(177)</u>	<u>(1,398)</u>	<u>3,133</u>
Debt securities in issue								
Europe	HSBC Bank	1,130	(183)	8	1,305	(615)	(2,081)	4,001
	HSBC France	160	(58)	(112)	330	(270)	(847)	1,447
	HSBC Finance	–	–	–	–	(8)	–	8
Hong Kong	Hang Seng Bank	13	(3)	(5)	21	(16)	(20)	57
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	218	6	(6)	218	(255)	(167)	640
	HSBC Bank Malaysia	15	(1)	–	16	(3)	(1)	20
Middle East	HSBC Bank Middle East	63	20	(19)	62	11	(39)	90
North America	HSBC Bank USA	375	(233)	18	590	(37)	(225)	852
	HSBC Finance	1,766	(593)	(151)	2,510	(1,326)	71	3,765
	HSBC Bank Canada	343	10	11	322	(147)	(135)	604
Latin America	HSBC Mexico	51	(25)	9	67	(111)	(65)	243
	Brazilian operations ⁶⁵	151	30	35	86	(24)	(46)	156
	HSBC Bank Panama	40	20	(14)	34	(4)	5	33
Other operations		606	11	255	340	15	259	66
		<u>4,931</u>	<u>(937)</u>	<u>(33)</u>	<u>5,901</u>	<u>(2,557)</u>	<u>(3,524)</u>	<u>11,982</u>

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)**Short-term borrowings**

We include short-term borrowings within customer accounts, deposits by banks and debt securities in issue and do not show short-term borrowings separately on the balance sheet. Short-term borrowings are defined by the US Securities and

Exchange Commission as Federal funds purchased and securities sold under agreements to repurchase, commercial paper and other short-term borrowings. Our only significant short-term borrowings are securities sold under agreements to repurchase and certain debt securities in issue. Additional information on these is provided in the table below.

Repos and short-term bonds

	2010	2009	2008
	US\$	US\$m	US\$m
Securities sold under agreements to repurchase			
Outstanding at 31 December	159,256	152,218	145,180
Average amount outstanding during the year	175,955	170,671	177,256
Maximum quarter-end balance outstanding during the year	193,319	157,778	190,651
Weighted average interest rate during the year	0.5%	0.8%	3.8%
Weighted average interest rate at the year-end	0.9%	0.4%	2.9%
Short-term bonds			
Outstanding at 31 December	44,152	38,776	40,279
Average amount outstanding during the year	37,981	33,010	45,330
Maximum quarter-end balance outstanding during the year	44,152	38,776	55,842
Weighted average interest rate during the year	2.9%	3.2%	5.0%
Weighted average interest rate at the year-end	4.5%	0.6%	3.1%

Contractual obligations

The table below provides details of our material contractual obligations as at 31 December 2010.

	Payments due by period			
	Total	Less than	1 – 5 years	More than
	US\$m	1 year	US\$m	5 years
		US\$m	US\$m	US\$m
Long-term debt obligations	236,144	71,913	90,284	73,947
Term deposits and certificates of deposit	207,805	193,131	10,643	4,031
Capital (finance) lease obligations	684	107	187	390
Operating lease obligations	6,257	943	2,700	2,614
Purchase obligations	1,071	657	414	–
Short positions in debt securities and equity shares	102,615	74,979	8,412	19,224
Current tax liability	1,804	1,804	–	–
Pension/healthcare obligation	16,643	1,304	5,700	9,639
	573,023	344,838	118,340	109,845

Ratios of earnings to combined fixed charges (and preference share dividends)

	2010	2009	2008	2007	2006
Ratios of earnings to combined fixed charges and preference share dividends: ⁷⁰					
– excluding interest on deposits	5.89	2.64	2.97	6.96	7.22
– including interest on deposits	1.69	1.20	1.13	1.34	1.40
Ratios of earnings to combined fixed charges: ⁷⁰					
– excluding interest on deposits	7.10	2.99	3.17	7.52	7.93
– including interest on deposits	1.73	1.22	1.14	1.34	1.41

For footnote, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Loan maturity and interest sensitivity analysis

At 31 December 2010, the geographical analysis of loan maturity and interest sensitivity by loan type on a contractual repayment basis was as follows:

	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Total US\$m
Maturity of 1 year or less							
Loans and advances to banks	<u>75,280</u>	<u>32,974</u>	<u>40,116</u>	<u>9,034</u>	<u>18,820</u>	<u>24,032</u>	<u>200,256</u>
Commercial loans to customers							
Commercial, industrial and international trade	72,108	25,889	34,536	8,139	7,242	14,215	162,129
Real estate and other property related	16,040	10,739	5,753	1,635	5,892	1,851	41,910
Non-bank financial institutions	64,313	1,994	1,641	785	13,126	1,137	82,996
Governments	1,432	38	178	1,170	41	513	3,372
Other commercial	31,377	4,383	6,759	1,830	5,641	3,440	53,430
	<u>185,270</u>	<u>43,043</u>	<u>48,867</u>	<u>13,559</u>	<u>31,942</u>	<u>21,156</u>	<u>343,837</u>
Hong Kong Government Home Ownership Scheme Residential mortgages and other personal loans	–	370	–	–	–	–	370
	<u>29,904</u>	<u>15,337</u>	<u>12,161</u>	<u>2,819</u>	<u>31,174</u>	<u>9,190</u>	<u>100,585</u>
Loans and advances to customers	<u>215,174</u>	<u>58,750</u>	<u>61,028</u>	<u>16,378</u>	<u>63,116</u>	<u>30,346</u>	<u>444,792</u>
	<u>290,454</u>	<u>91,724</u>	<u>101,144</u>	<u>25,412</u>	<u>81,936</u>	<u>54,378</u>	<u>645,048</u>
Maturity after 1 year but within 5 years							
Loans and advances to banks	<u>2,499</u>	<u>204</u>	<u>285</u>	<u>234</u>	<u>626</u>	<u>487</u>	<u>4,335</u>
Commercial loans to customers							
Commercial, industrial and international trade	29,641	6,920	6,178	2,371	7,859	6,086	59,055
Real estate and other property related	13,901	16,940	7,630	1,202	6,057	1,524	47,254
Non-bank financial institutions	4,866	748	362	540	6,689	1,161	14,366
Governments	309	2,188	159	165	40	843	3,704
Other commercial	13,573	4,509	4,306	1,692	2,113	2,821	29,014
	<u>62,290</u>	<u>31,305</u>	<u>18,635</u>	<u>5,970</u>	<u>22,758</u>	<u>12,435</u>	<u>153,393</u>
Hong Kong Government Home Ownership Scheme Residential mortgages and other personal loans	–	1,228	–	–	–	–	1,228
	<u>33,732</u>	<u>10,922</u>	<u>8,301</u>	<u>1,741</u>	<u>38,223</u>	<u>6,572</u>	<u>99,491</u>
Loans and advances to customers	<u>96,022</u>	<u>43,455</u>	<u>26,936</u>	<u>7,711</u>	<u>60,981</u>	<u>19,007</u>	<u>254,112</u>
	<u>98,521</u>	<u>43,659</u>	<u>27,221</u>	<u>7,945</u>	<u>61,607</u>	<u>19,494</u>	<u>258,447</u>
Interest rate sensitivity of loans and advances to banks and commercial loans to customers							
Fixed interest rate	17,263	78	1,233	1,358	8,209	3,432	31,573
Variable interest rate	47,526	31,431	17,687	4,846	15,175	9,490	126,155
	<u>64,789</u>	<u>31,509</u>	<u>18,920</u>	<u>6,204</u>	<u>23,384</u>	<u>12,922</u>	<u>157,728</u>
Maturity after 5 years							
Loans and advances to banks	<u>460</u>	<u>407</u>	<u>36</u>	<u>67</u>	<u>33</u>	<u>2,835</u>	<u>3,838</u>
Commercial loans to customers							
Commercial, industrial and international trade	10,231	642	560	663	1,636	2,778	16,510
Real estate and other property related	7,089	7,231	775	33	1,928	498	17,554
Non-bank financial institutions	840	82	55	10	1,294	520	2,801
Governments	548	113	78	10	8	761	1,518
Other commercial	13,477	1,596	536	662	1,019	226	17,516
	<u>32,185</u>	<u>9,664</u>	<u>2,004</u>	<u>1,378</u>	<u>5,885</u>	<u>4,783</u>	<u>55,899</u>
Hong Kong Government Home Ownership Scheme Residential mortgages and other personal loans	–	1,939	–	–	–	–	1,939
	<u>98,081</u>	<u>27,512</u>	<u>19,722</u>	<u>811</u>	<u>69,720</u>	<u>5,861</u>	<u>221,707</u>
Loans and advances to customers	<u>130,266</u>	<u>39,115</u>	<u>21,726</u>	<u>2,189</u>	<u>75,605</u>	<u>10,644</u>	<u>279,545</u>
	<u>130,726</u>	<u>39,522</u>	<u>21,762</u>	<u>2,256</u>	<u>75,638</u>	<u>13,479</u>	<u>283,383</u>
Interest rate sensitivity of loans and advances to banks and commercial loans to customers							
Fixed interest rate	8,326	412	108	855	1,669	2,369	13,739
Variable interest rate	24,319	9,659	1,932	590	4,249	5,249	45,998
	<u>32,645</u>	<u>10,071</u>	<u>2,040</u>	<u>1,445</u>	<u>5,918</u>	<u>7,618</u>	<u>59,737</u>

Report of the Directors: Operating and Financial Review (continued)**Deposits**

The following tables summarise the average amount of bank deposits, customer deposits and certificates of deposit ('CD's) and other money market instruments (which are included within 'Debt securities in issue' in the balance sheet), together

with the average interest rates paid thereon for each of the past three years. The geographical analysis of average deposits is based on the location of the office in which the deposits are recorded and excludes balances with HSBC companies. The 'Other' category includes securities sold under agreements to repurchase.

Deposits by banks

	2010		2009		2008	
	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %
Europe	85,973		87,677		99,228	
Demand and other – non-interest bearing	8,298	–	6,415	–	5,231	–
Demand – interest bearing	13,783	0.6	14,259	1.0	19,204	3.2
Time	28,337	0.9	30,367	1.6	43,695	3.9
Other	35,555	0.8	36,636	1.3	31,098	4.4
Hong Kong	10,000		10,725		5,916	
Demand and other – non-interest bearing	2,860	–	2,975	–	1,375	–
Demand – interest bearing	4,787	0.2	5,526	0.1	2,780	2.0
Time	1,803	0.3	1,637	0.3	1,583	2.7
Other	550	0.7	587	0.5	178	3.4
Rest of Asia-Pacific	11,476		12,467		18,203	
Demand and other – non-interest bearing	1,746	–	1,605	–	1,546	–
Demand – interest bearing	4,937	1.2	4,097	1.2	4,317	2.3
Time	3,626	1.5	4,682	1.9	9,103	3.5
Other	1,167	2.0	2,083	1.4	3,237	3.8
Middle East	1,250		1,317		2,151	
Demand and other – non-interest bearing	484	–	539	–	365	–
Demand – interest bearing	9	–	18	–	15	–
Time	685	0.6	691	1.2	1,239	2.7
Other	72	1.2	69	1.4	532	0.2
North America	13,324		13,203		14,835	
Demand and other – non-interest bearing	2,493	–	1,755	–	761	–
Demand – interest bearing	3,386	0.1	4,770	0.1	5,684	1.7
Time	4,716	0.4	5,422	0.2	7,941	2.3
Other	2,729	0.5	1,256	0.7	449	1.6
Latin America	5,523		5,959		5,058	
Demand and other – non-interest bearing	222	–	212	–	366	–
Demand – interest bearing	322	4.3	219	0.9	81	2.5
Time	2,246	5.5	4,171	5.0	3,357	5.6
Other	2,733	6.6	1,357	8.1	1,254	7.8
Total	127,546		131,348		145,391	
Demand and other – non-interest bearing	16,103	–	13,501	–	9,644	–
Demand – interest bearing	27,224	0.6	28,889	0.7	32,081	2.7
Time	41,413	1.1	46,970	1.7	66,918	3.7
Other	42,806	1.3	41,988	1.6	36,748	4.5

Report of the Directors: Operating and Financial Review (continued)

Customer accounts

	2010		2009		2008	
	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %
Europe	424,561		440,450		447,982	
Demand and other – non-interest bearing	62,869	–	55,751	–	39,610	–
Demand – interest bearing	203,727	0.4	212,178	0.4	225,034	2.9
Savings	51,793	1.8	57,344	2.2	73,479	4.3
Time	60,140	1.2	67,045	1.4	83,208	3.8
Other	46,032	0.5	48,132	0.8	26,651	3.9
Hong Kong	280,733		261,703		236,109	
Demand and other – non-interest bearing	27,412	–	22,056	–	15,620	–
Demand – interest bearing	202,330	–	171,846	0.1	126,199	0.4
Savings	37,119	0.5	45,537	0.6	65,068	2.4
Time	12,793	0.7	20,901	0.6	27,659	2.3
Other	1,079	0.2	1,363	0.1	1,563	1.2
Rest of Asia-Pacific	142,807		126,144		128,381	
Demand and other – non-interest bearing	16,418	–	13,425	–	11,872	–
Demand – interest bearing	63,033	1.0	53,108	0.8	49,329	2.0
Savings	51,757	2.4	46,137	2.5	52,849	3.8
Time	10,734	0.9	12,542	1.2	13,342	3.3
Other	865	2.2	932	1.8	989	3.6
Middle East	32,747		33,211		35,546	
Demand and other – non-interest bearing	11,873	–	9,865	–	10,849	–
Demand – interest bearing	6,315	1.5	6,364	1.4	6,324	1.6
Savings	13,774	2.8	15,005	3.4	16,119	3.1
Time	604	2.6	1,424	2.7	1,884	2.9
Other	181	0.1	553	0.2	370	0.5
North America	157,361		145,820		144,982	
Demand and other – non-interest bearing	22,235	–	18,350	–	16,759	–
Demand – interest bearing	28,569	0.2	25,870	0.2	18,261	1.6
Savings	78,040	0.8	69,296	1.4	87,001	2.5
Time	17,975	0.8	25,164	1.3	17,838	3.2
Other	10,542	0.6	7,140	0.8	5,123	2.4
Latin America	77,618		63,635		65,071	
Demand and other – non-interest bearing	12,407	–	10,598	–	12,507	–
Demand – interest bearing	6,270	1.2	4,734	1.1	4,994	1.9
Savings	41,784	8.5	33,091	8.5	31,442	10.3
Time	15,716	3.9	14,244	4.8	15,179	5.2
Other	1,441	7.5	968	6.4	949	8.2
Total	1,115,827		1,070,963		1,058,071	
Demand and other – non-interest bearing	153,214	–	130,045	–	107,217	–
Demand – interest bearing	510,244	0.3	474,100	0.3	430,141	1.9
Savings	274,267	2.5	266,410	2.6	325,958	3.9
Time	117,962	1.4	141,320	1.6	159,110	3.6
Other	60,140	0.7	59,088	0.9	35,645	3.6

Report of the Directors: Operating and Financial Review (continued)*Certificates of deposit and other money market instruments*

	2010		2009		2008	
	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %
Europe	57,018	0.4	65,151	0.9	74,007	4.5
Hong Kong	213	3.8	278	3.6	745	3.0
Rest of Asia-Pacific	3,529	3.4	3,536	3.7	6,966	6.6
Middle East	68	0.5	265	6.4	648	4.6
North America	10,607	0.5	14,218	1.1	22,278	3.3
Latin America	1,126	4.0	1,227	3.6	3,036	7.8
	72,561	0.6	84,675	1.2	107,680	4.5

Certificates of deposit and other time deposits

The maturity analysis of certificates of deposit ('CD's) and other wholesale time deposits is expressed by remaining maturity. The majority of CDs and time deposits are in amounts of US\$100,000 and over or the equivalent in other currencies.

	At 31 December 2010				
	3 months or less US\$m	After 3 months but within 6 months US\$m	After 6 months but within 12 months US\$m	After 12 months US\$m	Total US\$m
Europe	98,113	14,977	15,726	7,587	136,403
Certificates of deposit	14,153	7,660	6,018	–	27,831
Time deposits:					
– banks	25,183	2,530	1,671	2,221	31,605
– customers	58,777	4,787	8,037	5,366	76,967
Hong Kong	12,420	564	1,289	722	14,995
Certificates of deposit	87	45	6	314	452
Time deposits:					
– banks	2,234	10	65	24	2,333
– customers	10,099	509	1,218	384	12,210
Rest of Asia-Pacific	15,375	877	542	1,530	18,324
Certificates of deposit	3,347	370	373	559	4,649
Time deposits:					
– banks	1,777	34	2	107	1,920
– customers	10,251	473	167	864	11,755
Middle East	507	113	120	568	1,308
Certificates of deposit	–	–	–	–	–
Time deposits:					
– banks	364	–	2	340	706
– customers	143	113	118	228	602
North America	12,220	1,979	1,977	1,152	17,328
Time deposits:					
– banks	2,501	13	3	204	2,721
– customers	9,719	1,966	1,974	948	14,607
Latin America	13,213	1,446	1,673	3,115	19,447
Certificates of deposit	183	53	447	382	1,065
Time deposits:					
– banks	1,855	290	163	305	2,613
– customers	11,175	1,103	1,063	2,428	15,769
Total	151,848	19,956	21,327	14,674	207,805
Certificates of deposit	17,770	8,128	6,844	1,255	33,997
Time deposits:					
– banks	33,914	2,877	1,906	3,201	41,898
– customers	100,164	8,951	12,577	10,218	131,910

Report of the Directors: Operating and Financial Review (continued)

Economic profit

Our internal performance measures include economic profit/(loss), a calculation which compares the return on financial capital invested in HSBC by our shareholders with the cost of that capital. We price our cost of capital internally and the difference between that cost and the post-tax profit attributable to ordinary shareholders represents the amount of economic profit/(loss) generated. Economic profit/(loss) generated is used by management as one input in deciding where to allocate capital and other resources.

In order to concentrate on external factors rather than measurement bases, we emphasise the trend in economic profit/(loss) ahead of absolute amounts within business units. Our long-term cost of capital is reviewed annually and for 2010 it was revised to 11% from the 10% used in 2009. We use a Capital Asset Pricing Model to determine our cost of capital. The main drivers of the increase were an increase in the risk free rate and an increase in the betas used in

the calculation. The following commentary is on a reported basis.

Our economic loss decreased by US\$4.7bn to US\$3.3bn as a result of an increase in profit attributable to shareholders. This was predominantly driven by lower loan impairment charges across all regions and customer groups, notably in the US due to lower balances and decreased delinquency rates in Card and Retail Services, and the run-off of the Consumer Lending and mortgage services portfolio.

The increase in average invested capital reflected higher retained earnings and a significant decrease in reserves representing unrealised losses on available-for-sale securities due to a slowing in the rate of anticipated losses in the underlying collateral pools.

The return on invested capital increased by 4.6 percentage points, although it remained below our benchmark cost of capital. The economic spread improved by 3.6 percentage points, the result of an increase in return on invested capital, partly offset by the rise in the cost of capital in 2010.

Average total shareholders' equity	
Adjusted by:	
Goodwill previously amortised or written off	
Property revaluation reserves	
Reserves representing unrealised losses on effective cash flow hedges	
Reserves representing unrealised losses on available-for-sale securities	
Preference shares and other equity instruments	
Average invested capital ⁴²	
Return on invested capital ⁴³	
Benchmark cost of capital	
Economic loss and spread	

2010		2009	
US\$m	% ⁴¹	US\$m	% ⁴⁰
138,224		115,431	
8,123		8,123	
(813)		(799)	
100		385	
6,129		16,189	
(5,473)		(3,538)	
146,290		135,791	
12,746	8.7	5,565	4.1
(16,092)	(11.0)	(13,579)	(10.0)
(3,346)	(2.3)	(8,014)	(5.9)

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Critical accounting policies

(Audited)

Introduction

The results of HSBC are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of our consolidated financial statements. The significant accounting policies are described in Note 2 on the Financial Statements.

When preparing the financial statements, it is the Directors' responsibility under UK company law to select suitable accounting policies and to make judgements and estimates that are reasonable and prudent. The accounting policies that are deemed critical to our results and financial position, in terms of the materiality of the items to which the policies are applied and the high degree of judgement involved, including the use of assumptions and estimation, are discussed below.

Impairment of loans and advances

Our accounting policy for losses arising from the impairment of customer loans and advances is described in Note 2g on the Financial Statements. Loan impairment allowances represent management's best estimate of losses incurred in the loan portfolios at the balance sheet date.

Management is required to exercise judgement in making assumptions and estimations when calculating loan impairment allowances on both individually and collectively assessed loans and advances. Of the Group's total loans and advances to customers before impairment allowances of US\$978bn (2009: US\$922bn), US\$15bn or 2% (2009: US\$15bn; 2%) were individually assessed for impairment, and US\$963bn or 98% (2009: US\$907bn; 98%) were collectively assessed for impairment.

The most significant judgemental area is the calculation of collective impairment allowances. The geographical area with most exposure to collectively assessed loans and advances is North America, which comprised US\$198bn or 21% (2009: US\$219bn; 24%) of the total. Collective impairment allowances in North America were US\$9bn, representing 64% (2009: US\$13bn; 68%) of the total collectively assessed loan impairment allowance.

The methods used to calculate collective impairment allowances on homogeneous groups of loans and advances that are not considered individually significant are disclosed in Note 2g on the Financial Statements. They are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan

basis because of the large number of individually insignificant loans in the portfolio.

The methods involve the use of statistically assessed historical information which is supplemented with significant management judgement to assess whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience. In normal circumstances, historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio, though sometimes it provides less relevant information about the inherent loss in a given portfolio at the balance sheet date, for example, when there have been changes in economic, regulatory or behavioural conditions which result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models. In these circumstances, the risk factors are taken into account by adjusting the impairment allowances derived solely from historical loss experience.

Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographical concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other influences on customer payment patterns. Different factors are applied in different regions and countries to reflect local economic conditions, laws and regulations. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. For example, roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

However, the exercise of judgement requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas. Many of the factors have a high degree of interdependency and there is no single factor to which our loan impairment allowances as a whole are sensitive. They are particularly sensitive to general economic and credit conditions in North America, however. For example, a 10% increase in impairment allowances on collectively assessed loans and advances in North America would increase loan impairment allowances by US\$0.9bn at 31 December 2010 (2009: US\$1.3bn). It is possible that the outcomes within the next

Report of the Directors: Operating and Financial Review (continued)

financial year could differ from the assumptions built into the models, resulting in a material adjustment to the carrying amount of loans and advances.

Goodwill impairment

Our accounting policy for goodwill is described in Note 2p on the Financial Statements. Note 24 on the Financial Statements lists our cash generating units ('CGU's) by geographical region and global business. HSBC's total goodwill amounted to US\$22bn at 31 December 2010 (2009: US\$23bn).

The review of goodwill impairment reflects management's best estimate of the following factors:

- the future cash flows of the CGUs are sensitive to the cash flows projected for the periods for which detailed forecasts are available and to assumptions regarding the long-term pattern of sustainable cash flows thereafter. Forecasts are compared with actual performance and verifiable economic data, but they necessarily and appropriately reflect management's view of future business prospects at the time of the assessment; and
- the rates used to discount future expected cash flows are based on the costs of capital assigned to individual CGUs and can have a significant effect on their valuation. The cost of capital percentage is generally derived from a Capital Asset Pricing Model, which incorporates inputs reflecting a number of financial and economic variables, including the risk-free interest rate in the country concerned and a premium for the inherent risk of the business being evaluated. These variables are subject to fluctuations in external market rates and economic conditions beyond our control and therefore require the exercise of significant judgement and are consequently subject to uncertainty.

A decline in a CGU's expected cash flows and/or an increase in its cost of capital reduces the CGU's estimated recoverable amount. If this is lower than the carrying value of the CGU, a charge for impairment of goodwill is recognised in our income statement for the year.

The accuracy of forecast cash flows is subject to a high degree of uncertainty in volatile market conditions. In such market conditions, management retests goodwill for impairment more frequently than annually to ensure that the assumptions on which the cash flow forecasts are based continue to reflect current market conditions and management's best estimate of future business prospects.

During 2010, no impairment of goodwill was identified (2009: nil). In addition to the annual impairment test which was performed as at 1 July 2010, management reviewed the current and expected performance of the CGUs as at 31 December 2010 and determined that there was no indication of potential impairment of the goodwill allocated to them. However, in the event of a significant deterioration in economic and credit conditions compared with those reflected by management in the cash flow forecasts for the CGUs, a material adjustment to a CGU's recoverable amount may occur which may result in the recognition of an impairment charge in the income statement.

Note 24 on the Financial Statements includes details of the CGU's with significant balances of goodwill, states the key assumptions used to assess the goodwill in each of those CGUs for impairment and provides a discussion of the sensitivity of the carrying value of goodwill to changes in key assumptions.

Valuation of financial instruments

Our accounting policy for determining the fair value of financial instruments is described in Note 2d on the Financial Statements.

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

Valuation techniques used to calculate fair values are discussed in Note 16 on the Financial Statements. The main assumptions and estimates which management consider when applying a model with valuation techniques are:

- the likelihood and expected timing of future cash flows on the instrument. These cash flows are usually governed by the terms of the instrument, although judgement may be required when the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt. Future cash flows may be sensitive to changes in market rates;

Report of the Directors: Operating and Financial Review (continued)

- selecting an appropriate discount rate for the instrument. The determination of this rate is based on an assessment of what a market participant would regard as the appropriate spread of the rate for the instrument over the appropriate risk-free rate; and
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

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

The value of financial assets and liabilities measured at fair value using a valuation technique was US\$599bn (2009: US\$599bn) and US\$499bn (2009: US\$447bn), respectively or 56% (2009: 56%) of total financial assets and 77% (2009: 75%) of total financial liabilities measured at fair value.

Disclosures of the types and amounts of adjustments made in determining the fair value of financial instruments measured at fair value using valuation techniques, and a sensitivity analysis of fair values for financial instruments with significant unobservable inputs to reasonably possible alternative assumptions can be found in Note 16 on the Financial Statements. Given the uncertainty and subjective nature of valuing financial instruments at fair value, it is possible that the outcomes in the next financial year could differ from the assumptions used, and this could result in a material adjustment to the carrying amount of financial instruments measured at fair value.

Impairment of available-for-sale financial assets

Our accounting policy for impairment of available-for-sale financial assets is described in Note 2j on the Financial Statements.

At 31 December 2010, our total available-for-sale financial assets amounted to US\$381bn (2009: US\$352bn), of which US\$373bn or 98% (2009: US\$342bn; 97%) were debt securities. The available-for-sale fair value reserve relating to debt securities amounted to a deficit of US\$6.2bn (2009: deficit of US\$11.4bn). A deficit in the available-for-sale fair value reserve occurs on debt securities when the fair value of a relevant security is less than its acquisition cost (net of any principal repayments and amortisation) after deducting any previous impairment loss recognised in the income statement, but where there is no evidence of any impairment or, if an impairment was previously recognised, any subsequent impairment.

Management is required to exercise judgement in determining whether there is objective evidence that an impairment loss has occurred. Once an impairment has been identified, the amount of impairment loss is measured with reference to the fair value of the asset. More information on assumptions and estimates requiring management judgement relating to the determination of fair values of financial instruments is provided above in 'Valuation of financial instruments'.

Deciding whether an available-for-sale debt security is impaired requires objective evidence of both the occurrence of a loss event and a related decrease in estimated future cash flows. The degree of judgement involved is less when cash flows are readily determinable, but increases when estimating future cash flows requires consideration of a number of variables, some of which may be unobservable in current market conditions.

There is no single factor to which the Group's charge for impairment of available-for-sale debt securities is particularly sensitive, because of the various types of securities we hold, the range of geographical areas in which those securities are held, and the wide range of factors which can affect the occurrence of loss events and the cash flows of securities, including different types of collateral.

The most significant judgements concern more complex instruments, such as ABSs, where it is necessary to consider factors such as the estimated future cash flows on underlying pools of collateral including prepayment speeds, the extent and depth of market price declines and changes in credit ratings. The review of estimated future cash flows on underlying collateral is subject to uncertainties when the assessment is based on historical information on pools of assets, and judgement is required to determine whether historical performance remains

Report of the Directors: Operating and Financial Review (continued)

representative of current economic and credit conditions.

Further details of the nature and extent of our exposures to ABSs classified as available-for-sale and a more detailed description of the assumptions and estimates used in assessing these securities for impairment, together with a discussion of those assets which are most sensitive to possible future impairment, are provided in 'Securitisation exposures and other structured products' on page 128.

It is possible that outcomes in the next financial year could be different from those modelled when seeking to identify impairment on available-for-sale debt securities. In this event, impairment may be identified in available-for-sale debt securities which had previously been determined not to be impaired, potentially resulting in the recognition of material impairment losses in the next financial year.

Deferred tax assets

Our accounting policy for the recognition of deferred tax assets is described in Note 2s on the Financial Statements. The recognition of a deferred tax asset relies on an assessment of the probability and sufficiency of future taxable profits, future reversals of existing taxable temporary differences and ongoing tax planning strategies.

The most significant judgements concern the US deferred tax assets, given the recent history of losses in our US operations. Net US deferred tax assets amounted to US\$4bn or 58% (2009: US\$5.1bn; 59%) of deferred tax assets recognised on the Group's balance sheet.

Recognition of US deferred tax assets is based on the evidence available about conditions at the balance sheet date, and requires significant judgements to be made regarding projections of loan impairment charges and the timing of recovery in the US economy. These judgements take into consideration the effect of both positive and negative

evidence, including historical financial performance, projections of future taxable income, future reversals of existing taxable temporary differences, tax planning strategies and the availability of loss carrybacks.

Projections of future taxable income in the US are based on business plans, future capital requirements and ongoing tax planning strategies. These projections include assumptions about future house prices, US economic conditions, including unemployment levels and their impact on loan impairment charges, and capital support from HSBC Holdings. These forecasts are consistent with the assumption that it is probable that the results of future operations will generate sufficient taxable income to support the deferred tax assets. In management's judgement, recent market conditions, which have resulted in losses being incurred in the US, will create significant downward pressure and volatility regarding the profit or loss before tax in the next few years. To reflect this, the assessment of recoverability of the deferred tax assets in the US significantly discounts any future expected taxable income and relies to a greater extent on capital support to the US operations from HSBC Holdings, including tax planning strategies implemented in relation to such support.

The most significant tax planning strategy is the investment of capital in our US operations to ensure the realisation of the deferred tax assets. The transfer of a subsidiary as part of an internal reorganisation on 31 January 2010 provided substantial support for the recoverability of the US deferred tax assets. Management expects that, with support, our US operations will continue to execute their business strategies and plans until they return to profitability. If HSBC Holdings were to decide not to provide ongoing support, the full recovery of the deferred tax asset may no longer be probable and could result in a significant reduction of the deferred tax asset which would be recognised as a charge in the income statement.

Report of the Directors: Operating and Financial Review (continued)

Customer groups and global businesses

Summary	Page
Products and services	37
Personal Financial Services	38
Commercial Banking	40
Global Banking and Markets	42
Global Private Banking	44
Other	46
Reconciliation of reported and underlying profit/(loss) before tax	47
Analysis by customer group and global business	47(a) 48

Basis of preparation

The results are presented in accordance with the accounting policies used in the preparation of HSBC's consolidated financial statements. Our operations are closely integrated and, accordingly, the presentation of customer group and global business data includes internal allocations of certain items of income and expense. These allocations include the costs of certain support services and GMO functions, to the extent that these can be meaningfully attributed to operational business lines. While such allocations have been made on a systematic and consistent basis, they necessarily involve a degree of subjectivity.

Where relevant, income and expense amounts presented include the results of inter-segment funding as well as inter-company and inter-business line transactions. All such transactions are undertaken on arm's length terms.

Summary

HSBC's senior management reviews operating activity on a number of bases, including by geographical region and by customer group and global business. Capital resources are allocated and performance is assessed primarily by geographical region, as presented on page 50.

The commentaries below present customer groups and global businesses followed by

Profit/(loss) before tax

	2010		2009		2008	
	US\$m	%	US\$m	%	US\$m	%
Personal Financial Services	3,518	18.5	(2,065)	(29.2)	(10,974)	(117.9)
Commercial Banking	6,090	32.0	4,275	60.4	7,194	77.3
Global Banking and Markets	9,536	50.1	10,481	148.1	3,483	37.4
Global Private Banking	1,054	5.5	1,108	15.6	1,447	15.6
Other ⁴⁴	(1,161)	(6.1)	(6,720)	(94.9)	8,157	87.6
	19,037	100.0	7,079	100.0	9,307	100.0

Total assets⁴⁵

	At 31 December			
	2010		2009	
	US\$m	%	US\$m	%
Personal Financial Services	527,698	21.5	554,074	23.4
Commercial Banking	296,797	12.1	251,143	10.6
Global Banking and Markets	1,758,315	71.6	1,683,672	71.2
Global Private Banking	116,846	4.8	116,148	4.9
Other	161,458	6.6	150,983	6.4
Intra-HSBC items	(406,425)	(16.6)	(391,568)	(16.5)
	2,454,689	100.0	2,364,452	100.0

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Products and services

Personal Financial Services

PFS offers its products and services to customers based on their individual needs. Premier and Advance services are targeted at mass affluent and emerging affluent customers who value international connectivity and benefit from our global reach and scale. For customers who have simpler everyday banking needs, we offer a full range of banking products and services reflecting local requirements.

In addition, we are one of the largest card issuers in the world, offering HSBC branded cards, co-branded cards with selected partners and private label (store) cards.

Typically, customer offerings include personal banking products (current and savings accounts, mortgages and personal loans, credit cards, debit cards and local and international payment services) and wealth management services (insurance and investment products and financial planning services).

- **HSBC Premier** provides preferential banking services and global recognition to our high net worth customers and their immediate families with a dedicated relationship manager, specialist wealth advice and tailored solutions. Customers can access emergency travel assistance, priority telephone banking and an online 'global view' of their Premier accounts around the world with free money transfers between them.
- **HSBC Advance** provides a range of preferential products and services customised to meet local needs. With a dedicated telephone service, access to wealth advice and online tools to support financial planning, it gives customers an online 'global view' of their Advance accounts with money transfers between them.
- **Wealth Solutions & Financial Planning:** a financial planning process designed around individual customer needs to help our clients to protect, grow and manage their wealth through best-in-class investment and wealth insurance products manufactured by in-house partners (Global Asset Management, Global Markets and HSBC Insurance) and by selected third party providers.

Customers can transact with the bank via a range of channels such as internet banking and self-service terminals in addition to traditional and automated branches and telephone service centres.

Commercial Banking

We segment our CMB business into Corporate, to serve both Corporate and Mid-Market companies with more sophisticated financial needs and Business Banking, to serve the small and medium-sized enterprises ('SME's) sector. This enables the development of tailored customer propositions while adopting a broader view of the entire commercial banking sector, from sole proprietors to large corporations. This allows us to provide continuous support to companies as they expand both domestically and internationally, and ensures a clear focus on the business banking segments, which are typically the key to innovation and growth in market economies.

We place particular emphasis on international connectivity to meet our business customers' needs and aim to be recognised as the leading international bank in all our markets and the best bank for business in our largest markets.

- **Financing:** we offer a broad range of financing, both domestic and cross-border, including overdrafts, receivables finance, term loans and syndicated, leveraged, acquisition and project finance. Asset finance is offered in selected sites, focused on leasing and instalment finance for vehicles, plant and equipment.
- **Payments and cash management:** we are a leading provider of domestic and cross-border payments and collections, liquidity management and account services worldwide, delivered through our e-platform, HSBC net.
- **International trade:** we provide various international trade products and services, to both buyers and suppliers such as export finance, guarantees, documentary collections and forfeiting to improve efficiency and help mitigate risk throughout the supply chain.
- **Treasury:** CMB customers are volume users of our foreign exchange, derivatives and structured products.
- **Capital markets & advisory:** capital raising on debt and equity markets and advisory services are available as required.
- **Commercial cards:** card issuing helps customers enhance cash management, credit control and purchasing. Card acquiring services enable merchants to accept credit and debit card payments in person or remotely.
- **Insurance:** CMB offers key person, employee benefits and a variety of commercial risk insurance such as property, cargo and trade credit.
- **Direct channels:** these include online and direct banking offerings such as telephone banking, HSBCnet and Business Internet Banking.

Report of the Directors: Operating and Financial Review (continued)

Global Banking and Markets

GB&M provides tailored financial solutions to major government, corporate and institutional clients and private investors worldwide. Managed as a global business, GB&M operates a long-term relationship management approach to build a full understanding of clients' financial requirements. Sector-focused client service teams comprising relationship managers and product specialists develop financial solutions to meet individual client needs. With dedicated offices in over 65 countries and access to HSBC's worldwide presence and capabilities, this business serves subsidiaries and offices of our clients on a global basis.

GB&M is managed as four principal business lines: Global Markets, Global Banking, Global Asset Management and Principal Investments. This structure allows us to focus on relationships and sectors that best fit the Group's footprint and facilitate seamless delivery of our products and services to clients.

- **Global Markets** operations consist of treasury and capital markets services. Products include foreign exchange; currency, interest rate, bond, credit, equity and other derivatives; government and non-government fixed income and money market instruments; precious metals and exchange-traded futures; equity services; distribution of capital markets instruments; and securities services, including custody and clearing services and funds administration to both domestic and cross-border investors.
- **Global Banking** offers financing, advisory and transaction services. Products include:
 - capital raising, advisory services, bilateral and syndicated lending, leveraged and acquisition finance, structured and project finance, lease finance and non-retail deposit taking;
 - international, regional and domestic payments and cash management services; and trade services for large corporate clients.
- **Global Asset Management** offers investment solutions to institutions, financial intermediaries and individual investors globally.
- **Principal Investments** includes our strategic relationships with third-party private equity managers and other investments.

Global Private Banking

HSBC Private Bank is the principal marketing name of our international private banking business, Global Private Banking ('GPB'). Utilising the most suitable products from the marketplace, GPB works with its clients to offer both traditional and innovative ways to manage and preserve wealth while optimising returns.

GPB accesses expertise in six major advisory centres in Hong Kong, Singapore, Geneva, New York, Paris and London to identify opportunities which meet clients' needs and investment strategies.

- **Private Banking** services comprise multi-currency deposit accounts and fiduciary deposits, credit and specialist lending, treasury trading services, cash management, securities custody and clearing. GPB works to ensure that its clients have full access to other products and services available in HSBC such as credit cards, internet banking, corporate banking and investment banking.
- **Private Wealth Management** comprises both advisory and discretionary investment services. A wide range of investment vehicles is covered, including bonds, equities, derivatives, options, futures, structured products, mutual funds and alternatives (hedge funds, private equity and real estate).
 - Corporate Finance Solutions helps provide clients with cross border solutions for their companies, working in conjunction with GB&M.
- **Private Wealth Solutions** comprise inheritance planning, trustee and other fiduciary services designed to protect wealth and preserve it for future generations through structures tailored to meet the individual needs of each family. Areas of expertise include trusts, foundation and company administration, charitable trusts and foundations, insurance, family office advisory and philanthropy.

Report of the Directors: Operating and Financial Review (continued)

Personal Financial Services

PFS provides 92 million individual and self-employed customers with financial services in over 60 markets worldwide.

	2010 US\$m	2009 US\$m	2008 US\$m
Net interest income	24,161	25,107	29,419
Net fee income	7,336	8,238	10,107
Other income	1,079	2,070	1,963
Net operating income⁴⁶	32,576	35,415	41,489
Impairment charges ⁴⁷	(11,259)	(19,902)	(21,220)
Net operating income	21,317	15,513	20,269
Total operating expenses	(18,805)	(18,292)	(31,704)
Operating profit/(loss)	2,512	(2,779)	(11,435)
Income from associates ⁴⁸	1,006	714	461
Profit/(loss) before tax	3,518	(2,065)	(10,974)

**Return to profitability in PFS
as credit quality
improved**

**HSBC Advance
launched in
34
markets in its first year**

**Significant increase
in mortgage lending
in Hong Kong and the UK**

Strategic direction

Our strategy for PFS is to use our global reach and scale to grow profitably in selected markets by providing relationship banking and wealth management services. PFS employs two globally consistent propositions in Premier and Advance and focuses on deepening customer relationships and increasing the penetration of wealth management services. In markets where we already have scale or where scale can be built over time, we provide services to all customer segments. In other markets, we participate more selectively, targeting mass affluent customers which have strong international connectivity or where our global scale is crucial.

For footnotes, see page 83.

Review of performance

- PFS reported a profit before tax of US\$3.5bn compared with a reported and underlying loss of US\$2.1bn in 2009. This was largely attributable to a decline in loan impairment charges in the US and the managed reduction of certain higher risk portfolios in Latin America, Asia and the Middle East. Performance improved in all regions as the credit quality of our lending portfolios generally rose and revenue grew in Asia and Europe, reflecting higher investment-related income, increased insurance revenue in Hong Kong and mortgage lending growth combined with wider spreads in the UK. Income from associates, particularly Ping An Insurance, increased, driven by strong sales growth.
- Revenue fell, largely in HSBC Finance, due to lower lending balances in both the run-off portfolio and in the Card and Retail Services business. Card fees also decreased in North America following the implementation of the CARD Act. Revenue was further affected by an adverse fair value movement related to the non-qualifying hedges recorded in HSBC Finance compared with a favourable movement in 2009, as long-term interest rates declined.
- We continued to invest in our business by hiring new relationship managers, investing in systems and infrastructure and developing our product offerings. Operating expenses remained broadly unchanged as a rise in costs in Asia from increased headcount and higher marketing expenditure in support of business expansion was broadly offset by strict cost control across the Group and lower costs associated with the reduced scope of the business in the US.
- Loan impairment charges and other credit risk provisions fell by 44% in the improved economic conditions, reflecting a decline in lending balances, enhanced collection processes and tighter lending criteria. The decline in lending was significant in the US as the run-off of the non-core portfolio continued and balances fell in the Card and Retail Services business, where there were fewer active accounts and customers reduced their credit card debt. In addition, certain higher risk portfolios in Latin America, Asia and the Middle East were managed down and repositioned to higher quality assets, resulting in an improvement in credit quality.
- In the UK, we increased our market share of mortgage lending, while maintaining a conservative loan to value ratio on new business. We grew mortgage lending in Asia,

Report of the Directors: Operating and Financial Review (continued)

significantly in Hong Kong, where the introduction of HIBOR-linked mortgages drove volume growth and enabled us to maintain our market leadership. In Australia, Singapore and Malaysia we were able to grow mortgage volumes through targeted marketing campaigns. Customer account balances also grew, largely on the back of increased customer numbers in Asia and the UK.

- HSBC Premier, our flagship global customer proposition, was available in 47 markets and had grown to 4.4m customers at the end of 2010. We attracted over 980,000 net new customers in 2010, of whom over 50% were new to HSBC.
- We made further progress in standardising our various offerings across the Group for emerging mass affluent customers with the continued transition of eligible customers to HSBC Advance, our second globally consistent proposition. At 31 December 2010, Advance had a customer base of 4.6m and was available in 34 markets.
- During 2010, HSBC's Global View and Global Transfer online capabilities were extended to our Advance customer base. These services allow Premier and Advance customers to access and manage all their accounts through one single logon and transfer funds between their overseas accounts online. Both the volume and the value of transfers increased strongly during the year as our target customer base and general awareness of these services grew.
- Our World Selection global investment offering continued to grow and is now available in 26 markets with total assets under management of US\$7.2bn at 31 December 2010.
- We further enhanced our services and made banking easier for our customers with initiatives such as increased Saturday branch opening in the UK, the launch of retail renminbi wealth management products, mobile banking and online real time bond trading in Hong Kong, and the upgrading of the US automatic teller machine ('ATM') network to accept deposits.

Report of the Directors: Operating and Financial Review (continued)

Commercial Banking

CMB offers a full range of commercial financial services and tailored propositions to 3.6m customers ranging from sole proprietors to publicly quoted companies in 65 countries.

	2010 US\$m	2009 US\$m	2008 US\$m
Net interest income	8,487	7,883	9,494
Net fee income	3,964	3,702	4,097
Other income	1,383	1,268	1,726
Net operating income⁴⁶	13,834	12,853	15,317
Impairment charges ⁴⁷	(1,805)	(3,282)	(2,173)
Net operating income	12,029	9,571	13,144
Total operating expenses	(6,831)	(5,963)	(6,581)
Operating profit	5,198	3,608	6,563
Income from associates ⁴⁸	892	667	631
Profit before tax	6,090	4,275	7,194

**Strong balance sheet growth with
21%
rise in lending to US\$239bn**

**Significant-pre-tax profit
contribution from
emerging markets at
67%**

**First international bank to
complete renminbi trade
settlements across six continents**

Strategic direction

CMB's core strategy is focused on two key initiatives:

- to be the leading international business bank in all our markets, leveraging HSBC's extensive geographical network together with its product expertise in payments, trade, receivables finance and foreign exchange to actively support customers who are trading and investing internationally; and
- to be the best bank for small- and medium-sized enterprises in our largest markets.

For footnotes, see page 83.

Review of performance

- In 2010, CMB reported profit before tax of US\$6.1bn, 42% higher than in 2009 with growth across all regions. Excluding the gains from the sales in 2010 of HSBC Insurance Brokers and our stake in the Wells Fargo HSBC Trade Bank, and similar non-recurring items in 2009, (see page 14), profit before tax increased by 48%. The rise in profit reflected an improvement in the credit environment and strong growth in world trade.
- Revenue grew by 8% to US\$13.7bn, mainly in Asia, where we expanded customer lending significantly and increased our fee income from remittances, trade and investments. Our insurance operations also performed strongly in Asia, with an increased uptake of our life insurance products in Hong Kong. In North America, repricing initiatives led to a notable increase in revenue.
- Loan impairment charges and other credit risk provisions declined by 46% to US\$1.8bn with favourable variances in all regions as the credit environment improved and our exposure to higher risk portfolios was managed down.
- Excluding CMB's share of the non-recurring accounting gains related to the change in the UK pension scheme, (see page 26), operating expenses increased by 11% to US\$6.8bn as we continued to invest for future revenue growth in those markets that we see as central to international connectivity. We hired more relationship managers in France, Brazil, Mexico and Hong Kong, and continued to invest in systems to improve our customer experience. As a result, our cost efficiency ratio rose to 49.8% in 2010.
- CMB's share of income from associates grew by 33% to US\$892m, notably in mainland China.
- Customer lending balances rose by 21% to US\$239bn, driven by increased demand in Asia as market sentiment improved, and growth in key developed markets such as France and the UK, where we actively supported corporates and SMEs in response to changes in the economy. Our corporate segment increased lending by 25% to US\$183bn, notably in Hong Kong and mainland China.
- CMB attracted over half a million new customers in 2010, taking the total to 3.6m, and we grew customer account balances by 8%, with significant growth in Asia where HSBC was

Report of the Directors: Operating and Financial Review (continued)

ranked as the best cash management bank in 2010 by *Euromoney*.

- In line with our strategy to be the leading international business bank, we continued to pursue opportunities to expand our customer base of businesses that trade and invest internationally. In 2010, we opened CMB's first corporate branch in Switzerland to enable our Swiss-based customers to access our international banking services, particularly in faster growing markets. In the UK, we recruited 139 new International Commercial Managers to support the international expansion plans of UK businesses.
- Our geographical presence across both developed and emerging markets allowed us to capitalise on the rising levels of international trade flows, notably in Asia and Europe, where we gained export market share in 2010. In the Middle East, we increased our lending to exporters in the region by 69%. In the United Arab Emirates ('UAE') specifically, our average lending to exporters more than doubled in 2010 to US\$700m.
- The number of successful cross-border referrals increased by 77% compared with 2009, with a total transaction value in 2010 of almost US\$15bn. Significantly, successful intra-Asia referrals doubled from 2009, while referrals from mainland China more than doubled reflecting the increased appetite of Chinese business to explore international opportunities.
- CMB continued to demonstrate connectivity with other customer groups within HSBC. Our partnership with GB&M allowed us to support our customers in accessing capital markets to help them grow and expand internationally. Successful referrals from CMB represented 51% of total net new money generated from internal referrals to GPB in 2010, while 5% of new Premier accounts were referred from CMB.
- CMB has a diverse suite of products to support businesses that trade internationally. We are the second largest export factor globally and, in 2010, we launched our Receivables Finance proposition in Germany, Europe's largest economy, which has rapidly growing export ties with Asia. In the UK, we increased international trade finance by 13%. In addition, we successfully piloted the Supplier Invoice Finance Scheme, a reverse factoring product, in India, mainland China and Hong Kong.
- We became the first international bank to provide renminbi-denominated trade settlements across six continents in 2010 and we are one of the largest international banks in Hong Kong to offer renminbi products, with total transactions exceeding US\$6.7bn in 2010.
- Our Business Banking propositions are focused on better serving SMEs, especially those that trade internationally. At the end of 2010, we had over 3.4m customers worldwide in the Business Banking segment, representing 55% of CMB's total deposit balances and providing an important source of funding for our Corporate segment.
- We continue to recognise the importance of SMEs to sustained economic recovery and provided working capital finance for this sector throughout 2010. In Hong Kong, we maintained our active participation in the Government Special Loan Guarantee Scheme, through which we provided US\$1.5bn in SME financing in 2010. In the UK, we increased new lending to SMEs by 19% in 2010, opened accounts for over 125,000 customers starting new businesses and added over 170 extra local business managers.
- We continued to develop and improve our direct channels through enhanced telephone-based relationship management services in key markets, including the launch of smartphone services in Hong Kong. In the UK, we also launched straight-through foreign exchange services. Notably, we are now the leading direct bank in Europe with over one million SME business customers using our Business Internet Banking platform.

Report of the Directors: Operating and Financial Review (continued)

Global Banking and Markets

GB&M is a global business which provides tailored financial solutions to major government, corporate and institutional clients worldwide.

	2010 US\$m	2009 US\$m	2008 US\$m
Net interest income	7,348	8,610	8,541
Net fee income	4,725	4,363	4,291
Net trading income ⁴⁹	5,831	6,875	481
Other income	2,043	1,972	205
Net operating income⁴⁶	19,947	21,820	13,518
Impairment charges ⁴⁷	(990)	(3,168)	(1,471)
Net operating income	18,957	18,652	12,047
Total operating expenses	(9,962)	(8,537)	(9,092)
Operating profit	8,995	10,115	2,955
Income from associates ⁴⁸	541	366	528
Profit before tax	9,536	10,481	3,483

Employee expenses (including payroll and bonus taxes) in operating expenses US\$4,737m

(2009: US\$4,335m; 2008: US\$4,263m)

Strong contribution from emerging markets

Best Global Emerging Markets Bank

Best Global Emerging Markets Debt House

Best Debt House in Asia

Euromoney Awards for Excellence 2010

Emerging Markets Bond House of the Year

International Financing Review Awards 2010

Strategic direction

In 2010, GB&M continued to pursue its now well-established 'emerging markets-led and financing-focused' strategy, encompassing HSBC's objective to be a leading wholesale bank by:

- utilising the Group's extensive distribution network;
- developing GB&M's hub-and-spoke business model; and
- continuing to build capabilities in major hubs to support the delivery of an advanced suite of services to major government, corporate and institutional clients across the HSBC network.

This combination of product depth and distribution strength is fundamental to meeting the needs of existing and new clients and allowing GB&M to achieve its strategic goals.

For footnotes, see page 83.

Review of performance

- GB&M reported profit before tax of US\$9.5bn, 9% lower than in 2009. On an underlying basis, which excludes the gains resulting from the sale of Eversholt Rail Group and HSBC Private Equity (Asia) Ltd in 2010, profit before tax declined by 14%, driven by lower income from Balance Sheet Management and Credit and Rates trading and higher operating costs. Profitability benefited from a significant reduction in loan impairment charges and other credit risk provisions. Operating results remained well diversified across our businesses with a strong contribution from emerging markets, where we continued to support existing and anticipated new business, including introducing a 'China desk' in the Middle East and a 'Latam desk' in Hong Kong.
- Net operating income before loan impairment charges and other credit risk provisions decreased by 11%, mainly due to lower net interest income in Balance Sheet Management from the maturing of higher yielding positions, low interest rates and flattening yield curves. Lower trading income largely reflected uncertainty in the eurozone, particularly in the second half of 2010. This was offset in part by a net release of US\$429m largely relating to legacy positions in Credit trading and monoline Credit exposures, compared with a reported write-down of US\$331m in 2009, following a general improvement in ABS prices. Trading income also benefited from a small favourable fair value movement on structured liabilities, compared with an adverse fair value movement in 2009, resulting in a reported favourable movement of US\$466m.
- Loan impairment charges and other credit risk provisions decreased by US\$2.2bn. A US\$1.2bn reduction in loan impairment charges to US\$500m was driven by a general improvement in the credit environment and the non-recurrence of significant charges taken in relation to a small number of clients in 2009. Credit risk provisions on the available-for-sale portfolio decreased by US\$981m to US\$490m, of which US\$444m related to ABSs, significantly lower than the US\$1.5bn impairment reported in 2009, due to a slowing in the rate of anticipated losses in the underlying collateral pools.
- Higher operating expenses in 2010 reflected the one-off payroll and bonus taxes in the UK and France on certain bonuses paid in respect of 2009 totalling US\$309m, the non-recurrence of an accounting gain related to a change in the

Report of the Directors: Operating and Financial Review (continued)

Management view of total operating income

	2010 US\$m	2009 US\$m	2008 US\$m
Global Markets ⁵⁰	9,173	10,364	2,676
Credit	1,649	2,330	(5,502)
Rates	2,052	2,648	2,033
Foreign Exchange	2,752	2,979	3,842
Equities	755	641	(64)
Securities Services ⁵¹	1,511	1,420	2,116
Asset and Structured Finance	454	346	251
Global Banking	4,621	4,630	5,718
Financing and Equity Capital Markets	2,852	3,070	3,572
Payments and Cash Management ⁵²	1,133	1,053	1,665
Other transaction services ⁵³	636	507	481
Balance Sheet Management ⁵⁴	4,102	5,390	3,618
Global Asset Management	1,077	939	934
Principal Investments	319	42	(415)
Other ⁵⁵	655	455	987
Total operating income	19,947	21,820	13,518

Comparative information has been adjusted to reflect the current management view.

For footnotes, see page 83.

delivery of certain staff benefits in the main UK pension scheme in 2009, higher support costs and continued investment in strategic initiatives being undertaken to drive future revenue growth. These included the development of Prime Services and equity market capabilities and the expansion of the Rates and Foreign Exchange e-commerce platforms. The percentage of total reported compensation pool allocated in respect of performance in 2010 to revenues net of loan impairment charges (excluding payroll taxes levied on 2009 bonuses) remained consistent with 2009 on a reported basis.

- Global Markets' revenues were second only to the results recorded in 2009, demonstrating the continuing strength of our client-facing businesses. Trading income declined, driven by increased competition and reduced margins across core products. Credit and Rates were adversely affected by less favourable market conditions as European sovereign debt concerns resulted in increased economic uncertainty in the eurozone. Foreign Exchange revenues were lower, reflecting spread compression in the more competitive trading environment and a decline in market volatility. Investment in the Equities business, particularly the enhancement

of the sales and trading platforms, led to increased market share in our target markets despite lower market volumes and increased competition. Securities Services income grew by 4%, with particularly strong performances in Asia driven by increasing market values and Latin America due to higher interest income. Asset and Structured Finance reported higher revenues from increased deal activity during the year.

- Global Banking produced a robust performance as it continued the strategy of focusing on key client relationships to drive market share growth in event-driven and other ancillary businesses. A decrease in revenues from Financing and Equity Capital Markets was due to the adverse effect of continued spread compression. Higher project and export finance revenues were driven by increased deal volumes, while growth in revenue and market share was achieved in the advisory business. Equity Capital Markets revenues fell as total deal values declined due to a reduction in client activity. Despite the adverse effect of the continued low interest rate environment, Payments and Cash Management delivered a 6% increase in revenue driven by strong growth in transaction-driven fee income and customer account balances in Asia.
- Revenues in Balance Sheet Management remained high by historical standards but, as expected, declined in 2010 as higher-yielding positions matured and the opportunity for reinvestment was limited by the prevailing low interest rate environment and flatter yield curves.
- Robust revenue growth was reported in Global Asset Management. Higher management fee income was recorded across all regions, most notably in our emerging markets businesses. Funds under management ('FuM') reached a year-end high of US\$439bn at 31 December 2010 of which emerging markets FuM, in countries outside North America, Western Europe, Japan and Australia, were US\$145bn. Total FuM grew by 4% compared with 2009, benefiting from positive net inflows of US\$16bn and strengthening market performance. New funds launched in the year included the Global High Income Fund and the MultiAlpha Global High Yield Bond Fund.
- Principal Investments reported an increase in revenues as improved market conditions resulted in higher gains on sale and a reduction in impairments.

Report of the Directors: Operating and Financial Review (continued)

Global Private Banking

GPB works with our high net worth clients to offer both traditional and innovative ways to manage and preserve wealth while optimising returns.

	2010 US\$m	2009 US\$m	2008 US\$m
Net interest income	1,345	1,474	1,612
Net fee income	1,299	1,236	1,476
Other income	449	402	543
Net operating income⁴⁶	3,093	3,112	3,631
Impairment (charges)/ recoveries ⁴⁷	12	(128)	(68)
Net operating income	3,105	2,984	3,563
Total operating expenses	(2,035)	(1,884)	(2,116)
Operating profit	1,070	1,100	1,447
Income from associates ⁴⁸	(16)	8	–
Profit before tax	1,054	1,108	1,447

Client assets over 6% up at

US\$390bn

2009: US\$367bn; 2008: US\$352bn

Higher investment in GPB operations in Asia, Latin America and the Middle East

Best Global Wealth Manager *Euromoney Awards for Excellence 2010*

Best Private Bank in Asia

Euromoney 2011 Private Banking Survey

Outstanding Private Bank – Middle East

Private Banker International Awards 2010

Strategic direction

GPB strives to be the world's leading international private bank, recognised for excellent client experience and global connections.

Our brand, capital strength, extensive global network and positioning provide a strong foundation from which GPB continues to attract and retain clients. Product and service leadership in areas such as alternative investments, foreign exchange, estate planning, credit and investment advice helps us meet the complex international financial needs of individuals and families.

We are well-positioned for sustainable long-term growth through continuing investment in our people, integrated IT solutions and emerging markets-focused domestic operations, along with ensuring our cross-border business meets high standards in the evolving regulatory environment.

For footnotes, see page 83.

Review of performance

- Reported profit before tax was US\$1.1bn, 5% below 2009 on a reported and an underlying basis, driven by lower net interest income as the persistent low interest rate environment continued to affect deposit spreads and higher operating expenses. Loan impairment charges fell following the non-recurrence of a single specific impairment charge in North America in 2009 and the release of several charges made in previous years as markets recovered.
- Net fee income and trading income rose, notably in Asia, as improved client risk appetite led to higher levels of activity, an increase in transaction volumes and positive net inflows of client assets.
- Operating expenses increased, reflecting the hiring of front-line staff to cover emerging markets as part of a long-term strategy to further strengthen our international network to better serve clients, along with investment in systems and higher compliance costs resulting from the evolving regulatory environment.

Client assets

	2010 US\$bn	2009 US\$bn
At 1 January	367	352
Net new money	13	(7)
Value change	13	27
Exchange and other	(3)	(5)
At 31 December	390	367

- Reported client assets, which include funds under management and cash deposits, increased by US\$23bn due to net new money inflows compared with outflows in 2009, and favourable market movements. Net inflows benefited from our strength in emerging markets, newly recruited key relationship managers, and cross-business referrals which generated US\$8bn in 2010. This also resulted in an increase in 'total client assets', the equivalent to many industry definitions of assets under management which includes some non-financial assets held in client trusts, from US\$460bn to US\$499bn. Investor demand for alternatives, including real estate investments, also attracted strong inflows into HSBC Alternative Investments Limited.
- The Family Office Partnership had a number of successes in its first full year, producing a complete range of corporate and personal solutions for top tier clients and strengthening its links with GB&M.

Report of the Directors: Operating and Financial Review (continued)**Other**

'Other' contains the results of certain property transactions, unallocated investment activities, centrally held investment companies, movements in fair value of own debt, HSBC's holding company and financing operations.

	2010 US\$m	2009 US\$m	2008 US\$m
Net interest expense	(998)	(1,035)	(956)
Net trading income/ (expense)	(311)	279	(530)
Net income/(expense) from financial instruments designated at fair value	(216)	(6,443)	7,426
Other income	6,185	5,176	6,355
Net operating income/ (expense)⁴⁶	4,660	(2,023)	12,295
Impairment (charges)/ recoveries ⁴⁷	3	(8)	(5)
Net operating income/ (expense)	4,663	(2,031)	12,290
Total operating expenses	(5,918)	(4,715)	(4,174)
Operating profit/(loss)	(1,255)	(6,746)	8,116
Income from associates ⁴⁸	94	26	41
Profit/(loss) before tax	(1,161)	(6,720)	8,157

US\$250m

gain on sale and leaseback of Paris and New York headquarters buildings

US\$6.5bn

reduction in adverse fair value movements on own debt

Investment in Group Service Centres as migrated activities increase

For footnotes, see page 83.

Notes

- Reported loss before tax of US\$1.2bn compared with a loss before tax of US\$6.7bn in 2009. This included adverse movements of US\$63m on the fair value of our own debt attributable to movements in credit spreads in 2010, compared with adverse movements of US\$6.5bn in 2009. In addition, 2010 included gains of US\$188m following the dilution of our holding in Ping An Insurance and US\$62m on the reclassification of Bao Viet to an associate following the purchase of an additional 8% stake. On an underlying basis, the loss before tax increased by US\$1.2bn to US\$1.3bn. The main items reported under 'Other', are described in footnote 44 on page 85.
- Net trading expense of US\$311m compared with income of US\$276m in 2009. This change was largely attributable to fair value movements on cross-currency swaps used to economically hedge fixed rate long-term debt issued by HSBC Holdings. The adverse fair value movements of US\$304m, which were driven by a decline in long-term US interest rates relative to sterling and euro rates, compared with favourable fair value movements of US\$748m on these instruments in 2009. This was partly offset by the non-recurrence of fair value losses arising from the implied contingent forward contract entered into with the underwriters of our rights issue in 2009 and forward foreign exchange contracts associated with the rights issue, which were accounted as derivatives with fair value taken to profit or loss in 2009.
- We recognised gains of US\$194m and US\$56m, respectively, from the sale and leaseback of our headquarters buildings in Paris and New York. These compared with more substantial underlying gains totalling US\$667m (US\$686m as reported) on the sale and leaseback of 8 Canada Square, London and the sale of a property in Hong Kong in 2009.
- Operating expenses rose by 24% to US\$5.9bn as an increasing number of operational activities were centralised, notably in the US. These costs were previously incurred directly by customer groups, but are now recorded in 'Other' and charged to customer groups through a recharge mechanism with income reported as 'Other operating income'. In addition, costs at our Group Service Centres rose by 6% as the number of migrated activities increased in line with our Global Resourcing model.

Report of the Directors: Operating and Financial Review (continued)

Reconciliation of reported and underlying profit/(loss) before tax

Personal Financial Services

2010 compared with 2009

	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2009 at 2010 exchange rates ¹² US\$m	2010 as reported US\$m	2010 adjust- ments ¹⁰ US\$m	2010 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	25,107	–	419	25,526	24,161	(8)	24,153	(4)	(5)
Net fee income	8,238	(8)	115	8,345	7,336	(1)	7,335	(11)	(12)
Other income	2,070	–	101	2,171	1,079	(5)	1,074	(48)	(51)
Net operating income¹⁵	35,415	(8)	635	36,042	32,576	(14)	32,562	(8)	(10)
Loan impairment charges and other credit risk provisions	(19,902)	–	(271)	(20,173)	(11,259)	–	(11,259)	43	44
Net operating income	15,513	(8)	364	15,869	21,317	(14)	21,303	37	34
Operating expenses	(18,292)	6	(440)	(18,726)	(18,805)	4	(18,801)	(3)	–
Operating profit/(loss)	(2,779)	(2)	(76)	(2,857)	2,512	(10)	2,502		
Income from associates	714	–	6	720	1,006	–	1,006	41	40
Profit/(loss) before tax	(2,065)	(2)	(70)	(2,137)	3,518	(10)	3,508		

2009 compared with 2008

	2008 as reported US\$m	2008 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2008 at 2009 exchange rates ¹⁶ US\$m	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	2009 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	29,419	(36)	(1,534)	27,849	25,107	(3)	25,104	(15)	(10)
Net fee income	10,107	(32)	(645)	9,430	8,238	–	8,238	(18)	(13)
Other income	1,963	(121)	(258)	1,584	2,070	(1)	2,069	5	31
Net operating income¹⁵	41,489	(189)	(2,437)	38,863	35,415	(4)	35,411	(15)	(9)
Loan impairment charges and other credit risk provisions	(21,220)	3	595	(20,622)	(19,902)	–	(19,902)	6	3
Net operating income	20,269	(186)	(1,842)	18,241	15,513	(4)	15,509	(23)	(15)
Operating expenses (excluding goodwill impairment)	(21,140)	38	1,372	(19,730)	(18,292)	1	(18,291)	13	7
Goodwill impairment	(10,564)	–	–	(10,564)	–	–	–	100	100
Operating loss	(11,435)	(148)	(470)	(12,053)	(2,779)	(3)	(2,782)	76	77
Income from associates	461	–	13	474	714	–	714	55	51
Loss before tax	(10,974)	(148)	(457)	(11,579)	(2,065)	(3)	(2,068)	81	82

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Commercial Banking

2010 compared with 2009

	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2009 at 2010 exchange rates ¹² US\$m	2010 as reported US\$m	2010 adjust- ments ¹⁰ US\$m	2010 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	7,883	(1)	193	8,075	8,487	(20)	8,467	8	5
Net fee income	3,702	(164)	51	3,589	3,964	(2)	3,962	7	10
Other income	1,268	(283)	12	997	1,383	(124)	1,259	9	26
Net operating income¹⁵	12,853	(448)	256	12,661	13,834	(146)	13,688	8	8
Loan impairment charges and other credit risk provisions	(3,282)	–	(73)	(3,355)	(1,805)	–	(1,805)	45	46
Net operating income	9,571	(448)	183	9,306	12,029	(146)	11,883	26	28
Operating expenses	(5,963)	143	(122)	(5,942)	(6,831)	13	(6,818)	(15)	(15)
Operating profit	3,608	(305)	61	3,364	5,198	(133)	5,065	44	51
Income from associates	667	(1)	3	669	892	–	892	34	33
Profit before tax	4,275	(306)	64	4,033	6,090	(133)	5,957	42	48

2009 compared with 2008

	2008 as reported US\$m	2008 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2008 at 2009 exchange rates ¹⁶ US\$m	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	2009 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	9,494	(29)	(697)	8,768	7,883	(45)	7,838	(17)	(11)
Net fee income	4,097	(26)	(367)	3,704	3,702	(5)	3,697	(10)	–
Other income	1,726	(464)	(213)	1,049	1,268	(295)	973	(27)	(7)
Net operating income¹⁵	15,317	(519)	(1,277)	13,521	12,853	(345)	12,508	(16)	(7)
Loan impairment charges and other credit risk provisions	(2,173)	3	68	(2,102)	(3,282)	–	(3,282)	(51)	(56)
Net operating income	13,144	(516)	(1,209)	11,419	9,571	(345)	9,226	(27)	(19)
Operating expenses	(6,581)	30	537	(6,014)	(5,963)	27	(5,936)	9	1
Operating profit	6,563	(486)	(672)	5,405	3,608	(318)	3,290	(45)	(39)
Income from associates	631	–	7	638	667	–	667	6	5
Profit before tax	7,194	(486)	(665)	6,043	4,275	(318)	3,957	(41)	(35)

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Global Banking and Markets

2010 compared with 2009

	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2009 at 2010 exchange rates ¹² US\$m	2010 as reported US\$m	2010 adjust- ments ¹⁰ US\$m	2010 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	8,610	–	60	8,670	7,348	(3)	7,345	(15)	(15)
Net fee income	4,363	(38)	20	4,345	4,725	–	4,725	8	9
Net trading income	6,875	–	103	6,978	5,831	–	5,831	(15)	(16)
Other income	1,972	–	–	1,972	2,043	(341)	1,702	4	(14)
Net operating income¹⁵	21,820	(38)	183	21,965	19,947	(344)	19,603	(9)	(11)
Loan impairment charges and other credit risk provisions	(3,168)	–	13	(3,155)	(990)	–	(990)	69	69
Net operating income	18,652	(38)	196	18,810	18,957	(344)	18,613	2	(1)
Operating expenses	(8,537)	51	(25)	(8,511)	(9,962)	2	(9,960)	(17)	(17)
Operating profit	10,115	13	171	10,299	8,995	(342)	8,653	(11)	(16)
Income from associates	366	–	2	368	541	–	541	48	47
Profit before tax	10,481	13	173	10,667	9,536	(342)	9,194	(9)	(14)

2009 compared with 2008

	2008 as reported US\$m	2008 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2008 at 2009 exchange rates ¹⁶ US\$m	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	2009 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	8,541	–	(451)	8,090	8,610	(5)	8,605	1	6
Net fee income	4,291	–	(267)	4,024	4,363	(1)	4,362	2	8
Net trading income	481	–	(404)	77	6,875	–	6,875	1,329	8,829
Other income	205	–	(151)	54	1,972	(2)	1,970	862	3,548
Net operating income¹⁵	13,518	–	(1,273)	12,245	21,820	(8)	21,812	61	78
Loan impairment charges and other credit risk provisions	(1,471)	–	45	(1,426)	(3,168)	–	(3,168)	(115)	(122)
Net operating income	12,047	–	(1,228)	10,819	18,652	(8)	18,644	55	72
Operating expenses	(9,092)	–	743	(8,349)	(8,537)	3	(8,534)	6	(2)
Operating profit	2,955	–	(485)	2,470	10,115	(5)	10,110	242	309
Income from associates	528	–	6	534	366	–	366	(31)	(31)
Profit before tax	3,483	–	(479)	3,004	10,481	(5)	10,476	201	249

Report of the Directors: Operating and Financial Review (continued)*Balance sheet data significant to Global Banking and Markets*

	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Total US\$m
At 31 December 2010							
Trading assets ⁷¹	232,918	32,023	18,256	958	87,120	6,459	377,734
Derivative assets ⁷²	199,654	21,644	17,135	832	65,153	3,955	308,373
Trading liabilities	178,861	8,650	3,846	122	91,980	2,702	286,161
Derivative liabilities ⁷²	199,751	22,622	17,121	845	66,323	3,913	310,575
At 31 December 2009							
Trading assets ⁷¹	294,951	25,742	15,960	511	67,466	6,283	410,913
Derivative assets ⁷²	190,900	16,937	15,660	668	61,192	2,820	288,177
Trading liabilities	169,814	10,720	3,040	13	69,302	2,875	255,764
Derivative liabilities ⁷²	191,480	16,619	15,500	651	60,178	3,270	287,698
At 31 December 2008							
Trading assets ⁷¹	281,089	45,398	19,192	414	74,498	5,004	425,595
Derivative assets ⁷²	349,035	34,146	29,124	1,014	156,056	9,618	578,993
Trading liabilities	144,759	13,056	3,633	54	72,325	2,546	236,373
Derivative liabilities ⁷²	345,970	35,693	29,097	1,016	152,907	9,088	573,771

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Global Private Banking

2010 compared with 2009

	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2009 at 2010 exchange rates ¹² US\$m	2010 as reported US\$m	2010 adjust- ments ¹⁰ US\$m	2010 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	1,474	–	(2)	1,472	1,345	–	1,345	(9)	(9)
Net fee income	1,236	–	(1)	1,235	1,299	–	1,299	5	5
Other income	402	–	–	402	449	1	450	12	12
Net operating income¹⁵	3,112	–	(3)	3,109	3,093	1	3,094	(1)	–
Loan impairment charges and other credit risk provisions	(128)	–	1	(127)	12	–	12		
Net operating income	2,984	–	(2)	2,982	3,105	1	3,106	4	4
Operating expenses	(1,884)	–	3	(1,881)	(2,035)	–	(2,035)	(8)	(8)
Operating profit	1,100	–	1	1,101	1,070	1	1,071	(3)	(3)
Income from associates	8	–	–	8	(16)	–	(16)		
Profit before tax	1,108	–	1	1,109	1,054	1	1,055	(5)	(5)

2009 compared with 2008

	2008 as reported US\$m	2008 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2008 at 2009 exchange rates ¹⁶ US\$m	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	2009 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	1,612	–	(52)	1,560	1,474	–	1,474	(9)	(6)
Net fee income	1,476	–	(33)	1,443	1,236	–	1,236	(16)	(14)
Other income	543	–	(19)	524	402	–	402	(26)	(23)
Net operating income¹⁵	3,631	–	(104)	3,527	3,112	–	3,112	(14)	(12)
Loan impairment charges and other credit risk provisions	(68)	–	2	(66)	(128)	–	(128)	(88)	(94)
Net operating income	3,563	–	(102)	3,461	2,984	–	2,984	(16)	(14)
Operating expenses	(2,116)	–	54	(2,062)	(1,884)	–	(1,884)	11	9
Operating profit	1,447	–	(48)	1,399	1,100	–	1,100	(24)	(21)
Income from associates	–	–	–	–	8	–	8		
Profit before tax	1,447	–	(48)	1,399	1,108	–	1,108	(23)	(21)

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Other

2010 compared with 2009

	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2009 at 2010 exchange rates ¹² US\$m	2010 as reported US\$m	2010 adjust- ments ¹⁰ US\$m	2010 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest expense	(1,035)	–	21	(1,014)	(998)	–	(998)	4	2
Net fee income	125	–	(3)	122	31	–	31	(75)	(75)
Changes in fair value ¹⁴	(6,533)	6,533	–	–	(63)	63	–	99	–
Other income	5,420	–	29	5,449	5,690	(250)	5,440	5	–
Net operating income/(expense)¹⁵	(2,023)	6,533	47	4,557	4,660	(187)	4,473		(2)
Loan impairment (charges)/recoveries and other credit risk provisions	(8)	–	–	(8)	3	–	3		
Net operating income/(expense)	(2,031)	6,533	47	4,549	4,663	(187)	4,476		(2)
Operating expenses	(4,715)	–	(50)	(4,765)	(5,918)	–	(5,918)	(26)	(24)
Operating loss	(6,746)	6,533	(3)	(216)	(1,255)	(187)	(1,442)	81	(568)
Income from associates	26	–	–	26	94	–	94	262	262
Loss before tax	(6,720)	6,533	(3)	(190)	(1,161)	(187)	(1,348)	83	(609)

2009 compared with 2008

	2008 as reported US\$m	2008 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2008 at 2009 exchange rates ¹⁶ US\$m	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	2009 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest expense	(956)	–	12	(944)	(1,035)	–	(1,035)	(8)	(10)
Net fee income	53	–	(3)	50	125	–	125	136	150
Changes in fair value ¹⁴	6,570	(6,570)	–	–	(6,533)	6,533	–		
Gains on disposal of French regional banks	2,445	(2,445)	–	–	–	–	–	(100)	
Other income	4,183	(95)	(13)	4,075	5,420	–	5,420	30	33
Net operating income/(expense)¹⁵	12,295	(9,110)	(4)	3,181	(2,023)	6,533	4,510		42
Loan impairment charges and other credit risk provisions	(5)	–	(1)	(6)	(8)	–	(8)	(60)	(33)
Net operating income/(expense)	12,290	(9,110)	(5)	3,175	(2,031)	6,533	4,502		42
Operating expenses	(4,174)	–	70	(4,104)	(4,715)	–	(4,715)	(13)	(15)
Operating profit/(loss)	8,116	(9,110)	65	(929)	(6,746)	6,533	(213)		77
Income from associates	41	–	(1)	40	26	–	26	(37)	(35)
Profit/(loss) before tax	8,157	(9,110)	64	(889)	(6,720)	6,533	(187)		79

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Analysis by customer group and global business

HSBC profit/(loss) before tax and balance sheet data

	2010						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other ⁴⁴ US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	24,161	8,487	7,348	1,345	(998)	(902)	39,441
Net fee income	7,336	3,964	4,725	1,299	31	–	17,355
Trading income/(expense) excluding net interest income	(107)	427	4,327	391	(358)	–	4,680
Net interest income on trading activities	28	28	1,504	21	47	902	2,530
Net trading income/(expense) ⁴⁹	(79)	455	5,831	412	(311)	902	7,210
Changes in fair value of long- term debt issued and related derivatives	–	–	–	–	(258)	–	(258)
Net income from other financial instruments designated at fair value	1,210	190	36	–	42	–	1,478
Net income/(expense) from financial instruments designated at fair value	1,210	190	36	–	(216)	–	1,220
Gains less losses from financial investments	42	(1)	797	(6)	136	–	968
Dividend income	27	12	48	5	20	–	112
Net earned insurance premiums	9,737	1,379	41	–	(11)	–	11,146
Other operating income	650	585	1,147	38	6,005	(5,863)	2,562
Total operating income	43,084	15,071	19,973	3,093	4,656	(5,863)	80,014
Net insurance claims ⁵⁷	(10,508)	(1,237)	(26)	–	4	–	(11,767)
Net operating income⁴⁶	32,576	13,834	19,947	3,093	4,660	(5,863)	68,247
Loan impairment (charges)/recoveries and other credit risk provisions	(11,259)	(1,805)	(990)	12	3	–	(14,039)
Net operating income	21,317	12,029	18,957	3,105	4,663	(5,863)	54,208
Employee expenses ⁵⁸	(5,388)	(2,153)	(4,735)	(1,237)	(6,323)	–	(19,836)
Other operating expenses	(13,417)	(4,678)	(5,227)	(798)	405	5,863	(17,852)
Total operating expenses	(18,805)	(6,831)	(9,962)	(2,035)	(5,918)	5,863	(37,688)
Operating profit/(loss)	2,512	5,198	8,995	1,070	(1,255)	–	16,520
Share of profit/(loss) in associates and joint ventures	1,006	892	541	(16)	94	–	2,517
Profit/(loss) before tax	3,518	6,090	9,536	1,054	(1,161)	–	19,037
	%	%	%	%	%		%
Share of HSBC's profit before tax	18.5	32.0	50.1	5.5	(6.1)		100.0
Cost efficiency ratio	57.7	49.4	49.9	65.8	127.0		55.2
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	390,957	239,286	284,503	40,665	2,955		958,366
Total assets	527,698	296,797	1,758,315	116,846	161,458	(406,425)	2,454,689
Customer accounts	525,184	286,007	308,453	107,130	951		1,227,725

Report of the Directors: Operating and Financial Review (continued)

	2009						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other ⁴⁴ US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	25,107	7,883	8,610	1,474	(1,035)	(1,309)	40,730
Net fee income	8,238	3,702	4,363	1,236	125	–	17,664
Trading income excluding net interest income	637	332	4,701	322	244	–	6,236
Net interest income on trading activities	65	22	2,174	22	35	1,309	3,627
Net trading income ⁴⁹	702	354	6,875	344	279	1,309	9,863
Changes in fair value of long- term debt issued and related derivatives	–	–	–	–	(6,247)	–	(6,247)
Net income/(expense) from other financial instruments designated at fair value	2,339	100	473	–	(196)	–	2,716
Net income/(expense) from financial instruments designated at fair value	2,339	100	473	–	(6,443)	–	(3,531)
Gains less losses from financial investments	224	23	265	5	3	–	520
Dividend income	33	8	68	5	12	–	126
Net earned insurance premiums	9,534	886	54	–	(3)	–	10,471
Other operating income	809	739	1,146	48	5,042	(4,996)	2,788
Total operating income/(expense)	46,986	13,695	21,854	3,112	(2,020)	(4,996)	78,631
Net insurance claims ⁵⁷	(11,571)	(842)	(34)	–	(3)	–	(12,450)
Net operating income/(expense) ⁴⁶	35,415	12,853	21,820	3,112	(2,023)	(4,996)	66,181
Loan impairment charges and other credit risk provisions	(19,902)	(3,282)	(3,168)	(128)	(8)	–	(26,488)
Net operating income/(expense)	15,513	9,571	18,652	2,984	(2,031)	(4,996)	39,693
Employee expenses ⁵⁸	(6,069)	(2,072)	(4,335)	(1,198)	(4,790)	–	(18,464)
Other operating expenses	(12,223)	(3,891)	(4,202)	(686)	75	4,996	(15,931)
Total operating expenses	(18,292)	(5,963)	(8,537)	(1,884)	(4,715)	4,996	(34,395)
Operating profit/(loss)	(2,779)	3,608	10,115	1,100	(6,746)	–	5,298
Share of profit in associates and joint ventures	714	667	366	8	26	–	1,781
Profit/(loss) before tax	(2,065)	4,275	10,481	1,108	(6,720)	–	7,079
	%	%	%	%	%		%
Share of HSBC's profit before tax	(29.2)	60.4	148.1	15.6	(94.9)		100.0
Cost efficiency ratio	51.7	46.4	39.1	60.5	(233.1)		52.0
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	399,460	199,674	256,956	37,031	3,110		896,231
Total assets	554,074	251,143	1,683,672	116,148	150,983	(391,568)	2,364,452
Customer accounts	499,109	267,388	284,727	106,533	1,277		1,159,034

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)*Profit/(loss) before tax and balance sheet data (continued)*

Total	2008						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other ⁴⁴ US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	29,419	9,494	8,541	1,612	(956)	(5,547)	42,563
Net fee income	10,107	4,097	4,291	1,476	53	–	20,024
Trading income/(expense) excluding net interest income	175	369	157	408	(262)	–	847
Net interest income/(expense) on trading activities	79	17	324	14	(268)	5,547	5,713
Net trading income/(expense) ⁴⁹	254	386	481	422	(530)	5,547	6,560
Changes in fair value of long- term debt issued and related derivatives	–	–	–	–	6,679	–	6,679
Net income/(expense) from other financial instruments designated at fair value	(2,912)	(224)	(438)	–	747	–	(2,827)
Net income/(expense) from financial instruments designated at fair value	(2,912)	(224)	(438)	–	7,426	–	3,852
Gains less losses from financial investments	663	193	(327)	64	(396)	–	197
Dividend income	90	88	76	8	10	–	272
Net earned insurance premiums	10,083	679	105	–	(17)	–	10,850
Gains on disposal of French regional banks	–	–	–	–	2,445	–	2,445
Other operating income	259	939	868	49	4,261	(4,568)	1,808
Total operating income	47,963	15,652	13,597	3,631	12,296	(4,568)	88,571
Net insurance claims ⁵⁷	(6,474)	(335)	(79)	–	(1)	–	(6,889)
Net operating income ⁴⁶	41,489	15,317	13,518	3,631	12,295	(4,568)	81,682
Loan impairment charges and other credit risk provisions	(21,220)	(2,173)	(1,471)	(68)	(5)	–	(24,937)
Net operating income	20,269	13,144	12,047	3,563	12,290	(4,568)	56,745
Employee expenses ⁵⁸	(7,905)	(2,549)	(4,263)	(1,308)	(4,767)	–	(20,792)
Goodwill impairment	(10,564)	–	–	–	–	–	(10,564)
Other operating expenses	(13,235)	(4,032)	(4,829)	(808)	593	4,568	(17,743)
Total operating expenses	(31,704)	(6,581)	(9,092)	(2,116)	(4,174)	4,568	(49,099)
Operating profit/(loss)	(11,435)	6,563	2,955	1,447	8,116	–	7,646
Share of profit in associates and joint ventures	461	631	528	–	41	–	1,661
Profit/(loss) before tax	(10,974)	7,194	3,483	1,447	8,157	–	9,307
Share of HSBC's profit before tax	(117.9)	77.3	37.4	15.6	87.6	–	100.0
Cost efficiency ratio	76.4	43.0	67.3	58.3	33.9	–	60.1
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net)	401,402	203,949	287,306	37,590	2,621	–	932,868
Total assets	527,901	249,218	1,991,852	133,216	145,581	(520,303)	2,527,465
Customer accounts	440,338	235,879	320,386	116,683	2,041	–	1,115,327

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)**Geographical regions**

Summary	50
Europe	51
Hong Kong	56
Rest of Asia-Pacific	60
Middle East	66
North America	71
Latin America	76
Reconciliation of reported and underlying profit/(loss) before tax	80(b)

Summary

Additional information on results in 2010 may be found in the 'Financial Summary' on pages 14 to 36.

In the analysis of profit by geographical regions that follows, operating income and operating expenses include intra-HSBC items of US\$3,125m (2009: US\$2,756m; 2008: US\$2,492m).

Profit/(loss) before tax

	2010		2009		2008	
	US\$m	%	US\$m	%	US\$m	%
Europe	4,302	22.6	4,009	56.7	10,869	116.7
Hong Kong	5,692	29.9	5,029	71.0	5,461	58.7
Rest of Asia-Pacific	5,902	31.0	4,200	59.3	4,722	50.7
Middle East	892	4.7	455	6.4	1,746	18.8
North America	454	2.4	(7,738)	(109.3)	(15,528)	(166.8)
Latin America	1,795	9.4	1,124	15.9	2,037	21.9
	19,037	100.0	7,079	100.0	9,307	100.0

Total assets⁴⁵

	At 31 December			
	2010		2009	
	US\$m	%	US\$m	%
Europe	1,249,527	50.9	1,268,600	53.7
Hong Kong	429,565	17.5	399,243	16.9
Rest of Asia-Pacific	278,062	11.3	222,139	9.4
Middle East	52,757	2.1	48,107	2.0
North America	492,487	20.1	475,014	20.1
Latin America	139,938	5.7	115,967	4.9
Intra-HSBC items	(187,647)	(7.6)	(164,618)	(7.0)
	2,454,689	100.0	2,364,452	100.0

Risk-weighted assets⁵⁹

	At 31 December			
	2010		2009	
	US\$bn	%	US\$bn	%
Total	1,103.1		1,133.2	
Europe	301.6	27.2	339.7	29.8
Hong Kong	106.9	9.7	119.5	10.5
Rest of Asia-Pacific	217.5	19.6	173.9	15.3
Middle East	54.1	4.9	54.3	4.8
North America	330.7	29.9	369.2	32.4
Latin America	95.9	8.7	81.7	7.2

For footnote, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Europe

Our principal banking operations in Europe are HSBC Bank plc in the UK, HSBC France, HSBC Bank A.S. in Turkey, HSBC Bank Malta p.l.c., HSBC Private Bank (Suisse) S.A. and HSBC Trinkaus & Burkhardt AG. Through these operations we provide a wide range of banking, treasury and financial services to personal, commercial and corporate customers across Europe.

	2010 US\$m	2009 US\$m	2008 US\$m
Net interest income	11,250	12,268	9,696
Net fee income	6,371	6,267	7,492
Net trading income	2,863	5,459	5,357
Other income/(expense)	2,266	(450)	8,134
Net operating income⁴⁶	22,750	23,544	30,679
Impairment charges ⁴⁷	(3,020)	(5,568)	(3,754)
Net operating income	19,730	17,976	26,925
Total operating expenses	(15,445)	(13,988)	(16,072)
Operating profit	4,285	3,988	10,853
Income from associates ⁴⁸	17	21	16
Profit before tax	4,302	4,009	10,869
Cost efficiency ratio	67.9%	59.4%	52.4%
Year-end staff numbers	75,698	76,703	82,093

**Reduction in
underlying impairment charges⁴⁷**
45%

**Total UK mortgage
market share**
5.2%
2009: 4.8%

**Strong trade
revenue growth**

Economic background

After falling by 4.9% in 2009, UK Gross Domestic Product ('GDP') only partially recovered in 2010, rising 1.4%. This revival in activity was not reflected in a corresponding rise in employment, and the unemployment rate remained at 7.9% in the three months to November. Despite the general economic weakness, the annual rate of Consumer Price Index ('CPI') inflation rose during 2010, reaching 3.7% in December, partly because of the rise in value added tax to 17.5% in January, and increases in the price of food and energy following rapid gains in global commodity prices. Wage growth remained subdued, however, with average earnings rising just 2.0% in the year to December. The Bank of England chose to maintain Bank Rate at 0.5% throughout 2010.

The eurozone economy also partially recovered during the year, with GDP rising 1.7% in 2010 compared to 2009. The region benefited from the pick-up in the world economy and some improvement in domestic demand. Within the region, Germany recorded the strongest growth rate with its GDP rising 3.5% in the year as a whole. The unemployment rate in the eurozone increased slightly to 10.0% by the end of 2010. The large increases in government debt that emerged in certain parts of the region in recent years began to put upward pressure on government bond yields during 2010, and some governments encountered funding difficulties. In response, a temporary European support fund, the €440bn European Financial Stability Facility was created, and the EU set aside €60bn in a package named the European Financial Stabilisation Mechanism. Greece received a €110bn aid package provided jointly by the International Monetary Fund and eurozone governments. Ireland also drew on international assistance in December. The European Central Bank left its key interest rate at 1.0% throughout the year.

Review of performance

Our European operations reported a pre-tax profit of US\$4.3bn, compared with US\$4.0bn in 2009, an increase of 7%. In 2010, this included adverse fair value movements of US\$198m due to the change in credit spreads on the Group's own debt held at fair value, compared with adverse fair value movements of US\$2.8bn in 2009. In addition, we made gains of US\$107m on the disposal of the HSBC Insurance Brokers business and US\$255m on the sale of Eversholt Rail Group. In 2009, we recorded a gain on the sale of the residual stake in our UK card merchant acquiring business. Excluding these items, underlying pre-tax profits decreased by 35%,

For footnotes, see page 83.

The commentary on Europe is on an underlying basis unless stated otherwise.

Report of the Directors: Operating and Financial Review (continued)

Profit/(loss) before tax by country within customer groups and global businesses

	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Total US\$m
2010						
UK	1,223	827	1,730	223	(1,605)	2,398
France ⁶⁰	109	135	405	18	26	693
Germany	–	32	267	30	4	333
Malta	35	56	19	–	–	110
Switzerland	–	(5)	–	265	–	260
Turkey	64	80	105	1	–	250
Other	(142)	80	200	103	17	258
	1,289	1,205	2,726	640	(1,558)	4,302
2009						
UK	364	1,026	3,045	252	(2,561)	2,126
France ⁶⁰	54	102	894	3	(429)	624
Germany	–	21	255	32	(18)	290
Malta	33	58	9	–	–	100
Switzerland	–	–	5	448	(3)	450
Turkey	43	97	119	2	–	261
Other	(182)	(12)	218	117	17	158
	312	1,292	4,545	854	(2,994)	4,009
2008						
UK	1,546	2,361	(469)	250	2,997	6,685
France ⁶⁰	139	176	273	10	2,242	2,840
Germany	–	31	184	32	(22)	225
Malta	59	67	16	–	–	142
Switzerland	–	–	–	553	–	553
Turkey	3	91	130	–	–	224
Other	(89)	(4)	61	153	79	200
	1,658	2,722	195	998	5,296	10,869

For footnote, see page 83.

largely due to lower income from GB&M, whose exceptional results of 2009 were not repeated, and an unfavourable year on year movement in certain non-qualifying hedges of US\$1.1bn.

GB&M results remained strong by historical standards. However, revenues decreased in 2010 due to less favourable market conditions caused by the impact of the European sovereign debt crisis, particularly in the second half of the year, and lower revenues, as forecast, in Balance Sheet Management.

In PFS, we continued to build long-term relationships through our Premier and Advance offerings, focusing on wealth management and secured lending. We increased our total UK mortgage market share to 5.2%, while maintaining a conservative new lending loan to value ratio of 54%.

In CMB, we made further progress on our strategy of becoming the leading international business bank. We also expanded our business in Germany and launched in Switzerland. In the UK, we increased new lending to SMEs by 19% in 2010.

Net interest income decreased by 7%. Balance Sheet Management revenues declined, as higher-yielding positions matured, interest rates remained low and yield curves flattened in 2010. In Global Banking, tighter spreads in the lending business and lower average lending balances as customers reduced their debt also contributed to the decrease. Customer deposit spreads were adversely affected by the low interest rate environment and competition for deposits. These reductions were offset in part by growth in mortgage lending in the UK and improved asset spreads in both PFS and CMB.

Net fee income increased by 7%, reflecting higher management fees due to an increase in the average value of funds under management, which arose from net inflows and higher market performance. Fees were also received for management services we provided to certain of our Structured Investment Conduits. Partly offsetting these increases were reductions in the levels of debt and equity issuance in the market, compared with the significant volumes seen in 2009.

Report of the Directors: Operating and Financial Review (continued)

Net trading income decreased by 47% to US\$2.9bn. Less favourable market conditions caused by the impact of the European sovereign debt crisis adversely affected Credit and Rates income. Spread compression from increased competition similarly affected foreign exchange revenues. In addition, net interest income earned on trading activities decreased, driven by reduced holdings of debt securities. These decreases were offset in part by lower net adverse fair value movements on structured liabilities.

Net trading income also included adverse fair value movements of US\$304m on non-qualifying hedges used to economically hedge fixed-rate long-term debt issued by HSBC Holdings. These movements were driven by the decline in long-term US dollar interest rates relative to sterling and euro rates in 2010, and compared with favourable fair value movements of US\$748m on these instruments in 2009.

Within our legacy Credit book, a net release of previous write-downs on ABSs and monoline exposures as asset prices improved was more than offset by the non-recurrence of gains in other parts of the business.

Net income from financial instruments designated at fair value fell by US\$808m. The growth in equity markets in 2010 was lower than in 2009, resulting in lower investment gains recognised on the fair value of assets held to meet liabilities under insurance and investment contracts. To the extent that these gains accrued to policyholders holding unit-linked insurance policies and insurance or investment contracts with DPF, there was a corresponding decrease in 'Net insurance claims incurred and movement in liabilities to policyholders'. In addition, adverse foreign exchange movements were reported in the year on foreign currency debt designated at fair value, issued as part of our overall funding strategy with an offset from trading assets held as economic hedges reported in 'Net trading income'.

Gains less losses from financial investments increased by US\$455m as improved market conditions led to gains on sale of private equity investments and lower impairment charges on certain available-for-sale investments.

Net earned insurance premiums were in line with 2009. The decision in 2009 to place our UK motor insurance business into run-off resulted in no new premiums being written in 2010. In addition, a decision was taken during 2010 not to renew certain contracts in the Irish business. By contrast, we

generated strong sales activity in the UK life and French insurance businesses.

Other operating income decreased by US\$193m because the gain on the sale and leaseback of our Paris headquarters building in 2010 was exceeded by the gain on the sale and leaseback of the Group's London headquarters building in 2009.

Net insurance claims incurred and movement in liabilities to policyholders decreased by 11%. This was driven by lower investment gains compared with 2009 and by the non-recurrence of the strengthening of reserves in 2009 on the now-closed UK motor insurance book which reflected the rising incidence and severity of claims at that time. The decision not to renew certain contracts in the Irish business resulted in a further decrease in claims.

Loan impairment charges and other credit risk provisions decreased by 45% to US\$3.0bn, reflecting the more stable credit environment and helped by mitigating actions taken by management. In GB&M, the improved credit outlook, loan restructuring activity, a release of previous collective impairments and lower specific impairment charges in 2010 contributed to a decline in loan impairment charges and other credit risk provisions. Credit risk provisions on certain available-for-sale ABSs also reduced due to a slowing in the rate of anticipated losses in the underlying collateral pools.

In CMB, the reduction in loan impairment charges and other credit risk provisions was largely due to an improvement in the UK property, retail and services sectors, with reductions also seen in our Continental European businesses. The improvement in economic conditions across the region and the effect of low interest rates also resulted in lower delinquencies in the PFS portfolios.

Operating expenses in 2010 included one-off payroll and bonus taxes in the UK and France on certain bonuses paid in respect of 2009 totalling US\$324m, primarily in GB&M. Operating expenses in 2009 included an accounting gain of US\$480m (US\$499m as reported) related to a change in the delivery of certain staff benefits in the main UK pension scheme. Excluding these items, operating expenses were 8% higher than in 2009. This was driven by continued strategic investments in people and infrastructure to support our customers, drive future growth and deliver sustainable long-term reductions in our cost base by re-engineering business processes. In addition, rental expenses increased following the sale and leaseback of our headquarters buildings in London and Paris.

Report of the Directors: Operating and Financial Review (continued)

2009 compared with 2008

Economic background

The **UK** economy suffered a sharp contraction during the course of 2009, although evidence from the final months of the year suggested that some growth had resumed. Gross Domestic Product ('GDP') fell by 5% in 2009 – the sharpest contraction in over 60 years – after a 0.5% increase in 2008. Weakness affected most sectors of the economy, and the unemployment rate hit a 13-year high of 7.9% in July 2009, although some stabilisation of labour market conditions was apparent towards the end of the year. Consumer Price Index ('CPI') inflation reached a five-year low of 1.1% in September 2009 before moving towards the Bank of England's 2% target by the end of the year. Nominal house prices appreciated modestly during the second half of 2009, although indicators of housing market activity remained at relatively weak levels. After reducing interest rates to just 0.5% in March 2009, the Bank of England launched the Asset Purchase Facility in an attempt to improve the circulation of credit throughout the economy and support expectations of future economic activity.

The **eurozone** economy also performed poorly during 2009, with GDP falling by 4% following a 0.5% expansion in 2008. Much of this weakness was concentrated in the early months of 2009 and growth resumed in the third quarter, helped by a variety of fiscal stimulus programmes and a rebuilding of inventory levels. Consumer spending proved relatively resilient in early 2009, boosted by a number of purchase incentive schemes, and some weakness was observed as these programmes expired. Unemployment rose to an 11-year high of 10% in December 2009, while CPI temporarily turned negative during the third quarter of the year. The European Central Bank cut interest rates by 150 basis points to finish the year at 1%.

Review of performance

Our European operations reported a pre-tax profit of US\$4.0bn, compared with US\$10.9bn in 2008. This decline was largely caused by movement in the fair value attributable to credit spread on our own debt. A US\$2.8bn expense in 2009 following stabilisation in financial markets and a narrowing of credit spreads largely reversed the US\$3.1bn income recognised in 2008, giving a US\$5.9bn year on year movement. Also included within these results was a gain on the sale of the residual stake in the UK card merchant acquiring business to Global Payments Inc. of US\$280m in June 2009. This followed a

US\$425m gain realised in 2008 on the sale of the first tranche.

Excluding these gains on sale, the profit on disposal of the French regional banks in July 2008 and the reversal of movements in the fair value of own debt, underlying pre-tax profits grew by US\$3.0bn or 83%. This was driven by robust performances in our European GB&M businesses, in particular from the non-recurrence of significant credit-related write-downs taken in 2008 and outstanding results in Rates and Balance Sheet Management. Deterioration in the economic environment and higher unemployment levels led to a rise in loan impairment charges in both PFS and CMB. HSBC Bank continued to provide lending services to its customers while maintaining effective credit control and strengthening collection practices and systems.

Net interest income increased by 43%, with Balance Sheet Management revenues in GB&M rising robustly. This resulted from the early positioning of our balance sheet in anticipation of decisions by central banks to maintain a low base rate environment. Net interest income also benefited from a reduction in the cost of funding trading activities as interest rates fell. Conversely, the PFS and CMB businesses and payments and cash management were adversely affected by continued margin compression following interest rate reductions in late 2008 and early 2009.

Mortgage balances increased as we gained market share in the UK through the success of a new Rate Matcher mortgage promotion and other campaigns launched in line with our secured lending growth strategy. In 2009, our UK bank more than met its commitment to make £15bn (US\$24.7bn) of new mortgage lending available to borrowers. In CMB, net lending fell compared with 2008 as a result of muted customer demand. Utilisation of committed overdraft facilities provided by HSBC in the UK to commercial customers was only 40% at the end of 2009, illustrating the potential availability of credit when customer demand resumes. Across most businesses, asset balances declined reflecting reduced customer demand for credit, increased debt issuance as the bond markets reopened in 2009 and our diminished appetite for unsecured lending in Europe. Asset spreads widened, most notably in the UK and Turkey, as funding costs fell in the low interest rate environment and market pricing of corporate lending increased.

Throughout 2009, we worked to retain and build on the personal and commercial banking deposit bases gained in the last quarter of 2008 in the face of fierce competition and the narrowing of spreads across the region following interest rate cuts.

Report of the Directors: Operating and Financial Review (continued)

Net fee income fell by 4%. The overall reduction in fees was a consequence of the part-disposal of the UK card merchant acquiring business to a joint venture in 2008 and lower insurance income following the closure of our consumer finance branch network in the UK and reduced sales of discontinued products. In GBP, lower equity brokerage commissions and reduced performance and management fees reflected subdued investor sentiment for risk and structured products; this, together with stock market declines, reduced the average value of funds under management during the year.

We generated higher underwriting fees than in 2008 from increased government and corporate debt issuances, and by taking market share in equity capital markets issues as corporates and financial institutions restructured their balance sheets by raising share capital. As part of our wealth management strategy, we continued to grow our Premier customer base and successfully launched the World Selection fund in the UK which raised US\$1.5bn. In France, the Premier customer base grew by over 10% as HSBC brand awareness increased.

Trading income increased by 23% to US\$5.5bn due to strong revenues across core businesses. Rates reported a significant increase in income driven by a growth in market share, higher client trading volumes and wider bid-offer spreads. Similarly, revenue in the Credit trading business also rose as credit prices improved and client activity increased with the return of liquidity to the market. Foreign exchange revenue fell, however, reflecting a combination of reduced customer volumes and relatively low market volatility when compared with the exceptional experience of 2008.

Trading income also benefited from significantly lower write-downs on legacy positions in Credit trading, leveraged and acquisition financing and monoline exposures, and from the non-recurrence of a reported US\$854m loss in 2008 following the fraud at Madoff Securities. These benefits were partly offset by losses on structured liabilities as credit spreads narrowed (compared with gains in 2008) and a reduction in net interest income on trading activities. This was due to the decline in interest rates, which also contributed to the reduction in the cost of funding trading activities as reported in 'Net interest income'. The tightening of credit spreads also led to a reduction in the carrying value of credit default swap transactions held as hedges in parts of the Global Banking portfolio. In 2008, gains were reported on these credit default swaps following widening credit spreads.

We incurred a net expense of US\$1.4bn on *financial instruments designated at fair value*, compared with income in 2008. Gains on the fair value of assets held to meet liabilities under insurance and investment contracts were recognised as equity markets recovered from declines sustained in 2008. To the extent that these gains were attributed to policyholders holding either insurance contracts or investment contracts with DPF, there was a corresponding increase in *net insurance claims incurred and movement in liabilities to policyholders*.

Gains less losses from financial investments were US\$192m lower than in 2008 due to the non-recurrence of certain disposals in that year, including MasterCard shares, private equity investments and the remaining stake in the Hermitage Fund.

Net earned insurance premiums decreased by 12%. In the UK demand for the insurance-linked Guaranteed Income Bond fell as we offered more favourable rates on an alternative non-insurance deposit product, giving rise to a US\$1.1bn decrease in insurance premium income, with a corresponding decrease in 'Net insurance claims incurred and movement in liabilities to policyholders'. Excluding the effect of a significant re-insurance transaction in 2008 which passed insurance premiums to a third-party reinsurer, net premiums in France increased despite a significant reduction in the distribution network following the disposal of the regional banks in July 2008.

Other operating income increased by 45%, mainly due to a US\$576m gain on the sale and leaseback of 8 Canada Square in London which was effected through the disposal of our entire shareholding in the company which was the legal owner of the building and long leasehold interest in 8 Canada Square. In 2008, we reported a gain of US\$416m representing the equity deposit on a previously negotiated sale of the building which ultimately did not complete. In addition, a change in mortality assumptions in France resulted in increased PVIF of long-term insurance business. The growth in revenue also reflected the non-recurrence of costs associated with the support of money market funds in the global asset management business in 2008. Offsetting this was the non-recurrence of a favourable embedded value adjustment following the introduction of enhanced benefits to our existing pension products in the UK in 2008, and lower gains on the sale and leaseback of branches.

Net insurance claims incurred and movement in liabilities to policyholders increased by US\$2.5bn. The majority of the movement was due to the change

Report of the Directors: Operating and Financial Review (continued)

in liabilities to policyholders reported above in 'Financial instruments designated at fair value', and the large one-off reinsurance transaction in France in 2008. In addition, an increase of US\$310m in claims reserving was required to reflect a higher incidence and severity of insurance claims in the UK motor underwriting business and a higher incidence of credit protection claims through the reinsurance business in Ireland. Risk mitigation measures implemented in 2009 included the decision to cease originations of UK motor insurance business. This was partly offset by the decrease in liabilities following reduced sales of the personal customer bond product offering noted above.

Loan impairment charges and other credit risk provisions rose by 66% to US\$5.6bn as the impact of weaker economic conditions across the region fed through to higher delinquency and default. In GB&M, loan impairment charges and credit risk provisions increased, with the charges concentrated among a small number of clients in the financial and property sectors. The emergence in the year of cash flow impairment on certain asset-backed debt securities held within the available-for-sale portfolios added US\$1.1bn to the charge. Impairment booked on these exposures reflects mark-to-market losses which we judge to be significantly in excess of the likely ultimate cash losses.

In CMB, loan impairment charges rose by US\$471m, again reflecting the economic downturn. Our commercial property portfolio in the UK

declined during 2009, reflecting our efforts to reduce risk in this sector. In the personal sector, deterioration was most evident in the unsecured portfolios as unemployment rose. As a result of past management action, unsecured lending remained a small proportion of our personal lending portfolio, with the bulk of the portfolio secured in the form of residential mortgages. Despite some increase in losses in the residential sector, impairment charges as a percentage of total lending in this portfolio remained very low at 0.14%.

Operating expenses were held broadly in line with 2008. Excluding an accounting gain of US\$499m following a change in the basis of delivering death-in-service, ill health and early retirement benefits for some UK employees, operating expenses increased slightly despite efficiency benefits as higher performance-related awards were made to reflect GB&M's exceptional revenue and profit growth in selective businesses.

In PFS and CMB businesses, operational cost savings reflected the leverage of our global technology platforms and processes to reduce costs and improve customer experience, complemented by tight control over discretionary expenditure and a reduction in staff numbers. Payroll savings and lower Financial Services Compensation Scheme costs were partly offset by an increase in rental costs following the sale and leaseback of properties and higher regular defined benefit pension charges. In Europe, full time equivalent staff numbers fell by some 6,000 during the year.

Report of the Directors: Operating and Financial Review (continued)

Profit/(loss) before tax and balance sheet data – Europe

	2010						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	5,536	2,774	2,936	871	(654)	(213)	11,250
Net fee income	2,016	1,570	1,863	883	39	–	6,371
Trading income/(expense) excluding net interest income	(7)	3	1,542	185	(262)	–	1,461
Net interest income/(expense) on trading activities	(1)	19	1,127	21	23	213	1,402
Net trading income/(expense) ⁴⁹	(8)	22	2,669	206	(239)	213	2,863
Changes in fair value of long- term debt issued and related derivatives	–	–	–	–	(365)	–	(365)
Net income/(expense) from other financial instruments designated at fair value	496	113	(23)	–	61	–	647
Net income/(expense) from financial instruments designated at fair value	496	113	(23)	–	(304)	–	282
Gains less losses from financial investments	29	–	460	(7)	4	–	486
Dividend income	–	1	16	2	1	–	20
Net earned insurance premiums	3,800	278	–	–	(11)	–	4,067
Other operating income	165	163	839	7	754	189	2,117
Total operating income/(expense)	12,034	4,921	8,760	1,962	(410)	189	27,456
Net insurance claims ⁵⁷	(4,364)	(342)	–	–	–	–	(4,706)
Net operating income/(expense)⁴⁶	7,670	4,579	8,760	1,962	(410)	189	22,750
Loan impairment (charges)/recoveries and other credit risk provisions	(1,217)	(997)	(783)	(26)	3	–	(3,020)
Net operating income/(expense)	6,453	3,582	7,977	1,936	(407)	189	19,730
Total operating expenses	(5,166)	(2,378)	(5,265)	(1,296)	(1,151)	(189)	(15,445)
Operating profit/(loss)	1,287	1,204	2,712	640	(1,558)	–	4,285
Share of profit in associates and joint ventures	2	1	14	–	–	–	17
Profit/(loss) before tax	1,289	1,205	2,726	640	(1,558)	–	4,302
	%	%	%	%	%	%	%
Share of HSBC's profit before tax	6.8	6.3	14.3	3.4	(8.2)	–	22.6
Cost efficiency ratio	67.4	51.9	60.1	66.1	(280.7)	–	67.9
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m	–	US\$m
Loans and advances to customers (net)	145,063	91,744	170,375	27,629	988	–	435,799
Total assets	202,431	111,356	965,462	76,631	65,824	(172,177)	1,249,527
Customer accounts	168,979	96,597	169,873	56,114	–	–	491,563

Report of the Directors: Operating and Financial Review (continued)

Europe	2009						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	5,413	2,739	4,367	949	(525)	(675)	12,268
Net fee income	1,949	1,679	1,670	883	86	–	6,267
Trading income excluding net interest income	34	3	2,267	175	382	–	2,861
Net interest income/(expense) on trading activities	(1)	17	1,869	23	15	675	2,598
Net trading income ⁴⁹	33	20	4,136	198	397	675	5,459
Changes in fair value of long- term debt issued and related derivatives	–	–	–	–	(2,746)	–	(2,746)
Net income/(expense) from other financial instruments designated at fair value	1,012	133	375	–	(199)	–	1,321
Net income/(expense) from financial instruments designated at fair value	1,012	133	375	–	(2,945)	–	(1,425)
Gains less losses from financial investments	20	2	25	5	(2)	–	50
Dividend income	2	1	26	3	(3)	–	29
Net earned insurance premiums	3,975	253	(2)	–	(3)	–	4,223
Other operating income	182	373	670	28	914	95	2,262
Total operating income/(expense)	12,586	5,200	11,267	2,066	(2,081)	95	29,133
Net insurance claims ⁵⁷	(5,221)	(365)	–	–	(3)	–	(5,589)
Net operating income/(expense) ⁴⁶	7,365	4,835	11,267	2,066	(2,084)	95	23,544
Loan impairment charges and other credit risk provisions	(1,992)	(1,267)	(2,277)	(29)	(3)	–	(5,568)
Net operating income/(expense)	5,373	3,568	8,990	2,037	(2,087)	95	17,976
Total operating expenses	(5,062)	(2,294)	(4,447)	(1,183)	(907)	(95)	(13,988)
Operating profit/(loss)	311	1,274	4,543	854	(2,994)	–	3,988
Share of profit in associates and joint ventures	1	18	2	–	–	–	21
Profit/(loss) before tax	312	1,292	4,545	854	(2,994)	–	4,009
	%	%	%	%	%		%
Share of HSBC's profit before tax	4.4	18.3	64.2	12.1	(42.3)		56.7
Cost efficiency ratio	68.7	47.4	39.5	57.3	(43.5)		59.4
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	147,760	89,084	176,123	25,541	973		439,481
Total assets	208,669	111,874	981,831	76,871	84,010	(194,655)	1,268,600
Customer accounts	165,161	102,249	169,390	58,213	6		495,019

Report of the Directors: Operating and Financial Review (continued)

Europe	2008						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	6,464	3,435	3,488	1,046	(459)	(4,278)	9,696
Net fee income	2,612	2,025	1,763	1,020	72	–	7,492
Trading income/(expense) excluding net interest income	47	71	1,513	198	(138)	–	1,691
Net interest income/(expense) on trading activities	–	12	(655)	14	17	4,278	3,666
Net trading income/(expense) ⁴⁹	47	83	858	212	(121)	4,278	5,357
Changes in fair value of long- term debt issued and related derivatives	–	–	–	–	2,939	–	2,939
Net income/(expense) from other financial instruments designated at fair value	(1,634)	(214)	(611)	–	633	–	(1,826)
Net income/(expense) from financial instruments designated at fair value	(1,634)	(214)	(611)	–	3,572	–	1,113
Gains less losses from financial investments	281	132	(30)	62	(27)	–	418
Dividend income	35	74	25	5	(9)	–	130
Net earned insurance premiums	4,927	391	–	–	(19)	–	5,299
Gains on disposal of French regional banks	–	–	–	–	2,445	–	2,445
Other operating income	230	620	398	16	832	–	2,096
Total operating income	12,962	6,546	5,891	2,361	6,286	–	34,046
Net insurance claims ⁵⁷	(3,224)	(143)	–	–	–	–	(3,367)
Net operating income ⁴⁶	9,738	6,403	5,891	2,361	6,286	–	30,679
Loan impairment charges and other credit risk provisions	(1,971)	(867)	(875)	(38)	(3)	–	(3,754)
Net operating income	7,767	5,536	5,016	2,323	6,283	–	26,925
Total operating expenses	(6,107)	(2,830)	(4,823)	(1,325)	(987)	–	(16,072)
Operating profit	1,660	2,706	193	998	5,296	–	10,853
Share of profit/(loss) in associates and joint ventures	(2)	16	2	–	–	–	16
Profit before tax	1,658	2,722	195	998	5,296	–	10,869
	%	%	%	%	%		%
Share of HSBC's profit before tax	17.8	29.2	2.1	10.7	56.9		116.7
Cost efficiency ratio	62.7	44.2	81.9	56.1	15.7		52.4
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	126,909	87,245	185,818	25,722	497		426,191
Total assets	171,962	107,495	1,180,759	84,485	64,423	(217,075)	1,392,049
Customer accounts	145,411	91,188	199,687	66,007	183		502,476

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Hong Kong

HSBC's principal banking subsidiaries in Hong Kong are The Hongkong and Shanghai Banking Corporation Limited and Hang Seng Bank Limited. The former is the largest bank incorporated in Hong Kong and is our flagship bank in the Asia-Pacific region. It is one of Hong Kong's three note-issuing banks, accounting for more than 65% by value of banknotes in circulation in 2010.

	2010 US\$m	2009 US\$m	2008 US\$m
Net interest income	4,246	4,195	5,698
Net fee income	2,962	2,669	2,580
Net trading income	1,312	1,225	1,193
Other income	1,682	1,378	683
Net operating income⁴⁶	10,202	9,467	10,154
Impairment charges ⁴⁷	(114)	(500)	(765)
Net operating income	10,088	8,967	9,389
Total operating expenses	(4,431)	(3,946)	(3,943)
Operating profit	5,657	5,021	5,446
Income from associates ⁴⁸	35	8	15
Profit before tax	5,692	5,029	5,461
Cost efficiency ratio	43.4%	41.7%	38.8%
Year-end staff numbers	29,171	27,614	29,330

Best Bank in Hong Kong

(Euromoney Awards for Excellence 2010)

**Market leadership in mortgages,
cards, life insurance
and deposits**

**64%
growth in
commercial lending balances**

For footnotes, see page 83.

The commentary on Hong Kong is on an underlying basis unless stated otherwise.

Economic background

Relatively low interest rates and rapid growth in demand from mainland China contributed to Hong Kong's economic recovery in 2010. GDP in the year was 6.8% higher than in 2009. A revival in both employment and wage growth helped to boost consumer demand. Inflationary pressures began to emerge in the second half of the year with the annual rate of CPI inflation rising to 3.1% in December. The government initiated a number of measures in November aimed at restricting the pace of price increases in the property market.

Review of performance

Our operations in Hong Kong reported pre-tax profits of US\$5.7bn compared with US\$5.0bn in 2009, an increase of 13%. On an underlying basis, excluding accounting gains arising from the reclassification of Bao Viet as an associate and following the sale of HSBC Private Equity (Asia) Ltd, profit before tax increased by 11%.

The increase in profitability was driven by strong revenue growth, particularly in investment and insurance product sales and trade-related fees, as we capitalised on the improved economic conditions. Lending balances rose, most notably in CMB and GB&M following a recovery in trade flows and strong economic growth. Customer deposit balances increased, reflecting growth in customer numbers in PFS and CMB. Loan impairment charges were significantly lower than in 2009 across all customer groups, reflecting an improvement in credit conditions. Revenue growth was in part offset by an increase in staff and IT costs driven by business expansion to maintain our strong market position.

We retained our market leadership in residential mortgages, credit cards, life insurance and deposits. The Premier customer base increased by 31% compared with 31 December 2009 to more than 500,000 customers. The Advance proposition, which was launched in early 2010, had a customer base of over 670,000 by the end of the year. In life insurance, we retained the number one market share position for new business annualised premiums as a result of successful sales activity and customer demand and a strategy targeted towards the high net worth customer segment. CMB's cross-border referrals more than doubled with the increase in trade flows from mainland China. We continued the development of offshore renminbi-related products and maintained our position as a market leader for renminbi products in Hong Kong.

Report of the Directors: Operating and Financial Review (continued)

Profit/(loss) before tax by customer group and global business

	2010 US\$m	2009 US\$m	2008 US\$m
Personal Financial Services	2,918	2,728	3,428
Commercial Banking	1,352	956	1,315
Global Banking and Markets	1,430	1,507	1,436
Global Private Banking	227	197	237
Other	(235)	(359)	(955)
	5,692	5,029	5,461

Net interest income was broadly in line with 2009, as strong loan growth was partly offset by lower spreads resulting from competitive pressures and the low interest rate environment. In Balance Sheet Management, net interest income decreased as yield curves flattened, higher yielding positions matured and funds were reinvested at lower rates.

The recovery in trade volumes in 2010 and the pursuit of CMB's leading international bank for business strategy resulted in significant growth in commercial lending, notably in commercial, industrial and trade related lending. To a lesser extent, growth was also noted in commercial real estate, supported by a buoyant property market. Average personal lending balances also rose, driven by strong growth in residential mortgage lending, where we continued to lend conservatively with average loan-to-value ratios of 55% on new mortgage drawdowns and an estimated 38% on the overall portfolio.

Asset spreads narrowed as a result of competitive pressures, particularly in trade-related lending and HIBOR-linked residential mortgages.

The growth in customer numbers in the Premier proposition in PFS and new-to-bank customers in CMB resulted in increased customer deposits. The benefit of the higher average deposit balances was limited by narrower deposit spreads as interest rates remained at historically low levels.

Net fee income increased by 11%, primarily due to an increase in sales of investment products driven by improved market sentiment and successful sales campaigns, and growth in trade-related fees and income from Payments and Cash Management as volumes improved. Fees from funds under management also grew as a result of higher net inflows and improved fund performance, while underwriting fees rose due to several significant initial public offerings ('IPO's) and loan syndications concluded in 2010.

Net trading income was 7% higher than in 2009. Increased holdings of debt securities led to a rise in net interest income from trading activities. Foreign exchange revenues benefited from increased turnover due to high levels of client demand. This

was partly offset by lower revenues from Credit trading, following the strong results achieved in 2009 as credit spreads narrowed, and from Rates trading as market volatility reduced in 2010.

Net income from financial instruments designated at fair value was US\$384m compared with US\$784m in 2009. The movement was primarily due to lower revaluation gains in 2010 on assets held to support linked insurance liabilities, where the value of our liabilities to policyholders is determined in line with the value of supporting assets. To the extent that these lower investment gains were attributed to policyholders, there was a corresponding decrease in *Net insurance claims incurred and movement in liabilities to policyholders*.

Net earned insurance premiums grew by 18% to US\$4.3bn as successful sales campaigns drove strong growth, particularly in deferred annuity and unit-linked products. A life insurance product targeted at high net worth individuals also performed well. Growth in the insurance business resulted in a related increase in 'Net insurance claims incurred and movement in liabilities to policyholders'.

Other operating income increased by 21% to US\$1.5bn due to an increase in PVIF reflecting higher life insurance sales, partly offset by the non-recurrence of a gain on sale of a property in 2009.

Loan impairment charges and other credit risk provisions decreased by 77% to US\$114m, reflecting the recovery in economic conditions. Lower specific impairment charges in CMB and GB&M were incurred as credit conditions improved and loan impairment charges fell in PFS, mainly on unsecured lending as unemployment and bankruptcy levels fell.

Operating expenses rose by 12% as the business grew and the economy recovered. Staff costs grew as we recruited in a competitive market and from general wage increases, while bonuses rose in line with the strong business performance. Marketing costs rose notably in PFS due to the launch of several large campaigns, including Advance and credit cards promotions and rising transaction volumes led to higher back office and support costs.

Report of the Directors: Operating and Financial Review (continued)

2009 compared with 2008

Economic background

The performance of the **Hong Kong** economy proved variable during the course of 2009, with a robust recovery developing after a sharp contraction was recorded during the first quarter of the year. GDP in 2009 fell by 2.7% after growth of 2.1% in 2008. Unemployment rose during the first half of 2009, before falling slightly to end the year at 4.9%, a figure still well below the average of the past 10 years. The CPI profile proved volatile during the course of the year, turning negative between June and August before rising to 1.3% by December 2009, although these movements largely reflected the trends of food and energy prices. The Hong Kong Monetary Authority held the base rates steady at 0.5% throughout the course of the year. Asset price performance proved unusually volatile as the Hang Seng Index recovered strongly from a weak start to 2009 to record a 52% increase during the year.

Review of performance

Our operations in Hong Kong reported pre-tax profits of US\$5.0bn compared with US\$5.5bn in 2008, an 8% decline on both a reported and an underlying basis.

The decrease in profits came from lower revenue, which resulted from compressed deposit spreads in a near-zero interest rate environment. This loss of revenue was partly offset by significantly lower loan impairment charges and other credit risk provisions during 2009, and a recovery in trade activity triggered by an improvement in regional economic conditions in the second half of the year.

Despite continuing economic challenges, performance remained robust, and was underpinned by our market-leading share in deposits, residential mortgages, cards and insurance. In particular, we consolidated our position as Hong Kong's leading bancassurer, growing the value of new life insurance business by 38%. In residential mortgages, business growth was combined with conservative loan-to-value ratios on new business.

Net interest income declined by 27% to US\$4.2bn, driven by significant deposit spread compression as HIBOR and LIBOR remained low throughout 2009. Selective repricing of customer loans helped to mitigate the impact of lower rates on lending spreads and the continued increase in customer account balances has positioned us to benefit from economic recovery and a resulting widening of deposit spreads.

Average customer lending balances remained broadly in line with 2008, as lower CMB balances, which reflected the reduction in exports in the first half of 2009, were broadly offset by higher lending in PFS and GB&M. As the regional economy rebounded, trade volumes and CMB lending activity increased in the second half of the year. Throughout this challenging period for trade, we continued to support local business through our HK\$20bn (US\$2.6bn) global loan fund for smaller businesses. These facilities were fully utilised by over 8,600 companies at 31 December 2009.

As residential property prices increased, personal lending volumes rose, and we consolidated our mortgage market share by originating significant volumes of new mortgages. We led this market with a 38% share of new loan drawdowns with an average loan-to-value ratio of 58% on new business. Asset spreads improved as a result of selective risk-based repricing, notably in cards, while funding costs fell in the low interest rate environment.

We continued to increase market share in savings and deposit accounts, and balances grew following a series of deposit acquisition campaigns. In PFS, customer account balances rose by 15% and Premier customer numbers grew to over 380,000. Strong growth in CMB was driven by a rise in customer numbers, also supported by a series of deposit acquisition campaigns and increased liquidity in the region.

Overall, deposit balances grew by 10%. Liability spreads remained under severe pressure throughout 2009, however.

Net fee income increased by 3% with an increase in IPO underwriting fees in the second half of the year, triggered by improved investor sentiment and a recovery in equity markets. PFS customers' preference for deposit products rather than equity-linked products in the first half of the year reversed as equity markets recovered in the second half of 2009, resulting in a recovery in revenue generated from unit trusts, wealth management, custody and other investment products. Similarly, the increase in trade flows in the second half of 2009 affected trade-related fee income in CMB.

Trading income increased by 2%, primarily due to increased volumes of bond trading and wider margins on market making activities. The non-recurrence of US\$0.2bn of write-downs on a legacy monoline exposure also contributed to the rise. Foreign exchange trading revenue decreased from the exceptional results reported in 2008, reflecting the lower market volatility and a decline in customer

Report of the Directors: Operating and Financial Review (continued)

volumes. Interest on trading assets declined due to a reduced holding of trading debt securities.

Income of US\$0.8bn was generated from *financial instruments designated at fair value*, compared with an expense of US\$1.2bn in 2008. The positive movement in fair value was primarily driven by equity market-related gains in unit-linked insurance products. To the extent that these gains were attributed to policyholders, there was a corresponding increase in *net insurance claims incurred and movement in liabilities to policyholders*.

Net earned premiums increased by 13% to US\$3.7bn due to strong sales of both existing and new products, including a life insurance product designed for high net worth individuals, all of which contributed to a rise in market share. The proportion of regular premium policies grew and sales of investment-linked insurance products began to improve in the second half of the year. We retained our market leadership position in the regular-premium individual-life new business. The growth in our insurance business also resulted in higher net insurance claims incurred and movement in liabilities to policyholders.

Gains less losses from financial investments moved from a loss of US\$310m to a net gain of US\$9m, mainly due to the non-recurrence of impairments against our available-for-sale equity investments following declines in market valuations in 2008. The loss recognised in 2008 on the equity investments concerned was partially recovered in 2009 but this gain was reflected in reserves rather than reversing through the income statement.

Other operating income of US\$1.3bn was 55% higher than in 2008, reflecting a positive movement in PVIF driven largely by an increase in insurance sales to new customers. We recognised a gain of US\$110m in respect of the disposal of a property in Hong Kong.

Loan impairment charges and other credit risk provisions fell by 35% to US\$0.5bn, as the credit environment was more stable in 2009 following deterioration in the second half of 2008. The high level of credit risk provisions and loan impairment charges taken in 2008 against financial institutions and export-led customers moderated in 2009 as credit conditions recovered and international trade volumes improved.

A rise in unemployment and in bankruptcy petitions led to increased impairment charges against unsecured lending in PFS, though bankruptcy levels improved in the second half of the year. Property prices increased during 2009 and mortgage lending remained well secured with conservative loan-to-value ratios and origination subject to tight internal and regulatory guidelines.

Operating expenditure was held in line with 2008 as higher staff costs were offset by lower general and administrative costs. The increase in staff costs, driven by higher performance-related pay, was partly offset by reduced staff numbers. Non-staff costs fell as marketing expenditure was reduced and operational efficiencies improved as a result of our increased use of direct channels.

Report of the Directors: Operating and Financial Review (continued)

Profit/(loss) before tax and balance sheet data – Hong Kong

	2010						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	2,604	1,106	915	173	(463)	(89)	4,246
Net fee income	1,521	634	630	163	14	–	2,962
Trading income/(expense) excluding net interest income	197	121	681	120	(12)	–	1,107
Net interest income on trading activities	4	–	100	–	12	89	205
Net trading income ⁴⁹	201	121	781	120	–	89	1,312
Changes in fair value of long- term debt issued and related derivatives	–	–	–	–	(2)	–	(2)
Net income/(expense) from other financial instruments designated at fair value	328	(10)	61	–	1	–	380
Net income/(expense) from financial instruments designated at fair value	328	(10)	61	–	(1)	–	378
Gains less losses from financial investments	–	–	56	1	41	–	98
Dividend income	–	1	12	–	17	–	30
Net earned insurance premiums	3,655	665	12	–	–	–	4,332
Other operating income	503	68	166	12	1,140	(283)	1,606
Total operating income	8,812	2,585	2,633	469	748	(283)	14,964
Net insurance claims ⁵⁷	(4,193)	(559)	(10)	–	–	–	(4,762)
Net operating income⁴⁶	4,619	2,026	2,623	469	748	(283)	10,202
Loan impairment charges and other credit risk provisions	(76)	(28)	(10)	–	–	–	(114)
Net operating income	4,543	1,998	2,613	469	748	(283)	10,088
Total operating expenses	(1,630)	(653)	(1,187)	(242)	(1,002)	283	(4,431)
Operating profit/(loss)	2,913	1,345	1,426	227	(254)	–	5,657
Share of profit in associates and joint ventures	5	7	4	–	19	–	35
Profit/(loss) before tax	2,918	1,352	1,430	227	(235)	–	5,692
	%	%	%	%	%		%
Share of HSBC's profit before tax	15.3	7.1	7.5	1.2	(1.2)		29.9
Cost efficiency ratio	35.3	32.2	45.3	51.6	134.0		43.4
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	50,983	48,670	34,491	4,760	1,787		140,691
Total assets ⁶¹	76,665	55,030	223,492	20,598	62,486	(8,706)	429,565
Customer accounts	176,960	71,209	29,388	19,241	686		297,484

Report of the Directors: Operating and Financial Review (continued)

Hong Kong	2009						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	2,577	938	1,150	212	(558)	(124)	4,195
Net fee income	1,410	530	563	125	41	–	2,669
Trading income/(expense) excluding net interest income	186	92	792	91	(93)	–	1,068
Net interest income on trading activities	3	–	16	–	14	124	157
Net trading income/(expense) ⁴⁹	189	92	808	91	(79)	124	1,225
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	(3)	–	(3)
Net income/(expense) from other financial instruments designated at fair value	707	(46)	138	–	(11)	–	788
Net income/(expense) from financial instruments designated at fair value	707	(46)	138	–	(14)	–	785
Gains less losses from financial investments	80	18	(108)	–	19	–	9
Dividend income	1	1	10	–	16	–	28
Net earned insurance premiums	3,161	500	13	–	–	–	3,674
Other operating income	346	64	59	10	1,062	(267)	1,274
Total operating income	8,471	2,097	2,633	438	487	(267)	13,859
Net insurance claims ⁵⁷	(3,979)	(404)	(9)	–	–	–	(4,392)
Net operating income ⁴⁶	4,492	1,693	2,624	438	487	(267)	9,467
Loan impairment (charges)/ recoveries and other credit risk provisions	(203)	(168)	(131)	1	1	–	(500)
Net operating income	4,289	1,525	2,493	439	488	(267)	8,967
Total operating expenses	(1,566)	(570)	(987)	(242)	(848)	267	(3,946)
Operating profit/(loss)	2,723	955	1,506	197	(360)	–	5,021
Share of profit in associates and joint ventures	5	1	1	–	1	–	8
Profit/(loss) before tax	2,728	956	1,507	197	(359)	–	5,029
	%	%	%	%	%		%
Share of HSBC's profit before tax	38.5	13.5	21.3	2.8	(5.1)		71.0
Cost efficiency ratio	34.9	33.7	37.6	55.3	174.1		41.7
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	43,869	28,217	21,991	3,361	1,943		99,381
Total assets ⁶¹	83,497	34,743	217,146	20,353	52,508	(9,004)	399,243
Customer accounts	166,445	62,146	26,650	19,474	726		275,441

Report of the Directors: Operating and Financial Review (continued)

Hong Kong	2008						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	3,381	1,498	1,524	214	(669)	(250)	5,698
Net fee income	1,441	548	414	163	14	–	2,580
Trading income excluding net interest income	143	79	483	120	30	–	855
Net interest/(expense) income on trading activities	11	1	244	–	(168)	250	338
Net trading income/(expense) ⁴⁹	154	80	727	120	(138)	250	1,193
Changes in fair value of long- term debt issued and related derivatives	–	–	–	–	3	–	3
Net income/(expense) from other financial instruments designated at fair value	(1,291)	(10)	39	–	68	–	(1,194)
Net income/(expense) from financial instruments designated at fair value	(1,291)	(10)	39	–	71	–	(1,191)
Gains less losses from financial investments	156	32	(109)	–	(388)	–	(309)
Dividend income	3	2	17	–	19	–	41
Net earned insurance premiums	3,047	181	17	–	2	–	3,247
Other operating income	132	38	101	8	906	(368)	817
Total operating income	7,023	2,369	2,730	505	(183)	(368)	12,076
Net insurance claims ⁵⁷	(1,773)	(136)	(11)	–	(2)	–	(1,922)
Net operating income ⁴⁶	5,250	2,233	2,719	505	(185)	(368)	10,154
Loan impairment (charges)/recoveries and other credit risk provisions	(134)	(335)	(284)	(13)	1	–	(765)
Net operating income/(expense)	5,116	1,898	2,435	492	(184)	(368)	9,389
Total operating expenses	(1,691)	(584)	(1,000)	(255)	(781)	368	(3,943)
Operating profit/(loss)	3,425	1,314	1,435	237	(965)	–	5,446
Share of profit in associates and joint ventures	3	1	1	–	10	–	15
Profit/(loss) before tax	3,428	1,315	1,436	237	(955)	–	5,461
	%	%	%	%	%		%
Share of HSBC's profit before tax	36.9	14.1	15.4	2.6	(10.3)		58.7
Cost efficiency ratio	32.2	26.2	36.8	50.5	(422.2)		38.8
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	41,447	30,331	23,042	3,605	1,795		100,220
Total assets	75,419	36,428	233,187	28,800	66,192	(25,542)	414,484
Customer accounts	145,002	54,869	30,866	19,416	364		250,517

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Rest of Asia-Pacific

We offer a full suite of banking and financial services in mainland China, mainly through our local subsidiary, HSBC Bank (China) Company Limited. We also participate indirectly in mainland China through our four associates.

Outside Hong Kong and mainland China, we conduct business in 22 countries and territories in the Rest of Asia-Pacific region, primarily through branches and subsidiaries of The Hongkong and Shanghai Banking Corporation, with particularly strong coverage in Australia, India, Indonesia, Malaysia and Singapore.

	2010 US\$m	2009 US\$m	2008 US\$m
Net interest income	3,828	3,539	3,937
Net fee income	1,932	1,557	1,867
Net trading income	1,618	1,606	2,042
Other income	1,854	1,301	1,135
Net operating income⁴⁶	9,232	8,003	8,981
Impairment charges ⁴⁷	(439)	(896)	(852)
Net operating income	8,793	7,107	8,129
Total operating expenses	(5,143)	(4,450)	(4,704)
Operating profit	3,650	2,657	3,425
Income from associates ⁴⁸	2,252	1,543	1,297
Profit before tax	5,902	4,200	4,722
Cost efficiency ratio	55.7%	55.6%	52.4%
Year-end staff numbers	91,607	87,141	89,706

41%
growth in reported pre-tax profit

**Leadership in renminbi
product development**

**Significant and growing presence
in mainland China**

Economic background

Economic activity accelerated in **mainland China**, building on the recovery which began in 2009. Annual GDP growth peaked at 11.9% in the first quarter of the year, as resilient domestic demand coincided with an acceleration in export growth as world demand recovered. Investment growth remained strong amid large scale government infrastructure projects and construction of public housing. Meanwhile, consumer spending was boosted by robust growth in employment and wages. In the final months of 2010, inflation became more of a concern, with the annual rate of CPI inflation rising to 4.6% in December. The People's Bank of China increased the commercial banking sector's required Statutory Deposit Ratio by 4.5 percentage points to 19.5% (for major banks) and 17.0% (for the rest) and raised the policy rate by 50 basis points over the course of the year. The renminbi exchange rate rose by 3% against the US dollar throughout the course of the year.

Japan's economic conditions improved in 2010, led mainly by a recovery in world trade, though unemployment remained at about 5% throughout the year. The Bank of Japan introduced a new programme of monetary stimulus in October 2010, aimed at curbing yen appreciation and reducing the deflationary pressures evident in the economy.

Elsewhere in the region, economies rebounded strongly, with growth in external demand a common feature. Comparing the third quarter of 2010 with the same period in 2009, GDP in **Taiwan** grew by 9.8%, in **South Korea** by 4.4% and in **India** by 8.9%. In the last, concerns emerged over the rate of wholesale price inflation, which rose to 8.4% in December. In **Singapore**, GDP growth was volatile as activity in the pharmaceutical sector fluctuated, contracting at an annualised rate of nearly 19% in the third quarter but rising 6.9% in the fourth quarter. **Malaysian** GDP, boosted by private consumption and exports, rose by 5.3% year on year in the third quarter, after surging 10.1% in the first quarter and 8.9% in the second quarter. In **Thailand**, the re-emergence of political risks in the second quarter of 2010 appeared not to dent household consumption or foreign direct investment. Foreign direct investment into **Indonesia** underpinned GDP growth of 5.8% in the third quarter. The economies of the **Philippines** and **Vietnam** also grew strongly. In **Australia** growth was more modest, in part because of a rise in the Reserve Bank of Australia's interest rate to 4.75% in the second half of the year. Activity in the mining sector continued to grow rapidly.

For footnotes, see page 83.

The commentary on Rest of Asia-Pacific is on an underlying basis unless stated otherwise.

Report of the Directors: Operating and Financial Review (continued)*Profit/(loss) before tax by country within customer groups and global businesses*

	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Total US\$m
2010						
Australia	59	96	95	–	8	258
India	(82)	71	507	4	179	679
Indonesia	12	94	116	–	(3)	219
Japan	(76)	–	119	(1)	(6)	36
Mainland China	839	833	683	(7)	217	2,565
Associates	973	746	443	–	188	2,350
Other mainland China	(134)	87	240	(7)	29	215
Malaysia	120	88	194	–	(1)	401
Singapore	126	87	143	84	84	524
South Korea	2	(4)	305	–	50	353
Taiwan	19	36	99	–	(7)	147
Vietnam	(7)	50	61	–	7	111
Other	54	205	262	1	87	609
	1,066	1,556	2,584	81	615	5,902
2009						
Australia	30	32	140	–	(4)	198
India	(219)	(41)	393	1	240	374
Indonesia	(24)	60	129	–	(11)	154
Japan	(79)	–	65	(4)	1	(17)
Mainland China	494	616	479	(7)	50	1,632
Associates	678	558	285	–	–	1,521
Other mainland China	(184)	58	194	(7)	50	111
Malaysia	88	53	140	–	5	286
Singapore	129	77	247	98	(9)	542
South Korea	(3)	(5)	342	–	25	359
Taiwan	(3)	65	96	–	2	160
Vietnam	(8)	40	63	–	6	101
Other	58	167	225	2	(41)	411
	463	1,064	2,319	90	264	4,200
2008						
Australia	19	68	102	–	(13)	176
India	(155)	118	578	2	123	666
Indonesia	(22)	17	126	–	–	121
Japan	(88)	(1)	88	1	4	4
Mainland China	284	622	688	(5)	16	1,605
Associates	393	558	335	–	–	1,286
Other mainland China	(109)	64	353	(5)	16	319
Malaysia	94	96	171	–	8	369
Singapore	104	83	337	110	(37)	597
South Korea	(16)	(13)	304	–	38	313
Taiwan	(41)	45	179	–	(8)	175
Vietnam	(16)	32	63	–	(14)	65
Other	48	168	334	1	80	631
	211	1,235	2,970	109	197	4,722

Report of the Directors: Operating and Financial Review (continued)

Review of performance

Our operations in the Rest of Asia-Pacific region reported pre-tax profits of US\$5.9bn compared with US\$4.2bn in 2009, an increase of 41%. Reported profits included an accounting gain of US\$188m arising from the dilution of HSBC's shareholding in Ping An Insurance following its issue of share capital to a third party in 2010. On an underlying basis, which excludes this dilution gain, pre-tax profit rose by 29% as business volumes increased across many countries and all customer groups as the economic environment in the region improved.

The economic performance of the region was reflected in a recovery in trade volumes, an increase in our customers' appetite for investment-related products, strong growth in lending balances and a significant decline in loan impairment charges. All these factors contributed to an increase in our profitability, as did a rise in our share of profit from associates in mainland China. Operating expenses increased to support this business growth.

During 2010 we continued to target growth, particularly in the key regional markets of mainland China, India, Indonesia, Singapore, Malaysia and Australia. We consolidated our position as the leading foreign bank in mainland China with 106 outlets in 27 cities, 16 rural bank outlets and 38 Hang Seng Bank outlets in 13 cities. We maintained our leadership in the development of renminbi products and now have renminbi capabilities in 36 countries across all six continents. In July 2010 we agreed to acquire a substantial part of The Royal Bank of Scotland Group plc's commercial and retail businesses in India. In Malaysia, four additional Amanah branches were opened.

Our focus on higher value segments was reflected in the Premier customer base in the region which grew by 33% while the Advance proposition was launched in nine markets, exceeding 660,000 customers by the year end. In CMB, we continued to build on our international connectivity, with cross-regional referrals nearly doubling as we pursued our objective to be the leading international business bank.

Net interest income was broadly in line with 2009 as strong loan growth was offset by narrower asset spreads in the face of strong competition. Higher average lending balances resulted from business growth in GB&M and CMB across the region, reflecting the recovery in trade activity. Average PFS lending balances also rose, mainly in the mortgage book, most notably in Australia, Singapore and Malaysia, as well as in Taiwan and

mainland China, supported by successful marketing campaigns.

The narrower asset spreads were also the consequence of a shift to lower risk customers following the managed reduction of certain unsecured lending portfolios, particularly in India.

Average customer deposit balances grew, primarily in mainland China, Australia and Singapore as a result of a targeted strategy to expand the customer base.

Balance Sheet Management income declined from 2009 as higher yielding trades matured, interest rates generally remained low and yield curves flattened.

Net fee income was 16% higher. An improvement in equity markets and inflows of funds under management drove a significant increase in fee income in GB&M while, in CMB, the recovery in trade activity led to higher trade-related fees and credit facilities. In PFS, fee income also rose from the increased sales of investment and insurance products.

Net trading income declined by 7%, as reduced market volatility led to lower Rates trading income. In India, trading income further declined as gains achieved in 2009 from narrowing bond yields did not recur while in South Korea, lower trading revenues reflected the non-recurrence of one-off gains recognised in 2009. These were partly offset by higher foreign exchange income in mainland China and wider margins in India as a result of strong client volumes in the growing economies and a rise in interest income from trading activities resulting from increased holdings of debt securities.

Net income from financial instruments designated at fair value fell by US\$95m. The movement was due to lower revaluation gains in 2010 than in 2009 on assets held to support insurance contracts. To the extent that these lower investment gains were attributed to policyholders, there was a corresponding decrease in 'Net insurance claims incurred and movement in liabilities to policyholders'.

Gains less losses from financial investments were US\$141m compared with losses of US\$15m in 2009, as a result of a gain on disposal of an equity investment in a Singaporean property company and gains on sales of other available-for-sale investments. Impairments reported in 2009 did not recur in 2010.

Other operating income increased by 8% to US\$1.4bn, largely due to an increase in PVIF,

Report of the Directors: Operating and Financial Review (continued)

reflecting higher life insurance sales in the region and recoveries against initial fair value on loan portfolios acquired with Bank Ekonomi in Indonesia and from The Chinese Bank Co., Ltd in Taiwan.

Net earned insurance premiums increased by 15% to US\$448m, largely due to higher sales in Malaysia, Taiwan and mainland China, primarily from successful product launches and marketing campaigns.

Growth in the insurance business resulted in a related increase in *Net insurance claims incurred and movement in liabilities to policyholders* which was more than offset by the decrease corresponding to the lower investment gains reported above in 'Net income from financial instruments designated at fair value'.

Loan impairment charges and other credit risk provisions decreased by 55% to US\$439m. As economic and credit conditions improved across the region, loan impairment charges fell in PFS, most notably in India as certain unsecured lending portfolios were managed down, and fewer specific impairments were recognised in CMB. Partly offsetting this

improvement were specific impairment charges booked in GB&M.

Operating expenses increased by 8% to US\$5.1bn in support of business growth and to capitalise on the region's economic recovery. Examples were the continuing expansion of the branch network in mainland China and the opening of the new headquarters building in Shanghai, as well as local incorporation and expansion of the Taiwan operations. Staff numbers rose to support business expansion, particularly in the key regional markets of mainland China, Australia, Singapore and Indonesia. Business initiatives were supported by marketing campaigns in most markets and higher transaction volumes which led to increased processing costs.

Share of profit from associates and joint ventures in the region increased by 45%, with a higher contribution from Ping An Insurance driven by strong sales growth. The share of profit from Bank of Communications also increased due to growth in lending and higher fee income from cards, wealth management and settlement activity. Growth in lending and an increase in fee income led to a higher contribution from Industrial Bank.

Report of the Directors: Operating and Financial Review (continued)

2009 compared with 2008

Economic background

Growth in **mainland China** accelerated throughout the course of the year as the government's fiscal stimulus package helped offset weak levels of demand within key export markets. Overall GDP growth totalled 8.7% in 2009, down from 9.6% in 2008, although on a quarterly basis the annual rate of growth rose to a very high 10.7% in the final three months of the year. Industrial production also gathered momentum as the year progressed, while very strong levels of bank lending growth helped fixed asset investment expenditure to maintain a rapid pace of expansion throughout 2009. Consumer spending remained robust, with retail sales rising by 17.5% in the year. The annual CPI rate was negative throughout much of 2009, largely reflecting the earlier movements in food and energy prices, before accelerating to 1.9% in December 2009. The renminbi exchange rate was little changed against the US dollar throughout the course of the year.

Economic conditions proved difficult in **Japan** during 2009, although some signs of stabilisation did emerge following an extremely weak start to the year. First quarter GDP fell by 3.2% on a quarter-on-quarter basis, before gains of 1.3%, zero and 1.1% were recorded in the next three quarters, respectively. The unemployment rate rose from 4.3% in December 2008 to a record high of 5.7% in July 2009, before declining to finish the year at 5.1%. The Bank of Japan introduced a range of initiatives in January 2009 with the intention of improving financing conditions across the corporate sector, while fiscal stimulus packages were also implemented.

Elsewhere in Asia, most economies experienced a further year of uneven growth in 2009. Sharp economic contractions proved commonplace across the region during the early months of 2009 before economic recovery began, often helped by an aggressive loosening of both monetary and fiscal policy. Such trends were particularly evident in **Singapore** where, following a very weak start to 2009, a rapid rate of expansion was recorded during the second quarter, although GDP growth fell back into negative territory during the final months of the year. Growth proved much more stable in **India**, with GDP rising by 6.3% in the first three quarters of the fiscal year 2009/10 following a 5.7% expansion in the same period in 2008/09, helped by an aggressive reduction in interest rates and a sharp increase in government expenditure. Although growth slowed in 2009 in **Indonesia**, the 4.5% increase in GDP and the relative stability of growth

left the country as one of the region's better performers. Economic conditions proved very weak during the early months of 2009 in **Malaysia** as first quarter GDP fell by 6.2% on the same period in 2008, but a strong recovery, helped by an improvement in regional trade activity and a domestic stimulus package, placed fourth quarter GDP some 4.5% above the comparable figure from a year earlier. A recovery in both exports and domestic demand helped the **South Korean** economy to record a strong recovery from a very weak start to 2009, with GDP increasing slightly by 0.2% for the full year, following a 2.2% increase during 2008. Increased public expenditure helped the **Philippines** economy to return to growth following a weak start to 2009, with full year growth of 0.9% being recorded, down from 3.8% in 2008. **Taiwan's** economy proved particularly vulnerable to the sharp fall in global trade activity during the early months of 2009, although the year-on-year rate of decline in GDP moderated as 2009 progressed, thanks in part to a recovery in consumer expenditure around the middle of the year. A substantial fiscal stimulus package in **Vietnam** contributed to improved growth momentum during the first half of 2009, although concerns over the deterioration in the trade position led to a devaluation of the currency and a tightening of monetary policy during the final weeks of the year. Full year 2009 GDP growth slowed slightly to 5.3% from 6.2% in 2008.

Review of performance

Our operations in the Rest of Asia-Pacific region reported a pre-tax profit of US\$4.2bn compared with US\$4.7bn in 2008, a decline of 11% or 8% on an underlying basis. The decline in regional performance was primarily attributable to the challenging economic conditions which resulted in deposit spread compression, lower fee income and credit quality deterioration.

During 2009, we continued to build our presence in the region through organic growth, the acquisition of Bank Ekonomi, and strategic investments. The purchase of Bank Ekonomi nearly doubled our presence in Indonesia to over 200 outlets in 27 cities. We became the first foreign bank to incorporate locally in Vietnam in January 2009, creating the opportunity to widen the product range and increase distribution channels to customers. The integration of IL&FS Investsmart, subsequently rebranded to HSBC InvestDirect, has strengthened our network in India, allowing us to offer wealth management products through over 200 additional outlets. Building our mainland China business and renminbi capabilities continued to be a key focus, as

Report of the Directors: Operating and Financial Review (continued)

demonstrated by the opening of onshore renminbi accounts in mainland China and the launch of renminbi trade settlement in seven ASEAN countries. 19 new HSBC branded outlets were opened in mainland China in 2009, as well as eight additional rural bank outlets and four new Hang Seng Bank branches, consolidating our position as the leading foreign bank in the country. We also launched a new jointly-owned life insurance company in mainland China, and announced the intention to establish a new cards joint venture with Bank of Communications to which over 11m cards in force will be transferred. In insurance, we expanded our regional coverage and increased our stake in Bao Viet in January 2010, allowing it to extend its position in the Vietnamese market.

Net interest income declined by 8% to US\$3.5bn, driven by deposit spread compression in the low interest rate environment and a decline in lending balances. This was partly offset by asset repricing, particularly in CMB.

Average lending balances fell in GB&M and CMB as a result of lower demand for financing as international trade volumes declined, especially in the first half of the year. Growth returned in the second half of the year as the volume of trade activity improved.

Customer deposits grew compared with 2008. PFS continued to successfully attract deposits and the acquisition of Premier customers was strong with the region growing customer numbers by 35% to over 580,000. Payments and cash management was adversely affected by the low interest rate environment.

Net fee income was 13% lower than in 2008, driven by a decline in income from funds under management and global custody. Fees from funds under management in Singapore, Japan and Taiwan declined as a result of weak investor sentiment and lower fee margins as customers moved away from equity investment products though, in the latter part of the year, an improvement in equity markets drove a recovery in our investment-related fee income. In India, tightened credit criteria resulted in lower fees from the card business. By contrast, trade services and cash management increased in a number of countries, and we took various steps to capture cross-border business and continued to benefit from our international business reach. Significant cross-border referral growth was seen in Greater China where numbers rose compared with 2008.

Net trading income declined by 16%, as the fall in interest rates reduced net interest income from trading activities. Foreign exchange and Rates

trading income also declined across the region, reflecting relatively low market volatility, though Credit trading performance was strong, particularly in mainland China, Japan and Singapore. In mainland China, the decline in Rates income resulted from losses on bond positions following an upward shift in yields. However, in South Korea, revenue increased as opportunities arose from market-making and client hedging activities.

Net income from *financial instruments designated at fair value* of US\$110m was recorded compared with a net expense of US\$171m in 2008. This was primarily attributable to equity market-related gains on unit-linked insurance products and was largely offset by a corresponding increase in liabilities to policyholders reflected in net insurance claims incurred and movement in liabilities to policyholders.

Net earned insurance premiums increased by 91% to US\$365m. Sales growth was particularly strong in Singapore following the launch of new products, including a life insurance product designed for high net worth individuals and a single premium guaranteed saver product. Growth in insurance business resulted in higher *net insurance claims incurred and movement in liabilities to policyholders*.

Loan impairment charges and other credit risk provisions rose by 9% compared with 2008 as credit quality deteriorated in India.

In PFS, loan impairment charges rose by 9% to US\$649m, primarily due to rising delinquencies in our unsecured consumer lending businesses in India and Indonesia. In India, a challenging credit environment and high delinquency rates contributed to increased loan impairment charges in personal loans, consumer finance and mortgages. The delinquencies in India began to moderate in the second half of 2009 as the measures we had implemented in the second half of 2008 to mitigate loan losses, including ceasing consumer finance loan origination and tightening lending criteria on other unsecured lending products, began to take effect. As a result, loan impairment charges against cards remained broadly in line with 2008. In CMB, significant deterioration was experienced in India in the first half of 2009. The loan impairment charges across the region improved in the second half of 2009 with credit quality stabilising as a result of support from the governments' various economic stimulus initiatives, together with improved liquidity and actions taken by our customers to adjust in difficult times. Notwithstanding the improvement

Report of the Directors: Operating and Financial Review (continued)

towards the end of the year, we continue to closely monitor portfolios for signs of weakness.

Operating expenditure was broadly in line with 2008. Tight cost control resulted in lower administrative costs and marketing expenditure. Staff costs fell due to lower performance-related costs and a decrease in staff numbers. These were broadly offset by expenditure to support the ongoing development of infrastructure in the region, including branch expansion in mainland China, Vietnam and Malaysia and integration and development costs related to HSBC InvestDirect and the operations of The Chinese Bank Co., Ltd ('The Chinese Bank') in Taiwan.

In an effort to improve operational efficiencies and reduce costs, an increased number of transactions were completed through direct channels, including internet banking, telephone services and self-service machines compared with 2008.

Operating expenses within the Group Service and Software Development Centres rose by 9% as the number of migrated activities and processes increased in accordance with our global resourcing strategy to develop centres of excellence. All related costs are recharged to other Group entities and the income from these recharges is reported within *other operating income*.

Profit from associates and joint ventures in the region was 17% higher as a result of the non-recurrence of Ping An Insurance's impairment of its investment in Fortis in 2008, and an increase in new business sales and investment returns which were boosted by a recovery in equity markets. Income from Bank of Communications remained in line with 2008.

Report of the Directors: Operating and Financial Review (continued)

Profit before tax and balance sheet data – Rest of Asia-Pacific

	2010						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit before tax</i>							
Net interest income	1,581	938	1,435	91	55	(272)	3,828
Net fee income/(expense)	668	442	777	55	(10)	–	1,932
Trading income/(expense) excluding net interest income	81	129	966	69	(38)	–	1,207
Net interest income on trading activities	–	–	138	–	1	272	411
Net trading income/(expense) ⁴⁹	81	129	1,104	69	(37)	272	1,618
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	(2)	–	(2)
Net income/(expense) from other financial instruments designated at fair value	41	2	(1)	–	(16)	–	26
Net income/(expense) from financial instruments designated at fair value	41	2	(1)	–	(18)	–	24
Gains less losses from financial investments	1	3	50	–	92	–	146
Dividend income	–	–	1	–	–	–	1
Net earned insurance premiums	386	62	–	–	–	–	448
Other operating income	108	86	56	1	1,499	(152)	1,598
Total operating income	2,866	1,662	3,422	216	1,581	(152)	9,595
Net insurance claims ⁵⁷	(324)	(39)	–	–	–	–	(363)
Net operating income⁴⁶	2,542	1,623	3,422	216	1,581	(152)	9,232
Loan impairment charges and other credit risk provisions	(298)	(19)	(122)	–	–	–	(439)
Net operating income	2,244	1,604	3,300	216	1,581	(152)	8,793
Total operating expenses	(2,164)	(799)	(1,163)	(135)	(1,034)	152	(5,143)
Operating profit	80	805	2,137	81	547	–	3,650
Share of profit in associates and joint ventures	986	751	447	–	68	–	2,252
Profit before tax	1,066	1,556	2,584	81	615	–	5,902
	%	%	%	%	%		%
Share of HSBC's profit before tax	5.6	8.2	13.6	0.4	3.2		31.0
Cost efficiency ratio	85.1	49.2	34.0	62.5	65.4		55.7
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	37,831	31,423	35,810	3,489	178		108,731
Total assets	49,508	41,588	166,960	12,126	19,450	(11,570)	278,062
Customer accounts	54,741	36,943	53,752	12,620	99		158,155

Report of the Directors: Operating and Financial Review (continued)

Rest of Asia-Pacific

	2009						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit before tax</i>							
Net interest income	1,493	807	1,174	115	91	(141)	3,539
Net fee income/(expense)	554	331	636	55	(19)	–	1,557
Trading income/(expense) excluding net interest income	80	134	1,013	55	(18)	–	1,264
Net interest income/(expense) on trading activities	(1)	–	202	–	–	141	342
Net trading income/(expense) ⁴⁹	79	134	1,215	55	(18)	141	1,606
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	(1)	–	(1)
Net income/(expense) from other financial instruments designated at fair value	110	1	(2)	–	2	–	111
Net income/(expense) from financial instruments designated at fair value	110	1	(2)	–	1	–	110
Gains less losses from financial investments	5	2	(7)	–	(19)	–	(19)
Dividend income	–	–	1	–	1	–	2
Net earned insurance premiums	337	28	–	–	–	–	365
Other operating income/(expense)	67	66	41	(2)	1,200	(134)	1,238
Total operating income	2,645	1,369	3,058	223	1,237	(134)	8,398
Net insurance claims ⁵⁷	(380)	(15)	–	–	–	–	(395)
Net operating income ⁴⁶	2,265	1,354	3,058	223	1,237	(134)	8,003
Loan impairment charges and other credit risk provisions	(649)	(221)	(23)	(2)	(1)	–	(896)
Net operating income	1,616	1,133	3,035	221	1,236	(134)	7,107
Total operating expenses	(1,839)	(636)	(1,006)	(131)	(972)	134	(4,450)
Operating profit/(loss)	(223)	497	2,029	90	264	–	2,657
Share of profit in associates and joint ventures	686	567	290	–	–	–	1,543
Profit before tax	463	1,064	2,319	90	264	–	4,200
	%	%	%	%	%		%
Share of HSBC's profit before tax	6.5	15.0	32.8	1.3	3.7		59.3
Cost efficiency ratio	81.2	47.0	32.9	58.7	78.6		55.6

Balance sheet data⁴⁵

	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net)	30,433	22,595	23,989	2,834	192	80,043
Total assets	40,266	31,221	138,884	11,928	7,160	222,139
Customer accounts	47,573	30,196	43,698	12,496	36	133,999

Report of the Directors: Operating and Financial Review (continued)

Rest of Asia-Pacific	2008						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit before tax</i>							
Net interest income	1,708	934	1,524	103	139	(471)	3,937
Net fee income	592	356	831	71	17	–	1,867
Trading income/(expense) excluding net interest income	65	122	1,233	77	(54)	–	1,443
Net interest income/(expense) on trading activities	(5)	–	123	–	10	471	599
Net trading income/(expense) ⁴⁹	60	122	1,356	77	(44)	471	2,042
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	1	–	1
Net income/(expense) from other financial instruments designated at fair value	(172)	–	(4)	–	4	–	(172)
Net income/(expense) from financial instruments designated at fair value	(172)	–	(4)	–	5	–	(171)
Gains less losses from financial investments	15	3	6	–	–	–	24
Dividend income	–	–	2	–	–	–	2
Net earned insurance premiums	172	25	–	–	–	–	197
Other operating income/ (expense)	58	76	79	(1)	1,070	(227)	1,055
Total operating income	2,433	1,516	3,794	250	1,187	(227)	8,953
Net insurance claims ⁵⁷	42	(14)	–	–	–	–	28
Net operating income ⁴⁶	2,475	1,502	3,794	250	1,187	(227)	8,981
Loan impairment charges and other credit risk provisions	(640)	(137)	(73)	(1)	(1)	–	(852)
Net operating income	1,835	1,365	3,721	249	1,186	(227)	8,129
Total operating expenses	(2,016)	(689)	(1,086)	(140)	(1,000)	227	(4,704)
Operating profit/(loss)	(181)	676	2,635	109	186	–	3,425
Share of profit in associates and joint ventures	392	559	335	–	11	–	1,297
Profit before tax	211	1,235	2,970	109	197	–	4,722
	%	%	%	%	%		%
Share of HSBC's profit before tax	2.3	13.3	31.9	1.2	2.0		50.7
Cost efficiency ratio	81.5	45.9	28.6	56.0	84.2		52.4
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	27,634	21,967	27,941	2,960	159		80,661
Total assets	36,310	29,030	147,714	12,440	5,528	(5,449)	225,573
Customer accounts	42,778	25,372	42,977	12,713	354		124,194

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Middle East

In the Middle East, the network of branches of HSBC Bank Middle East Limited, together with HSBC's subsidiaries and associates, gives us the widest coverage in the region. Our associate in Saudi Arabia, The Saudi British Bank (40% owned), is the Kingdom's fifth largest bank by total assets.

	2010 US\$m	2009 US\$m	2008 US\$m
Net interest income	1,367	1,485	1,556
Net fee income	677	625	691
Net trading income	370	394	402
Other income	(4)	90	19
Net operating income⁴⁶	2,410	2,594	2,668
Impairment charges ⁴⁷	(627)	(1,334)	(279)
Net operating income	1,783	1,260	2,389
Total operating expenses	(1,078)	(1,001)	(959)
Operating profit	705	259	1,430
Income from associates ⁴⁸	187	196	316
Profit before tax	892	455	1,746
Cost efficiency ratio	44.7%	38.6%	35.9%
Year-end staff numbers	8,676	8,281	8,453

**Underlying pre-tax
profit doubled**

**Leading provider of
traditional trade services
in the UAE**

**PFS in the Middle East
returns to profitability**

Economic background

Economic activity in much of the Middle East showed signs of stabilising during 2010. A 30% year on year rise in average oil prices led to a marked strengthening of public finances in the Gulf states, allowing governments such as **Saudi Arabia** to boost public current and capital spending. The high and stable average oil prices also improved external account positions in the Gulf, leading to an increase in reserves and overall net foreign asset accumulation following the modest drawdowns in 2009.

As well as receiving support from rising public spending, non-oil goods and service exporters in the region also benefited from rising external demand, particularly from Asia. The **UAE** was a leading beneficiary, most notably in its transport and logistics sectors. Banking sector activity remained relatively subdued, with rates of credit growth flat or negative in real terms across much of the region. This contributed to subdued consumer and asset price inflation. Although there was some evidence in **Saudi Arabia, Oman and Kuwait** that stronger growth and higher commodity prices were putting pressure on prices in late 2010, the pace of increase remained below that seen in other emerging markets. Inflation was largely absent in the UAE.

Dubai had another challenging year in 2010, as it continued to struggle with high levels of debt, falling real estate prices and a stagnant credit market. Although no figures have been released, officials estimated in October that real GDP was likely to have grown by 2.3% in 2010, mostly from global trade as exports rose 35% in the year to the third quarter. The domestic economy was considerably weaker through most of the year although there were signs of an improvement by the year end.

In **Egypt**, GDP growth returned to 6% by the end of 2010, driven primarily by domestic demand. Egypt's structural economic strengths leave us positive on the medium-term outlook, although recent political turmoil might overshadow its near-term prospects.

Review of performance

Our operations in the Middle East reported pre-tax profits of US\$892m, an increase of US\$437m compared with 2009.

In October 2010, we completed the sale of our investment in the British Arab Commercial Bank, on which a loss of US\$42m was recorded. On an underlying basis and excluding this loss, pre-tax profits increased by US\$481m.

For footnotes, see page 83.

The commentary on the Middle East is on an underlying basis unless stated otherwise.

Report of the Directors: Operating and Financial Review (continued)

Profit/(loss) before tax by country within customer groups and global businesses

	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Total US\$m
2010						
Egypt	38	82	77	–	(2)	195
Qatar	19	52	67	–	–	138
United Arab Emirates	17	186	121	1	(1)	324
Other	19	57	(19)	–	–	57
Middle East (excluding Saudi Arabia)	93	377	246	1	(3)	714
Saudi Arabia	7	107	71	(16)	9	178
	100	484	317	(15)	6	892
2009						
Egypt	18	51	97	–	58	224
Qatar	10	60	66	–	–	136
United Arab Emirates	(177)	(136)	307	(2)	5	(3)
Other	3	(15)	(80)	–	(3)	(95)
Middle East (excluding Saudi Arabia)	(146)	(40)	390	(2)	60	262
Saudi Arabia	20	61	77	8	27	193
	(126)	21	467	6	87	455
2008						
Egypt	16	68	90	–	49	223
Qatar	23	33	57	–	–	113
United Arab Emirates	133	330	388	4	6	861
Other	57	92	104	–	1	254
Middle East (excluding Saudi Arabia)	229	523	639	4	56	1,451
Saudi Arabia	60	35	177	–	23	295
	289	558	816	4	79	1,746

Profits increased strongly in the second half of 2010 compared with the first half of the year, reflecting increased stability in the regional economy and growing momentum in several of the key markets.

The improvement in the credit environment and our risk management actions combined to contribute to significantly lower loan impairment charges and other credit risk provisions. The benefit was partly offset by lower revenues from the run-off of higher yielding unsecured loans, mainly in the UAE.

Our Premier and Advance customer base continued to grow in line with our strategy to build a sustainable wealth-driven, premium-based PFS business, with Premier attracting 35,000 net new customers in the year, of whom 19,000 were new to the Group. During 2010, we launched the Advance proposition across most of the region and the number of customers reached 152,000 at 31 December 2010. The opening of our 100th branch in Egypt is an example of initiatives to expand our regional presence.

In CMB, we continued to build on our competitive advantage in international connectivity.

The increased opportunities to support business and trade flows between the region and the rest of the world, particularly mainland China and India, led to strong trade-related revenues and supported our market-leading position in this business. As a result, we gained market share in our key markets and received several awards for trade services including 'Leading Trade Services Bank in the Middle East and North Africa' which was awarded by *Global Trade Review* for the fourth consecutive year.

As part of our continued support to local internationally-focused businesses, we fully allocated the pledged US\$100m fund to UAE SME customers engaged in international cross-border business.

In GB&M we continued to invest in the region to support existing and anticipated new business and we now have a fully functional dealing room in Abu Dhabi and a 'China desk' in the UAE to support 'East-East' business. We continued to be recognised as the dominant player in regional bond markets and won several awards, including 'Best Investment Bank in the Middle East' awarded by *Euromoney*.

Report of the Directors: Operating and Financial Review (continued)

Net interest income decreased by 8% as average lending balances declined in both PFS and CMB, the proportion of higher yielding assets fell and the cost of liquidity remained high.

In PFS, spreads narrowed as we focused new lending on Premier and Advance customers, while concurrently managing down higher risk unsecured lending balances, mostly in the UAE.

In CMB, asset balances and net interest income rose throughout the second half of 2010 as increasing trade finance balances contributed to growing revenues.

Average customer accounts declined as corporate customers reduced their deposits in response to tighter liquidity in the local markets. This was partly offset by an increase in average liability balances in PFS, which was driven by successful deposit campaigns launched in 2010 and by the acquisition of Premier and Advance customers. Our overall liquidity position improved although the market returns on the deployment of liquidity remained low.

Net fee income increased by 8%, primarily driven by higher volumes of credit facilities related to trade, guarantees and remittances in CMB. The benefit was partly offset by lower advisory revenues from equity capital markets in GB&M as a result of limited issuances in the regional equity markets.

Net trading income fell by 6% to US\$370m. Subdued trading conditions and the non-recurrence of gains which had resulted from the tightening of credit spreads on certain positions in early 2009 resulted in lower Credit trading income. Foreign exchange income decreased with the easing in market volatility as speculation regarding the unpegging of Gulf currencies from the US dollar receded.

Other operating income declined by US\$37m as gains arising in 2009 from the buy-back and extinguishment of own debt did not recur.

Loan impairment charges and other credit risk provisions decreased by 53%. An overall improvement in credit conditions in the region along with enhanced collections processes, improvements in the quality of our customer base and a reduction in unsecured lending resulted in significantly lower net collective impairment provisions, notably in the UAE, and lower requirements for specific corporate provisions.

In PFS, strengthened collections processes and a repositioning of the loan book contributed to lower delinquency rates. In CMB, loan impairment charges and other credit risk provisions decreased due to significantly lower net collectively assessed impairment charges and fewer specific loan impairment charges, with the majority of the charge in 2010 relating to a small number of large corporate customers.

Loan impairment charges and other credit risk provisions in GB&M rose, mainly from restructuring activity which drove UAE-related loan impairments for a small number of large corporate customers in the first half of 2010. The improvement in economic conditions during the latter part of 2010 resulted in lower loan impairment charges in the second half of the year.

Operating expenses increased by 8%, driven by increased investment in marketing and advertising, including key sponsorship deals and the promotion of the HSBC brand through strategic messaging in the Abu Dhabi and Dubai airports, together with an increase in premises and people costs, mainly from the investment in the branch network expansion in Egypt.

Profit from associates and joint ventures decreased by 5%. The contribution from The Saudi British Bank was lower as revenue fell in challenging operating conditions.

Report of the Directors: Operating and Financial Review (continued)

2009 compared with 2008

Economic background

Although the majority of economies in the **Middle East** were spared the most severe effects of the global recession, 2009 marked a dramatic downturn as growth slowed markedly, bringing a sharp end to a five-year run of strong expansion.

In part, the region proved vulnerable to weakened external demand, particularly economies such as Egypt and the UAE that are significant service and merchandise exporters to the West and are exposed to global trade patterns. A sharp drop in hydrocarbon prices in late 2008 and early 2009 adversely affected sentiment and caused some oil-exporters to reassess spending plans as their revenue streams weakened.

In addition, the liquidity environment tightened considerably during the course of the year. This led to a rapid slowdown in credit creation, weighing heavily on private consumption and investment spending and contributing to marked downward pressure on asset prices. Access to international funding was also impaired as global capital flows slowed, further impeding local investment spending.

The recovery of the region may lag behind that of some other emerging markets. However, in contrast to 1998 (the last occasion on which growth trends sharply reversed) policymakers in Saudi Arabia and elsewhere were able to draw on reserves built up during years of high oil earnings to maintain spending, rather than boosting borrowing. With the recovery in oil prices from mid-2009 onward, the reserves allowed the region to weather the difficult economic environment without experiencing pressure on external balances or a downturn in the dollar value of local currencies. Inflation also fell across the region as growth slowed and import prices fell, and policymakers were able to track the exceptionally low level of interest rates in the US.

Review of performance

Our operations in the Middle East reported a pre-tax profit of US\$0.5bn compared with US\$1.7bn in 2008, a decrease of 74% on both reported and underlying bases. The decline in profitability was largely due to the impact of the global recession, which brought a sharp decline in oil prices and a considerable reduction in capital inflows in the second half of 2008, triggering a regional economic downturn which continued throughout 2009. The UAE was significantly affected by declines in construction and global trade, losses incurred by regional investors, and tight liquidity and lower real-

estate prices, which together resulted in higher loan impairment charges as the crisis affected both personal and corporate customers. However, despite the severe deterioration in credit conditions, the region remained profitable due to GB&M. In PFS, we continued to focus on Premier and affluent mass market customers, growing our Premier customer base by 32% compared with 2008. We further expanded our presence in Egypt, opening 15 new branches in 2009.

Net interest income declined by 4%, driven by lower deposit and lending balances and deposit spread compression across all customer groups.

CMB lending balances fell as trade levels declined. In PFS, average mortgages and credit card balances were higher than in 2008, reflecting the deferred drawdown of facilities approved in 2008. Unsecured personal lending balances declined during the year due to tighter origination criteria and a move towards relationship lending. The shift in the composition of personal lending portfolios, from unsecured to secured lending, resulted in narrower asset spreads.

Customer deposit balances fell, mainly due to an outflow of funds from corporate customers reflecting tighter liquidity in the local markets. In PFS, liability balances rose due to the combination of attractive rates offered and ongoing marketing campaigns, although the higher rates resulted in narrower deposit spreads.

Net fee income fell by 9%, due to a decline in custody, insurance and unit trust income as investor sentiment weakened in the difficult market conditions and trade finance fees declined as regional trade deteriorated. Cards income also fell due to lower drawdowns and originations as underwriting criteria were tightened.

Trading income was broadly in line with 2008 as weaker foreign exchange and Rates trading revenue were offset by higher revenue from Credit trading on favourable positioning of the trading portfolio in expectation of spreads narrowing from their peak in the third quarter of 2008.

Other operating income rose by US\$62m, driven by gains arising from the buy-back and extinguishment of our own debt issued locally.

Loan impairment charges and other credit risk provisions rose significantly from US\$0.3bn to US\$1.3bn, reflecting substantially higher charges in the UAE where the deterioration in credit quality was particularly significant. The UAE's real estate and construction industries were adversely affected by the global economic crisis, resulting in several

Report of the Directors: Operating and Financial Review (continued)

large infrastructure projects being postponed or cancelled, and triggering higher levels of unemployment. This resulted in increased delinquencies, notably in credit cards and personal loans, which were exacerbated by large numbers of expatriate workers departing the region leaving debts unpaid. We took steps to mitigate losses, including reducing our credit lines, tightening origination criteria and strengthening collections activities.

Commercial and corporate banking loan impairment charges rose sharply, primarily due to a few individually significant impairment charges recorded on exposures to large corporates.

Operating expenditure increased by 6%. Staff costs remained broadly flat as higher expenditure in GB&M was offset by lower staff costs in PFS and CMB as headcount declined. Non-staff costs rose as new headquarter buildings in the UAE and Qatar caused higher rental costs, and IT investment increased from systems upgrades and rollouts.

Profit from associates and joint ventures in the region fell by 38% as our share of income from The Saudi British Bank declined as a result of higher loan impairment charges. Our share of income from HSBC Saudi Arabia Ltd declined as a result of a slowdown in IPOs and a decline in assets under management.

Report of the Directors: Operating and Financial Review (continued)

Profit/(loss) before tax and balance sheet data – Middle East

	2010						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income	553	473	334	–	14	(7)	1,367
Net fee income	200	258	202	17	–	–	677
Trading income/(expense) excluding net interest income	59	85	205	1	(7)	–	343
Net interest income/(expense) on trading activities	1	7	18	–	(6)	7	27
Net trading income/(expense) ⁴⁹	60	92	223	1	(13)	7	370
Gains less losses from financial investments	1	–	(3)	–	(1)	–	(3)
Dividend income	2	1	4	–	–	–	7
Other operating income/(expense)	27	(8)	(1)	1	40	(67)	(8)
Total operating income	843	816	759	19	40	(67)	2,410
Net insurance claims ⁵⁷	–	–	–	–	–	–	–
Net operating income⁴⁶	843	816	759	19	40	(67)	2,410
Loan impairment charges and other credit risk provisions	(227)	(145)	(255)	–	–	–	(627)
Net operating income	616	671	504	19	40	(67)	1,783
Total operating expenses	(524)	(297)	(263)	(18)	(43)	67	(1,078)
Operating profit/(loss)	92	374	241	1	(3)	–	705
Share of profit/(loss) in associates and joint ventures	8	110	76	(16)	9	–	187
Profit/(loss) before tax	100	484	317	(15)	6	–	892
	%	%	%	%	%		%
Share of HSBC's profit before tax	0.5	2.6	1.7	(0.1)	–		4.7
Cost efficiency ratio	62.2	36.4	34.7	94.7	107.5		44.7
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	5,063	12,293	7,247	21	2		24,626
Total assets	6,244	13,991	31,295	59	4,129	(2,961)	52,757
Customer accounts	17,538	10,319	5,306	290	58		33,511

Report of the Directors: Operating and Financial Review (continued)

Middle East

	2009						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income	644	464	330	1	46	–	1,485
Net fee income	203	219	198	3	2	–	625
Trading income excluding net interest income	55	75	235	1	3	–	369
Net interest income on trading activities	–	–	20	–	5	–	25
Net trading income ⁴⁹	55	75	255	1	8	–	394
Gains less losses from financial investments	12	(2)	1	–	5	–	16
Dividend income	–	–	3	–	–	–	3
Other operating income/ (expense)	35	39	35	(1)	39	(76)	71
Total operating income	949	795	822	4	100	(76)	2,594
Net insurance claims ⁵⁷	–	–	–	–	–	–	–
Net operating income ⁴⁶	949	795	822	4	100	(76)	2,594
Loan impairment charges and other credit risk provisions	(588)	(573)	(173)	–	–	–	(1,334)
Net operating income	361	222	649	4	100	(76)	1,260
Total operating expenses	(508)	(269)	(255)	(6)	(39)	76	(1,001)
Operating profit/(loss)	(147)	(47)	394	(2)	61	–	259
Share of profit in associates and joint ventures	21	68	73	8	26	–	196
Profit/(loss) before tax	(126)	21	467	6	87	–	455
	%	%	%	%	%		%
Share of HSBC's profit before tax	(1.8)	0.3	6.6	0.1	1.2		6.4
Cost efficiency ratio	53.5	33.8	31.0	150.0	39.0		38.6
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	5,979	10,281	6,554	28	2		22,844
Total assets	6,810	11,861	28,189	96	4,952	(3,801)	48,107
Customer accounts	15,074	10,122	5,752	1,172	409		32,529

Report of the Directors: Operating and Financial Review (continued)

Middle East

	2008						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit before tax</i>							
Net interest income	652	510	362	3	46	(17)	1,556
Net fee income	227	241	217	6	–	–	691
Trading income excluding net interest income	47	65	244	–	24	–	380
Net interest income/(expense) on trading activities	–	–	20	–	(15)	17	22
Net trading income ⁴⁹	47	65	264	–	9	17	402
Gains less losses from financial investments	14	–	(6)	–	–	–	8
Dividend income	–	–	2	–	–	–	2
Other operating income	21	8	11	3	26	(60)	9
Total operating income	961	824	850	12	81	(60)	2,668
Net insurance claims ⁵⁷	–	–	–	–	–	–	–
Net operating income ⁴⁶	961	824	850	12	81	(60)	2,668
Loan impairment (charges)/ recoveries and other credit risk provisions	(223)	(45)	(12)	–	1	–	(279)
Net operating income	738	779	838	12	82	(60)	2,389
Total operating expenses	(511)	(264)	(212)	(8)	(24)	60	(959)
Operating profit	227	515	626	4	58	–	1,430
Share of profit in associates and joint ventures	62	43	190	–	21	–	316
Profit before tax	289	558	816	4	79	–	1,746
	%	%	%	%	%		%
Share of HSBC's profit before tax	3.1	6.0	8.9	–	0.8		18.8
Cost efficiency ratio	53.2	32.0	24.9	66.7	29.6		35.9
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	7,226	13,221	6,649	29	170		27,295
Total assets	8,168	14,672	27,975	46	5,754	(5,663)	50,952
Customer accounts	13,753	10,978	7,628	1,762	1,044		35,165

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

North America

Our North American businesses are located in the US, Canada and Bermuda. Operations in the US are primarily conducted through HSBC Bank USA, N.A., which is concentrated in New York State, and HSBC Finance, a national consumer finance company based near Chicago. HSBC Markets (USA) Inc. is the intermediate holding company of, inter alia, HSBC Securities (USA) Inc. HSBC Bank Canada and HSBC Bank Bermuda operate in their respective countries.

	2010 US\$m	2009 US\$m	2008 US\$m
Net interest income	12,439	13,670	15,218
Net fee income	3,664	4,817	5,227
Net trading income/ (expense)	314	331	(3,135)
Other income/(expense)	630	(2,513)	3,869
Net operating income⁴⁶	17,047	16,305	21,179
Impairment charges ⁴⁷	(8,295)	(15,664)	(16,795)
Net operating income	8,752	641	4,384
Total operating expenses	(8,322)	(8,391)	(19,923)
Operating profit/(loss)	430	(7,750)	(15,539)
Income from associates ⁴⁸	24	12	11
Profit/(loss) before tax	454	(7,738)	(15,528)
Cost efficiency ratio	48.8%	51.5%	94.1%
Year-end staff numbers	33,865	35,458	44,725

Pre-tax profit for the first time since 2006

Impairment charges at lowest levels since 2006

Card and Retail Services pre-tax profit

US\$2.0bn

2009: US\$641m; 2008: US\$837m

Economic background

The economic recession in the US officially ended in the middle of 2009 but, given its depth and duration, the subsequent recovery was disappointing. In 2010, GDP expanded by 2.9%. The initial stage of the recovery was helped by tax reductions and direct subsidies for home purchases, but the growth momentum faded as their impact waned. In addition, fiscal tightening by state and local governments intensified, leading to spending cutbacks and job cuts that adversely affected consumer confidence and the rate of growth of consumer spending. Unemployment fell from 10.0% in the fourth quarter of 2009 to 9.4% by the end of 2010. The annual rate of 'core' inflation (excluding food and energy products) fell steadily during the year to 0.8% in December, the smallest rate of annual increase in the 50 year history of the series.

In the fourth quarter of 2010, the Federal Reserve launched a US\$600bn programme of large scale asset purchases to ease monetary conditions. Asset prices rebounded and consumer spending picked up sharply, helping to renew economic activity.

In the year ended November 2010, Canadian GDP rose by 3%, compared with a decline of 1.2% in the year to November 2009, driven by housing construction, consumer spending and inventory restocking. Employment growth in the first half of 2010 was strong and the unemployment rate fell to 7.6% in December 2010 from the high of 8.7% in 2009. CPI inflation remained close to the Bank of Canada's 2% target through much of 2010 but the recovery in economic activity prompted the central bank to begin normalising the policy rate from a low of 0.25% to 1% by October.

Review of performance

In North America, a reported profit before tax of US\$454m in 2010 compared with a loss of US\$7.7bn in 2009. On an underlying basis, the pre-tax profit of US\$246m compared with a pre-tax loss of US\$4.0bn. The improved performance was largely due to a marked decline in loan impairment charges in our Card and Retail Services business and run-off portfolios, partly offset by lower revenue reflecting a reduction in lending balances, the effects of the CARD Act (see page 19) and adverse fair value movements on non-qualifying hedges.

Our results in 2011 will continue to be affected in general terms by the strength of the US economy and the impact of proposed regulatory changes on

For footnotes, see page 83.

The commentary on North America is on an underlying basis unless stated otherwise.

Report of the Directors: Operating and Financial Review (continued)*Profit/(loss) before tax by country within customer groups and global businesses*

	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Total US\$m
2010						
US	(2,306)	402	1,285	113	(39)	(545)
Canada	110	505	248	–	4	867
Bermuda	47	32	49	(3)	7	132
Other	–	–	–	1	(1)	–
	(2,149)	939	1,582	111	(29)	454
2009						
US	(5,292)	158	505	(49)	(3,626)	(8,304)
Canada	17	347	159	–	(100)	423
Bermuda	49	37	47	(2)	10	141
Other	–	1	1	1	(1)	2
	(5,226)	543	712	(50)	(3,717)	(7,738)
2008						
US ⁶²	(17,364)	226	(2,899)	67	3,427	(16,543)
Canada	106	380	252	5	96	839
Bermuda	31	51	72	11	9	174
Other	(1)	1	–	–	2	2
	(17,228)	658	(2,575)	83	3,534	(15,528)

For footnote, see page 83.

our business and, specifically, by the extent to which unemployment rates improve and the recovery in the housing market is sustained.

In 2010, we continued to reposition our core businesses and we remained focused on managing down our run-off assets. In addition, we made progress with the changes required to conform with new regulatory frameworks and policies.

In our core PFS business, we continued to grow our Premier proposition, with customer numbers increasing by 37% to over 700,000, and we expanded our branch network, opening five new branches in the states of California, Maryland and Virginia. Our Card and Retail Services business continued to be profitable, despite a decline in lending balances as customers reduced their outstanding credit card debt.

In CMB, we increased pre-tax profits by 51% to US\$873m as credit quality improved and we grew our revenue through repricing. In line with our global strategy to be the leading international business bank, CMB actively targeted the growing number of companies with international banking requirements achieving a 28% increase in referral volumes to other HSBC sites, and GB&M drove cross-regional and cross-customer group connectivity. GB&M and GPB also continued to appeal to internationally focused customers, attracted by the Group's presence in both emerging and developed markets.

Net interest income fell by 10% to US\$12.4bn as customer lending balances declined, mainly in HSBC

Finance, due to the run-off of the residual balances in our Mortgage Services, Consumer Lending and vehicle finance portfolios. We took additional steps during 2010 to accelerate this process, selling US\$1.0bn in vehicle finance loans in March and the remainder of the portfolio (US\$4.3bn) in August to the same purchaser. Lower balances in our Card and Retail Services business reflected a decline in active accounts, actions taken to mitigate risk and an increased focus by our customers on reducing their credit card debt.

Asset spreads in Mortgage Services and Consumer Lending widened, reflecting lower funding costs and higher yields resulting from lower levels of modified loans and delinquent balances. In our Card and Retail Services portfolio asset spreads also widened due to lower funding costs, re-pricing initiatives and contract re-negotiation with certain merchants, partly offset by the effects of the CARD Act.

Average customer deposit balances increased in PFS and CMB as we continued to grow our customer base. In GB&M, our increased deposit base reflected a rise in repurchase transactions. Deposit spreads improved, despite falling interest rates, mainly due to repricing as competitive pressures eased.

Lower net interest income from Balance Sheet Management reflected the sales and maturities of higher yielding assets and the reinvestment of the proceeds into lower yielding, lower risk assets.

Report of the Directors: Operating and Financial Review (continued)

Net fee income fell by 25% to US\$3.7bn. Lower transaction volumes, a reduction in customer spending and customers actively seeking to reduce credit card debt improved delinquency trends, and the effects of changes required by the CARD Act led to lower late and overlimit fees in our Card and Retail Services business.

Net trading income of US\$314m was 8% lower than in 2009, primarily because of US\$353m adverse fair value movements in non-qualifying hedges due to the decrease in long-term US interest rates. This compared with US\$184m in favourable fair value movements on these instruments in 2009. The majority of these instruments were interest rate swaps used to economically hedge floating rate debt issued by HSBC Finance. The debt was issued to offset the increase in the duration of the company's mortgage portfolio resulting from lower prepayment rates and the corresponding rise in interest rate risk.

In 2010, we increased our estimates of exposure on repurchase obligations associated with loans previously sold, primarily to Government-sponsored enterprises ('GSE's), which reduced our trading income by US\$341m compared with US\$65m in 2009. This related mainly to mortgages originated through broker channels. These trading losses were partly offset by a rise in GB&M, despite lower revenue from Rates, as write-backs on legacy positions in Credit trading compared with write-downs in 2009.

Net expense from financial instruments designated at fair value of US\$31m compared with net income of US\$192m in 2009. This was due to adverse fair value movements from interest rate ineffectiveness in the economic hedging of our long-term debt. In 2009, fair value movements on economic hedges resulted in net income.

Gains less losses from financial investments declined by 52% due to lower gains from asset sales in the available-for-sale portfolio, undertaken to reduce the overall level of balance sheet risk.

Net earned insurance premiums and *Net insurance claims incurred and movement in liabilities to policyholders* both declined. Lower premiums reflected a fall in sales of payment protection products following the discontinuance of mortgage originations in HSBC Finance. Claims and reserves declined as the lending balances and associated in-force insurance contracts reduced.

Other operating income declined by 70% to US\$167m as we recognised a loss of US\$207m on the sale of our vehicle finance loan portfolio and loan servicing platform. In addition, gains in 2009

from the sale of residential mortgages and the refinement of the income recognition methodology of long-term insurance contracts did not recur. This was partly offset by a gain on the sale of our New York headquarters building in 2010.

Loan impairment charges and other credit risk provisions decreased by 47% to US\$8.3bn, the lowest level since 2006. Although most significant in PFS, the decline was across all businesses as the economy generally improved in 2010.

Loan impairment charges in Card and Retail Services declined by 57%, reflecting lower lending balances and an increased focus by our customers on reducing outstanding credit card debt. There was also an overall improvement in the credit quality of the portfolio, with lower delinquency levels and better delinquency roll rates.

Loan impairment charges in our Mortgage Services and Consumer Lending businesses fell by 29% as balances continued to run-off and delinquent balances reduced. Loss severity also improved reflecting an increase in deed-in-lieu and short sales agreements, both of which result in lower losses than foreclosed loans.

As a result of investigations into the foreclosure practices of certain mortgage service providers, there could be additional delays in the processing of foreclosures. See page 83 for more information.

In GB&M, a net release of loan impairment charges and other credit risk provisions of US\$184m compared with a reported net charge of US\$621m in 2009. This reflected an improvement in the credit environment and a release of impairments on available-for-sale ABSs. In CMB, loan impairment charges declined as the improved economic conditions resulted in credit upgrades on certain accounts and fewer downgrades across all business lines. Further commentary on delinquency trends in the US PFS portfolios is provided on page 110.

Operating expenses fell by 2% to US\$8.3bn, reflecting the non-recurrence of restructuring costs following the closure of the Consumer Lending branch network in 2009 and the reduced scope of our business operations in the US as we ran off the legacy portfolios in HSBC Finance. In addition, we recorded a pension curtailment gain in 2010 and deposit insurance costs declined as a 2009 special assessment did not recur. These reductions were partly offset by a rise in marketing expenses in Card and Retail Services, an increase in litigation provisions and higher regulatory and compliance costs.

Report of the Directors: Operating and Financial Review (continued)

2009 compared with 2008

Economic background

Economic conditions remained extremely difficult in the US during the early months of 2009 before some signs of recovery appeared as the year progressed, limiting the decline in full year GDP to 2.4% after a 0.4% increase during 2008. Housing sales and residential construction activity showed some improvement from very depressed levels and this, along with the introduction of tax incentives, drove a reduction in the rate of decline of house prices in some states as the year progressed. Labour market conditions weakened throughout the year as the unemployment rate rose to a 26-year high of 10.1% in October 2009, contributing to concerns around the trend of delinquencies on both secured and unsecured debt within the household sector. The annual CPI rate remained negative during the second and third quarters of the year before rising to 2.7% by December 2009, although this trend was largely reflective of the earlier volatility of energy prices. Measures of consumer confidence improved during the year, but remained consistent with a weak overall level of household expenditure. The Standard & Poor's S&P 500 stock market index recovered from a weak start to 2009 to eventually record a gain of 23% in the year. Having already lowered the Fed funds target rate to within a narrow range of between zero and 25 basis points, the Federal Reserve maintained their efforts to improve the availability of credit across the economy by purchasing a range of financial instruments, while a substantial fiscal stimulus package provided additional support to economic activity from the middle of the year.

Canadian GDP fell by 3.2% during the first eleven months of 2009 compared with the equivalent period of 2008, led by a sharp contraction of output within the manufacturing sector. Labour market conditions deteriorated as the unemployment rate rose from a level of 6.8% in December 2008 to an 11 year high of 8.7% in August 2009, before then declining slightly in the final months of the year. In common with many other economies, the headline CPI rate turned negative around the middle of 2009, largely reflecting the trend of energy prices, and the core rate of inflation displayed a more pronounced downward trend as 2009 progressed. Responding to this deteriorating economic outlook, the Bank of Canada cut its overnight interest rate from 1.5% in December 2008 to 0.25% in April 2009, and provided a conditional commitment to maintain this level of interest rates until the end of the second quarter of 2010.

Review of performance

In North America, we reported a loss before tax of US\$7.7bn in 2009 compared with a loss of US\$15.5bn in 2008. On an underlying basis, excluding US\$3.7bn of fair value movements on our own debt, and also excluding an impairment charge of US\$10.6bn in 2008 to fully write-off goodwill in respect of North America PFS, the pre-tax loss fell by 52% to US\$4.1bn. This improved performance was largely due to a marked reduction in write-downs and losses in GB&M, lower loan impairment charges in PFS and lower operating expenses following the closure of our Consumer Lending branch network at the beginning of 2009, partly offset by higher loan impairment charges and other credit risk provisions in the corporate and commercial, and GPB, books.

Net interest income in 2009 declined by 10%, mainly reflecting reduced asset balances in the legacy consumer finance portfolios, increases in average delinquencies and modified loans (which generate lower yields), the compression of deposit spreads and lower revenue from Balance Sheet Management activities. These effects were partly offset by lower funding costs from the decline in interest rates and higher credit card yields which were driven by the effects of re-pricing initiatives, interest rate floors and lower levels of promotional balances.

Loans and advances to customers declined, mainly in HSBC Finance, following decisions taken to cease new originations and run off the residual balances in Mortgage Services, Consumer Lending and vehicle finance. HSBC Bank USA sold US\$4.5bn of prime mortgages in 2009 in addition to normal sale activity. In our Card and Retail Services, balances declined due to lower consumer spending and steps taken by management to mitigate risk and reduce originations, including tightening initial credit-line sales authorisation criteria, closing inactive accounts, decreasing credit lines, restricting underwriting criteria, restricting cash access and reducing marketing expenditure. In the second half of the year, we resumed direct marketing mailings and new customer account originations for portions of the sub-prime credit card portfolio which had held up well through the economic downturn.

In November 2009, we entered into an agreement to sell the vehicle finance loan servicing operation and US\$1.0bn of associated loans. This transaction is expected to close in the first quarter of 2010.

In December 2009, HSBC Finance revised the write-off period for its real estate secured and other

Report of the Directors: Operating and Financial Review (continued)

personal lending portfolios in order to reflect changed customer behaviour, aligning it with the policy used across the Group. As a consequence of this, real estate secured loan balances are now written down to net realisable value generally no later than the end of the month in which the account becomes 180 days delinquent, and personal lending products balances are now written off no later than the end of the month in which the account becomes 180 days delinquent. This change did not have a material effect on our financial results as write-offs were offset with releases of related impairment allowances. However, the write-offs resulted in a US\$3.3bn reduction in gross balances in Mortgage Services and Consumer Lending.

Asset spreads narrowed slightly in the Mortgage Services and Consumer Lending portfolios as the effect of credit quality deterioration and increased loan modifications were partly offset by lower funding costs. Vehicle finance spreads widened due to lower funding costs. In Card and Retail Services, spreads widened due to lower funding costs, repricing initiatives, lower levels of promotional balances and interest rate floors on portions of the portfolio. In GB&M and CMB, asset spreads widened, primarily due to loan repricing and lower funding costs.

Customer deposit balances were broadly unchanged. In GB&M, reduced deposits reflected the decline in assets being funded. This reduction was partly offset in both PFS and CMB, which were successful in increasing deposits through Premier, the expanded branch network and various internet-based propositions. Liability spreads tightened as base rates declined, although spreads widened in the second half of 2009 as rates paid to customers decreased in line with major competitors.

Net interest income from Balance Sheet Management fell, despite strong performance in the first half of the year, affected by risk management initiatives which included selling higher yielding assets and reinvesting the proceeds in assets with a reduced risk profile, resulting in lower yield.

Net fee income declined by 7% to US\$4.8bn, driven by lower late, overlimit, interchange and cash advance fees in the US credit cards business. This was mainly due to a reduction in our cards in issue, lower transaction volumes and changes in customer behaviour. Fee income from enhancement services also decreased due to lower balances and fewer accounts, and the discontinuance of all but one partner relationship and a change in product mix to lower revenue products led to a decline in fee income from Taxpayer Financial Services. In

GB&M, fee income from underwriting increased, driven by higher debt origination volumes.

Net trading income of US\$331m compared with a net trading loss of US\$3.1bn in 2008, primarily due to significantly lower write-downs on exposures in GB&M, as the effect of downgrades of monoline insurers and mortgage-backed securities were far less marked than in 2008. Revenue from foreign exchange fell, following a record performance in 2008 in which there had been unprecedented levels of market volatility and wider spreads. In Global Banking, fair value losses were recorded on certain credit default swap transactions used to hedge corporate loan exposures following the tightening of credit spreads, compared with gains in 2008.

Net income from financial instruments designated at fair value declined by 35% to US\$192m, as income from ineffective interest rate hedges related to long-term debt issued by our subsidiaries in North America reduced.

Gains less losses from financial investments were US\$296m, compared with a net loss of US\$123m in 2008. Gains in the current year were largely attributable to the sale of mortgage-backed securities, compared with losses on the sale of US government agency securities in 2008. Gains from the sale of Visa shares in 2008 did not recur.

Net earned insurance premiums declined by 21% as lower loan balances and the discontinuation of real estate originations in HSBC Finance led to lower premiums from payment protection insurance products.

Other operating income was US\$566m compared with US\$26m in 2008 due to lower losses on sales of repossessed properties during 2009. House prices began to stabilise during the second half of the year and this resulted in less deterioration in value in the time between taking title and selling the property. Also, there were further delays in the foreclosure process in 2009, resulting in lower inventory levels and fewer sales. In addition, HSBC Finance recognised gains from the refinement of the income recognition methodology of long-term insurance contracts, and gains on the sale of prime mortgages in HSBC Bank USA increased.

Net insurance claims incurred and movements in liabilities to policyholders increased marginally to US\$241m as higher claims and an increase in liabilities for credit protection policies written against the US prime mortgage book were largely offset by reduced life insurance and disability claims due to a decline in the number of policies underwritten.

Report of the Directors: Operating and Financial Review (continued)

Loan impairment charges and other credit risk provisions decreased by 7% to US\$15.7bn. Lower loan impairment charges in HSBC Finance were partly offset by increases in loan impairment charges and other credit risk provisions in GB&M, CMB, the US prime mortgage book and GPB.

Loan impairment charges in US consumer finance decreased by 12% to US\$13.5bn, due to a stabilisation in delinquency trends. In our Mortgage Services portfolio, loan impairment charges fell by 40% to US\$2.1bn as the portfolio progressed further into run-off. By contrast, there was a 4% rise in loan impairment charges in Consumer Lending, primarily in the unsecured portfolio due to a deterioration in the 2006 and 2007 vintages and, to a lesser extent, first lien real estate secured loans. This was partly offset by lower loan impairment charges for second lien real estate secured loans, reflecting a reduction in portfolio risk factors as delinquency trends stabilised and the outlook for current inherent losses on certain first lien real estate secured vintages improved. The change in write-off period referred above had no significant effect on loan impairment charges.

In Card and Retail Services, loan impairment charges decreased by 4%, due to lower loan balances, reflecting lower consumer spending and actions taken to manage risk, and stable credit conditions. In addition, the outlook for future loss estimates improved: the effect of higher unemployment on losses was not as severe as had been predicted, in part due to tighter underwriting; fuel prices declined; and government stimulus activities helped household cashflow. These developments occurred despite the continued deterioration of the US economy and higher levels of unemployment and personal bankruptcy filings.

In PFS in HSBC Bank USA, loan impairment charges rose by 18% to US\$616m, mainly in the prime residential mortgage portfolios. Higher delinquencies and losses were experienced due to credit quality deterioration and continued weakness in house prices in certain markets.

Loan impairment charges and other credit risk provisions in GB&M rose from US\$198m to US\$621m, driven by deterioration in the credit position of certain corporate clients and additional impairments recognised in respect of certain ABSs held in the available-for-sale portfolio which reflected mark-to-market losses. In CMB, loan impairment charges rose by 15% to US\$519m as the recession adversely affected the commercial real estate and construction portfolios in the US, and the commercial real estate, manufacturing, trade and

service sectors in Canada. In GPB, higher loan impairment charges were attributable to a single specific charge.

Further commentary on delinquency trends in our US PFS portfolios is provided in 'Areas of special interest – personal lending' on page 106.

Operating expenses declined to US\$8.4bn. Apart from the non-recurrence of a US\$10.6bn charge for the impairment of the goodwill of the North American PFS business, savings from the decision to discontinue originations and close branches in the Consumer Lending business and other cost reduction initiatives drove expense reduction. Restructuring costs associated with the closure of our branch network amounted to US\$150m. Staff costs decreased as a result of lower staff numbers, offsetting higher performance-related costs in GB&M. General and administrative costs declined with lower marketing costs in Card and Retail Services as a significant element as origination activity was curtailed. Deposit insurance expenses increased by US\$143m following a Federal Deposit Insurance Corporation special assessment in response to the bail out of a number of regional banks.

Report of the Directors: Operating and Financial Review (continued)

Profit/(loss) before tax and balance sheet data – North America

	2010						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	9,912	1,525	952	190	(71)	(69)	12,439
Net fee income/(expense)	2,032	534	955	149	(6)	–	3,664
Trading income/(expense) excluding net interest income	(472)	17	563	13	(12)	–	109
Net interest income on trading activities	24	2	93	–	17	69	205
Net trading income/(expense) ⁴⁹	(448)	19	656	13	5	69	314
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	111	–	111
Net income/(expense) from other financial instruments designated at fair value	6	–	(2)	–	(4)	–	–
Net income/(expense) from financial instruments designated at fair value	6	–	(2)	–	107	–	111
Gains less losses from financial investments	5	(6)	141	–	3	–	143
Dividend income	18	7	12	3	2	–	42
Net earned insurance premiums	245	–	–	–	–	–	245
Other operating income	(243)	242	64	15	2,351	(2,196)	233
Total operating income	11,527	2,321	2,778	370	2,391	(2,196)	17,191
Net insurance claims ⁵⁷	(148)	–	–	–	4	–	(144)
Net operating income⁴⁶	11,379	2,321	2,778	370	2,395	(2,196)	17,047
Loan impairment (charges)/recoveries and other credit risk provisions	(8,194)	(323)	184	38	–	–	(8,295)
Net operating income	3,185	1,998	2,962	408	2,395	(2,196)	8,752
Total operating expenses	(5,338)	(1,081)	(1,380)	(297)	(2,422)	2,196	(8,322)
Operating profit/(loss)	(2,153)	917	1,582	111	(27)	–	430
Share of profit/(loss) in associates and joint ventures	4	22	–	–	(2)	–	24
Profit/(loss) before tax	(2,149)	939	1,582	111	(29)	–	454
	%	%	%	%	%		%
Share of HSBC's profit before tax	(11.3)	5.0	8.3	0.6	(0.2)		2.4
Cost efficiency ratio	46.9	46.6	49.7	80.3	101.1		48.8
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	131,194	30,277	24,338	4,723	–		190,532
Total assets	154,086	39,213	306,416	5,824	9,373	(22,425)	492,487
Customer accounts	76,817	46,425	22,324	12,812	108		158,486

Report of the Directors: Operating and Financial Review (continued)

North America

	2009						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	11,244	1,391	999	178	(84)	(58)	13,670
Net fee income	3,174	453	1,045	142	3	–	4,817
Trading income/(expense) excluding net interest income	257	(10)	(179)	(3)	(30)	–	35
Net interest income/(expense) on trading activities	60	3	175	(1)	1	58	296
Net trading income/(expense) ⁴⁹	317	(7)	(4)	(4)	(29)	58	331
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	(3,497)	–	(3,497)
Net income from other financial instruments designated at fair value	–	–	–	–	1	–	1
Net expense from financial instruments designated at fair value	–	–	–	–	(3,496)	–	(3,496)
Gains less losses from financial investments	16	3	277	–	–	–	296
Dividend income	21	5	27	2	(2)	–	53
Net earned insurance premiums	309	–	–	–	–	–	309
Other operating income	9	162	317	11	1,828	(1,761)	566
Total operating income/(expense)	15,090	2,007	2,661	329	(1,780)	(1,761)	16,546
Net insurance claims ⁵⁷	(241)	–	–	–	–	–	(241)
Net operating income/(expense) ⁴⁶	14,849	2,007	2,661	329	(1,780)	(1,761)	16,305
Loan impairment charges and other credit risk provisions	(14,424)	(519)	(621)	(98)	(2)	–	(15,664)
Net operating income/(expense)	425	1,488	2,040	231	(1,782)	(1,761)	641
Total operating expenses	(5,651)	(958)	(1,328)	(281)	(1,934)	1,761	(8,391)
Operating profit/(loss)	(5,226)	530	712	(50)	(3,716)	–	(7,750)
Share of profit/(loss) in associates and joint ventures	–	13	–	–	(1)	–	12
Profit/(loss) before tax	(5,226)	543	712	(50)	(3,717)	–	(7,738)
	%	%	%	%	%		%
Share of HSBC's profit before tax	(73.8)	7.7	10.1	(0.7)	(52.6)		(109.3)
Cost efficiency ratio	38.1	47.7	49.9	85.4	(108.7)		51.5
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	151,671	31,292	18,654	5,236	–		206,853
Total assets	179,597	38,232	260,131	6,572	2,071	(11,589)	475,014
Customer accounts	74,228	42,900	19,095	12,834	100		149,157

Report of the Directors: Operating and Financial Review (continued)

North America

	2008						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income	12,632	1,480	1,064	224	22	(204)	15,218
Net fee income/(expense)	3,896	391	818	181	(59)	–	5,227
Trading income/(expense) excluding net interest income	(250)	5	(3,516)	10	(128)	–	(3,879)
Net interest income/(expense) on trading activities	66	–	584	–	(110)	204	744
Net trading income/(expense) ⁴⁹	(184)	5	(2,932)	10	(238)	204	(3,135)
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	3,736	–	3,736
Net income/(expense) from other financial instruments designated at fair value	(2)	–	(1)	–	4	–	1
Net income/(expense) from financial instruments designated at fair value	(2)	–	(1)	–	3,740	–	3,737
Gains less losses from financial investments	65	5	(209)	–	19	–	(120)
Dividend income	36	11	27	3	–	–	77
Net earned insurance premiums	390	–	–	–	–	–	390
Other operating income/(expense)	(426)	140	240	20	1,419	(1,370)	23
Total operating income/(expense)	16,407	2,032	(993)	438	4,903	(1,370)	21,417
Net insurance claims ⁵⁷	(238)	–	–	–	–	–	(238)
Net operating income/(expense) ⁴⁶	16,169	2,032	(993)	438	4,903	(1,370)	21,179
Loan impairment charges and other credit risk provisions	(16,132)	(449)	(198)	(16)	–	–	(16,795)
Net operating income/(expense)	37	1,583	(1,191)	422	4,903	(1,370)	4,384
Operating expenses (excluding goodwill impairment)	(6,701)	(937)	(1,384)	(339)	(1,368)	1,370	(9,359)
Goodwill impairment	(10,564)	–	–	–	–	–	(10,564)
Operating profit/(loss)	(17,228)	646	(2,575)	83	3,535	–	(15,539)
Share of profit/(loss) in associates and joint ventures	–	12	–	–	(1)	–	11
Profit/(loss) before tax	(17,228)	658	(2,575)	83	3,534	–	(15,528)
	%	%	%	%	%		%
Share of HSBC's profit before tax	(185.1)	7.1	(27.7)	0.9	38.0		(166.8)
Cost efficiency ratio	106.8	46.1	(139.4)	77.4	27.9		94.1
<i>Balance sheet data</i> ⁴⁵							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	179,663	35,725	35,583	5,243	–		256,214
Total assets	205,722	42,211	348,347	7,054	3,323	(10,355)	596,302
Customer accounts	65,830	39,105	23,844	14,657	96		143,532

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Latin America

Our operations in Latin America principally comprise HSBC Bank Brasil S.A.-Banco Múltiplo, HSBC México, S.A., HSBC Bank Argentina S.A. and HSBC Bank (Panama) S.A. In addition to banking services, we operate insurance businesses in Brazil, Mexico, Argentina, Panama and a range of smaller markets.

	2010 US\$m	2009 US\$m	2008 US\$m
Net interest income	6,311	5,573	6,458
Net fee income	1,749	1,729	2,167
Net trading income	733	848	701
Other income	938	874	1,187
Net operating income⁴⁶	9,731	9,024	10,513
Impairment charges ⁴⁷	(1,544)	(2,526)	(2,492)
Net operating income	8,187	6,498	8,021
Total operating expenses	(6,394)	(5,375)	(5,990)
Operating profit	1,793	1,123	2,031
Income from associates ⁴⁸	2	1	6
Profit before tax	1,795	1,124	2,037
Cost efficiency ratio	65.7%	59.6%	57.0%
Year-end staff numbers	56,044	54,288	58,559

**Higher pre-tax profits
driven by an improvement
in credit quality**

**Record pre-tax profits
in Brazil of over
US\$1bn**

**New sales desks established
to promote trade with
mainland China**

Economic background

The **Brazilian** economy expanded at its fastest rate in three decades in 2010, with GDP growing 7.5% on an annual basis in the third quarter. Consumer demand played a major role supported by a rapid expansion of credit, which rose by 20.5% in 2010, and robust labour market conditions, as the unemployment rate fell to an all-time low of 5.3% in December. The growth of domestic demand led to a rapid rise in import growth and a widening of Brazil's current account deficit and contributed, along with a rise in food prices during the year, to an increase in CPI inflation to 5.9% in December compared with 4.3% at the end of 2009. The Central Bank tightened monetary policy by 2 percentage points between April and July 2010 and raised commercial banks' reserve requirements and capital adequacy ratios on certain consumer loans in December.

Mexico's economy continued to recover in 2010, and GDP rose by 5.5% in the year. Strong external demand was the main driver of the recovery, leading to robust growth in the production of Mexican manufactured goods. By contrast, domestic demand was lacklustre, reflecting high unemployment, restricted credit availability and low levels of consumer confidence. This weak domestic demand and the rise in the peso kept inflation subdued during 2010 and the Central Bank of Mexico maintained its policy rate at 4.5% throughout the year.

In **Argentina**, third quarter GDP was 7.5% higher than for the comparable period in 2009. This improvement was led by a strong rebound in industrial production, which expanded by 12.7% in the year to November 2010. The manufacture of motor vehicles recovered particularly strongly, rising by 35% during the year, with many being exported to Brazil. Inflation remained high, in part due to rapid growth in the price of food and beverages.

Review of performance

Our operations in Latin America reported pre-tax profits of US\$1.8bn compared with US\$1.1bn in 2009, largely reflecting the strong performance in Brazil, which recorded pre-tax profits in excess of US\$1bn for the first time. On an underlying basis, pre-tax profits increased by 49% as loan impairment charges declined, reflecting better economic conditions and actions taken to improve asset quality by managing down riskier portfolios and enhancing risk management processes. Revenue was marginally lower as trading income declined from the strong performance recorded in 2009 and fee income fell

For footnotes, see page 83.

The commentary on Latin America is on an underlying basis unless stated otherwise.

Report of the Directors: Operating and Financial Review (continued)

Profit/(loss) before tax by country within customer groups and global businesses

	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Total US\$m
2010						
Argentina	88	90	106	–	–	284
Brazil	93	382	488	6	64	1,033
Mexico	165	24	219	4	(11)	401
Panama	48	57	33	2	–	140
Other	(100)	1	51	(2)	(13)	(63)
	294	554	897	10	40	1,795
2009						
Argentina	24	86	122	–	–	232
Brazil	(224)	211	515	5	3	510
Mexico	(31)	66	230	7	–	272
Panama	69	55	24	–	–	148
Other	(54)	(19)	40	(1)	(4)	(38)
	(216)	399	931	11	(1)	1,124
2008						
Argentina	–	111	113	–	–	224
Brazil	250	348	298	8	6	910
Mexico	360	157	190	7	–	714
Panama	51	37	33	–	–	121
Other	7	53	7	1	–	68
	668	706	641	16	6	2,037

due to reduced transaction volumes, although this was largely offset by increased income from Balance Sheet Management.

In PFS, spreads tightened in Mexico as lending was refocused from higher-yielding consumer loans to higher quality assets. The managing down of certain portfolios in Brazil and Mexico and the strengthening of underwriting and collections processes resulted in an overall increase in pre-tax profit in PFS. Across the region we continued to focus on new customer acquisition in the mass affluent market segment through our Premier and Advance propositions. The number of Premier customers increased to over 790,000 at 31 December 2010. Advance was launched in Brazil, Mexico, Argentina, Panama and Chile in 2010 and customer numbers exceeded 425,000 at the end of the year. The insurance business continued to perform strongly, with revenue growing in Brazil, Mexico and Argentina due to the improving economic conditions.

The regional economic recovery and our focus on growing the CMB business drove increased domestic lending in our major markets. GB&M and CMB both benefited from our global connectivity by increasing intra-regional and inter-regional business, with GB&M in particular contributing to other regions and customer groups through increased cross-referrals. Our operations in Brazil and

mainland China worked closely together on a number of initiatives, including the completion of the first renminbi-denominated trade settlement in the region. Dedicated sales desks were established in mainland China and Hong Kong to support our Latin America customers and promote trade with Brazil.

Net interest income increased by 4% to US\$6.3bn. Increased volumes of financial investments, a decline in the cost of funding trading positions as market interest rates fell and a change in the portfolio mix to higher-yielding longer-term assets drove a rise in revenue from Balance Sheet Management.

Average customer lending balances fell in PFS, as certain portfolios were managed down, notably in credit cards in Mexico and other higher-risk personal loan balances in Mexico and Brazil. However, year-end balances were higher than in 2009 as we reversed the decline in customer lending by selectively growing certain portfolios. Demand-driven lending increased in CMB and GB&M in Brazil and Argentina while, in Mexico, increased average lending balances in CMB were attributable to the continued strategy of targeting state and municipal customers.

Our operations in Brazil actively grew customer account balances to fund loan growth and meet higher liquidity requirements following regulatory

Report of the Directors: Operating and Financial Review (continued)

changes. In Mexico and Argentina, sales and marketing initiatives supported by product and channel enhancements resulted in an increase in current and savings account balances. However, the benefit was partly offset by tighter spreads on customer accounts as a result of decreased market interest rates in Mexico and Argentina.

Fee income fell by 7% to US\$1.7bn, driven by lower transaction volumes in credit cards and account services in Mexico and reduced account services income in Brazil. Regulatory restrictions in Brazil and Mexico also reduced the fees that could be charged for certain banking services.

Net trading income of US\$733m was 23% lower than in 2009. A decline in market volatility which resulted in fewer trading opportunities meant that the strong performances in Foreign Exchange and Rates in 2009 were not repeated.

Net income on financial instruments designated at fair value declined by 21% to US\$425m, primarily due to lower investment returns experienced on assets held in support of the pension-linked portfolio in Brazil and annuity products in Argentina. An offsetting decrease was recorded in 'Net insurance claims incurred and movement in liabilities to policyholders'.

Gains less losses from financial investments declined by US\$93m, largely because the gains on the sale of Visa Inc. shares in 2009 did not recur.

Net earned insurance premiums increased marginally to US\$2.1bn, driven by improved economic conditions which resulted in higher sales of policies in Brazil and Argentina through the branch network and a rise in premiums in Mexico. This, combined with repricing initiatives in Argentina and higher contributions in the pension-linked product in Brazil from PFS and CMB customers, resulted in increased premiums.

Net insurance claims incurred and movement in liabilities to policyholders of US\$1.8bn declined by 9%, mainly in pension-linked products in Brazil as lower investment gains were allocated to policyholders. This was partly offset by an increase related to higher premiums in Argentina and Mexico.

Loan impairment charges and other credit risk provisions declined by 44% in 2010 to US\$1.5bn. In PFS, the reduction in loan impairment charges reflected a significant decline in the size of the credit card portfolio in Mexico and an improvement in its quality as a result of repositioning the portfolio towards higher quality customers, tighter origination criteria and improved collection practices. Loan impairment charges also declined in Brazil, primarily in consumer finance portfolios including motor vehicle finance and payroll loans, as economic conditions improved and these portfolios were managed down. In CMB, loan impairment charges fell, largely in Brazil, as improved economic conditions and better credit quality resulted in lower specific impairment charges, while in Mexico loan impairment charges remained broadly unchanged.

Operating expenses increased by 10% to US\$6.4bn, driven largely by inflationary pressures and investment in infrastructure and technology projects across the region in support of improved operational efficiency and business growth. Staff costs increased in Brazil and Argentina due to union-agreed wage increases, although this was partly offset by a decline in average headcount as costs continued to be managed carefully. Non-staff expenditure also rose, driven mainly by higher marketing and advertising costs in Brazil as we positioned ourselves in this key growth market, and transactional taxes increased as sales grew.

Report of the Directors: Operating and Financial Review (continued)

2009 compared with 2008

Economic background

A mixture of weak external demand and the disruption caused by the H1N1 virus contributed to a substantial deterioration in economic conditions in **Mexico** during the first half of 2009. The period of recession ended decisively as the economy improved strongly during the third quarter of the year, but the previous sharp decline in activity had left GDP some 6.2% below the comparable figure in 2008. The annual CPI rate continued to moderate, falling from 6.5% in December 2008 to 3.6% in December 2009. In response to the deterioration in economic conditions, the Bank of Mexico cut its overnight interest rate by 375 basis points during the first seven months of 2009 to 4.5% by the end of the year.

The **Brazilian** economy experienced a mild contraction during the early months of 2009 but returned to growth during the second quarter of the year, helped by a recovery in household consumption and a broader stabilisation of external demand and commodity prices. Starting the year at unusually low levels, the unemployment rate increased during the early months of 2009 relative to the comparable period of 2008, before declining to the historically low level of 6.8% in December 2009. The annual CPI rate moderated from 5.9% in December 2008 to a level slightly below the central banks' targeted rate of 4.5% at the year end. Faced with this softening of economic conditions and diminishing inflationary pressures, the central bank of Brazil reduced the policy Selic target rate by a cumulative 500 basis points during the first seven months of 2009, placing the rate at 8.75% at the end of the period.

In **Argentina**, economic activity was adversely affected by the decline in external demand during 2009, with a very weak level of growth being reported around the middle of the year. Industrial production is reported to have risen by 0.4% during 2009. The improving global and regional outlook during the second half of 2009 and a recovery in commodity prices provided some relief to the economy, enabling interest rates to ease.

Review of performance

Our operations in Latin America reported pre-tax profits of US\$1.1bn, compared with US\$2.0bn in 2008. On an underlying basis, pre-tax profits decreased by 33%, primarily attributable to significantly higher loan impairment charges in PFS and CMB and lower revenues in PFS. GB&M's

performance improved driven by strong results in trading and Balance Sheet Management.

2009 was a year of consolidating risk policies and strongly emphasising cost control. We injected additional capital into Brazil and Mexico during the fourth quarter of 2009, in line with our strategy of focusing on emerging markets. In both Panama and Argentina, strong results were achieved in spite of the challenging economic environment. However, performance in Honduras, Costa Rica and El Salvador was significantly affected by higher loan impairment charges and lower income. One HSBC and Group systems were implemented in Chile and the operations in Panama were fully integrated.

Net interest income remained broadly in line with 2008 excluding the one-off interest income which arose on recovery of transactional taxes on insurance transactions in Brazil in 2008. Net interest income decreased in PFS as average customer lending volumes declined, primarily driven by actions taken to tighten credit criteria and manage down existing higher risk portfolios including credit cards, personal loans and vehicle finance. The effect was partly offset by higher income on increased lending to commercial customers, primarily in Brazil. Repricing initiatives taken during 2008 and early 2009 drove increased spreads on lending products.

Average customer deposit balances rose, resulting from an increase in commercial and Global Banking balances. In Mexico, PFS launched new deposit products to mitigate the fall in deposits. Deposit spreads narrowed due to falling interest rates, also primarily in Mexico.

Interest income rose in Balance Sheet Management, primarily in Brazil.

Net fee income declined by 8%. Tighter credit origination criteria resulted in lower credit card fees in Mexico. Account service fees also fell, primarily due to lower transaction volumes. Weak equity market performance in Brazil led to lower assets under management and related fee income. This was partly offset by growth in restructuring fees in GB&M.

Net trading income rose by 42% due to a strong performance in GB&M, particularly in the first half of the year in Brazil. This resulted from increased foreign exchange and Rates trading income, which benefited from early positioning against interest rate movements in a volatile market.

Net income from financial instruments designated at fair value rose by 36%, primarily from higher insurance-related assets. This resulted from

Report of the Directors: Operating and Financial Review (continued)

business growth and a recovery of the Brazilian equity markets as well as an increase in the fair value of fixed income securities held in support of personal pension portfolios in the country. An offsetting increase was recorded in net insurance claims incurred and movement in liabilities to policyholders.

Net earned insurance premiums rose by 24%, driven by higher sales of pension and life assurance products. In addition, a number of customers in Brazil switched their personal pension annuities to HSBC. These gains were partially offset by the impact of the 2008 nationalisation of the pension system in Argentina on the annuities business there.

Net insurance claims incurred and movement in liabilities to policyholders rose, primarily as a result of the fair value movement on financial instruments referred to above and insurance business growth.

Other operating income fell by 29%, largely due to the non-recurrence of gains arising in 2008 on a refinement of the income recognition methodology used in respect of long-term insurance contracts in Brazil. In 2009, a one-off gain was realised on the sale of the head office in Argentina.

Loan impairment charges and other credit risk provisions rose by 15% as economic conditions deteriorated across the region. In the first half of 2009, our delinquencies rose as GDP fell and unemployment increased. The situation was exacerbated by the H1N1 virus in Mexico and the related economic shutdown. With the introduction of enhanced credit risk management techniques and gradual economic recovery, loan impairment charges in the second half of 2009 decreased by 11% compared with the second half of 2008 and by 27% on the first half of 2009.

In PFS, the combination of portfolio seasoning, which followed expansion in market share in

previous years, and increased delinquencies in secured and unsecured personal lending products such as personal loans and payroll loans in Brazil and cards and mortgages in Mexico, resulted in higher loan impairment charges, mainly in the first half of 2009. Some payroll loan portfolios were run down in Brazil, as were several consumer finance and unsecured portfolios in Mexico. Loan impairment charges in PFS fell by 8% in the second half of the year compared with the same period in 2008 and by 27% compared with the first half of 2009.

Loan impairment charges rose in commercial lending portfolios, primarily in Business Banking and mid-market business segments in Brazil, as trade levels fell as a consequence of the global economic slowdown. This was partly offset by net releases in loan impairment charges in GB&M when compared with a net charge in 2008.

Operating expenses increased slightly by 2%, well below the inflation rates of the main economies in which we operate, reflecting significant cost control measures. The benefit from the reduction in staff numbers, which began in 2008 and continued in 2009, was partially offset by union-agreed pay rises. Savings in general and administrative costs were offset by investment expenditure on regional initiatives to centralise certain back office processes, and the implementation of One HSBC and Group systems intended to drive future operational efficiencies. Costs also increased in the form of higher litigation expenses and transactional taxes, the latter partly from the non-recurrence of a recovery of transactional taxes in the insurance business in 2008.

Report of the Directors: Operating and Financial Review (continued)

Profit/(loss) before tax and balance sheet data – Latin America

	2010						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income	3,975	1,671	776	20	121	(252)	6,311
Net fee income/(expense)	899	526	298	32	(6)	–	1,749
Trading income/(expense) excluding net interest income	35	72	370	3	(27)	–	453
Net interest income on trading activities	–	–	28	–	–	252	280
Net trading income/(expense) ⁴⁹	35	72	398	3	(27)	252	733
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	–	–	–
Net income from other financial instruments designated at fair value	339	85	1	–	–	–	425
Net income from financial instruments designated at fair value	339	85	1	–	–	–	425
Gains less losses from financial investments	6	2	93	–	(3)	–	98
Dividend income	7	2	3	–	–	–	12
Net earned insurance premiums	1,651	374	29	–	–	–	2,054
Other operating income	90	34	23	2	221	(229)	141
Total operating income	7,002	2,766	1,621	57	306	(229)	11,523
Net insurance claims ⁵⁷	(1,479)	(297)	(16)	–	–	–	(1,792)
Net operating income⁴⁶	5,523	2,469	1,605	57	306	(229)	9,731
Loan impairment charges and other credit risk provisions	(1,247)	(293)	(4)	–	–	–	(1,544)
Net operating income	4,276	2,176	1,601	57	306	(229)	8,187
Total operating expenses	(3,983)	(1,623)	(704)	(47)	(266)	229	(6,394)
Operating profit	293	553	897	10	40	–	1,793
Share of profit in associates and joint ventures	1	1	–	–	–	–	2
Profit before tax	294	554	897	10	40	–	1,795
	%	%	%	%	%		%
Share of HSBC's profit before tax	1.5	2.9	4.7	0.1	0.2		9.4
Cost efficiency ratio	72.1	65.7	43.9	82.5	86.9		65.7
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	20,823	24,879	12,242	43	–		57,987
Total assets	38,764	35,619	64,690	1,608	196	(939)	139,938
Customer accounts	30,149	24,514	27,810	6,053	–		88,526

Report of the Directors: Operating and Financial Review (continued)

Latin America	2009						
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	Total US\$m
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	3,736	1,544	590	19	(5)	(311)	5,573
Net fee income	948	490	251	28	12	–	1,729
Trading income excluding net interest income	25	38	573	3	–	–	639
Net interest income/(expense) on trading activities	4	2	(108)	–	–	311	209
Net trading income ⁴⁹	29	40	465	3	–	311	848
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	–	–	–
Net income/(expense) from other financial instruments designated at fair value	510	12	(38)	–	11	–	495
Net income/(expense) from financial instruments designated at fair value	510	12	(38)	–	11	–	495
Gains less losses from financial investments	91	–	77	–	–	–	168
Dividend income	9	1	1	–	–	–	11
Net earned insurance premiums	1,752	105	43	–	–	–	1,900
Other operating income/(expense)	170	35	24	2	(1)	(97)	133
Total operating income	7,245	2,227	1,413	52	17	(97)	10,857
Net insurance claims ⁵⁷	(1,750)	(58)	(25)	–	–	–	(1,833)
Net operating income ⁴⁶	5,495	2,169	1,388	52	17	(97)	9,024
Loan impairment (charges)/ recoveries and other credit risk provisions	(2,046)	(534)	57	–	(3)	–	(2,526)
Net operating income	3,449	1,635	1,445	52	14	(97)	6,498
Total operating expenses	(3,666)	(1,236)	(514)	(41)	(15)	97	(5,375)
Operating profit/(loss)	(217)	399	931	11	(1)	–	1,123
Share of profit in associates and joint ventures	1	–	–	–	–	–	1
Profit/(loss) before tax	(216)	399	931	11	(1)	–	1,124
	%	%	%	%	%		%
Share of HSBC's profit before tax	(3.1)	5.6	13.2	0.2	–	–	15.9
Cost efficiency ratio	66.7	57.0	37.0	78.8	88.2		59.6
<i>Balance sheet data⁴⁵</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	19,748	18,205	9,645	31	–		47,629
Total assets	35,236	23,212	57,491	328	281	(581)	115,967
Customer accounts	30,628	19,775	20,142	2,344	–		72,889

Report of the Directors: Operating and Financial Review (continued)

Latin America

	2008						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁵⁶ US\$m	
<i>Profit before tax</i>							
Net interest income/(expense)	4,582	1,637	579	22	(35)	(327)	6,458
Net fee income	1,339	536	248	35	9	–	2,167
Trading income excluding net interest income	123	27	200	3	4	–	356
Net interest income/(expense) on trading activities	7	4	8	–	(2)	327	345
Net trading income ⁴⁹	130	31	208	3	2	327	701
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	–	–	–
Net income from other financial instruments designated at fair value	187	–	139	–	38	–	364
Net income from financial instruments designated at fair value	187	–	139	–	38	–	364
Gains less losses from financial investments	132	21	21	2	–	–	176
Dividend income	16	1	3	–	–	–	20
Net earned insurance premiums	1,547	82	88	–	–	–	1,717
Other operating income	244	57	39	3	8	(51)	300
Total operating income	8,177	2,365	1,325	65	22	(51)	11,903
Net insurance claims ⁵⁷	(1,281)	(42)	(68)	–	1	–	(1,390)
Net operating income ⁴⁶	6,896	2,323	1,257	65	23	(51)	10,513
Loan impairment charges and other credit risk provisions	(2,120)	(340)	(29)	–	(3)	–	(2,492)
Net operating income	4,776	1,983	1,228	65	20	(51)	8,021
Total operating expenses	(4,114)	(1,277)	(587)	(49)	(14)	51	(5,990)
Operating profit	662	706	641	16	6	–	2,031
Share of profit in associates and joint ventures	6	–	–	–	–	–	6
Profit before tax	668	706	641	16	6	–	2,037
	%	%	%	%	%		%
Share of HSBC's profit before tax	7.2	7.6	6.9	0.2	–	–	21.9
Cost efficiency ratio	59.7	55.0	46.7	75.4	60.9	–	57.0

Balance sheet data⁴⁵

	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net)	18,523	15,460	8,273	31	–	42,287
Total assets	30,320	19,382	53,870	391	361	102,946
Customer accounts	27,564	14,367	15,384	2,128	–	59,443

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Reconciliation of reported and underlying profit/(loss) before tax

Europe

2010 compared with 2009

	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2009 at 2010 exchange rates ¹² US\$m	2010 as reported US\$m	2010 adjust- ments ¹⁰ US\$m	2010 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	12,268	(1)	(189)	12,078	11,250	–	11,250	(8)	(7)
Net fee income	6,267	(210)	(125)	5,932	6,371	–	6,371	2	7
Changes in fair value ¹⁴	(2,841)	2,841	–	–	(198)	198	–	93	–
Other income	7,850	(283)	(104)	7,463	5,327	(362)	4,965	(32)	(33)
Net operating income¹⁵	23,544	2,347	(418)	25,473	22,750	(164)	22,586	(3)	(11)
Loan impairment charges and other credit risk provisions	(5,568)	–	48	(5,520)	(3,020)	–	(3,020)	46	45
Net operating income	17,976	2,347	(370)	19,953	19,730	(164)	19,566	10	(2)
Operating expenses	(13,988)	200	220	(13,568)	(15,445)	–	(15,445)	(10)	(14)
Operating profit	3,988	2,547	(150)	6,385	4,285	(164)	4,121	7	(35)
Income from associates	21	(1)	(2)	18	17	–	17	(19)	(6)
Profit before tax	4,009	2,546	(152)	6,403	4,302	(164)	4,138	7	(35)

2009 compared with 2008

	2008 as reported US\$m	2008 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2008 at 2009 exchange rates ¹⁶ US\$m	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	2009 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	9,696	(65)	(1,049)	8,582	12,268	–	12,268	27	43
Net fee income	7,492	(58)	(917)	6,517	6,267	–	6,267	(16)	(4)
Changes in fair value ¹⁴	3,118	(3,118)	–	–	(2,841)	2,841	–	–	–
Gains on disposal of French regional banks	2,445	(2,445)	–	–	–	–	–	(100)	–
Other income	7,928	(609)	(1,206)	6,113	7,850	(280)	7,570	(1)	24
Net operating income¹⁵	30,679	(6,295)	(3,172)	21,212	23,544	2,561	26,105	(23)	23
Loan impairment charges and other credit risk provisions	(3,754)	6	395	(3,353)	(5,568)	–	(5,568)	(48)	(66)
Net operating income	26,925	(6,289)	(2,777)	17,859	17,976	2,561	20,537	(33)	15
Operating expenses	(16,072)	68	1,723	(14,281)	(13,988)	–	(13,988)	13	2
Operating profit	10,853	(6,221)	(1,054)	3,578	3,988	2,561	6,549	(63)	83
Income from associates	16	–	–	16	21	–	21	31	31
Profit before tax	10,869	(6,221)	(1,054)	3,594	4,009	2,561	6,570	(63)	83

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Hong Kong

2010 compared with 2009

	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2009 at 2010 exchange rates ¹² US\$m	2010 as reported US\$m	2010 adjust- ments ¹⁰ US\$m	2010 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	4,195	–	(7)	4,188	4,246	–	4,246	1	1
Net fee income	2,669	–	(4)	2,665	2,962	–	2,962	11	11
Changes in fair value ¹⁴	(1)	1	–	–	(6)	6	–	(500)	–
Other income	2,604	–	(6)	2,598	3,000	(136)	2,864	15	10
Net operating income¹⁵	9,467	1	(17)	9,451	10,202	(130)	10,072	8	7
Loan impairment charges and other credit risk provisions	(500)	–	1	(499)	(114)	–	(114)	77	77
Net operating income	8,967	1	(16)	8,952	10,088	(130)	9,958	13	11
Operating expenses	(3,946)	–	6	(3,940)	(4,431)	–	(4,431)	(12)	(12)
Operating profit	5,021	1	(10)	5,012	5,657	(130)	5,527	13	10
Income from associates	8	–	–	8	35	–	35	338	338
Profit before tax	5,029	1	(10)	5,020	5,692	(130)	5,562	13	11

2009 compared with 2008

	2008 as reported US\$m	2008 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2008 at 2009 exchange rates ¹⁶ US\$m	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	2009 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	5,698	–	21	5,719	4,195	–	4,195	(26)	(27)
Net fee income	2,580	–	10	2,590	2,669	–	2,669	3	3
Changes in fair value ¹⁴	5	(5)	–	–	(1)	1	–	–	–
Other income	1,871	–	7	1,878	2,604	–	2,604	39	39
Net operating income¹⁵	10,154	(5)	38	10,187	9,467	1	9,468	(7)	(7)
Loan impairment charges and other credit risk provisions	(765)	–	(2)	(767)	(500)	–	(500)	35	35
Net operating income	9,389	(5)	36	9,420	8,967	1	8,968	(4)	(5)
Operating expenses	(3,943)	–	(16)	(3,959)	(3,946)	–	(3,946)	–	–
Operating profit	5,446	(5)	20	5,461	5,021	1	5,022	(8)	(8)
Income from associates	15	–	–	15	8	–	8	(47)	(47)
Profit before tax	5,461	(5)	20	5,476	5,029	1	5,030	(8)	(8)

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Rest of Asia-Pacific

2010 compared with 2009

	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2009 at 2010 exchange rates ¹² US\$m	2010 as reported US\$m	2010 adjust- ments ¹⁰ US\$m	2010 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	3,539	–	240	3,779	3,828	(31)	3,797	8	–
Net fee income	1,557	–	109	1,666	1,932	(3)	1,929	24	16
Changes in fair value ¹⁴	(3)	3	–	–	(1)	1	–	67	–
Other income	2,910	–	208	3,118	3,473	(197)	3,276	19	5
Net operating income¹⁵	8,003	3	557	8,563	9,232	(230)	9,002	15	5
Loan impairment charges and other credit risk provisions	(896)	–	(74)	(970)	(439)	–	(439)	51	55
Net operating income	7,107	3	483	7,593	8,793	(230)	8,563	24	13
Operating expenses	(4,450)	–	(291)	(4,741)	(5,143)	19	(5,124)	(16)	(8)
Operating profit	2,657	3	192	2,852	3,650	(211)	3,439	37	21
Income from associates	1,543	–	13	1,556	2,252	–	2,252	46	45
Profit before tax	4,200	3	205	4,408	5,902	(211)	5,691	41	29

2009 compared with 2008

	2008 as reported US\$m	2008 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2008 at 2009 exchange rates ¹⁶ US\$m	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	2009 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	3,937	–	(165)	3,772	3,539	(53)	3,486	(10)	(8)
Net fee income	1,867	–	(80)	1,787	1,557	(6)	1,551	(17)	(13)
Changes in fair value ¹⁴	3	(3)	–	–	(3)	3	–	(8)	(3)
Other income	3,174	–	(205)	2,969	2,910	(18)	2,892	(8)	(3)
Net operating income¹⁵	8,981	(3)	(450)	8,528	8,003	(74)	7,929	(11)	(7)
Loan impairment charges and other credit risk provisions	(852)	–	31	(821)	(896)	–	(896)	(5)	(9)
Net operating income	8,129	(3)	(419)	7,707	7,107	(74)	7,033	(13)	(9)
Operating expenses	(4,704)	–	208	(4,496)	(4,450)	31	(4,419)	5	2
Operating profit	3,425	(3)	(211)	3,211	2,657	(43)	2,614	(22)	(19)
Income from associates	1,297	–	27	1,324	1,543	–	1,543	19	17
Profit before tax	4,722	(3)	(184)	4,535	4,200	(43)	4,157	(11)	(8)

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Middle East

2010 compared with 2009

	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2009 at 2010 exchange rates ¹² US\$m	2010 as reported US\$m	2010 adjust- ments ¹⁰ US\$m	2010 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	1,485	–	(4)	1,481	1,367	–	1,367	(8)	(8)
Net fee income	625	–	(1)	624	677	–	677	8	8
Other income	484	–	(1)	483	366	42	408	(24)	(16)
Net operating income¹⁵	2,594	–	(6)	2,588	2,410	42	2,452	(7)	(5)
Loan impairment charges and other credit risk provisions	(1,334)	–	1	(1,333)	(627)	–	(627)	53	53
Net operating income	1,260	–	(5)	1,255	1,783	42	1,825	42	45
Operating expenses	(1,001)	–	3	(998)	(1,078)	–	(1,078)	(8)	(8)
Operating profit	259	–	(2)	257	705	42	747	172	191
Income from associates	196	–	–	196	187	–	187	(5)	(5)
Profit before tax	455	–	(2)	453	892	42	934	96	106

2009 compared with 2008

	2008 as reported US\$m	2008 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2008 at 2009 exchange rates ¹⁶ US\$m	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	2009 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	1,556	–	(7)	1,549	1,485	–	1,485	(5)	(4)
Net fee income	691	–	(4)	687	625	–	625	(10)	(9)
Other income	421	–	(7)	414	484	–	484	15	17
Net operating income¹⁵	2,668	–	(18)	2,650	2,594	–	2,594	(3)	(2)
Loan impairment charges and other credit risk provisions	(279)	–	(1)	(280)	(1,334)	–	(1,334)	(378)	(376)
Net operating income	2,389	–	(19)	2,370	1,260	–	1,260	(47)	(47)
Operating expenses	(959)	–	11	(948)	(1,001)	–	(1,001)	(4)	(6)
Operating profit	1,430	–	(8)	1,422	259	–	259	(82)	(82)
Income from associates	316	–	1	317	196	–	196	(38)	(38)
Profit before tax	1,746	–	(7)	1,739	455	–	455	(74)	(74)

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

North America

2010 compared with 2009

	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2009 at 2010 exchange rates ¹² US\$m	2010 as reported US\$m	2010 adjust- ments ¹⁰ US\$m	2010 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	13,670	–	134	13,804	12,439	–	12,439	(9)	(10)
Net fee income	4,817	–	56	4,873	3,664	–	3,664	(24)	(25)
Changes in fair value ¹⁴	(3,688)	3,688	–	–	142	(142)	–	–	–
Other income/ (expense)	1,506	–	12	1,518	802	(66)	736	(47)	(52)
Net operating income¹⁵	16,305	3,688	202	20,195	17,047	(208)	16,839	5	(17)
Loan impairment charges and other credit risk provisions	(15,664)	–	(53)	(15,717)	(8,295)	–	(8,295)	47	47
Net operating income	641	3,688	149	4,478	8,752	(208)	8,544	1,265	91
Operating expenses (excluding goodwill impairment)	(8,391)	–	(103)	(8,494)	(8,322)	–	(8,322)	1	2
Operating profit/(loss)	(7,750)	3,688	46	(4,016)	430	(208)	222		
Income from associates	12	–	–	12	24	–	24	100	100
Profit/(loss) before tax	(7,738)	3,688	46	(4,004)	454	(208)	246		

2009 compared with 2008

	2008 as reported US\$m	2008 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2008 at 2009 exchange rates ¹⁶ US\$m	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	2009 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	15,218	–	(79)	15,139	13,670	–	13,670	(10)	(10)
Net fee income	5,227	–	(33)	5,194	4,817	–	4,817	(8)	(7)
Changes in fair value ¹⁴	3,444	(3,444)	–	–	(3,688)	3,688	–	–	–
Other income/(expense)	(2,710)	–	(4)	(2,714)	1,506	–	1,506	–	–
Net operating income¹⁵	21,179	(3,444)	(116)	17,619	16,305	3,688	19,993	(23)	13
Loan impairment charges and other credit risk provisions	(16,795)	–	(8)	(16,803)	(15,664)	–	(15,664)	7	7
Net operating income	4,384	(3,444)	(124)	816	641	3,688	4,329	(85)	431
Operating expenses (excluding goodwill impairment)	(9,359)	–	58	(9,301)	(8,391)	–	(8,391)	10	10
Goodwill impairment	(10,564)	–	–	(10,564)	–	–	–	100	100
Operating loss	(15,539)	(3,444)	(66)	(19,049)	(7,750)	3,688	(4,062)	50	79
Income from associates	11	–	(1)	10	12	–	12	9	20
Loss before tax	(15,528)	(3,444)	(67)	(19,039)	(7,738)	3,688	(4,050)	50	79

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Latin America

2010 compared with 2009

	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2009 at 2010 exchange rates ¹² US\$m	2010 as reported US\$m	2010 adjust- ments ¹⁰ US\$m	2010 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	5,573	–	468	6,041	6,311	–	6,311	13	4
Net fee income	1,729	–	147	1,876	1,749	–	1,749	1	(7)
Other income	1,722	–	169	1,891	1,671	–	1,671	(3)	(12)
Net operating income¹⁵	9,024	–	784	9,808	9,731	–	9,731	8	(1)
Loan impairment charges and other credit risk provisions	(2,526)	–	(253)	(2,779)	(1,544)	–	(1,544)	39	44
Net operating income	6,498	–	531	7,029	8,187	–	8,187	26	16
Operating expenses	(5,375)	–	(453)	(5,828)	(6,394)	–	(6,394)	(19)	(10)
Operating profit	1,123	–	78	1,201	1,793	–	1,793	60	49
Income from associates	1	–	–	1	2	–	2	100	100
Profit before tax	1,124	–	78	1,202	1,795	–	1,795	60	49

2009 compared with 2008

	2008 as reported US\$m	2008 adjust- ments ¹⁰ US\$m	Currency translation ¹¹ US\$m	2008 at 2009 exchange rates ¹⁶ US\$m	2009 as reported US\$m	2009 adjust- ments ¹⁰ US\$m	2009 under- lying US\$m	Re- ported change ¹³ %	Under- lying change ¹³ %
Net interest income	6,458	–	(783)	5,675	5,573	–	5,573	(14)	(2)
Net fee income	2,167	–	(291)	1,876	1,729	–	1,729	(20)	(8)
Other income	1,888	(71)	(220)	1,597	1,722	–	1,722	(9)	8
Net operating income¹⁵	10,513	(71)	(1,294)	9,148	9,024	–	9,024	(14)	(1)
Loan impairment charges and other credit risk provisions	(2,492)	–	294	(2,198)	(2,526)	–	(2,526)	(1)	(15)
Net operating income	8,021	(71)	(1,000)	6,950	6,498	–	6,498	(19)	(7)
Operating expenses	(5,990)	–	709	(5,281)	(5,375)	–	(5,375)	10	(2)
Operating profit	2,031	(71)	(291)	1,669	1,123	–	1,123	(45)	(33)
Income from associates	6	–	(2)	4	1	–	1	(83)	(75)
Profit before tax	2,037	(71)	(293)	1,673	1,124	–	1,124	(45)	(33)

For footnotes, see page 83.

Report of the Directors: Operating and Financial Review (continued)

Disclosure controls

The Group Chief Executive and Group Finance Director, with the assistance of other members of management, carried out an evaluation of the effectiveness of the design and operation of HSBC Holdings' disclosure controls and procedures as of 31 December 2010. Based upon that evaluation, the Group Chief Executive and Group Finance Director concluded that our disclosure controls and procedures as of 31 December 2010 were effective to provide reasonable assurance that information required to be disclosed in the reports which the company files and submits under the US Securities Exchange Act of 1934, as amended, is recorded, processed, summarised and reported as and when required. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

There has been no change in HSBC Holdings' internal controls over financial reporting during the year ended 31 December 2010 that has materially affected, or is reasonably likely to materially affect, HSBC Holdings' internal controls over financial reporting.

Management's assessment of internal controls over financial reporting

Management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and has completed an assessment of the effectiveness of the Group's internal controls over financial reporting as of 31 December 2010. In making the assessment, management used the framework for Director's internal control evaluation contained within the Combined Code ('The Revised Turnbull Guidance'), as well as the criteria established by the Committee of Sponsoring Organisations of the Treadway Commission ('COSO') in 'Internal Control-Integrated Framework'.

Based on the assessment performed, management concluded that as at 31 December 2010, the Group's internal controls over financial reporting were effective.

KPMG Audit Plc, which has audited the consolidated financial statements of the Group for the year ended 31 December 2010, has also audited the effectiveness of the Group's internal control over financial reporting under Auditing Standard No. 5 of the Public Company Accounting Oversight Board (United States) as stated in their report on pages 235 and 236.

Report of the Directors: Operating and Financial Review (continued)

Other information

Funds under management and assets held in custody

Funds under management

	2010 US\$bn	2009 US\$bn
Funds under management		
At 1 January	857	735
Net new money	42	36
Value change	33	76
Exchange and other	(7)	10
At 31 December	925	857

	At 31 December	
	2010 US\$bn	2009 US\$bn
Funds under management by business		
Global Asset Management	439	423
Global Private Banking	277	251
Affiliates	3	3
Other	206	180
	925	857

Funds under management at 31 December 2010 amounted to US\$925bn, an increase of 8% when compared with 2009. Both Global Asset Management and GPB fund holdings increased, reflecting an improvement in equity market performance and strong net inflows.

Global Asset Management funds, including emerging market funds, increased by 4% to US\$439bn as a result of market performance gains and strong net inflows, particularly in Europe and Asia, partly offset by adverse foreign exchange movements. We remain one of the world's largest emerging market asset managers with funds under management of US\$145bn at 31 December 2010 in countries outside North America, Western Europe, Japan and Australia.

GPB funds increased by 10% in 2010 to US\$277bn, driven by an improvement in equity market performance and strong net inflows which benefited from our strength in emerging markets, hiring of key relationship managers and cross-business referrals. Client assets, which include funds under management and cash deposits and provide an indicator of the scale of GPB, increased by US\$23bn to US\$390bn due to the increase in funds under management.

Other funds under management, which are mainly held by a corporate trust business in Asia, increased by 14% to US\$206bn.

We announced in November 2010 that, with effect from 1 March 2011, Retail Banking and Wealth Management will be managed as a single global business from Hong Kong. Global Asset Management will become part of this business and will be transferred from GB&M.

Assets held in custody and under administration

Custody is the safekeeping and servicing of securities and other financial assets on behalf of clients. At 31 December 2010, we held assets as custodian of US\$5.7 trillion, 9% higher than the US\$5.2 trillion held at 31 December 2009. This was mainly driven by an increase in the market value of assets and favourable foreign exchange movements.

Our assets under administration business, which includes the provision of various support function activities including the valuation of portfolios of securities and other financial assets on behalf of clients, complements the custody business. At 31 December 2010, the value of assets held under administration by the Group amounted to US\$2.7 trillion, compared with US\$2.8 trillion in 2009.

Property

At 31 December 2010, we operated from some 9,950 operational properties worldwide, of which approximately 2,500 were located in Europe, 3,100 in Hong Kong and Rest of Asia-Pacific, 800 in North America, 3,350 in Latin America and 200 in the Middle East. These properties had an area of approximately 71.3m square feet (2009: 70.8m square feet).

Our freehold and long leasehold properties, together with all our leasehold land in Hong Kong, were valued in 2010. The value of these properties was US\$7.1bn (2009: US\$4.1bn) in excess of their carrying amount in the consolidated balance sheet. In addition, properties with a net book value of US\$1,133m were held for investment purposes.

HSBC's operational properties are stated at cost, being historical cost or fair value at the date of transition to IFRSs (their deemed cost) less any impairment losses, and are depreciated on a basis calculated to write off the assets over their estimated useful lives. Properties owned as a consequence of an acquisition are recognised initially at fair value.

Further details are included in Note 25 on the Financial Statements.

Report of the Directors: Operating and Financial Review (continued)

Legal proceedings, investigations and regulatory matters

As a result of an August 2002 restatement of previously reported consolidated financial statements and other corporate events, including the 2002 settlement with 46 State Attorneys General relating to real estate lending practices, Household International (now HSBC Finance) and certain former officers were named as defendants in a class action law suit, *Jaffe v Household International Inc, et al* No 2. C 5893 (N.D.Ill, filed 19 August 2002). Following a jury trial concluded in April 2009, the Court issued a ruling on 22 November 2010, within the second phase of the case to determine actual damages, that claim forms should be mailed to class members and also set out a method for calculating damages for class members who filed claims. Despite the jury verdict and the November 2010 ruling, HSBC continues to believe that it has meritorious defences and intends to seek an appeal of the Court's ruling. The timing and outcome of the resolution of this matter is uncertain. Given the complexity and uncertainties associated with the actual determination of damages, including but not limited to the number of class members that may file valid claims, the number of claims that can be substantiated by class members providing adequate documentation, the reduction of trading losses by any trading gains made over the relevant period, the determination of reliance by class members on the financial statements, and whether any given class member was the beneficial owner of the shares, HSBC is unable at this time to estimate reliably the amount of any damages or range of possible damages that could arise, but they could be significant.

In December 2008, Bernard L Madoff ('Madoff') was arrested for running a Ponzi scheme and a trustee was appointed for the liquidation of his firm, Bernard L Madoff Investment Securities LLC ('Madoff Securities'), a Securities and Exchange Commission ('SEC') registered broker-dealer and investment adviser. Madoff subsequently pleaded guilty to various charges and is serving a 150-year prison sentence. Various non-US HSBC companies provide custodial, administration and similar services to a number of funds incorporated outside the US whose assets were invested with Madoff Securities and have been named as defendants in suits in the US, Ireland, Luxembourg and other jurisdictions. There are many factors which may affect the range of possible outcomes including, but not limited to, the circumstances of the fraud, the multiple jurisdictions in which the proceedings have been brought, and the number of different plaintiffs

and defendants in such proceedings. The cases are at an early stage. For these reasons, among others, it is not practicable at this time for HSBC to estimate reliably the aggregate liabilities or ranges of liabilities that may arise as a result of all such claims but they could be significant. In any event, HSBC considers that it has good defences to these claims and will continue to defend them vigorously.

HSBC Bank USA entered into a consent cease and desist order with the Office of the Comptroller of the Currency and the indirect parent of that company, HSBC North America, entered into a consent cease and desist order with the Federal Reserve Board in the first week of October 2010. These actions require improvements for an effective compliance risk management programme across the Group's US businesses, including US Bank Secrecy Act ('BSA') and Anti Money Laundering ('AML') compliance. Steps continue to be taken to address the requirements of these Orders and to ensure that compliance and effective policies and procedures are maintained.

Various HSBC Group companies are the subject of ongoing investigations, including Grand Jury subpoenas and other requests for information, by US Government agencies, including the US Attorney's Office, the US Department of Justice and the New York County District Attorney's Office. These investigations pertain to, among other matters, HSBC Bank USA's bank note and foreign correspondent banking businesses and its compliance with BSA and AML controls, as well as various HSBC companies' compliance with Office of Foreign Asset Control ('OFAC') requirements, and adherence by certain customers to US tax reporting requirements.

The consent cease and desist orders do not preclude additional enforcement actions against HSBC Bank USA or HSBC North America by bank regulatory or law enforcement agencies, including actions to recover civil money penalties, fines and other financial penalties relating to activities which were the subject of the cease and desist orders. In addition, it is likely that there could be some form of formal enforcement action in respect of some or all of the ongoing investigations. Actual or threatened enforcement actions against other financial institutions for breaches of BSA, AML and OFAC requirements have resulted in settlements involving fines and penalties, some of which have been significant depending on the individual circumstances of each action. The ongoing investigations are at an early stage. Based on the facts currently known, it is not practicable at this time for HSBC to determine the terms on which the ongoing investigations will be resolved or the timing of such resolution or for HSBC

Report of the Directors: Operating and Financial Review (continued)

to estimate reliably the amounts, or range of possible amounts, of any fines and/or penalties. As matters progress, it is possible that any fines and/or penalties could be significant.

For further information see Note 44 on the Financial Statements.

Foreclosures

US State and federal officials recently announced investigations into the procedures followed by mortgage servicing companies and banks, including HSBC Finance and HSBC Bank USA, relating to foreclosures. We have responded to all related inquiries and co-operated with all applicable investigations, including a joint examination by staffs of the Federal Reserve Board and the Office of the Comptroller of the Currency as part of their broad review of industry foreclosure practices. Following the examination, our examiners issued supervisory letters noting certain deficiencies in our processing, preparation and signing of affidavits and other documents supporting foreclosures, and in the governance of and resources devoted to our foreclosure processes, including the evaluation and monitoring of third party law firms retained to effect our foreclosures. Certain other processes were deemed adequate. Management is reviewing foreclosures where judgement has not yet been entered and will correct deficient documentation and re-file affidavits where necessary. We have suspended foreclosures until such time as we have substantially addressed noted deficiencies in our processes. We are engaged in discussions with the Federal Reserve Board and the Office of the Comptroller of the Currency regarding the terms of consent cease and desist orders, which will prescribe actions to address the deficiencies noted in the joint examination. We expect the consent orders will be

finalised shortly. While the impact of the consent orders depends on the final terms, we believe they have the potential to increase our operational, reputational and legal risk profiles and expect implementation of their provisions will require significant and managerial resources. In addition, the consent orders will not preclude further actions against HSBC Bank USA or HSBC Finance by bank regulatory or other agencies, including the imposition of fines and civil money penalties. We are unable at this time, however, to determine the likelihood of any further action or the amount of fines or penalties, if any, that may be imposed by the regulators or agencies.

Data security

In March 2010 HSBC Private Bank (Suisse) SA announced that it had been the victim of a significant data theft. In 2010, HSBC Private Bank (Suisse) SA conducted a comprehensive review of its information security procedures, formulated and implemented major security upgrade programmes and continued a multi-million franc investment programme in systems to ensure industry-leading security standards. It also reviewed and strengthened risk management and operational controls and will continue to invest in these areas. In March 2010, the Swiss Financial Market Supervisory Authority ('FINMA') launched an investigation into the circumstances of the data theft. On 22 February 2011 a notice of decision with a declaratory ruling was received from FINMA following such investigation which found that, because of deficiencies in its internal organisation and oversight of its IT activities, HSBC Private Bank (Suisse) SA had breached various regulatory provisions. HSBC Private Bank (Suisse) SA is currently considering the details of the notice of decision and actions required by FINMA.

Footnotes to Overview and Operating and Financial Review

Financial highlights

- Dividends recorded in the financial statements are dividends per ordinary share declared in a year and are not dividends in respect of, or for, that year. The third interim dividend for 2009 of US\$0.08 was paid on 13 January 2010. The fourth interim dividend for 2009 of US\$0.10 was paid on 5 May 2010. First, second and third interim dividends for 2010, each of US\$0.08 per ordinary share, were paid on 7 July 2010, 6 October 2010 and 12 January 2011, respectively. Note 11 on the Financial Statements provides more information on the dividends declared in 2010. On 28 February 2011 the Directors declared a fourth interim dividend for 2010 of US\$0.12 per ordinary share in lieu of a final dividend, which will be payable to ordinary shareholders on 5 May 2011 in cash in US dollars, or in pounds sterling or Hong Kong dollars at exchange rates to be determined on 27 April 2011, with a scrip dividend alternative. The reserves available for distribution at 31 December 2010 were US\$36,013m.*

Quarterly dividends of US\$15.50 per 6.2% non-cumulative Series A US dollar preference share, equivalent to a dividend of US\$0.3875 per Series A ADS, each of which represents one-fortieth of a Series A US dollar preference share, were paid on 15 March 2010, 15 June 2010, 15 September 2010 and 15 December 2010.

Quarterly coupons of US\$0.508 per security were paid with respect to 8.125% capital securities on 15 January 2010, 15 April 2010, 15 July 2010 and 15 October 2010.

Quarterly coupons of US\$0.45 and US\$0.50 per security were paid with respect to 8% capital securities on 15 September 2010 and on 15 December 2010, respectively.
- Return on invested capital is based on the profit attributable to ordinary shareholders. Average invested capital is measured as average*

Report of the Directors: Operating and Financial Review (continued)

total shareholders' equity after adding back goodwill previously written-off directly to reserves, deducting average equity preference shares issued by HSBC Holdings and deducting/(adding) average reserves for unrealised gains/(losses) on effective cash flow hedges and available-for-sale securities. This measure reflects capital initially invested and subsequent profit.

- 3 The return on average total shareholders' equity is defined as profit attributable to shareholders of the parent company divided by average total shareholders' equity.
 4 The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.
 5 Each ADS represents five ordinary shares.
 6 Total shareholder return is defined as the growth in share value and declared dividend income during the relevant period.
 7 The Financial Times Stock Exchange 100 Index, the Morgan Stanley Capital International World Index and the Morgan Stanley Capital International World Bank Index.
 8 HBEU is HSBC Bank plc; HBAP is The Hongkong and Shanghai Banking Corporation; and HBUS is HSBC Bank USA. Figures provided for HSBC Bank plc and The Hongkong and Shanghai Banking Corporation incorporate the major overseas branches of these entities. Subsidiaries of these entities are not included unless there is unrestricted transferability of liquidity between the subsidiaries and the parent.
 9 This comprises our other main banking subsidiaries and, as such, includes businesses spread across a range of locations, in many of which we may require a higher ratio of net liquid assets to customer liabilities to reflect local market conditions.

Reconciliations of reported and underlying profit/(loss) before tax

- 10 These columns comprise the net increments or decrements in profits in the current year compared with the previous year which are attributable to acquisitions or disposals of subsidiaries and/or movements in fair value of own debt attributable to credit spread. The inclusion of acquisitions and disposals is determined in the light of events each year.
 11 'Currency translation' is the effect of translating the results of subsidiaries and associates for the previous year at the average rates of exchange applicable in the current year.
 12 Excluding adjustments in 2009.
 13 Positive numbers are favourable; negative numbers are unfavourable.
 14 Changes in fair value due to movements in own credit spread on long-term debt issued. This does not include the fair value changes due to own credit spread on structured notes issued and other hybrid instruments included within trading liabilities.
 15 Net operating income before loan impairment charges and other credit risk provisions.
 16 Excluding adjustments in 2008.

Financial summary

- 17 This footnote is intentionally left blank.
 18 The effect of the bonus element of the rights issue in 2009 has been included within the basic and diluted earnings per share.
 19 Dividends per ordinary share expressed as a percentage of earnings per ordinary share.
 20 Net interest income includes the cost of funding trading assets, while the related external revenues are reported in trading income. In our customer group results, the cost of funding trading assets is included with GB&M's net trading income as interest expense.
 21 Gross interest yield is the average annualised interest rate earned on average interest-earning assets ('AIEA').
 22 Net interest spread is the difference between the average annualised interest rate earned on AIEA, net of amortised premiums and loan fees, and the average annualised interest rate paid on average interest-bearing funds.
 23 Net interest margin is net interest income expressed as an annualised percentage of AIEA.
 24 Other interest-earning assets includes intercompany eliminations.
 25 Interest income on trading assets is reported as 'Net trading income' in the consolidated income statement.
 26 Interest income on financial assets designated at fair value is reported as 'Net income from financial instruments designated at fair value' in the consolidated income statement.
 27 This includes interest-bearing bank deposits only.
 28 Interest expense on financial liabilities designated at fair value is reported as 'Net income on financial instruments designated at fair value' in the consolidated income statement, other than interest on own debt which is reported in 'Interest Expense'.
 29 This includes interest-bearing customer accounts only.
 30 The cost of internal funding of trading assets was US\$902m (2009: US\$1,309m; 2008: US\$5,547m) and is excluded from the reported 'Net trading income' line and included in 'Net interest income'. However, this cost is reinstated in 'Net trading income' in HSBC's customer group and global business reporting.
 31 Net trading income includes income of US\$23m (2009: expense of US\$444m; 2008: income of US\$529m), associated with changes in the fair value of issued structured notes and other hybrid instrument liabilities derived from movements in HSBC issuance spreads.
 32 Other changes in fair value include gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with HSBC's long-term debt issued.
 33 Discretionary participation features.
 34 Net insurance claims incurred and movement in liabilities to policyholders arise from both life and non-life insurance business. For non-life business, amounts reported represent the cost of claims paid during the year and the estimated cost of notified claims. For life business, the main element of claims is the liability to policyholders created on the initial underwriting of the policy and any subsequent movement in the liability that arises, primarily from the attribution of investment performance to savings-related policies. Consequently, claims rise in line with increases in sales of savings-related business and with investment market growth.

Consolidated balance sheet

- 35 Net of impairment allowances.
 36 The calculation of capital resources, capital ratios and risk-weighted assets for 2008 to 2010 is on a Basel II basis. 2006 and 2007 comparatives are on a Basel I basis.
 37 Capital resources are total regulatory capital, the calculation of which is set out on page 180.
 38 Includes perpetual preferred securities, details of which can be found in Note 34 on the Financial Statements.

Report of the Directors: Operating and Financial Review (continued)

- 39 *The definition of net asset value per share is total shareholders' equity, less non-cumulative preference shares and capital securities, divided by the number of ordinary shares in issue.*
- 40 *'Currency translation' is the effect of translating the assets and liabilities of subsidiaries and associates for the previous year-end at the rates of exchange applicable at the current year-end.*

Economic profit

- 41 *Expressed as a percentage of average invested capital.*
- 42 *Average invested capital is measured as average total shareholders' equity after:*
- *adding back the average balance of goodwill amortised pre-transition to IFRSs or subsequently written-off, directly to reserves (less goodwill previously amortised in respect of the French regional banks sold in 2008);*
 - *deducting the average balance of HSBC's revaluation surplus relating to property held for own use. This reserve was generated when determining the deemed carrying cost of such properties on transition to IFRSs and will run down over time as the properties are sold;*
 - *deducting average preference shares and other equity instruments issued by HSBC Holdings; and*
 - *deducting average reserves for unrealised gains/(losses) on effective cash flow hedges and available-for-sale securities.*
- 43 *Return on invested capital is profit attributable to ordinary shareholders of the parent company, which can be found in Note 12 on the Financial Statements on page 296.*

Customer groups and global businesses and Geographical regions

- 44 *The main items reported under 'Other' are certain property activities, unallocated investment activities, centrally held investment companies, gains arising from the dilution of interests in associates, movements in the fair value of own debt designated at fair value (the remainder of the Group's gain on own debt is included in GB&M) and HSBC's holding company and financing operations. The results also include net interest earned on free capital held centrally, operating costs incurred by the head office operations in providing stewardship and central management services to HSBC, and costs incurred by the Group Service Centres and Shared Service Organisations and associated recoveries. At 31 December 2010, there was a US\$188m gain arising from the dilution of interests in associates (2009: nil; 2008: nil) and adverse fair value movements on HSBC's own debt designated at fair value were US\$0.1bn (2009: US\$6.5bn adverse; 2008: US\$6.6bn favourable).*
- 45 *Assets by geographical region and customer group include intra-HSBC items. These items are eliminated, where appropriate, under the heading 'Intra-HSBC items'.*
- 46 *Net operating income before loan impairment charges and other credit risk provisions.*
- 47 *Loan impairment charges and other credit risk provisions.*
- 48 *Share of profit in associates and joint ventures.*
- 49 *In the analyses of customer groups and global businesses, net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities classified as held for trading, together with related external and internal interest income and interest expense, and dividends received; in the statutory presentation internal interest income and expense are eliminated.*
- 50 *In 2010, Global Markets included a favourable fair value movement of US\$23m on the widening of credit spreads on structured liabilities (2009: adverse fair value movement of US\$444m; 2008: favourable fair value movement of US\$529m).*
- 51 *Total income earned on securities services products in the Group amounted to US\$1.5bn (2009: US\$1.4bn; 2008: US\$2.2bn), of which US\$1.5bn was in GB&M (2009: US\$1.4bn; 2008: US\$2.1bn) and US\$29m was in CMB (2009: US\$19m; 2008: US\$45m).*
- 52 *Total income earned on payments and cash management products in the Group amounted to US\$4.4bn (2009: US\$4.1bn; 2008: US\$5.8bn), of which US\$3.3bn was in CMB (2009: US\$3.1bn; 2008: US\$4.1bn) and US\$1.1bn was in GB&M (2009: US\$1.1bn; 2008: US\$1.7bn).*
- 53 *Total income earned on other transaction services in the Group amounted to US\$2.3bn (2009: US\$1.8bn; 2008: US\$1.8bn), of which US\$1.6bn was in CMB relating to trade and supply chain (2009: US\$1.3bn; 2008: US\$1.3bn) and US\$636m was in GB&M of which US\$523m related to trade and supply chain (2009: US\$382m; 2008: US\$355m) and US\$113m related to banknotes and other (2009: US\$125m; 2008: US\$126m).*
- 54 *In each Group entity, Balance Sheet Management is responsible for managing liquidity and funding under the supervision of the local ALCO. Balance Sheet Management also manages the structural interest rate position of the entity within a Global Markets limit structure.*
- 55 *'Other' in GB&M includes net interest earned on free capital held in the global business not assigned to products.*
- 56 *Inter-segment elimination comprises (i) the costs of shared services and Group Service Centres included within 'Other' which are recovered from customer groups, and (ii) the intra-segment funding costs of trading activities undertaken within GB&M. HSBC's Balance Sheet Management business, reported within GB&M, provides funding to the trading businesses. To report GB&M's 'Net trading income' on a fully funded basis, 'Net interest income' and 'Net interest income/(expense) on trading activities' are grossed up to reflect internal funding transactions prior to their elimination in the inter-segment column.*
- 57 *Net insurance claims incurred and movement in liabilities to policyholders.*
- 58 *'Employee expenses' comprises costs directly incurred by each customer group. The reallocation and recharging of employee and other expenses directly incurred in the 'Other' customer group is shown in 'Other operating expenses'.*
- 59 *RWAs are non-additive across geographical regions due to market risk diversification effects within the Group.*
- 60 *France primarily comprises the domestic operations of HSBC France, HSBC Assurances Vie and the Paris branch of HSBC Bank plc.*
- 61 *Hong Kong Government certificates of indebtedness were reclassified from PFS to 'Other' at 1 January 2010.*
- 62 *US includes the impairment of goodwill in respect of PFS – North America.*

Report of the Directors: Operating and Financial Review (continued)**Average balance sheet**

- 63 *Interest income on trading assets is reported as 'Net trading income' in the consolidated income statement.*
- 64 *Interest income on financial assets designated at fair value is reported as 'Net income from financial instruments designated at fair value' in the consolidated income statement.*
- 65 *Brazilian operations comprise HSBC Bank Brasil S.A.-Banco Múltiplo and subsidiaries, plus HSBC Serviços e Participações Limitada.*
- 66 *This includes interest-bearing bank deposits only. See page 31(n) for an analysis of all bank deposits.*
- 67 *Interest expense on financial liabilities designated at fair value is reported as 'Net income on financial instruments designated at fair value' in the consolidated income statement, other than interest on own debt which is reported in 'Interest Expense'.*
- 68 *This includes interest-bearing customer accounts only. See page 31(o) for an analysis of all customer accounts.*
- 69 *Net interest margin is calculated as net interest income divided by average interest earning assets.*
- 70 *For the purpose of calculating the ratios, earnings consist of income from continuing operations before taxation and non-controlling interests, plus fixed charges, and after deduction of the unremitted pre-tax income of associated undertakings. Fixed charges consist of total interest expense, including or excluding interest on deposits, as appropriate, dividends on preference shares and other equity instruments, as applicable, and the proportion of rental expense deemed representative of the interest factor.*
- 71 *Trading assets and financial investments held by GB&M in North America include financial assets which may be repledged or resold by counterparties.*
- 72 *Derivative assets and derivative liabilities of GB&M include derivative transactions between different regions of GB&M.*
- 73 *Ratio excludes trading loans classified as in default.*

Report of the Directors: Operating and Financial Review (continued)

Regulation and supervision

(Unaudited)

With listings of its ordinary shares in London, Hong Kong, New York, Paris and Bermuda, HSBC Holdings complies with the relevant requirements for listing and trading on each of these exchanges. In the UK, these are the Listing Rules of the Financial Services Authority ('FSA'); in Hong Kong, The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ('HKSE'); in the US, where the shares are traded in the form of ADSs, HSBC Holdings' shares are registered with the US Securities and Exchange Commission ('SEC'). As a consequence of its US listing, HSBC Holdings is also subject to the reporting and other requirements of the US Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and the New York Stock Exchange's ('NYSE') Listed Company Manual, in each case as applied to foreign private issuers. In France and Bermuda, HSBC Holdings is subject to the listing rules of Euronext, Paris and the Bermuda Stock Exchange respectively, applicable to companies with secondary listings.

A statement of our compliance with the provisions of the Combined Code on Corporate Governance issued by the Financial Reporting Council and with the Code on Corporate Governance Practices in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited is set out in the 'Report of the Directors: Governance' on page 183.

Our operations throughout the world are regulated and supervised by approximately 540 different central banks and regulatory authorities in those jurisdictions in which we have offices, branches or subsidiaries. These authorities impose a variety of requirements and controls designed to improve financial stability and the transparency of financial markets and their contribution to economic growth. These regulations and controls cover, *inter alia*, capital adequacy, depositor protection, market liquidity, governance standards, customer protection (for example, fair lending practices, product design, and marketing and documentation standards), and social responsibility obligations (for example, anti-money laundering and anti-terrorist financing measures). In addition, a number of countries in which we operate impose rules that affect, or place limitations on, foreign or foreign-owned or controlled banks and financial institutions. The rules include restrictions on the opening of local offices, branches or subsidiaries and the types of banking and non-banking activities that may be conducted by those local offices, branches or subsidiaries;

restrictions on the acquisition of local banks or regulations requiring a specified percentage of local ownership; and restrictions on investment and other financial flows entering or leaving the country. The supervisory and regulatory regimes of the countries where we operate will determine to some degree our ability to expand into new markets, the services and products that we will be able to offer in those markets and how we structure specific operations. As a result of government interventions in response to recent global economic conditions, it is widely anticipated that there will be a substantial increase in government regulation and supervision of the financial services industry, including the imposition of higher capital requirements, heightened disclosure standards and restrictions on certain types of transaction structures.

The FSA supervises us on a consolidated basis. In addition, each operating bank, finance company or insurance operation within HSBC is regulated by local supervisors. The primary regulatory authorities are those in the UK, Hong Kong and the US, our principal areas of operation.

UK regulation and supervision

UK banking and financial services institutions are subject to multiple regulations. The primary UK statute is the Financial Services and Markets Act 2000 ('FSMA'). Additionally, data privacy is regulated by the Data Protection Act 1998. Other UK financial services legislation is derived from EU directives relating to banking, securities, insurance, investments and sales of personal financial services.

In addition to its role as our lead regulator, the FSA is responsible for authorising and supervising all our businesses in the UK which require authorisation under FSMA. These include deposit-taking, retail banking, life and general insurance, pensions, investments, mortgages, custody and share dealing businesses, and treasury and capital markets activity. HSBC Bank is our principal authorised institution in the UK.

FSA rules establish the minimum criteria for authorisation for banks and financial services businesses in the UK. They also set out reporting (and, as applicable, consent) requirements with regard to large individual exposures and large exposures to related borrowers. In its capacity as our supervisor on a consolidated basis, the FSA receives information on the capital adequacy of, and sets requirements for, HSBC as a whole. Further details on capital measurement are included in 'Capital' on pages 177 to 182.

Report of the Directors: Operating and Financial Review (continued)

The FSA's approach to capital requirements for UK insurers is to require minimum capital to be calculated on two bases. First, firms must calculate their liabilities on a prudent basis and add a statutory solvency margin ('pillar 1'). Secondly, firms must calculate their liabilities on a realistic basis then add to this their own calculation of risk-based capital. The sum of realistic reserves and risk-based capital ('pillar 2') is agreed with the FSA. Insurers are required to maintain capital equal to the higher of pillars 1 and 2. The FSA has the right to object, on prudential grounds, to persons who hold, or intend to hold, 10% or more of the voting power of a financial institution.

The regulatory framework of the UK financial services system has traditionally been based on co-operation between the FSA and authorised institutions. The FSA monitors authorised institutions through ongoing supervision and the review of routine and *ad hoc* reports relating to financial and prudential matters. The FSA may periodically obtain independent reports, usually from the auditors of the authorised institution, as to the adequacy of internal control procedures and systems as well as procedures and systems governing records and accounting. The FSA meets regularly with our senior executives to discuss our adherence to the FSA's prudential guidelines. They also regularly discuss fundamental matters relating to our business in the UK and internationally, including areas such as strategic and operating plans, risk control, loan portfolio composition and organisational changes, including succession planning. In light of current conditions, we have experienced an increased level of ongoing interaction with the FSA.

Hong Kong regulation and supervision

Banking in Hong Kong is subject to the provisions of the Banking Ordinance and to the powers, functions and duties ascribed by the Banking Ordinance to the Hong Kong Monetary Authority (the 'HKMA'). The principal function of the HKMA is to promote the general stability and effective working of the banking system in Hong Kong. The HKMA is responsible for supervising compliance with the provisions of the Banking Ordinance. The Banking Ordinance gives power to the Chief Executive of Hong Kong to give directions to the HKMA and the Financial Secretary with respect to the exercise of their respective functions under the Banking Ordinance.

The HKMA has responsibility for authorising banks, and has discretion to attach conditions to its authorisation. The HKMA requires that banks or their holding companies file regular prudential

returns, and holds regular discussions with the management of the banks to review their operations. The HKMA may also conduct 'on-site' examinations of banks and, in the case of banks incorporated in Hong Kong, of any local and overseas branches and subsidiaries. The HKMA requires all authorised institutions to have adequate systems of internal control and requires the institutions' external auditors, upon request, to report on those systems and other matters such as the accuracy of information provided to the HKMA. In addition, the HKMA may from time to time conduct tripartite discussions with banks and their external auditors.

The HKMA has the power to serve a notice of objection on persons if they are no longer deemed to be fit and proper to be controllers of the bank, if they may otherwise threaten the interests of depositors or potential depositors, or if they have contravened any conditions specified by the HKMA. The HKMA may revoke authorisation in the event of an institution's non-compliance with the provisions of the Banking Ordinance. These provisions require, among other things, the furnishing of accurate reports.

The HKMA implemented Basel II with effect from 1 January 2007 for all Authorised Institutions incorporated in Hong Kong.

The marketing of, dealing in and provision of advice and asset management services in relation to securities in Hong Kong are subject to the provisions of the Securities and Futures Ordinance of Hong Kong ('Securities and Futures Ordinance'). Entities engaging in activities regulated by the Securities and Futures Ordinance are required to be licensed. The HKMA is the primary regulator for banks involved in the securities business, while the Securities and Futures Commission is the regulator for non-banking entities.

US regulation and supervision

We are subject to extensive federal and state supervision and regulation in the US. Banking laws and regulations of the Board of Governors of the Federal Reserve System (the 'Federal Reserve Board'), the Office of the Comptroller of the Currency (the 'OCC') and the Federal Deposit Insurance Corporation (the 'FDIC') govern many aspects of our US business.

On 21 July 2010, the United States enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act ('Dodd-Frank'), which provides a broad framework for significant regulatory changes that will extend to almost every area of US financial regulation. Implementation of Dodd-Frank will require further detailed rulemaking over several

Report of the Directors: Operating and Financial Review (continued)

years by different US regulators, including the Department of the Treasury, the Federal Reserve Board, the FDIC, the Securities and Exchange Commission (the 'SEC'), the Commodity Futures Trading Commission and the newly created Financial Stability Oversight Council (the 'FSOC') and Consumer Financial Protection Bureau (the 'Consumer Bureau'), and uncertainty remains about the final details, timing and impact of the rules.

HSBC and our US operations are subject to supervision, regulation and examination by the Federal Reserve Board because HSBC is a 'bank holding company' under the US Bank Holding Company Act of 1956 ('BHCA'), as a result of our control of HSBC Bank USA, N.A., McLean, Virginia ('HBUS'); and HSBC Trust Company (Delaware), N.A., Wilmington, Delaware ('HTCD'). HSBC North America Holdings Inc. ('HNAH'), formed to hold our US and Canadian operations is also a 'bank holding company'. Both HSBC and HNAH are registered as financial holding companies ('FHC's) under the BHCA, and, accordingly, may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental or complementary to activities that are financial in nature. The ability of HSBC and HNAH to engage in expanded financial activities as FHCs depends upon HSBC and HNAH continuing to meet certain criteria set forth in the BHCA, including requirements that our US depository institution subsidiaries be 'well capitalised' and 'well managed', and that such institutions have achieved at least a satisfactory record in meeting community credit needs during their most recent examinations pursuant to the Community Reinvestment Act.

Under Dodd-Frank, in order for HNAH to meet the criteria for qualifying as a financial holding company, it will be required to be well capitalised.

In general, under the BHCA, an FHC would be required, upon notice by the Federal Reserve Board, to enter into an agreement with the Federal Reserve Board to correct any failure to comply with the requirements to maintain FHC status. Until such deficiencies are corrected, the Federal Reserve Board may impose limitations on the US activities of an FHC and depository institutions under its control. If such deficiencies are not corrected, the Federal Reserve Board may require an FHC to divest its control of any subsidiary depository institution or to desist from certain financial activities in the US.

The two US banks, HBUS and HTCD are subject to regulation and examination primarily by the OCC, secondarily by the FDIC, and by

the Federal Reserve Board. Banking laws and regulations restrict many aspects of their operations and administration, including the establishment and maintenance of branch offices, capital and reserve requirements, deposits and borrowings, investment and lending activities, payment of dividends and numerous other matters.

In December 2007, US regulators published a final rule regarding Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II. This final rule represents the US adoption of Basel II. The final rule became effective on 1 April 2008, and requires large bank holding companies, including HNAH, to adopt its provisions no later than 1 April 2011. HNAH has established comprehensive Basel II implementation project teams comprised of risk management specialists representing all risk disciplines. In addition, US banking authorities have adopted 'leverage' capital requirements that generally require US banks and bank holding companies to maintain a minimum amount of capital in relation to their balance sheet assets (measured on a non-risk weighted basis).

Dodd-Frank also establishes minimum risk-based capital requirements that shall not be less than the currently "generally applicable" capital requirements, which shall serve as a floor for any capital requirements the bank regulatory agencies may require. We expect that the US bank regulatory agencies will adopt regulations to implement Basel III as well as various provisions of Dodd-Frank. We cannot be certain of the impact the new capital regulations will have on our US capital ratios at this time.

HSBC Bank USA and HTCD are subject to risk-based assessments from the FDIC, which insures deposits generally to a maximum of US\$250,000 per depositor for domestic deposits. Dodd-Frank provides for unlimited deposit insurance for certain non-interest-bearing transactions accounts for the period to 31 December 2012. Due to projected shortfalls in the FDIC fund as a result of continuing bank failures, the FDIC required all insured banks, including HBUS and HTCD, to prepay their insurance premium for the years 2010, 2011 and 2012.

Dodd-Frank changes the FDIC's risk-based deposit insurance assessment framework primarily by basing assessments on an FDIC-insured institution's total assets less tangible equity rather than US domestic deposits, which is expected to shift a greater portion of the aggregate assessments to large FDIC-insured institutions. The new large bank pricing system will result in higher assessment

Report of the Directors: Operating and Financial Review (continued)

rates for banks with high-risk asset concentrations, less stable balance sheet liquidity, or potentially higher loss severity in the event of failure.

Our US consumer finance operations are subject to extensive state-by-state regulation in the US, and to laws relating to consumer protection (both in general, and in respect of sub-prime lending operations, which have been subject to enhanced regulatory scrutiny); discrimination in extending credit; use of credit reports; privacy matters; disclosure of credit terms; and correction of billing errors. They also are subject to regulations and legislation that limit operations in certain jurisdictions.

Dodd-Frank will limit the ability of banking entities to sponsor or invest in private equity or hedge funds or to engage in certain types of proprietary trading in the United States unrelated to serving clients. Dodd-Frank also provides regulators with tools to provide greater capital, leverage and liquidity requirements and other prudential standards, particularly for financial institutions that pose significant systemic risk. However, in imposing heightened capital, leverage, liquidity and other prudential standards on non-US banks, the Federal Reserve Board is directed to take into account the principle of national treatment and equality of competitive opportunity, and the extent to which the foreign bank is subject to comparable home country standards.

US regulators will also be able to restrict the size and growth of systemically significant non-bank financial companies and large interconnected bank holding companies and will be required to impose bright-line debt-to-equity ratio limits on financial companies that the FSOC determines pose a grave threat to financial stability. Furthermore, Dodd-Frank provides for an extensive framework for the regulation of over-the-counter ('OTC') derivatives, including mandatory clearing, exchange trading and transaction reporting of certain OTC derivatives, as well as rules regarding the registration of swap dealers and major swap participants, and related capital, margin, business conduct, record keeping and other requirements applicable to such entities. Dodd-Frank also requires broader regulation of hedge funds and private equity funds, and imposes new requirements with respect to asset securitisation activities. In addition, effective by July 2012, Dodd-Frank will require that the lending limits applicable to HBUS and HTCD take into account credit exposure from derivative transactions, securities borrowing and lending transactions, and repurchase and reverse repurchase agreements.

Dodd-Frank also grants the SEC discretionary rule-making authority to impose a new fiduciary standard on brokers, dealers and investment advisers, and expands the extraterritorial jurisdiction of US courts over actions brought by the SEC or the United States with respect to violations of the anti-fraud provisions in the Securities Act, the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940. In addition, regulations which the FSOC, the Consumer Bureau or other regulators may adopt could affect the nature of the activities which our FDIC-insured depository institution subsidiaries may conduct, and may impose restrictions and limitations on the conduct of such activities. Dodd-Frank also establishes a new regime for the orderly liquidation of systemically significant financial companies and authorises assessments on financial institutions with US\$50bn or more in consolidated assets to repay outstanding debts owed to the Treasury in connection with a liquidation of a systemically significant financial company under the new insolvency regime.

Implementation of Dodd-Frank and related final regulations could result in additional costs or limit or restrict the way we conduct our business, although uncertainty remains about the details, impact and timing of these reforms.

The HSBC Group takes its obligations to prevent money laundering and terrorist financing very seriously. HSBC has policies, procedures and training intended to ensure that its employees know and understand HSBC's criteria for when a client relationship or business should be evaluated as higher risk. As part of its continuing evaluation of risk, the HSBC Group monitors its activities relating to the countries subject to US economic sanctions programmes administered by the Office of Foreign Assets Control as well as those subject to UN, UK and EU sanctions. HSBC Group policy requires that relevant Group offices should adhere to the letter and spirit of all applicable laws and regulations. HSBC's business activities include banking services for nationals of, and clients domiciled in, some of the countries. The Group had a small representative office in Tehran, Iran which was closed in December 2010.

HSBC Bank USA entered into a Consent Cease & Desist Order with OCC, and HNAH entered into a Consent Cease & Desist Order with the Federal Reserve Board in the first week of October 2010. These Orders require improvement for an effective Compliance Risk Management Programme including anti-money laundering controls across the Group's US businesses. Steps continue to be taken to address the requirements of these Orders and to ensure that

Report of the Directors: Operating and Financial Review (continued)

compliance and effective policies and procedures are maintained.

The US State Department has designated certain countries (Cuba, Iran, Sudan and Syria) as state sponsors of terrorism, and US law generally prohibits US persons from doing business with such countries. HSBC is aware of initiatives by governmental entities and institutions in the US to adopt rules, regulations or policies prohibiting transactions with or investments in entities doing business with such countries. HSBC Group Policy requires all Group companies to comply to the extent applicable with US law and regulation, including the

country and individual sanctions promulgated by OFAC sanctions. This means that not only must US subsidiaries and US nationals comply with OFAC regulations, but that HSBC subsidiaries outside the US which are not US persons must not participate in US Dollar business that would, if conducted by a US person, contravene the OFAC sanctions. The HSBC Group does not consider that its business activities with counterparties in, or directly relating to, these countries are material to its business, and such activities represented a very small part of total assets at 31 December 2010 and total revenues for the year ended 31 December 2010.

85(f)

Report of the Directors: Operating and Financial Review (continued)

Risk

	<i>Page</i>
Risk profile¹	86
Managing risk¹	87
Capital and liquidity	87
Risk governance¹	87
Scenario stress testing	88
Challenges and uncertainties¹	88
Business operations, governance and control	88
Macro-economic and geopolitical	89
Macro-prudential and regulatory	90
Credit risk	93
Credit risk management²	93
Credit exposure³	95
Areas of special interest¹	103
Credit quality of financial instruments²	114
Impairment charge¹	124
HSBC Holdings²	127
Securitisation exposures and other structured products³	128
Risk elements in the loan portfolio	139(a)
Liquidity and funding²	140
Policies and procedures	140
Primary sources of funding	141
The management of liquidity risk	142
Contingent liquidity risk	143
HSBC Holdings	144
Market risk	145
Monitoring and limiting market risk exposure²	145
Sensitivity analysis³	145
Trading and non-trading portfolios³	146
Structural foreign exchange exposures¹	149
Sensitivity of net interest income¹	149
Defined benefit pension schemes²	151
HSBC Holdings³	152
Operational risk¹	154
Legal risk	154
Compliance risk	155
Group security and fraud risk	155
Risk management of insurance operations²	155
Overview of insurance products	156
Nature and extent of risks	156
Insurance risk	157
Financial risks	161
Present value of in-force long-term insurance business	170
Economic assumptions	170
Non-economic assumptions	171
Other material risks¹	172
Reputational risk	172
Pension risk	172
Sustainability risk	173
Residual value risk	174

1 Unaudited 2 Audited 3 Audited where indicated

Risk Profile

(Unaudited)

Managing our risk profile

- A strong balance sheet remains core to our philosophy.
- We have reduced our exposure to higher risk asset classes while achieving controlled balance sheet growth.
- We have ensured that our portfolio remains diversified across regions, client sectors and risk types.

Maintaining capital strength and strong liquidity position

- Our tier 1 capital ratio remains strong at 12.1%.
- We have sustained our strong liquidity position throughout 2010.
- The ratio of customer advances to deposits remains below 80%.

Strong governance

- Our Global Risk function is independent of our commercial and operational functions.
- Robust risk governance and accountability is embedded across the Group.
- The Board, advised by the Group Risk Committee, approves our risk appetite.
- A global risk operating model provides consistent and effective oversight across all six regions and our customer groups and global businesses.

Our top and emerging risks

- Challenges to our business operations.
- Challenges to our governance and internal control systems.
- Macro-economic and geopolitical risk.
- Macro-prudential and regulatory risks to our business model.

Report of the Directors: Operating and Financial Review (continued)

Managing risk

(Unaudited)

The continued growth in our business in 2010 was achieved while ensuring risks were assumed in a measured manner and in line with our appetite for such risks. This approach is encapsulated within our risk appetite framework. It is approved by the Group Risk Committee and the Board.

The framework is maintained at Group, regional, global business and customer group levels, operating through governance bodies, processes and metrics designed to assist in risk management. Risk appetite statements define, at various levels of the business, the qualitative and quantitative expressions of the risks which HSBC is prepared to embrace in alignment with its strategy and business plans. Quantitative metrics are assigned to five key categories: earnings, capital and liquidity, impairments and expected losses, risk category and diversification and scenario stress testing. Measurement against the metrics serves to:

- guide underlying business activity, ensuring it is aligned to risk appetite statements;
- determine risk-adjusted remuneration;
- enable the key underlying assumptions to be monitored and, where necessary, adjusted through subsequent business planning cycles; and
- promptly identify business decisions needed to mitigate risk.

Report of the Group Risk Committee

Further commentary on risk appetite, risk governance and stress testing can be found within the Report of the Group Risk Committee, on pages 197 to 201 of the Governance section.

The diversification of our lending portfolio across our regions, together with our broad range of customer groups and products, ensure that we are not dependent on a few countries or markets to generate income and growth. Our geographical diversification also provides impetus to our strategies for growth in faster-growing markets and those with international connectivity.

During 2010, the financial markets were dominated by concerns over sovereign debt. In addition, the perception that the world economic recovery remained fragile created volatility in certain financial markets. Further quantitative easing from the US temporarily boosted market confidence, but inflationary pressures remained an issue, especially in the UK and some emerging markets.

With an ever-changing economic and financial environment, we pro-actively review our risk profile and, where appropriate, introduce new risk

measures. Stress testing will continue to evolve to ensure that it considers prevailing concerns.

Our insurance operations are managed with regard to the effects on financial markets of prevailing economic conditions such as the low yields available on fixed-interest investments and continuing high unemployment rates, particularly in the US and Europe.

Capital and liquidity

We maintained a strong balance sheet during 2010 while reducing the overall risk in our portfolio. Our balance sheet assets grew by 4% during the year while our credit risk-weighted assets fell by 1.4%. This was achieved, in part, by concentrating on our growth in core portfolios and running off those that were not core to our business.

In addition, we reduced our loan impairment charges and other credit risk provisions from US\$26.5bn in 2009 to US\$14.0bn in 2010, reflecting the general improvement in the credit quality of our portfolio.

Preserving our strong capital position has long been, and will remain, a key priority for HSBC. We are equipped to respond to the capital requirements imposed by Basel III, which are discussed further on pages 181 and 182, and to sustain future growth. We have adopted a holistic approach to testing the sensitivities of our capital plans against a number of scenarios; our approach to scenario stress testing analysis is discussed below.

We continue to maintain a strong liquidity position and are well positioned for the new regulatory landscape. The run-off of the HSBC Finance portfolio and the continuing moderation of market conditions in 2010 contributed to our strong liquidity position.

Risk governance

(Unaudited)

Our strong risk governance reflects the importance placed by the Board on shaping the Group's risk strategy and managing risks effectively. It is supported by a clear policy framework of risk ownership, by the cascading from the GMB of balanced scorecards that align business and risk objectives, and by the accountability of all officers for identifying, assessing and managing risks within the scope of their assigned responsibilities. This personal accountability, reinforced by the governance structure, experience and mandatory learning, helps to foster throughout HSBC a disciplined and constructive culture of risk management and control.

Report of the Directors: Operating and Financial Review (continued)

Scenario stress testing

We conduct a range of Group stress testing scenarios including, but not limited to, severe global economic downturn, country, sector and counterparty failures, and a variety of projected major operational risk events. The outcomes of the stress scenarios are used to assess the potential impact on demand for regulatory capital against its supply. We also participate, where appropriate, in scenario analyses requested by regulatory bodies.

In addition to the suite of risk scenarios considered for the Group, each major HSBC subsidiary conducts regular macro-economic and event-driven scenario analyses specific to its region.

Stress testing is also used by the market risk discipline to evaluate the potential impact on portfolio values of events or movements in a set of financial variables.

Challenges and uncertainties

(Unaudited)

The top and emerging risks identified through our risk management processes and outlined in the Report of the Group Risk Committee on page 199, present challenges and uncertainties as we carry out our activities. These are considered in further detail below.

Business operations, governance and control

Operational risks are inherent in our business

We are exposed to many types of operational risk, including fraudulent and other criminal activities (both internal and external), breakdowns in processes or procedures, or systems failure or unavailability. We are also subject to the risk of disruption to our business arising from events that are wholly or partially beyond our control (for example: natural disasters, acts of terrorism, epidemics and transport or utility failures) which may give rise to losses in service to customers and/or economic loss to HSBC. All of these risks are also applicable where we rely on external suppliers or vendors to provide services to us and our customers.

The reliability and security of our information and technology infrastructure and its customer databases, for example to combat internet fraud, are crucial to maintaining our banking applications and processes and to protecting the HSBC brand. Critical system failure, any prolonged loss of service availability or any material breach of data security, particularly involving confidential customer data,

could cause serious damage to our ability to serve our clients, could breach regulations under which we operate and could cause long-term damage to our business and brand. Information security and the management of increasing operational complexity are two of the key emerging operational risks that we face.

We are subject to legal and compliance risks, which could have an adverse effect on the Group

Legal and compliance risks arise from a variety of sources with the potential to cause harm to HSBC and our ability to operate. These issues require us to deal appropriately with potential conflicts of interest; regulatory requirements; ethical issues; anti-money laundering laws and regulations; privacy laws; information security policies; sales and trading practices; and the conduct of companies with which we are associated. Failure to address these issues appropriately may give rise to additional legal and compliance risk to HSBC, with an increase in the number of litigation claims and the amount of damages asserted against us, or subject us to regulatory enforcement actions, fines or penalties or reputational damage.

We are subject to tax-related risks in the countries in which we operate

We are subject to the substance and interpretation of tax laws in all countries in which we operate. Failure to respond to changes in tax rates and comply with procedures required by tax authorities could lead to increased tax charges, including financial or operating penalties.

Liquidity and funding risks are inherent in our business

HSBC's business model is founded upon having ready access to financial resources whenever required to meet our obligations and grow our business. To this end, our entities seek to maintain a diversified and stable funding base comprising core retail and corporate customer deposits and institutional balances, and certain entities augment this with amounts of long-term wholesale funding. In addition, we hold portfolios of highly liquid assets to enable us to respond to unusual liquidity requirements. We continue to maintain a strong liquidity position, moving into the new regulatory landscape.

Where markets become illiquid, the value at which financial instruments can be realised is highly uncertain, and capital resources may shrink as valuations decline. Rating agency downgrades of

Report of the Directors: Operating and Financial Review (continued)

instruments to which we have exposure, or threats of downgrades, can exacerbate the effect. The liquidity of those HSBC entities that utilise long-term wholesale markets could be constrained by an inability to access them due to a variety of unforeseen market dislocations or interruptions.

The market conditions that the financial services industry experienced during the recent financial crisis highlighted the significant benefits of a diversified core deposit base, leading to increased competition for such deposits and the greater risk of deposit migration between competitors.

Our GB&M business operates in many markets affected by illiquidity and is subject to the threat of extreme price volatility, either directly or indirectly, through exposures to securities, loans, derivatives and other commitments. Although market conditions continued to moderate in 2010, it is difficult to predict if this trend will continue and, if conditions worsen, which of our markets, products and other businesses will be affected. Any repeat of these factors could have an adverse effect on our results.

Macro-economic and geopolitical

Prevailing economic and market conditions may adversely affect our results

Our earnings are affected by global and local economic and market conditions. Following the problems experienced in financial markets in 2007-8, concerted government action in 2009 paved the way for a general improvement in the economic environment in 2010, though recovery was variable between regions. The eurozone economies came under greater pressure, the dominant concern being over sovereign debt. The financial services industry continued to face an unusually high degree of uncertainty.

With unemployment remaining high, consumer confidence weak in developed markets and amid signs of emerging inflationary pressures, economic conditions remain fragile and volatile. Some countries may recover only slowly to past levels of growth, with the possibility of a return to recessionary conditions in more sluggish economies, while others which are growing rapidly may need to undertake major adjustments to counter the formation of asset bubbles. This could have an adverse effect on our operating results. In particular, we may face the following challenges in connection with these events to our operations and operating model:

- the demand for borrowing from creditworthy customers may diminish if economic activity slows;

- trade and capital flows may contract as a result of protectionist measures being introduced in certain markets, or on the emergence of geopolitical risks;
- a prolonged period of low interest rates will constrain, for example through margin compression and low returns on assets, net interest income we earn on our excess deposits;
- our ability to borrow from other financial institutions or to engage in funding transactions could be adversely affected by market disruption, for example in the event of contagion from stress in the eurozone sovereign and financial sectors;
- market developments may depress consumer and business confidence, for example if growth in the US or the UK were to be poor, adversely affecting both asset prices and payment patterns and leading to increases in delinquencies and default rates, write-offs and loan impairment charges beyond our expectations. The effect of such conditions in 2010 and previous years on our North American retail business is described on page 110.

We are subject to political and economic risks in the countries in which we operate

We responded effectively to the financial crisis and, more recently, the sovereign debt problems within the eurozone, where we continued during 2010 to support our operations and carry out wider market functions.

As an organisation which operates in 87 countries and territories, however, our results are subject to the risk of loss from unfavourable political developments, currency fluctuations, social instability and changes in government policies on such matters as expropriation, authorisations, international ownership, interest-rate caps, foreign exchange transferability and tax in the jurisdictions in which we operate.

The ability of HSBC's subsidiaries and affiliates to pay dividends could be restricted by changes in official banking measures, exchange controls and other requirements. We prepare our accounts in US dollars, but because a substantial portion of our assets, liabilities, funds under management, revenues and expenses are denominated in other currencies, changes in foreign exchange rates have an effect on our reported income, cash flows and shareholders' equity.

Report of the Directors: Operating and Financial Review (continued)

We have significant exposure to counterparty risk within our portfolio

We have exposure to virtually all major industries and counterparties, and we routinely execute transactions with counterparties in financial services, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Many of these transactions expose us to credit risk in the event of default by our counterparty or client. Financial institutions are necessarily interdependent because of trading, clearing, counterparty or other relationships. As a consequence, a default by, or decline in market confidence in, individual institutions, or anxiety about the financial services industry generally, can lead to further individual and/or systemic losses. Our credit risk may remain high if the collateral taken to mitigate counterparty risk cannot be realised or has to be liquidated at prices which are insufficient to recover the full amount of our loan or derivative exposure. For further information relating to the major risk areas, see 'Areas of Special Interest' on page 103.

Macro-prudential and regulatory

We face a number of challenges in regulation and supervision

Financial services providers face increased regulation and supervision, with more stringent and costly requirements in the areas of capital and liquidity management and of compliance relating to conduct of business and the integrity of financial services delivery. Increased government intervention and control over financial institutions, together with measures to reduce systemic risk, could significantly alter the competitive landscape.

Recent regulatory and supervisory developments have largely been shaped by the leaders, Finance Ministers and Central Bank Governors of the Group of Twenty nations ('the G20'), who delegated the development and issuance of standards to the Basel Committee of Banking Supervisors ('the Basel Committee'). The G20 also established the Financial Stability Board ('FSB') to assess vulnerabilities affecting the financial system as a whole, as well as to monitor and advise on market developments and best practice in meeting regulatory standards.

In looking to address the systemic failures that caused the financial crisis of 2007-8, the authorities asserted two primary objectives: to establish a resilient system to reduce substantially the risks of failure of financial institutions and, in case failure in the end proved unavoidable, to have in place

measures to achieve orderly resolution without cost to taxpayers. Governments and regulators have embarked on significant change in the regulation of the financial system, highlighting the following priorities:

- a stronger international framework for prudential regulation, ensuring significantly increased liquidity and regulatory capital buffers and enhanced quality of capital;
- convergence towards a single set of high-quality, global, independent accounting standards, with particular focus on accounting for financial instruments and off-balance sheet exposures;
- strengthening the regulation of hedge funds and credit rating agencies, and improving the infrastructure for derivative transactions, including central counterparty clearing of over-the-counter derivatives;
- design and implementation of a system which will allow for the restructuring or resolution of financial institutions, without taxpayers ultimately bearing the burden;
- an increased role for colleges of supervisors to coordinate oversight of systemically significant institutions such as HSBC, and effective coordination of resolution regimes for failed banks;
- measures on financial sector compensation arrangements to prevent excessive short-term risk taking and mitigate systemic risk on a globally consistent basis; and
- a fair and substantial contribution by the financial sector towards paying for any burden associated with government interventions, where they occur, to repair and reduce risks from the financial system or to fund the resolution of problems.

Measures proposed by the Basel Committee to increase resilience in the financial system

The Basel Committee, following consultation, impact analyses and draft proposals during 2010, issued final proposals in December 2010, known as Basel III, on the twin areas of capital and liquidity, the key aspects of which are set out below.

- *Risk weightings*: increased weightings for the trading book and re-securitisations are planned for implementation by the end of 2011. A fundamental review of the trading book will continue during 2011.

Report of the Directors: Operating and Financial Review (continued)

- *Quality of capital:* there is renewed emphasis on common equity as the principal component of tier 1 capital, with increased deductions from shareholders' equity (calculated on an accounting basis) to determine the level of regulatory capital. The phasing-in periods for these new deductions will start in 2014, to be fully implemented by 2018.
- *Minimum ratios:* a new minimum common equity requirement of 4.5% is to be implemented in full by 1 January 2015. An additional capital conservation buffer of 2.5% in common equity effectively acts as a trigger for restrictions on management actions (such as the payment of dividends or bonuses) so that the capital structure can be rebuilt. This will be phased in between 1 January 2016 and 1 January 2019. In addition to these core tier 1 levels, additional requirements from the Basel Committee for tier 1 capital of 1.5% and tier 2 capital of 2.0%, by 2019, will lift the minimum total capital requirement for banks to around 10.5%.
- *Countercyclical capital buffer:* the Basel Committee has finalised its proposals for a countercyclical capital buffer of 2.5% in common equity, to be built up in periods of excess credit growth compared with GDP growth. It is not clear how these may operate in practice and there is doubt that either supervisors or the market would support release of a buffer again as the economic cycle turned.
- *Total leverage:* the Committee has proposed a leverage ratio of 3% of total assets to constrain aggregate size relative to the capital base. It is intended that an observation period of parallel running from 2013 to 2017 should enable a minimum standard to become mandatory in 2018.
- *Liquidity and funding:* a new minimum standard, the Liquidity Coverage Ratio, has been developed to promote the short-term resilience of a bank's liquidity risk profile. A Net Stable Funding Ratio has also been introduced to provide a sustainable maturity structure of assets and liabilities. As it is not yet clear what unintended consequences these measures may have, they will be phased in after observation periods in 2015 and 2018, respectively.
- The Basel Committee is also developing an approach, due by the end of 2011, to defining Global Systemically Important Financial Institutions ('G-SIFI's) to introduce more

rigorous oversight and co-ordinated assessment of their risks through international supervisory colleges, provide for higher levels of capital and liquidity resilience, and require mandatory recovery and resolution plans with institution-specific crisis cooperation agreements between cross-border crisis management groups.

A strong capital position has long been, and will remain, a key priority for HSBC. We are equipped to respond to the capital requirement standards of Basel III, as discussed further on pages 181 and 182, and to sustain future growth.

Other measures

- *Remuneration:* the FSB has issued principles on remuneration designed to guide regional and national authorities in establishing appropriate regimes to align remuneration in a risk-based manner with the long-term interests of stakeholders. The EU has implemented rule changes in the Capital Requirements Directive which impact the balance between fixed and variable remuneration, establishing limits on the percentage of bonus which can be paid in cash. Approaches to the issue remain divergent globally, however.
- *Bank levies:* a number of levies are being raised on banks, notably by the UK, Germany and France. There is a renewed US proposal to raise a financial crisis responsibility fee on certain financial companies with assets over US\$50bn. The European levies are calculated with reference to measures of stability of funding, in order to encourage more stable structures. In the UK, for example, the levy is to be charged at a rate of 0.075% on all liabilities excluding insured deposits and certain other elements, but with a lower rate for longer-term liabilities and uninsured deposits. Germany will hypothecate levy income to create resolution funds to support failing banks, while in other jurisdictions it will accrue to general tax revenues. Under the draft legislation, the UK levy is not tax deductible and does not meet the definition of an income tax for income statement purposes. For indicative purposes only, the UK levy that would be payable based on the closing 2010 balance sheet, after taking into account announced changes to deposit protection schemes in 2011, is estimated at US\$0.6bn.
- *Other taxes:* other areas of financial sector taxation being considered by the authorities are a Financial Activities Tax ('FAT'), a tax on profit and remuneration, and a Financial

Report of the Directors: Operating and Financial Review (continued)

Transaction Tax ('FTT') applied to a specified range of financial transactions. An IMF report for the G20 in 2010 saw merit in an FAT but did not recommend an FTT as it was felt not to address the key issues within the G20 mandate and might have unintended economic and regulatory consequences. In its Seoul 2010 communique the G20 did not promote any one approach for adoption. Both the European Commission and the UK Government are considering an FAT, which the former believes can work at EU level. The EU also sees merit in an FTT but, recognising the dependency on an international consensus, will continue to work within the G20 for its adoption.

- *The 'Volcker Rule'*: under the Dodd-Frank Act, banking organisations with operations in the US face limits on their ability to sponsor or invest in private equity or hedge funds and are prohibited from engaging in certain types of 'proprietary trading' in the US, subject to a number of exceptions allowing an entity significant leeway to engage in client-serving trading, such as market-making and underwriting, and risk-mitigating hedging activities. The ultimate impact of these restrictions will depend on how US regulators implement them in rulemaking.
- *Derivatives and central counterparties regulation*: as agreed by the G20, the authorities are seeking to reduce systemic risk and volatility relating to derivatives trading. In the US, the Dodd-Frank Act provides for an extensive regulatory framework for over the counter ('OTC') derivatives. In addition to the mandatory clearing, exchange trading and reporting of certain swaps and security-based swaps, it also requires the registration of swap dealers and major swap participants, making them subject to capital, margin, business conduct and record-keeping regulations. In September 2010, the EU Commission presented proposals, currently in negotiation, for all standardised OTC derivatives to be reported to trade repositories and centrally cleared by the end of 2012. The proposal disincentivises derivative contracts which are not eligible for central clearing by proposing higher capital requirements. Exemptions for foreign exchange swaps and forwards are currently being considered.
- *Markets in financial instruments*: the European Commission is conducting a major Review of the Markets in Financial Instruments Directive, potentially to extend its scope beyond equities to other asset classes including bonds, exchange-

traded funds and other equity-like and non-equity instruments, and to promote their trading on exchanges and other markets that will be subject to regulation. It also proposes giving additional power to regulators to ban trading in products that are eligible to be cleared but for which no clearing solution is currently available.

- *The UK Independent Commission on Banking*: this Commission was established to examine issues of banking activity and competition, including the potential impact on financial markets of a number of options to separate the retail and wholesale activities of universal banks. Responses to the opening consultation have been published and the Commission intends to publish an interim report in April 2011, with further consultation prior to a final report in September 2011. The UK Government is not bound to adopt the Commission's recommendations.
- *Recovery and resolution plans*: such plans are considered a key element in improving the ability of regulators to rescue (or 'resolve') firms when they get into difficulties without putting taxpayer monies at risk. Studies and pilots have been initiated by various official bodies on the resolution of financial firms and the international coordination of such exercises; the UK authorities have been at the forefront of work to develop approaches to this subject. The EU has consulted on a new framework for crisis management, including so-called 'bail-in' creditor write-down resolution. Legislative proposals are expected mid-2011. In the US, the Dodd-Frank Act established the Orderly Liquidation Authority which will ultimately provide a bank-like receivership process for large financial companies; resolution plans will be required of large financial institutions and rules for 'early remediation' will be forthcoming. There is currently no consistent approach and a number of key areas need to be addressed, including an international legal framework for addressing competing creditor claims and the application of collateral.

Restructuring of regulatory bodies

In addition to the significant volume of new regulation emanating from the Basel Committee and others, the landscape of financial sector regulation itself in a number of major Western countries is undergoing significant change, presenting its own challenges to the industry and its implementation of proposed reforms.

Report of the Directors: Operating and Financial Review (continued)

- In the EU, new authorities for segments of the financial services sector took up their powers with effect from 1 January 2011: the European Banking Authority, the European Securities Markets Authority and the European Insurance and Occupational Pension Authority. In addition, a European Systemic Risk Board will consider emerging macro-prudential risks.
- In the UK, the Financial Services Authority's ('FSA') prudential supervisory responsibilities will be transferred in 2012 to a Bank of England agency, the Prudential Regulatory Authority, while the Financial Conduct Authority will act as a single regulator of conduct of business for both retail and wholesale firms.
- In the US, the Dodd-Frank Act re-assigns responsibilities of existing agencies, demising the Office of Thrift Supervision and creating others, including a Financial Stability Oversight Council to address systemic matters and a Bureau of Consumer Protection.

Implementation risks

The extensive programme of regulatory change carries significant implementation risks for authorities and industry participants alike, including:

- *Disparities in implementation:* many official measures are proposals in development and negotiation, and have yet to be enacted into regional and national legislation. These processes could result in differing, fragmented and overlapping implementation around the world, leading to risks of regulatory arbitrage, a far from level competitive playing-field and increased compliance costs, especially for large, global financial institutions such as HSBC.
- *Timetable and market expectations:* while the Basel Committee has announced the timetable for its core proposals in Basel III, it remains uncertain how these and other measures will play out in practice, for instance with regard to differences in approach between Basel III and the Dodd-Frank Act in the US. Meanwhile, market expectations will exert pressure on institutions to assess and effect compliance well in advance of official timetables.
- *Wider economic impact and unforeseen consequences:* while the conclusions of official and industry studies have diverged, the measures proposed will clearly impact on financial and economic activity in ways that cannot yet be clearly foreseen. For example, higher capital requirements may seriously

constrain the availability of funds for lending to support economic recovery.

Credit Risk

Credit risk management

(Audited)

Credit risk is the risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises principally from direct lending, trade finance and leasing business, but also from off-balance sheet products such as counterparty risk guarantees and credit derivatives, and from our holdings of debt securities. Of the risks in which we engage, credit risk generates the largest regulatory capital requirement.

Principal objectives of our credit risk management

- to maintain across HSBC a strong culture of responsible lending and a robust risk policy and control framework;
- to both partner and challenge our businesses in defining, implementing and continually re-evaluating our risk appetite under actual and scenario conditions; and
- to ensure there is independent, expert scrutiny of credit risks, their costs and their mitigation.

The Credit Risk department fulfils the role of an independent credit control unit as part of the Global Risk function in our Group Management Office ('GMO'). Credit approval authorities are delegated by the Board to the most senior Chief Executive Officers, who receive commensurate authorities from their own boards. In each major subsidiary, a Chief Risk Officer reports to the local Chief Executive Officer on credit-related issues, while maintaining a direct functional reporting line to the Group Chief Risk Officer in GMO.

Credit quality

(Audited)

Our credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. In the case of individually significant accounts, risk ratings are reviewed regularly and any amendments are implemented promptly. Within our retail businesses, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

Our risk rating system facilitates the internal ratings-based ('IRB') approach under Basel II adopted by the Group to support calculation of our minimum credit regulatory capital requirement. For further details, see 'Credit quality of financial instruments' on page 114.

Report of the Directors: Operating and Financial Review (continued)

Special attention is paid to problem exposures in order to accelerate remedial action. Where appropriate, our operating companies use specialist units to provide customers with support in order to help them avoid default wherever possible.

The high-level oversight and management of credit risk provided globally by the Credit Risk function within GMO

- to formulate Group credit policy. Compliance, subject to approved dispensations, is mandatory for all operating companies which must develop local credit policies consistent with Group policies;
- to guide operating companies on our appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain higher-risk sectors;
- to undertake an independent review and objective assessment of risk. Global Risk assesses all commercial non-bank credit facilities and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken;
- to monitor the performance and management of portfolios across the Group;
- to control exposure to sovereign entities, banks and other financial institutions, as well as debt securities which are not held solely for the purpose of trading;
- to set our policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to our capital base, and remain within internal and regulatory limits;
- to control our cross-border exposures (see page 102);
- to maintain and develop our risk rating framework and systems. The Group Chief Risk Officer chairs the Credit Risk Analytics Oversight Committee, which reports to the Risk Management Meeting and oversees risk rating model governance for both wholesale and retail business;
- to report on retail portfolio performance, high risk portfolios, risk concentrations, country limits and cross-border exposures, large impaired accounts, impairment allowances and stress testing results and recommendations to the Risk Management Meeting, the Group Risk Committee and the Board; and
- to act on behalf of HSBC Holdings as the primary interface, for credit-related issues, with the Bank of England, the FSA, local regulators, rating agencies, analysts and counterparts in major banks and non-bank financial institutions.

Group and regional Credit Review and Risk Identification teams regularly review exposures and processes in order to provide an independent, rigorous assessment of credit risk across the HSBC Group, reinforce secondary risk management controls and share best practice. Internal audit, as a tertiary control function, focuses on risks with a global perspective and on the design and effectiveness of primary and secondary controls, carrying out oversight audits via sampling of global/regional control frameworks, themed audits of key or emerging risks and project audits to assess major change initiatives.

Impairment assessment

(Audited)

It is HSBC's policy that each operating company creates allowances for impaired loans promptly and consistently.

Impairment allowances may be assessed and created either for individually significant accounts or, on a collective basis, for groups of individually significant accounts for which no evidence of impairment has been individually identified or for high-volume groups of homogeneous loans that are not considered individually significant.

When impairment losses occur, we reduce the carrying amount of loans and advances through the use of an allowance account. When impairment of available-for-sale financial assets and held-to-maturity financial investments occurs, we reduce the carrying amount of the asset directly. For further details, see 'Critical accounting policies' on page 33.

Write-off of loans and advances

Loans are normally written off, either partially or in full, when there is no realistic prospect of further recovery. For secured loans, write-off generally occurs after receipt of any proceeds from the realisation of security. Write-off may occur earlier when the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery.

In HSBC Finance, the carrying amounts of residential mortgage and second lien loans in excess of net realisable value are written off at or before the time foreclosure is completed or settlement is reached with the borrower. If there is no reasonable expectation of recovery, and foreclosure is pursued, the loan is normally written off no later than the end of the month in which the loan becomes 180 days contractually past due.

Unsecured personal facilities, including credit cards, are generally written off at between 150 and 210 days past due, the standard period being the end of the month in which the account becomes 180 days contractually delinquent. Write-off periods may be extended, generally to no more than 360 days past due but in very exceptional circumstances exceeding that figure, in a few countries where local regulation or legislation constrain earlier write-off, or where the realisation of collateral for secured real estate lending extends to this time.

In the event of bankruptcy or analogous proceedings, write-off may occur earlier than at the

Report of the Directors: Operating and Financial Review (continued)

periods stated above. Collections procedures may continue after write-off.

Cross-border exposures

We assess the vulnerability of countries to foreign currency payment restrictions, including economic and political factors, when considering impairment allowances on cross-border exposures. Impairment allowances are assessed in respect of all qualifying exposures within vulnerable countries unless these exposures and the inherent risks are:

- performing, trade-related and of less than one year's maturity;
- mitigated by acceptable security cover which is, other than in exceptional cases, held outside the country concerned;
- in the form of securities held for trading purposes for which a liquid and active market exists, and which are measured at fair value daily; and
- performing facilities with a principal (excluding security) of US\$1m or below and/or with maturity dates shorter than three months.

Credit exposure

Maximum exposure to credit risk

(Audited)

Our credit exposure is spread across a broad range of asset classes, including derivatives, trading assets, loans and advances to customers, loans and advances to banks and financial investments. In 2010, exposure to credit risk remained diversified across classes. However, the balance changed compared with the end of 2009, reflecting growth in loans and advances to both customers and banks, and a reduction in trading assets due to the deconsolidation of the Constant Net Asset Value funds.

Residential mortgage lending continued to represent a significant portion of our overall credit exposure. In 2010, the credit quality of our mortgage portfolios generally improved, reflecting economic conditions and a stabilisation of unemployment and house prices in most of our key markets. Despite

some improvement, economic and housing market conditions remain difficult across the US and we remain focused on running off the residual balances in our Consumer Lending and Mortgage Services portfolio. In the UK, we grew our residential mortgage lending exposure as a result of successful promotional campaigns and competitive pricing. The consistent application of conservative underwriting criteria ensured the credit quality of our residential mortgage exposure in the UK remained satisfactory and well secured. Our exposure to the Hong Kong residential mortgage market also grew during 2010; we continued to lend conservatively with an average loan-to-value ratio of 55% on new mortgage sales. For further commentary on personal lending, see 'Areas of special interest — Personal Lending' on page 106.

Loss experience: percentage of total loan impairment charges and other credit risk provisions
(Unaudited)



The following table presents the maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements (unless such credit enhancements meet accounting offsetting requirements). For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees and similar contracts granted, it is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, it is generally the full amount of the committed facilities.

Report of the Directors: Operating and Financial Review (continued)*Maximum exposure to credit risk**(Audited)*

	At 31 December 2010			At 31 December 2009		
	Maximum exposure US\$m	Offset US\$m	Exposure to credit risk (net) US\$m	Maximum exposure US\$m	Offset US\$m	Exposure to credit risk (net) US\$m
Cash and balances at central banks	57,383	–	57,383	60,655	–	60,655
Items in the course of collection from other banks	6,072	–	6,072	6,395	–	6,395
Hong Kong Government certificates of indebtedness	19,057	–	19,057	17,463	–	17,463
Trading assets	343,966	(4,189)	339,777	386,070	(8,496)	377,574
Treasury and other eligible bills	25,620	–	25,620	22,346	–	22,346
Debt securities	168,268	–	168,268	201,598	–	201,598
Loans and advances to banks	70,456	–	70,456	78,126	–	78,126
Loans and advances to customers	79,622	(4,189)	75,433	84,000	(8,496)	75,504
Financial assets designated at fair value	19,593	–	19,593	22,198	–	22,198
Treasury and other eligible bills	159	–	159	223	–	223
Debt securities	18,248	–	18,248	20,718	–	20,718
Loans and advances to banks	315	–	315	354	–	354
Loans and advances to customers	871	–	871	903	–	903
Derivatives	260,757	(197,501)	63,256	250,886	(189,606)	61,280
Loans and advances held at amortised cost	1,166,637	(91,966)	1,074,671	1,076,012	(91,127)	984,885
– to banks	208,271	(3,099)	205,172	179,781	(116)	179,665
– to customers	958,366	(88,867)	869,499	896,231	(91,011)	805,220
Financial investments	392,772	–	392,772	360,034	–	360,034
Treasury and other similar bills	57,129	–	57,129	58,434	–	58,434
Debt securities	335,643	–	335,643	301,600	–	301,600
Other assets	30,371	(29)	30,342	36,373	(4)	36,369
Endorsements and acceptances	10,116	(29)	10,087	9,311	(4)	9,307
Other	20,255	–	20,255	27,062	–	27,062
Financial guarantees and similar contracts	49,436	–	49,436	53,251	–	53,251
Loan and other credit-related commitments ¹	602,513	–	602,513	558,050	–	558,050
	2,948,557	(293,685)	2,654,872	2,827,387	(289,233)	2,538,154

For footnote, see page 174.

Collateral and other credit enhancements*(Audited)*

Collateral held against financial instruments presented in the above table is described in more detail below.

Loans and advances

Although collateral can be an important mitigant of credit risk, it is our policy to lend on the basis of the customer's capacity to repay rather than to rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured.

We employ the following principal collateral types:

- in the personal sector, mortgages over residential properties;
- in the commercial and industrial sector, charges over business assets such as premises, stock and debtors;

- in the commercial real estate sector, charges over the properties being financed; and

- in the financial sector, charges over financial instruments such as cash, debt securities and equities in support of trading facilities.

In addition, credit derivatives and securitisation structures are used to hedge or transfer credit risk within our loan portfolio.

The loans and advances offset adjustment in the table above primarily relates to customer loans and deposits, and balances arising from repo and reverse repo transactions. The offset relates to balances where there is a legally enforceable right of offset in the event of counterparty default, and where, as a result, there is a net exposure for credit risk management purposes. However, as there is no intention to settle these balances on a net basis under normal circumstances, they do not qualify for net presentation for accounting purposes.

Report of the Directors: Operating and Financial Review (continued)

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

Derivatives

The International Swaps and Derivatives Association ('ISDA') Master Agreement is our preferred agreement for documenting derivatives activity. It provides the contractual framework within which dealing activity across a full range of OTC products is conducted, and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or another pre-agreed termination event occurs. It is common, and our preferred practice, for the parties to execute a Credit Support Annex ('CSA') in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between the parties to mitigate the counterparty risk inherent in outstanding positions. The majority of our CSAs are with financial institutional clients.

The derivative offset amount in the above table relates to exposures where the counterparty has an offsetting derivative exposure with HSBC, a master netting arrangement is in place and the credit risk exposure is managed on a net basis, or the position is specifically collateralised, normally in the form of cash. At 31 December 2010, the total amount of such offsets was US\$197.5bn (2009: US\$189.6bn), of which US\$178.3bn (2009: US\$168.5bn) were offsets under a master netting arrangement, US\$19.0bn (2009: US\$21.0bn) were collateral received in cash and US\$0.2bn (2009: US\$0.1bn) were other collateral. These amounts do not qualify for net presentation for accounting purposes, as settlement may not actually be made on a net basis.

Treasury, other eligible bills and debt securities

Debt securities, treasury and other eligible bills are generally unsecured except for asset-backed securities ('ABS') and similar instruments, which are secured by pools of financial assets.

Items in the course of collection from other banks

Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt of cash, securities or equities. Daily settlement limits are established for counterparties to cover the aggregate of our transactions with each one on any single day.

We substantially mitigate settlement risk on many transactions, particularly those involving

securities and equities, by settling through assured payment systems or on a delivery-versus-payment basis.

Concentration of exposure

(Audited)

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or such counterparties are engaged in similar activities or operate in the same geographical areas or industry sectors, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. We use a number of controls and measures to minimise undue concentration of exposure in our portfolios across industry, country and customer groups. These include portfolio and counterparty limits, approval and review controls, and stress testing.

Wrong-way risk is an aggravated form of concentration risk and arises when there is a strong correlation between the counterparty's probability of default and the mark-to-market value of the underlying transaction. We use a range of procedures to monitor and control wrong-way risk, including requiring entities to obtain prior approval before undertaking wrong-way risk transactions outside pre-agreed guidelines.

Securities held for trading

(Unaudited)

A detailed analysis of securities held for trading is set out in Note 15 on the Financial Statements and an analysis of credit quality is provided on page 114.

Debt securities, treasury and other eligible bills

(Unaudited)

HSBC's holdings of corporate debt, ABS and other securities were spread across a wide range of issuers and geographical regions, with 25% invested in securities issued by banks and other financial institutions. A more detailed analysis of financial investments is set out in Note 21 on the Financial Statements and an analysis by credit quality is provided on page 114.

At 31 December 2010, our insurance businesses held diversified portfolios of debt and equity securities designated at fair value (2010: US\$28bn; 2009: US\$25bn) and debt securities classified as financial investments (2010: US\$38bn; 2009: US\$35bn). A more detailed analysis of securities held by the insurance businesses is set out on page 162.

Report of the Directors: Operating and Financial Review (continued)

Derivatives

(Unaudited)

Derivative assets at 31 December 2010 were US\$261bn, a rise of 4% from 31 December 2009. Our single largest exposure was to interest rate derivatives, and this balance increased in 2010 reflecting downward shifts in yield curves, partly offset by higher netting from increased trading with clearing houses. The notional value of outstanding contracts also rose, reflecting an increase in the number of open transactions compared with 2009. In addition our exposure to exchange rate derivatives rose as a result of increased volatility.

Loans and advances

(Unaudited)

On a reported basis, gross loans and advances to customers (excluding the financial sector) at 31 December 2010 increased by US\$52bn or 6% from 31 December 2009. On a constant currency basis the increase was 7%. The rise was primarily due to growth in Asia, mainly in trade-related lending and, to a lesser extent, our commercial real estate and personal lending portfolios, as the region prospered.

Summary of gross loans and advances to customers (Unaudited)



The following commentary is on a constant currency basis:

Personal lending was US\$425bn, a decline of 2% compared with the end of 2009 as growth in residential mortgage lending was more than offset by lower other personal lending balances. Personal lending represented 43% of our total lending to customers. At US\$269bn, residential mortgage lending constituted the Group's largest concentration in a single exposure type. In 2010, residential mortgage lending increased by 4%, reflecting strong growth in new mortgage sales in Hong Kong and the UK. This was partly offset by a 12% decline in the US, mainly due to the continued run-off of our Consumer Lending and Mortgage Services portfolios.

Corporate and commercial lending was 46% of gross lending to customers at 31 December 2010, comprising our largest lending category. Commercial, industrial and international trade represented the largest portion of this category and this increased by 23% in the year, reflecting the growth in trade activity, particularly in Asia. Commercial real estate lending, which represented 7% of total gross lending to customers, increased by 5% due to strong growth in Hong Kong.

In the financial category, our largest exposure was to non-bank financial institutions; this largely comprised secured lending on trading accounts, mainly repo facilities.

Loans and advances to banks were widely distributed across major institutions in 2010 and increased by 16% as placements with central and commercial banks in Europe, Asia and Latin America rose.

The following tables analyse loans by industry sector and by the location of the principal operations of the lending subsidiary or, in the case of the operations of The Hongkong and Shanghai Banking Corporation, HSBC Bank, HSBC Bank Middle East and HSBC Bank USA, by the location of the lending branch.

Report of the Directors: Operating and Financial Review (continued)

Gross loans and advances by industry sector (Audited)

	2010 US\$m	Currency effect US\$m	Move- ment US\$m	2009 US\$m	2008 US\$m	2007 US\$m	2006 US\$m
Personal ²	425,320	(2,026)	(6,860)	434,206	440,227	500,834	476,146
Residential mortgages ^{2,3}	268,681	(1,707)	9,719	260,669	243,337	269,068	265,337
Other personal ^{2,4}	156,639	(319)	(16,579)	173,537	196,890	231,766	210,809
Corporate and commercial	445,512	(5,297)	67,719	383,090	407,474	400,771	343,107
Commercial, industrial and international trade	237,694	(2,948)	44,514	196,128	209,840	202,038	162,109
Commercial real estate	71,880	(773)	3,264	69,389	70,969	72,345	60,366
Other property-related	34,838	222	4,096	30,520	30,739	33,907	27,165
Government	8,594	(14)	1,919	6,689	6,544	5,708	8,990
Other commercial ⁵	92,506	(1,784)	13,926	80,364	89,382	86,773	84,477
Financial	101,725	(3,540)	8,615	96,650	101,085	99,148	62,458
Non-bank financial institutions	100,163	(3,544)	8,470	95,237	99,536	96,781	59,204
Settlement accounts	1,562	4	145	1,413	1,549	2,367	3,254
Asset-backed securities reclassified	5,892	(319)	(1,616)	7,827	7,991	–	–
Total gross loans and advances to customers ('TGLAC') ⁶	978,449	(11,182)	67,858	921,773	956,777	1,000,753	881,711
Gross loans and advances to banks	208,429	(8)	28,549	179,888	153,829	237,373	185,212
Total gross loans and advances	1,186,878	(11,190)	96,407	1,101,661	1,110,606	1,238,126	1,066,923
Impaired loans and advances to customers	28,091	(254)	(2,261)	30,606	25,352	19,582	15,071
– as a percentage of TGLAC	2.9%			3.3%	2.6%	2.0%	1.7%
Impairment allowances on loans and advances to customers	20,083	(75)	(5,384)	25,542	23,909	19,205	13,578
– as a percentage of TGLAC	2.1%			2.8%	2.5%	1.9%	1.5%
Charge for impairment losses	13,548	321	(11,715)	24,942	24,131	17,177	10,547
New allowances net of allowance releases	14,568	353	(11,617)	25,832	24,965	18,182	11,326
Recoveries	(1,020)	(32)	(98)	(890)	(834)	(1,005)	(779)

For footnotes, see page 174.

Report of the Directors: Operating and Financial Review (continued)

Gross loans and advances to customers by industry sector and by geographical region
(Audited)

	Gross loans and advances to customers						Total US\$m	As a % of total gross loans %
	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m		
At 31 December 2010								
Personal	161,717	57,308	40,184	5,371	139,117	21,623	425,320	43.4
Residential mortgages ³	111,618	42,488	28,724	1,751	78,842	5,258	268,681	27.4
Other personal ⁴	50,099	14,820	11,460	3,620	60,275	16,365	156,639	16.0
Corporate and commercial	203,804	80,823	67,247	19,560	38,707	35,371	445,512	45.6
Commercial, industrial and international trade	111,980	33,451	41,274	11,173	16,737	23,079	237,694	24.3
Commercial real estate	30,629	19,678	8,732	1,085	8,768	2,988	71,880	7.3
Other property-related	6,401	15,232	5,426	1,785	5,109	885	34,838	3.6
Government	2,289	2,339	415	1,345	89	2,117	8,594	0.9
Other commercial ⁵	52,505	10,123	11,400	4,172	8,004	6,302	92,506	9.5
Financial	70,725	3,189	2,259	1,347	21,202	3,003	101,725	10.4
Non-bank financial institutions	70,019	2,824	2,058	1,335	21,109	2,818	100,163	10.2
Settlement accounts	706	365	201	12	93	185	1,562	0.2
Asset-backed securities reclassified	5,216	–	–	–	676	–	5,892	0.6
TGLAC⁶	441,462	141,320	109,690	26,278	199,702	59,997	978,449	100.0
Percentage of TGLAC by geographical region	45.2%	14.4%	11.2%	2.7%	20.4%	6.1%	100.0%	
Impaired loans	10,557	660	1,324	2,433	10,727	2,390	28,091	
– as a percentage of TGLAC	2.4%	0.5%	1.2%	9.3%	5.4%	4.0%	2.9%	
Total impairment allowances	5,663	629	959	1,652	9,170	2,010	20,083	
– as a percentage of TGLAC	1.3%	0.4%	0.9%	6.3%	4.6%	3.4%	2.1%	
At 31 December 2009								
Personal	162,562	47,946	32,514	6,405	163,934	20,845	434,206	47.2
Residential mortgages ³	109,872	35,292	21,983	1,898	86,591	5,033	260,669	28.3
Other personal ⁴	52,690	12,654	10,531	4,507	77,343	15,812	173,537	18.9
Corporate and commercial ⁷	202,919	49,340	46,175	16,604	40,902	27,150	383,090	41.5
Commercial, industrial and international trade	112,374	17,728	28,228	9,336	11,528	16,934	196,128	21.3
Commercial real estate	33,853	13,782	6,475	1,309	11,527	2,443	69,389	7.5
Other property-related	6,231	10,062	3,863	1,357	8,452	555	30,520	3.3
Government	2,216	441	595	1,356	208	1,873	6,689	0.7
Other commercial ⁵	48,245	7,327	7,014	3,246	9,187	5,345	80,364	8.7
Financial	73,851	2,899	2,350	1,213	14,150	2,187	96,650	10.5
Non-bank financial institutions	73,225	2,462	2,246	1,206	13,963	2,135	95,237	10.3
Settlement accounts	626	437	104	7	187	52	1,413	0.2
Asset-backed securities reclassified	6,284	–	–	–	1,543	–	7,827	0.8
TGLAC⁶	445,616	100,185	81,039	24,222	220,529	50,182	921,773	100.0
Percentage of TGLAC by geographical region	48.3%	10.9%	8.8%	2.6%	23.9%	5.5%	100.0%	
Impaired loans	10,722	841	1,200	1,646	13,246	2,951	30,606	
– as a percentage of TGLAC	2.4%	0.8%	1.5%	6.8%	6.0%	5.9%	3.3%	
Total impairment allowances	6,135	804	996	1,378	13,676	2,553	25,542	
– as a percentage of TGLAC	1.4%	0.8%	1.2%	5.7%	6.2%	5.1%	2.8%	

For footnotes, see page 174.

Report of the Directors: Operating and Financial Review (continued)

Loans and advances to banks by geographical region (Audited)

	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Loans and advances to banks US\$m	Impair- ment allowances US\$m
At 31 December 2010^s	78,239	33,585	40,437	9,335	19,479	27,354	208,429	(158)
At 31 December 2009	65,614	36,197	35,648	8,435	15,386	18,608	179,888	(107)
At 31 December 2008	62,012	29,646	28,665	7,476	11,458	14,572	153,829	(63)
At 31 December 2007	104,534	63,737	32,373	7,488	16,566	12,675	237,373	(7)
At 31 December 2006	76,837	50,359	19,716	7,801	17,865	12,634	185,212	(7)

Gross loans and advances to customers by country (Audited)

	Residential mortgages US\$m	Other personal US\$m	Property- related US\$m	Commercial, international trade and other US\$m	Total US\$m
At 31 December 2010					
Europe	111,618	50,099	37,030	242,715	441,462
UK	103,037	25,636	26,002	165,283	319,958
France	3,749	9,550	8,737	56,613	78,649
Germany	11	356	79	4,015	4,461
Malta	1,656	599	563	1,643	4,461
Switzerland	1,358	10,708	114	1,837	14,017
Turkey	809	2,817	210	2,783	6,619
Other	998	433	1,325	10,541	13,297
Hong Kong	42,488	14,820	34,910	49,102	141,320
Rest of Asia-Pacific	28,724	11,460	14,158	55,348	109,690
Australia	8,405	1,267	2,346	4,867	16,885
India	920	526	680	4,583	6,709
Indonesia	74	531	115	3,374	4,094
Japan	226	199	1,214	2,503	4,142
Mainland China	2,046	310	3,836	12,932	19,124
Malaysia	3,833	2,053	1,361	4,845	12,092
Singapore	6,571	3,661	3,262	7,846	21,340
South Korea	2,295	248	58	2,494	5,095
Taiwan	3,002	527	135	2,832	6,496
Vietnam	35	162	59	1,255	1,511
Other	1,317	1,976	1,092	7,817	12,202
Middle East (excluding Saudi Arabia)	1,751	3,620	2,870	18,037	26,278
Egypt	3	396	111	2,484	2,994
Qatar	8	491	404	918	1,821
United Arab Emirates	1,477	2,099	1,359	11,043	15,978
Other	263	634	996	3,592	5,485
North America	78,842	60,275	13,877	46,708	199,702
US	57,630	51,686	8,269	31,496	149,081
Canada	19,505	8,070	5,079	14,711	47,365
Bermuda	1,707	519	529	501	3,256
Latin America	5,258	16,365	3,873	34,501	59,997
Argentina	30	918	103	2,172	3,223
Brazil	1,111	10,979	1,816	17,093	30,999
Mexico	2,097	2,365	1,146	8,622	14,230
Panama	1,155	982	489	3,794	6,420
Other	865	1,121	319	2,820	5,125
Total	268,681	156,639	106,718	446,411	978,449

Report of the Directors: Operating and Financial Review (continued)

	Residential mortgages US\$m	Other personal US\$m	Property-related US\$m	Commercial, international trade and other US\$m	Total US\$m
At 31 December 2009					
Europe	109,872	52,690	40,084	242,970	445,616
UK	100,667	29,018	28,339	175,513	333,537
France	4,326	10,224	9,429	48,570	72,549
Germany	10	404	90	3,689	4,193
Malta	1,730	612	660	1,689	4,691
Switzerland	1,301	9,197	175	1,413	12,086
Turkey	843	2,778	150	2,490	6,261
Other	995	457	1,241	9,606	12,299
Hong Kong	35,292	12,654	23,844	28,395	100,185
Rest of Asia-Pacific	21,983	10,531	10,338	38,187	81,039
Australia	5,919	993	1,785	3,496	12,193
India	883	864	458	3,002	5,207
Indonesia	59	571	71	2,114	2,815
Japan	109	149	796	1,444	2,498
Mainland China	1,503	319	2,633	8,915	13,370
Malaysia	2,925	1,717	1,085	3,548	9,275
Singapore	5,149	3,041	2,407	4,251	14,848
South Korea	2,093	407	30	1,932	4,462
Taiwan	2,205	503	53	1,578	4,339
Vietnam	23	132	51	1,042	1,248
Other	1,115	1,835	969	6,865	10,784
Middle East (excluding Saudi Arabia)	1,898	4,507	2,666	15,151	24,222
Egypt	4	326	126	2,132	2,588
Qatar	9	624	416	841	1,890
United Arab Emirates	1,650	2,881	1,395	8,848	14,774
Other	235	676	729	3,330	4,970
North America	86,591	77,343	19,979	36,616	220,529
US	65,784	69,275	8,922	25,747	169,728
Canada	19,228	7,526	10,641	10,339	47,734
Bermuda	1,579	542	416	530	3,067
Latin America	5,033	15,812	2,998	26,339	50,182
Argentina	31	628	49	1,689	2,397
Brazil	717	10,494	1,076	12,111	24,398
Mexico	2,259	2,702	995	6,762	12,718
Panama	1,151	973	475	3,464	6,063
Other	875	1,015	403	2,313	4,606
Total	260,669	173,537	99,909	387,658	921,773

Country distribution of outstandings and cross-border exposures (Unaudited)

We control the risk associated with cross-border lending through a centralised structure of internal country limits. Exposures to individual countries and cross-border exposure in the aggregate are kept under continual review.

The following table summarises the aggregate of in-country foreign currency and cross-border outstandings by type of borrower to countries which individually represent in excess of 0.75% of our total

assets. The classification is based on the country of residence of the borrower but also recognises the transfer of country risk in respect of third-party guarantees, eligible collateral held and residence of the head office when the borrower is a branch. In accordance with the Bank of England Country Exposure Report (Form CE) guidelines, outstandings comprise loans and advances (excluding settlement accounts), amounts receivable under finance leases, acceptances, commercial bills, certificates of deposit ('CD's) and debt and equity securities (net of short positions), and exclude accrued interest and intra-HSBC exposures.

Report of the Directors: Operating and Financial Review (continued)

*In-country foreign currency and cross-border amounts outstanding
(Unaudited)*

	Banks US\$bn	Government and official institutions US\$bn	Other US\$bn	Total US\$bn
At 31 December 2010				
UK	27.6	6.3	51.6	85.5
US	13.6	37.6	17.6	68.8
France	23.8	11.1	11.2	46.1
Hong Kong	15.4	1.6	17.2	34.2
Mainland China	21.5	1.2	9.1	31.8
Japan	14.0	16.2	1.3	31.5
Germany	17.8	4.2	9.4	31.4
At 31 December 2009				
UK	37.5	7.0	38.0	82.5
US	10.7	29.3	25.7	65.7
France	27.0	10.7	7.7	45.4
Germany	21.9	15.0	4.5	41.4
The Netherlands ⁹	10.3	1.7	7.6	19.6
At 31 December 2008				
UK	38.4	7.1	33.8	79.3
US	13.6	26.4	34.1	74.1
France	19.9	12.1	7.9	39.9
Germany	18.9	8.0	6.7	33.6
The Netherlands	14.1	1.9	10.3	26.3
Japan ⁹	2.6	19.4	2.3	24.3

For footnote, see page 174.

Areas of special interest**Wholesale lending**

(Unaudited)

Wholesale lending covers the range of credit facilities granted to sovereign borrowers, banks, non-bank financial institutions and corporate entities. Our wholesale portfolios are well diversified across geographical and industry sectors, with certain exposures subject to specific portfolio controls. Overall credit quality improved during 2010, as economies generally demonstrated signs of recovery.

Exposures to countries in the eurozone

(Unaudited)

Intervention by governments to stabilise and re-capitalise banks and other financial intermediaries during the financial crisis helped to reduce the possibility of a systemic threat to financial markets by transferring risk from the private sector to sovereign bodies. In 2010, this contributed to the creation of large fiscal imbalances in some industrialised economies and as a result, market concerns about sovereign credit risk in these countries intensified. Credit spreads for the affected sovereign and bank credit markets remained volatile during most of 2010. Risk aversion resurfaced, and the assumption of higher

sovereign credit risk premia in private securities prices triggered portfolio reallocation to safer assets and a tightening of market liquidity. Initial concerns over liquidity and funding spread to doubts about solvency in a number of cases. The table below summarises our exposures to governments and central banks of selected eurozone countries, and near/quasi government agencies and banks domiciled in those countries. An analysis of loans and advances to customers by significant countries is provided on page 101.

Our exposure to eurozone countries under pressure in 2010 was US\$25.4bn.

Sovereign debt

As a result of the disruption in global financial markets, the eurozone experienced a severe recession, followed by a sovereign debt crisis in some member countries, where the high level of government deficits, banking system problems, fiscal imbalances and low or declining GDP growth increased their perceived vulnerability to a future downturn. Various financial and political stresses forced Greece and Ireland to seek a bailout by the ECB and the International Monetary Fund ('IMF') in May and November 2010, respectively, and contagion risk to peripheral countries, notably Italy, Portugal and Spain persisted. Belgium was also

Report of the Directors: Operating and Financial Review (continued)

Exposures to selected eurozone countries¹⁰ (Unaudited)

	At 31 December 2010						Total US\$bn
	Not held for trading			Held for trading			
	Cash and lending to banks ¹¹ US\$bn	Financial investments US\$bn	Total balances US\$bn	Net debt securities and loans US\$bn	Derivatives ¹² US\$bn	Total balances US\$bn	
Belgium							
Sovereign and agencies	0.2	0.7	0.9	0.6	–	0.6	1.5
Banks	5.8	0.3	6.1	1.5	1.2	2.7	8.8
	<u>6.0</u>	<u>1.0</u>	<u>7.0</u>	<u>2.1</u>	<u>1.2</u>	<u>3.3</u>	<u>10.3</u>
Greece							
Sovereign and agencies	–	0.3	0.3	0.8	–	0.8	1.1
Banks	–	–	–	0.6	–	0.6	0.6
	<u>–</u>	<u>0.3</u>	<u>0.3</u>	<u>1.4</u>	<u>–</u>	<u>1.4</u>	<u>1.7</u>
Ireland							
Sovereign and agencies	–	0.2	0.2	0.1	0.1	0.2	0.4
Banks	0.2	0.5	0.7	1.1	0.4	1.5	2.2
	<u>0.2</u>	<u>0.7</u>	<u>0.9</u>	<u>1.2</u>	<u>0.5</u>	<u>1.7</u>	<u>2.6</u>
Italy							
Sovereign and agencies	–	1.7	1.7	1.8	–	1.8	3.5
Banks	1.9	0.4	2.3	0.2	–	0.2	2.5
	<u>1.9</u>	<u>2.1</u>	<u>4.0</u>	<u>2.0</u>	<u>–</u>	<u>2.0</u>	<u>6.0</u>
Portugal							
Sovereign and agencies	–	0.1	0.1	–	–	–	0.1
Banks	0.3	0.1	0.4	0.1	–	0.1	0.5
	<u>0.3</u>	<u>0.2</u>	<u>0.5</u>	<u>0.1</u>	<u>–</u>	<u>0.1</u>	<u>0.6</u>
Spain							
Sovereign and agencies	0.1	0.9	1.0	0.7	0.1	0.8	1.8
Banks	0.8	0.2	1.0	1.4	–	1.4	2.4
	<u>0.9</u>	<u>1.1</u>	<u>2.0</u>	<u>2.1</u>	<u>0.1</u>	<u>2.2</u>	<u>4.2</u>
Total							
Sovereign and agencies	0.3	3.9	4.2	4.0	0.2	4.2	8.4
Banks	9.0	1.5	10.5	4.9	1.6	6.5	17.0
	<u>9.3</u>	<u>5.4</u>	<u>14.7</u>	<u>8.9</u>	<u>1.8</u>	<u>10.7</u>	<u>25.4</u>

For footnotes, see page 174.

under pressure, but for its specific political situation. Rating agencies downgraded the debt of a number of eurozone countries during 2010 and put some on review for possible downgrades. While the ECB continues to provide broad access to liquidity support for eurozone sovereign borrowers and banks, the availability of longer-term fiscal support from the EU for sovereigns is less certain and may lead to debt restructuring and increased private sector participation.

The eurozone as a whole retained substantial economic and financial strength despite the stresses from the financial crisis. However, concerns remained over the refinancing risks for sovereign borrowers and banks posed by the problems with market liquidity and the uncertainty surrounding support arrangements in the longer term. Eurozone policymakers have created two major facilities to counter short-term financing problems, the European Financial Stability Facility and the European

Financial Stability Mechanism. This has been viewed as a positive development by the market and rating agencies, though implementation awaits disclosure of further details by the policymakers. We expect the ECB and eurozone countries will focus in 2011 on resolving intra-eurozone imbalances, rebuilding public finances, improving fiscal discipline, strengthening the banking system and managing cross-border risk.

We have closely managed our exposure to sovereign debt during 2010. At the end of the year, our exposure to the sovereign debt of Belgium, Greece, Ireland, Italy, Portugal and Spain was US\$8.4bn and the overall quality of the portfolio was strong with most in-country and cross-border limits extended to countries with high-grade internal credit risk ratings. We regularly update our assessment of higher risk countries and adjust our risk appetite to reflect such changes.

Report of the Directors: Operating and Financial Review (continued)

European banks

In May 2010, an FSB review indicated that European banks would have to make additional loan impairment charges of up to US\$143bn in 2011. Following the publication of this report, bond spreads on both European and US banks widened. The size of the financial sector's exposure to sovereign debt and doubts about economic conditions in parts of the eurozone raised fresh concerns about banks' credit ratings. In addition, uncertainty over liquidity, solvency, funding, changing regulation, capital requirements and taxation, and speculation over the stability of the euro, continued to cloud the future for European banking.

The banking sector in the eurozone remains under stress, mainly as a consequence of governments having to finance large budget deficits, troubles in property markets and weak credit growth. The Ireland bailout was a direct consequence of the failure of the Irish banking sector, largely driven by the domestic property price crash. Worries about the size and quality of eurozone banks' exposure to weaker eurozone countries are entwined with concerns about their ability to fund themselves. European banks share nearly three quarters of the public and private sector debt in Belgium, Greece, Ireland, Italy, Portugal and Spain. The regional and local banks in the eurozone are considered more vulnerable than well-diversified global banks.

During 2010, we were subject to the Committee of European Banking Supervisors (now the European Banking Authority) coordinated stress test of 91 EU financial institutions. Banks were required to meet a 6% minimum tier 1 target under stress. We passed the test satisfactorily, with a post-stress tier 1 ratio of 10.2% placing us in the top quartile of the institutions tested. Further stress testing is due to take place in 2011.

We expect that the pace of reforms outlined by various policymakers will gather speed in 2011, most notably the Basel III proposals. These regulations will require banks to hold more capital and a higher quality of capital and implement new liquidity rules, and are likely to result in a rise in the cost of funding and put pressure on credit pricing.

We continue to closely monitor and manage eurozone bank exposures, and are cautious in lending to this sector. We regularly update our assessment of higher-risk eurozone banks and adjust our risk appetite accordingly. We also, where possible, seek to play a positive role in maintaining credit and liquidity supply.

Middle East and North Africa

In 2009, Dubai World requested a standstill agreement with creditors in respect of the indebtedness of certain Dubai World group companies. The market disruption that ensued cut would-be borrowers off from the capital markets, although continued restructuring efforts throughout 2010 saw the return of significant positive sentiment from investors. As one of the long-term bankers to Dubai World and the various entities related to the Government of Dubai, the Group has worked closely during 2010 to address the prevailing issues. In October 2010, Dubai World obtained an agreement to restructure US\$25bn of its debt subject to final documentation expected to be signed in the first half of 2011. The arrangement extends loan maturities for five to eight years at discounted rates, allowing Dubai World time to sell off its non-core assets while focusing on its core earnings. The Group's exposure to Dubai is primarily spread across operating companies within the emirate.

Political developments in the region are being monitored closely and action taken to mitigate their impact. It is too early to foresee how events may unfold; hitherto, our business in the region has for the most part operated without serious disruption. In the medium term, economic growth in the region may be adversely affected, with wider implications if the prices of oil, food and commodities rise significantly.

Commercial real estate

Our exposure in the commercial real estate sectors is concentrated in the UK, North America and Hong Kong. While there were some positive signs of recovery in markets in the UK and the US, in part supported by the low levels of interest rates, the slow speed of the recovery meant that financing and re-financing activity in the sector remained subdued. In Hong Kong, the economy recovered robustly and the market was relatively buoyant in 2010, characterised by strong demand and continuing credit appetite.

On a constant currency basis, the aggregate of our commercial real estate and other property-related lending of US\$107bn at 31 December 2010 was 7% higher than at 31 December 2009 and represented 11% of total loans and advances to customers. The increase in exposure was largely in Hong Kong, offset by a reduction in North America. In 2010, credit quality across this sector generally showed signs of stabilising but remained under stress in certain markets.

Across our portfolios, credit risk is mitigated by long-standing and conservative policies on asset

Report of the Directors: Operating and Financial Review (continued)

origination which focus on relationships with long-term customers and limited initial leverage. We also set and monitor sector risk appetite limits at Group and regional levels to detect and prevent higher risk concentrations. While individual regions differ in their approach, typically origination loan to value ratios would be less than 65% across the Group.

Personal lending (Unaudited)

We provide a broad range of secured and unsecured personal lending products to meet customer needs. Given the diverse nature of the markets in which we operate, the range is not standard across all countries but is tailored to meet the demands of individual markets while using appropriate distribution channels and, wherever possible, global IT platforms.

Personal lending includes advances to customers for asset purchases, such as residential property and motor vehicles, where the loans are typically secured by the assets being acquired. We also offer loans secured on existing assets, such as first and second liens on residential property; unsecured lending products such as overdrafts, credit cards and payroll loans; and debt consolidation loans which may be secured or unsecured.

In 2010, credit quality in our personal lending portfolios improved, reflecting a recovery of economic conditions in most markets. Delinquency levels and loan impairment charges declined, particularly in those countries which had previously been most affected by rising unemployment and house price depreciation.

The commentary that follows is on an underlying basis.

At 31 December 2010, total personal lending was US\$425bn, a decline of 2% from 31 December 2009 as the reduction in our US run-off portfolios continued, partly offset by notable growth in Hong Kong and the UK. Within our PFS business, total loan impairment charges and other credit risk provisions of US\$11.3bn were 44% lower than in 2009, and were concentrated in North America (US\$8.2bn) and, to a lesser extent, Europe (US\$1.2bn) and Latin America (US\$1.2bn).

In the UK, total personal lending was US\$129bn, an increase of 4% compared with the end of 2009. The increase was due to growth in mortgage lending as a result of the enhancement of our product offerings, successful marketing and competitive pricing (UK mortgage lending is discussed in greater detail on page 108). This was partly offset by an 8%

fall in other personal lending balances, reflecting a reduction in unsecured lending products as we tightened our underwriting criteria and some consumers reduced their indebtedness.

Total personal lending balances in the US at 31 December 2010 were US\$109bn, a decrease of 19% compared with the end of 2009, reflecting the continued reduction in balances in our consumer finance run-off portfolios and lower balances in our Card and Retail Services business.

US residential mortgage lending balances fell by 12% to US\$58bn, driven by the decisions taken in 2007 to close the Mortgage Services business and in March 2009 to close all Consumer Lending branches and run off the residual consumer finance balances. US mortgage lending is discussed in greater detail on page 108.

In PFS, total loan impairment charges and other credit risk provisions were 44% down on 2009.

Other personal lending balances in the US were US\$52bn at 31 December 2010, 25% lower than at the end of 2009. Credit card balances declined by 14% reflecting a reduction in active customer accounts and an increased focus by our customers on reducing outstanding credit card debt.

In March we sold US\$1.0bn of vehicle finance loans. This was followed in August by the sale of the residual vehicle finance loans (US\$4.3bn) to the same purchaser.

In Hong Kong, total personal lending grew by 20% to US\$57bn as a result of strong growth in residential mortgage lending. In the Rest of Asia-Pacific region, personal lending also grew strongly across many countries, notably Australia, Singapore and Malaysia, through successful marketing. This growth was partly offset by a managed reduction in unsecured personal lending balances in India.

In Latin America, total personal lending was broadly flat at US\$22bn as moderate growth in residential mortgage lending, particularly in Brazil, was more than offset by a decline in other personal lending. The latter reflected falls in credit card lending in Mexico and other higher-risk portfolios in Mexico and Brazil as we continued to reduce higher-risk portfolios in the region and tighten our underwriting criteria.

For an analysis of loan impairment allowances and impaired loans, see page 119.

Report of the Directors: Operating and Financial Review (continued)

Total personal lending (Unaudited)

	UK US\$m	Rest of Europe US\$m	US ¹³ US\$m	Rest of North America US\$m	Other regions ¹⁴ US\$m	Total US\$m
At 31 December 2010						
Residential mortgages	103,037	8,581	57,630	21,212	78,221	268,681
Other personal lending	25,636	24,463	51,686	8,589	46,265	156,639
– motor vehicle finance	–	35	72	55	5,886	6,048
– credit cards	11,612	1,916	33,744	1,334	13,778	62,384
– second lien mortgages	846	2	9,322	578	422	11,170
– other	13,178	22,510	8,548	6,622	26,179	77,037
Total personal lending	128,673	33,044	109,316	29,801	124,486	425,320
Impairment allowances						
Residential mortgages	(275)	(58)	(3,592)	(25)	(297)	(4,247)
Other personal lending	(1,348)	(467)	(4,436)	(179)	(1,616)	(8,046)
– motor vehicle finance	–	(5)	–	–	(244)	(249)
– credit cards	(506)	(216)	(2,256)	(62)	(483)	(3,523)
– second lien mortgages	(58)	–	(889)	(19)	–	(966)
– other	(784)	(246)	(1,291)	(98)	(889)	(3,308)
Total impairment allowances on personal lending	(1,623)	(525)	(8,028)	(204)	(1,913)	(12,293)
– as a percentage of total personal lending	1.3%	1.6%	7.3%	0.7%	1.5%	2.9%
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
At 31 December 2009						
Residential mortgages	100,667	9,205	65,784	20,807	64,206	260,669
Other personal lending	29,018	23,672	69,275	8,068	43,504	173,537
– motor vehicle finance	–	65	5,771	99	6,378	12,313
– credit cards	12,427	1,820	39,374	1,118	13,319	68,058
– second lien mortgages	1,068	2	11,786	695	472	14,023
– other	15,523	21,785	12,344	6,156	23,335	79,143
Total personal lending	129,685	32,877	135,059	28,875	107,710	434,206
Impairment allowances						
Residential mortgages	(151)	(41)	(4,416)	(7)	(233)	(4,848)
Other personal lending	(1,443)	(552)	(7,691)	(206)	(2,349)	(12,241)
– motor vehicle finance	–	(7)	(211)	(1)	(351)	(570)
– credit cards	(524)	(233)	(3,895)	(42)	(854)	(5,548)
– second lien mortgages	(79)	–	(1,608)	(56)	–	(1,743)
– other	(840)	(312)	(1,977)	(107)	(1,144)	(4,380)
Total impairment allowances on personal lending	(1,594)	(593)	(12,107)	(213)	(2,582)	(17,089)
– as a percentage of total personal lending	1.2%	1.8%	9.0%	0.7%	2.4%	3.9%

For footnotes, see page 174.

Mortgage lending

We offer a wide range of mortgage products designed to meet customer needs, including capital repayment mortgages subject to fixed or variable interest rates and products designed to meet demand for housing loans with more flexible payment structures. We underwrite both first lien residential mortgages and loans secured on second lien mortgages.

Interest-only mortgages are those for which customers make regular payments of interest during the life of the loan and repay the principal from the sale of their home or alternative sources of funds. Typically, with introductory interest-only mortgages, the interest-only element is for a fixed term at the start of the loan, after which principal repayments commence.

Affordability mortgages include all products where the customers' monthly payments are set at

Report of the Directors: Operating and Financial Review (continued)

a low initial rate, either variable or fixed, before resetting to a higher rate once the introductory period is over. Offset mortgages are products linked to a current or savings account, where interest earned is used to repay mortgage debt.

UK mortgage lending

On a constant currency basis, total mortgage lending in the UK, comprising residential and second lien lending, increased by 7% to US\$104bn at 31 December 2010. Growth was achieved largely through the enhancement of our product offerings, successful marketing and competitive pricing. Nonetheless, mortgage lending was constrained by the decline in re-mortgage activity due to the low interest rate environment and consumer concerns over future employment and higher interest rates.

Our UK mortgage portfolio remained of high quality, consisting primarily of lending to owner-occupiers. We restricted lending to purchase residential property for the purpose of rental and almost all new business was originated through our own salesforce, with the self-certification of income not permitted. The majority of mortgage lending was to existing customers holding current or savings accounts with HSBC; this facilitated and strengthened the underwriting process.

Loan impairment charges and delinquency levels in our UK mortgage book declined despite unemployment remaining high, mainly due to improving economic conditions and low interest rates, which helped make mortgages more affordable for customers. Our continuing enhancements in credit underwriting, credit policies and collection processes contributed to the reduction in delinquencies.

The percentage of loans that were 30 days or more delinquent declined from 1.6% at 31 December 2009 to 1.4% in 2010 in the HSBC Bank mortgage portfolio and remained at less than 1.0% in the First Direct portfolio.

In 2010, the average loan-to-value ratio for new business in the UK was 54%, an increase of a single percentage point on the previous year.

Interest-only mortgage balances increased by 4% to US\$45bn compared with 2009. The majority of these mortgages were offset mortgages at First Direct for which delinquency rates remained at very low levels.

US mortgage lending

US mortgage lending balances, comprising residential and second lien lending, were US\$67bn at

31 December 2010, a decline of 14% compared with the end of 2009.

Mortgage lending in HSBC Finance fell by 17% to US\$51bn with declines in both the Consumer Lending and Mortgage Services portfolios from their planned run-off. See table on page 110 for a breakdown of mortgage lending in HSBC Finance.

Mortgage lending in the UK rose by 7% to US\$104bn, while in the US balances declined by 14% to US\$67bn.

Mortgage lending balances in HSBC Bank USA remained broadly unchanged at US\$16bn. We continue to sell the majority of new origination to the secondary markets as a means of managing our interest rate risk and improving structural liquidity. This reduction was partly offset by an increase in originations to Premier customers with whom we already held a banking relationship. At 31 December 2010, approximately 32% of the HSBC Bank USA mortgage portfolio were fixed rate loans and 77% were first lien.

During 2010, state and federal officials announced investigations into the procedures followed by mortgage servicing companies and banks, including HSBC Finance and its affiliates, in relation to foreclosures. This included a joint examination by the Federal Reserve and the Office of the Comptroller of the Currency. Following the examination, our examiners issued supervisory letters noting deficiencies in our processing, preparation and signing of affidavits and other documents supporting foreclosures, and in the governance of and resources devoted to our foreclosure process. We have suspended foreclosures pending correction of the weaknesses. Management is reviewing all foreclosures which have not yet been completed, and will correct deficient documentation and refile documents where required.

As a result of the investigations, we expect that the scrutiny of documents will increase, and in some states additional verification of information may be required. If these trends continue after we reinstate foreclosure, there could be additional delays in the process.

A discussion of credit trends in the US mortgage lending portfolio and the steps taken to mitigate risk is provided in 'US personal lending – credit quality' on page 110.

The following table shows the levels of mortgage lending products in the various portfolios in the US, the UK and the rest of the HSBC Group.

Report of the Directors: Operating and Financial Review (continued)

Mortgage lending products (Unaudited)

	UK US\$m	Rest of Europe US\$m	US ¹³ US\$m	Rest of North America US\$m	Other regions ¹⁴ US\$m	Total US\$m
At 31 December 2010						
Residential mortgages	103,037	8,581	57,630	21,212	78,221	268,681
Second lien mortgages	846	2	9,322	578	422	11,170
Total mortgage lending	103,883	8,583	66,952	21,790	78,643	279,851
Second lien as a percentage of total mortgage lending	0.8%	0.0%	13.9%	2.7%	0.5%	4.0%
Impairment allowances						
Residential mortgages	(275)	(58)	(3,592)	(25)	(297)	(4,247)
Second lien mortgages	(58)	–	(889)	(19)	–	(966)
Total impairment allowances on mortgage lending	(333)	(58)	(4,481)	(44)	(297)	(5,213)
Interest-only (including endowment) mortgages	45,039	51	–	908	1,282	47,280
Affordability mortgages, including ARMs	1,089	326	18,494	274	7,855	28,038
Other	102	–	–	–	183	285
Total interest-only and affordability mortgages	46,230	377	18,494	1,182	9,320	75,603
– as a percentage of total mortgage lending	44.5%	4.4%	27.6%	5.4%	11.9%	27.0%
Negative equity mortgages ¹⁵	2,436	–	15,199	103	291	18,029
Other loan-to-value ratios greater than 90% ¹⁶	5,802	263	10,460	1,698	1,348	19,571
Total negative equity and other mortgages	8,238	263	25,659	1,801	1,639	37,600
– as a percentage of total mortgage lending	7.9%	3.1%	38.3%	8.3%	2.1%	13.4%
At 31 December 2009						
Residential mortgages	100,667	9,205	65,784	20,807	64,206	260,669
Second lien mortgages	1,068	2	11,786	695	472	14,023
Total mortgage lending	101,735	9,207	77,570	21,502	64,678	274,692
Second lien as a percentage of total mortgage lending	1.0%	–	15.2%	3.2%	0.7%	5.1%
Impairment allowances						
Residential mortgages	(151)	(41)	(4,416)	(7)	(233)	(4,848)
Second lien mortgages	(79)	–	(1,608)	(56)	–	(1,743)
Total impairment allowances on mortgage lending	(230)	(41)	(6,024)	(63)	(233)	(6,591)
Interest-only (including endowment) mortgages	45,471	–	–	1,154	1,127	47,752
Affordability mortgages, including ARMs	2,681	1,084	21,024	232	5,921	30,942
Other	144	–	–	–	147	291
Total interest-only and affordability mortgages	48,296	1,084	21,024	1,386	7,195	78,985
– as a percentage of total mortgage lending	47.5%	11.8%	27.1%	6.4%	11.1%	28.8%
Negative equity mortgages ¹⁵	6,412	–	20,229	163	488	27,292
Other loan-to-value ratios greater than 90% ¹⁶	10,522	–	13,695	1,887	1,451	27,555
Total negative equity and other mortgages	16,934	–	33,924	2,050	1,939	54,847
– as a percentage of total mortgage lending	16.6%	–	43.7%	9.5%	3.0%	20.0%

For footnotes, see page 174.

HSBC Finance held approximately US\$51bn of residential mortgage and second lien loans and advances to personal customers secured on real

estate at 31 December 2010, 12% of the Group's gross loans and advances to personal customers.

Report of the Directors: Operating and Financial Review (continued)

HSBC Finance US mortgage lending¹⁷ (Unaudited)

	At 31 December 2010				At 31 December 2009			
	Mortgage Services US\$m	Consumer Lending US\$m	Other mortgage lending US\$m	Total US\$m	Mortgage Services US\$m	Consumer Lending US\$m	Other mortgage lending US\$m	Total US\$m
Fixed-rate	11,447	31,759	87	43,293	13,596	37,639	98	51,333
Other	6,122	1,517	2	7,641	8,168	1,867	6	10,041
Adjustable-rate	5,042	1,517	2	6,561	7,070	1,867	–	8,937
Interest-only (affordability mortgages) ¹⁸	1,080	–	–	1,080	1,098	–	6	1,104
	17,569	33,276	89	50,934	21,764	39,506	104	61,374
First lien	15,300	29,950	66	45,316	18,710	34,913	77	53,700
Second lien	2,269	3,326	23	5,618	3,054	4,593	27	7,674
	17,569	33,276	89	50,934	21,764	39,506	104	61,374
Stated income ¹⁹	2,905	–	–	2,905	3,905	–	–	3,905
Negative equity mortgages ¹⁵	5,161	8,910	–	14,071	6,770	12,031	–	18,801
Impairment allowances	1,837	2,474	–	4,311	2,419	3,167	1	5,587
– as a percentage of total mortgage lending	10.5%	7.4%	–	8.5%	11.1%	8.0%	1.0%	9.1%

For footnotes, see page 174.

US personal lending (Unaudited)

Credit quality

During 2010, economic conditions in the US generally improved, although the pace of improvement continued to be slow.

In the first half of 2010, house prices stabilised in many markets and began to recover in others, as the first time homebuyer tax credit and continued low interest rates favourably affected the housing market. However, in the second half of the year, house prices declined in many markets as the homebuyer tax credit ended and foreclosure levels rose.

HSBC Finance: geographical concentration of US lending^{17, 20} (Unaudited)

California	6	10	4	10	10
New York	4	7	3	7	7
Florida	4	6	2	5	6
Pennsylvania	3	6	2	5	6
Texas	2	4	3	7	5
Ohio	3	6	2	5	5

For footnotes, see page 174.

Unemployment rates, which have been a major factor in the deterioration of credit quality, were 9.4% in December 2010, a decrease of 60 basis points since December 2009. Unemployment rates in 18 states were at or above the US national average and unemployment rates in 5 states were at or above 11%, including California and Florida, where more than 5% of HSBC Finance's total loan balances are based.

Ongoing improvement in the US economy will be dependent on a sustained recovery in the housing market and unemployment rates, as well as the continuation of low interest rates. Renewed weakening in these factors and in consumer confidence may adversely affect consumer payment patterns and credit quality.

	Mortgage lending as a percentage of:		Other personal lending as a percentage of:		percentage of total lending %
	total lending %	total mortgage lending %	total lending %	total other personal lending %	
California	6	10	4	10	10
New York	4	7	3	7	7
Florida	4	6	2	5	6
Pennsylvania	3	6	2	5	6
Texas	2	4	3	7	5
Ohio	3	6	2	5	5

Report of the Directors: Operating and Financial Review (continued)

Mortgage lending

In 2010, we reduced our non-prime mortgage exposure as balances continued to run-off in our Consumer Lending and Mortgage Services portfolios in HSBC Finance. At 31 December 2010, residential mortgage lending balances were US\$58bn, a decline of 12% compared with the end of 2009.

In both our Consumer Lending and Mortgage Services *mortgage portfolios*, two months or more delinquent balances declined as balances ran-off and economic conditions improved. In addition, written-off balances were replaced with lower levels of new delinquency volumes as the portfolios continue to season. First lien two months or more delinquent balances in our Consumer Lending portfolio declined from US\$5.4bn at 31 December 2009 to US\$4.9bn at 31 December 2010 and, in our Mortgage Services portfolio, from US\$3.1bn at 31 December 2009 to US\$2.8bn at 31 December 2010. In each case, lending balances liquidated at a faster pace than delinquency. As a result, two months or more delinquency rates on first lien loans in our Consumer Lending portfolio increased from 15.4% at 31 December 2009 to 16.2%, while in our Mortgage Services portfolio, two months or more delinquency rates increased from 16.5% to 18.0%.

At HSBC Bank USA, we continued to sell the majority of new mortgage loan originations to the secondary markets. These decreases were partly offset by increases to the portfolio from new lending to our Premier relationship customers. Two months or more delinquency rates decreased from 8.6% to 7.9% at 31 December 2010, while delinquent balances remained flat at US\$1.0bn.

Second lien mortgage loans have a risk profile characterised by higher loan-to-value ratios because, in the majority of cases, the loans were taken out to complete the refinancing or purchase of properties. Loss experience on default of second lien loans has typically approached 100% of the amount owed, as any equity in the property is initially applied to the first lien loan. In the Mortgage Services second lien portfolio, outstanding balances declined by 26% to US\$2.3bn and two months or more delinquency rates decreased to 10.8% at 31 December 2010. In the Consumer Lending second lien portfolio, outstanding balances declined by 28% to US\$3.3bn, and two months or more delinquency rates decreased to 12.7% at 31 December 2010.

At HSBC Bank USA, second lien balances declined by 10% to US\$3.7bn, and two months or more delinquency rates increased from 4.0% at 31 December 2009 to 4.8% at 31 December 2010 due to the effects of high unemployment levels.

Stated-income mortgages are underwritten on the basis of borrowers' representations of annual income and are not verified by supporting documents and, as a result, represent a higher than average level of risk. Stated income balances in HSBC Finance declined from US\$3.9bn to US\$2.9bn as the portfolio continued to run off. Two months or more delinquency rates increased to 24.0% at 31 December 2010. In HSBC Bank USA, stated-income balances were unchanged at US\$2.1bn while delinquency rates decreased from 11.1% at 31 December 2009 to 10.6% at 31 December 2010.

At 31 December 2010, HSBC Finance had US\$7.6bn of *affordability mortgages*, a decline of 24% compared with 31 December 2009, as the portfolio continued to run off. At HSBC Bank USA, affordability mortgage balances of US\$10.9bn at 31 December 2010 compared with US\$11.1bn at 31 December 2009.

Real estate markets in the majority of the US have been and will continue to be, affected by stagnation or declines in property values. As a result, loan-to-value ratios for our real estate secured loans have generally deteriorated since origination. Loans with a loan-to-value of 100% or more have historically had a greater likelihood of becoming delinquent. At 31 December 2010 loans in negative equity were US\$14bn, compared with US\$19bn at the end of 2009.

At HSBC Finance, the number of *foreclosed properties* at 31 December 2010 increased compared with the end of 2009. The rise reflected the improvement in the processing of foreclosures as backlogs and action taken by local governments and certain states had lengthened proceedings in previous years. The average loss on sale of foreclosed properties decreased compared with 2009 though the average loss increased in the second half of 2010, as house prices in many markets showed signs of deterioration due to a rise in the number of foreclosed properties and the expiration of the homebuyer tax credit. We continued to assist customers in restructuring their debts to avoid foreclosure, including by modifying their loans when it was decided that they could be serviced on revised terms. For more details on the investigation into US foreclosure practices, see page 83.

Report of the Directors: Operating and Financial Review (continued)

HSBC Finance foreclosed properties in the US (Unaudited)

	2010	Quarter ended				2009
		31 Dec 2010	30 Sep 2010	30 Jun 2010	31 Mar 2010	
Number of foreclosed properties at end of period	10,940	10,940	9,798	8,394	6,961	6,188
Number of properties added to foreclosed inventory in the year/quarter	20,489	5,763	5,413	5,096	4,217	14,845
Average loss on sale of foreclosed properties ²¹	9%	15%	10%	4%	4%	12%
Average total loss on foreclosed properties ²²	51%	54%	52%	49%	49%	51%
Average time to sell foreclosed properties (days)	161	165	158	156	170	193

For footnotes, see page 174.

Credit cards

In our credit card and private label portfolios two months or more delinquency balances declined markedly, reflecting actions taken to improve credit quality, and our customer payment rates benefited from an increased focus by consumers on reducing outstanding credit card debt. Two months or more delinquent balances in our credit card portfolio declined from US\$1.8bn to US\$1.0bn, while in percentage terms they declined from 7.4% at 31 December 2009 to 4.7% at 31 December 2010. In the private label cards portfolio, two months or more delinquent balances declined from US\$622m to US\$404m while in percentage terms delinquency decreased from 4.1% at 31 December 2009 to 3.0% at 31 December 2010.

Loan delinquency

Trends in two months and over contractual delinquency in the US
(Unaudited)

					Quarter ended				
	31 Dec 2010	30 Sep 2010	30 Jun 2010	31 Mar 2010	As reported 31 Dec 2009	Ex. period change 31 Dec 2009	30 Sep 2009	30 Jun 2009	31 Mar 2009
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
In Personal Financial Services in the US									
Residential mortgages	8,632	8,885	8,591	8,960	9,551	11,519	10,834	10,070	9,892
Second lien mortgage lending	847	907	930	1,011	1,194	1,628	1,631	1,676	1,772
Vehicle finance	–	–	152	194	267	267	295	310	269
Credit card	957	1,066	1,201	1,511	1,798	1,798	1,834	1,864	1,992
Private label	404	445	478	510	622	622	639	636	659
Personal non-credit card	811	953	987	1,194	1,548	2,619	2,680	2,709	2,855
Total	11,651	12,256	12,339	13,380	14,980	18,453	17,913	17,265	17,439
	% ²³	% ²³	% ²³	% ²³	% ²³				
Residential mortgages	15.00	14.97	14.02	14.12	14.54	17.03	15.39	13.89	12.82
Second lien mortgage lending	9.10	9.23	8.98	9.17	10.14	13.35	12.71	12.35	12.59
Vehicle finance	–	–	3.59	3.96	4.63	4.63	4.61	3.97	2.79
Credit card	4.69	5.23	5.65	6.84	7.38	7.38	7.28	7.25	7.14
Private label	3.03	3.56	3.80	3.78	4.12	4.12	4.38	4.08	4.28
Personal non-credit card	9.49	10.15	9.60	10.75	12.55	19.77	18.73	18.02	18.30
Total	10.67	10.99	10.28	10.61	11.09	13.34	12.47	11.49	10.92

Report of the Directors: Operating and Financial Review (continued)

	Quarter ended									
	31 Dec 2010	30 Sep 2010	30 Jun 2010	31 Mar 2010	As reported 31 Dec 2009	Ex. period change 31 Dec 2009	30 Sep 2009	30 Jun 2009	31 Mar 2009	
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	
In Mortgage Services and Consumer Lending²⁴										
Mortgage Services:	3,002	3,117	3,067	3,236	3,477	4,456	4,250	4,257	4,535	
– first lien	2,757	2,850	2,788	2,928	3,093	3,900	3,688	3,642	3,824	
– second lien	245	267	279	308	384	556	562	615	711	
Consumer Lending:	5,284	5,495	5,278	5,493	6,022	7,445	7,131	6,514	6,203	
– first lien	4,861	5,022	4,795	4,970	5,380	6,541	6,241	5,640	5,322	
– second lien	423	473	483	523	642	904	890	874	881	
	% ²³	% ²³	% ²³	% ²³	% ²³					
Mortgage Services:										
– first lien	18.02	17.73	16.50	16.38	16.53	20.00	18.09	17.13	17.24	
– second lien	10.80	10.93	10.63	10.87	12.57	17.25	16.36	16.35	17.44	
– total	17.09	16.83	15.71	15.62	15.98	19.61	17.84	17.01	17.27	
Consumer Lending:										
– first lien	16.23	16.16	14.85	14.79	15.41	18.15	16.75	14.72	13.52	
– second lien	12.72	13.16	12.44	12.25	13.98	18.64	17.49	16.17	15.43	
– total	15.88	15.85	14.59	14.51	15.24	18.21	16.84	14.90	13.76	

For footnotes, see page 174.

Forbearance strategies and renegotiated loans (Audited)

A range of forbearance strategies are employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid foreclosure or repossession. Our policies and practices are based on criteria which, in the judgement of local management, indicate that repayment is likely to continue.

Forbearance arrangements include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, the deferral of foreclosures, other modifications, and loan restructures. These management policies and practices typically provide the customer with terms and conditions that are more favourable than those provided initially. Such arrangements could include cases where an account is brought up-to-date without full repayment of all the arrears.

Our most common forbearance arrangements are loan restructures applied to real estate loans within consumer finance portfolios in the US. Our credit risk management policy sets out restrictions on the number and frequency of restructures, the minimum period an account must have been opened before any restructure can be considered, and the number of qualifying payments that must be received before an account may be considered restructured and up-to-date. The application of this policy varies according to the nature of the market,

the product and the management of customer relationships through the occurrence of exceptional events.

Loans that are subject to restructuring may only be classified as restructured and up-to-date once a specified number and/or amount of qualifying payments have been received. These qualifying payments are set at a level appropriate to the nature of the loan and the customer's ability to make the repayment going forward. Typically the receipt of two or more qualifying payments is required within a certain period, generally 60 days (in the case of HSBC Finance, in certain circumstances, for example where debt has been restructured in bankruptcy proceedings, fewer or no payments may be required). Loans that have been restructured and would otherwise have been past due or impaired are classified as renegotiated.

Renegotiated loans are segregated from other parts of the loan portfolio for collective impairment assessment, to reflect the higher rates of losses often encountered in this segment of the portfolio. When empirical evidence indicates an increased propensity to default and higher losses on such accounts, the use of roll rate methodology ensures these factors are taken into account when calculating impairment allowances. The carrying amount of loans that have been classified as renegotiated retain this classification until maturity or derecognition. Interest is recorded on renegotiated loans on the basis of new contractual terms following renegotiation.

Report of the Directors: Operating and Financial Review (continued)

Renegotiated loans totalled US\$35bn at 31 December 2010 (2009: US\$39bn). The largest concentration was in the US and amounted to US\$28bn (2009: US\$33bn) or 82% (2009: 86%) of our total renegotiated loans, substantially all of which was held by HSBC Finance.

HSBC Finance loan modifications and re-ageing

(Unaudited)

HSBC Finance continued to refine its customer account management policies and practices, including account modification and re-age programmes. Modification occurs when the terms of a loan are modified either temporarily or permanently. Modification may also lead to a re-ageing of the account. In 2010, HSBC Finance modified 42,500 loans with an aggregate balance of US\$6.0bn in Consumer Lending and Mortgage Services through the foreclosure avoidance and account modification programmes.

At 31 December 2010, the total balance outstanding on HSBC Finance real estate secured accounts which have been re-aged or modified was US\$26.7bn, compared with US\$30.2bn at the end of 2009. US\$10.6bn relates to loans that had been re-aged without modification to the terms (2009: US\$11.1bn), and US\$13.9bn relates to loans whose terms have been modified and have been re-aged (2009: US\$15.7bn). These amounts are included in the renegotiated loans balance disclosed above. In addition, US\$2.2bn of loans have been modified but not re-aged (2009: US\$3.4bn) and as such do not meet the definition of a renegotiated loan as the impairment or past-due status of the loans did not change on modification. At 31 December 2010, 62% of modified or re-aged real estate loans remained up-to-date or past due less than 30 days (2009: 61%) and 26% were two or more months delinquent (2009: 26%).

Risk rating scales

Credit quality classification

(Unaudited)

Quality classification	Debt securities and other bills	Wholesale lending and derivatives		Retail lending	
	External credit rating	Internal credit rating	Probability of default %	Internal credit rating ²⁵	Expected loss %
Strong	A- and above	CRR1 to CRR2	0 – 0.169	EL1 to EL2	0 – 0.999
Good	BBB+ to BBB-	CRR3	0.170 – 0.740	EL3	1.000 – 4.999
Satisfactory	BB+ to B+ and unrated	CRR4 to CRR5	0.741 – 4.914	EL4 to EL5	5.000 – 19.999
Sub-standard	B and below	CRR6 to CRR8	4.915 – 99.999	EL6 to EL8	20.000 – 99.999
Impaired	Impaired	CRR9 to CRR10	100	EL9 to EL10	100+ or defaulted ²⁶

For footnotes, see page 174.

Collateral and other credit enhancements obtained

(Audited)

We obtained assets by taking possession of collateral held as security, or calling upon other credit enhancements, as follows:

Nature of assets	Carrying amount obtained in:	
	2010 US\$m	2009 US\$m
Residential property	2,052	1,587
Commercial and industrial property	61	93
Other	119	355
	2,232	2,035

We make repossessed properties available for sale in an orderly fashion, with the proceeds used to reduce or repay the outstanding indebtedness. If excess funds arise after the debt has been repaid, they are made available either to repay other secured lenders with lower priority or are returned to the customer. We do not generally occupy repossessed properties for our business use.

Credit quality of financial instruments

(Audited)

The five credit quality classifications defined below each encompass a range of more granular internal credit rating grades assigned to wholesale and retail lending business, as well as the external ratings attributed by external agencies to debt securities. There is no direct correlation between the internal and external ratings at a granular level, except to the extent each falls within a single quality classification.

Report of the Directors: Operating and Financial Review (continued)

Quality classification definitions

- *'Strong'*: exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss. Retail accounts operate within product parameters and only exceptionally show any period of delinquency.
- *'Good'*: exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.
- *'Satisfactory'*: exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minor following the adoption of recovery processes.
- *'Sub-standard'*: exposures require varying degrees of special attention and default risk is of greater concern. Retail portfolio segments show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes.
- *'Impaired'*: exposures have been assessed, individually or collectively, as impaired.

The Customer Risk Rating ('CRR') 10-grade scale above summarises a more granular underlying 23-grade scale (2009: 22-grade scale) of obligor probability of default ('PD'). The 23-grade scale was introduced in September 2010 following the harmonisation of PDs for three asset classes (banks, sovereigns and corporates) into one scale which required an additional PD band. All distinct HSBC customers are rated using the 10 or 23-grade scale, depending on the degree of sophistication of the Basel II approach adopted for the exposure.

The Expected Loss ('EL') 10-grade scale for retail business summarises a more granular underlying EL scale for these customer segments; this combines obligor and facility/product risk factors in a composite measure.

For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications. The ratings of Standard and Poor's are cited, with those of other agencies being treated equivalently. Debt securities with short-term issue ratings are reported against the long-term rating of the issuer of those securities. If major rating agencies have different ratings for the same debt securities, a prudent rating selection is made in line with regulatory requirements.

Additional credit quality information in respect of our consolidated holdings of ABSs is provided on pages 134 and 135.

For the purpose of the following disclosure, retail loans which are past due up to 89 days and are not otherwise classified as EL9 or EL10, are not disclosed within the EL grade to which they relate, but are separately classified as past due but not impaired.

Financial instruments by credit quality

2010 compared with 2009

Financial instruments on which credit quality has been assessed increased by 4% to US\$2,297bn due to strong growth in lending, mainly in Asia. At December 2010, US\$1,550bn or 67% was classified as 'strong' in line with the end of 2009, reflecting the continued actions by management to mitigate the Group's exposure to credit risk. The proportion of financial instruments classified as 'good' and 'satisfactory' were broadly unchanged at 16% and 12% respectively. The proportion of 'sub-standard' financial instruments was 2%.

Loans and advances on which credit quality has been assessed increased by 8% to US\$1,167bn, driven by growth in commercial and personal lending in Asia as generally economic conditions improved, while loans and advances to banks also rose. The growth was in balances classified as 'strong' and 'good', while balances classified as 'sub-standard' and 'past due but not impaired' declined.

Derivative assets on which credit quality has been assessed grew by 4% to US\$261bn from 31 December 2009, with growth in balances being classified as 'strong'. The increase was mainly in interest rate derivatives, reflecting a downward shift in yield curves.

At 31 December 2010, financial investments on which credit quality has been assessed increased by 9% compared with the end of 2009, to US\$393bn. Substantially all this growth was in assets classified as 'strong', reflecting increased investment of excess liquidity into low-risk government issued or government guaranteed bonds.

Report of the Directors: Operating and Financial Review (continued)

Trading assets on which credit quality has been assessed decreased by 11%, with the decline being in assets rated as 'strong'. This reflected the de-consolidation of the Constant Net Asset Value funds.

The following tables set out our distribution of financial instruments by measures of credit quality:

Distribution of financial instruments by credit quality (Audited)

	Neither past due nor impaired				Past due but not impaired US\$m	Impaired US\$m	Impairment allowances ²⁷ US\$m	Total US\$m
	Strong US\$m	Good US\$m	Satisfactory US\$m	Sub-standard US\$m				
At 31 December 2010								
Cash and balances at central banks	51,682	3,100	2,461	140				57,383
Items in the course of collection from other banks	5,631	101	340	–				6,072
Hong Kong Government certificates of indebtedness	19,057	–	–	–				19,057
Trading assets ²⁸	256,576	41,620	43,278	2,492				343,966
– treasury and other eligible bills	23,663	1,000	957	–				25,620
– debt securities	141,837	8,254	17,222	955				168,268
– loans and advances to banks	55,534	9,980	4,865	77				70,456
– loans and advances to customers	35,542	22,386	20,234	1,460				79,622
Financial assets designated at fair value ²⁸	8,377	4,640	6,536	40				19,593
– treasury and other eligible bills	158	–	1	–				159
– debt securities	7,310	4,368	6,530	40				18,248
– loans and advances to banks	38	272	5	–				315
– loans and advances to customers	871	–	–	–				871
Derivatives ²⁸	199,920	45,042	13,980	1,815				260,757
Loans and advances held at amortised cost	653,248	251,265	186,704	37,057	30,320	28,284	(20,241)	1,166,637
– loans and advances to banks	166,943	33,051	6,982	1,152	108	193	(158)	208,271
– loans and advances to customers ²⁹	486,305	218,214	179,722	35,905	30,212	28,091	(20,083)	958,366
Financial investments	345,265	23,253	17,168	4,479	16	2,591		392,772
– treasury and other similar bills	52,423	2,702	1,882	115	–	7		57,129
– debt securities	292,842	20,551	15,286	4,364	16	2,584		335,643
Other assets	9,752	6,067	12,212	1,510	513	317		30,371
– endorsements and acceptances	2,074	3,305	4,227	493	9	8		10,116
– accrued income and other	7,678	2,762	7,985	1,017	504	309		20,255
Total financial instruments	1,549,508	375,088	282,679	47,533	30,849	31,192	(20,241)	2,296,608

Report of the Directors: Operating and Financial Review (continued)

	Neither past due nor impaired				Past due but not impaired US\$m	Impaired US\$m	Impairment allowances ²⁷ US\$m	Total US\$m
	Strong US\$m	Good US\$m	Satisfactory US\$m	Sub-standard US\$m				
At 31 December 2009								
Cash and balances at central banks	55,355	3,414	1,589	297				60,655
Items in the course of collection from other banks	5,922	20	453	–				6,395
Hong Kong Government certificates of indebtedness	17,463	–	–	–				17,463
Trading assets ²⁸	306,481	37,911	39,457	2,221				386,070
– treasury and other eligible bills	21,747	315	169	115				22,346
– debt securities	180,876	7,499	12,360	863				201,598
– loans and advances to banks	59,152	14,213	4,572	189				78,126
– loans and advances to customers	44,706	15,884	22,356	1,054				84,000
Financial assets designated at fair value ²⁸	11,163	3,834	7,122	79				22,198
– treasury and other eligible bills	223	–	–	–				223
– debt securities	9,701	3,834	7,104	79				20,718
– loans and advances to banks	336	–	18	–				354
– loans and advances to customers	903	–	–	–				903
Derivatives ²⁸	169,430	60,759	15,688	5,009				250,886
Loans and advances held at amortised cost	570,357	231,394	185,167	43,820	40,078	30,845	(25,649)	1,076,012
– loans and advances to banks	130,403	34,646	13,154	1,434	12	239	(107)	179,781
– loans and advances to customers ²⁹	439,954	196,748	172,013	42,386	40,066	30,606	(25,542)	896,231
Financial investments	316,604	20,080	15,359	5,602	–	2,389		360,034
– treasury and other similar bills	54,158	1,458	2,315	498	–	5		58,434
– debt securities	262,446	18,622	13,044	5,104	–	2,384		301,600
Other assets	13,454	6,968	12,477	1,718	908	848		36,373
– endorsements and acceptances	1,349	3,200	4,161	512	12	77		9,311
– accrued income and other	12,105	3,768	8,316	1,206	896	771		27,062
Total financial instruments	1,466,229	364,380	277,312	58,746	40,986	34,082	(25,649)	2,216,086

For footnotes, see page 174.

Past due but not impaired gross financial instruments (Audited)

Examples of exposures past due but not impaired include overdue loans fully secured by cash collateral; mortgages that are individually assessed for impairment, and that are in arrears more than

90 days, but where the value of collateral is sufficient to repay both the principal debt and all potential interest for at least one year; and short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

Past due but not impaired loans and advances to customers and banks by geographical region (Audited)

	Europe US\$m	Hong Kong US\$m	Rest of Asia-Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Total US\$m
At 31 December 2010	2,518	1,158	2,092	1,351	20,227	2,974	30,320
At 31 December 2009	3,759	1,165	1,996	1,661	27,989	3,508	40,078

Report of the Directors: Operating and Financial Review (continued)*Past due but not impaired loans and advances to customers and banks by industry sector*
(Audited)

	At 31 December	
	2010 US\$m	2009 US\$m
Banks	108	12
Customers	30,212	40,066
Personal	24,824	34,306
Corporate and commercial	5,292	5,522
Financial	96	238
	30,320	40,078

Ageing analysis of days past due but not impaired gross financial instruments
(Audited)

	Up to 29 days US\$m	30-59 days US\$m	60-89 days US\$m	90-179 days US\$m	180 days and over US\$m	Total US\$m
At 31 December 2010						
Loans and advances held at amortised cost	19,481	6,915	3,281	482	161	30,320
– loans and advances to banks	108	–	–	–	–	108
– loans and advances to customers	19,373	6,915	3,281	482	161	30,212
Financial investments						
– debt securities	16	–	–	–	–	16
Other assets	262	123	57	26	45	513
– endorsements and acceptances	7	–	–	1	1	9
– other	255	123	57	25	44	504
	19,759	7,038	3,338	508	206	30,849
At 31 December 2009						
Loans and advances held at amortised cost	24,330	9,920	5,259	355	214	40,078
– loans and advances to banks	12	–	–	–	–	12
– loans and advances to customers	24,318	9,920	5,259	355	214	40,066
Financial investments						
– debt securities	–	–	–	–	–	–
Other assets	609	130	63	24	82	908
– endorsements and acceptances	9	1	–	1	1	12
– other	600	129	63	23	81	896
	24,939	10,050	5,322	379	296	40,986

Impaired loans and advances*Impaired loans and advances to customers and banks by industry sector*
(Audited)

	Impaired loans and advances at 31 December 2010			Impaired loans and advances at 31 December 2009		
	Individually assessed US\$m	Collectively assessed US\$m	Total US\$m	Individually assessed US\$m	Collectively assessed US\$m	Total US\$m
Banks	193	–	193	239	–	239
Customers	15,201	12,890	28,091	14,767	15,839	30,606
Personal	2,121	12,592	14,713	1,977	15,451	17,428
Corporate and commercial	11,964	298	12,262	11,839	387	12,226
Financial	1,116	–	1,116	951	1	952
	15,394	12,890	28,284	15,006	15,839	30,845

Report of the Directors: Operating and Financial Review (continued)**Impairment allowances on loans and advances to customers and banks**
(Audited)

loans and advances that are either individually assessed or collectively assessed, and collective impairment allowances on loans and advances classified as not impaired.

The tables below analyse by geographical region the impairment allowances recognised for impaired

Impairment allowances on loans and advances to customers by geographical region
(Audited)

	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Total US\$m
At 31 December 2010							
Gross loans and advances							
Individually assessed impaired loans ³⁰	8,831	637	1,185	2,137	1,632	779	15,201
Collectively assessed ³¹	432,631	140,683	108,505	24,141	198,070	59,218	963,248
Impaired loans ³⁰	1,726	23	139	296	9,095	1,611	12,890
Non-impaired loans ³²	430,905	140,660	108,366	23,845	188,975	57,607	950,358
Total gross loans and advances	441,462	141,320	109,690	26,278	199,702	59,997	978,449
Impairment allowances							
Individually assessed	3,563	345	629	1,163	390	367	6,457
Collectively assessed	2,100	284	330	489	8,780	1,643	13,626
Total impairment allowances	5,663	629	959	1,652	9,170	2,010	20,083
Net loans and advances	435,799	140,691	108,731	24,626	190,532	57,987	958,366
	%	%	%	%	%	%	%
Individually assessed allowances as a percentage of individually assessed loans and advances	40.3	54.2	53.1	54.4	23.9	47.1	42.5
Collectively assessed allowances as a percentage of collectively assessed loans and advances	0.5	0.2	0.3	2.0	4.4	2.8	1.4
Total allowances as a percentage of total gross loans and advances	1.3	0.4	0.9	6.3	4.6	3.4	2.1
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
At 31 December 2009							
Gross loans and advances							
Individually assessed impaired loans ³⁰	8,800	823	1,006	1,310	1,990	838	14,767
Collectively assessed ³¹	436,816	99,362	80,033	22,912	218,539	49,344	907,006
Impaired loans ³⁰	1,922	18	194	336	11,256	2,113	15,839
Non-impaired loans ³²	434,894	99,344	79,839	22,576	207,283	47,231	891,167
Total gross loans and advances	445,616	100,185	81,039	24,222	220,529	50,182	921,773
Impairment allowances							
Individually assessed	3,742	490	508	688	650	416	6,494
Collectively assessed	2,393	314	488	690	13,026	2,137	19,048
Total impairment allowances	6,135	804	996	1,378	13,676	2,553	25,542
Net loans and advances	439,481	99,381	80,043	22,844	206,853	47,629	896,231
	%	%	%	%	%	%	%
Individually assessed allowances as a percentage of individually assessed loans and advances	42.5	59.5	50.5	52.5	32.7	49.7	44.0
Collectively assessed allowances as a percentage of collectively assessed loans and advances	0.5	0.3	0.6	3.0	6.0	4.3	2.1
Total allowances as a percentage of total gross loans and advances	1.4	0.8	1.2	5.7	6.2	5.1	2.8

For footnotes, see page 174.

Report of the Directors: Operating and Financial Review (continued)*Movement in impairment allowances on loans and advances to customers and banks*
(Audited)

	Banks Individually assessed ⁸ US\$m	Customers		Total US\$m
		Individually assessed US\$m	Collectively assessed US\$m	
2010				
At 1 January	107	6,494	19,048	25,649
Amounts written off	(9)	(2,441)	(16,850)	(19,300)
Recoveries of loans and advances written off in previous years	2	143	875	1,020
Charge to income statement	12	2,613	10,923	13,548
Exchange and other movements	46	(352)	(370)	(676)
At 31 December	158	6,457	13,626	20,241
Customers				
Personal		615	11,678	12,293
Corporate and commercial		5,274	1,863	7,137
Financial		568	85	653
	%	%	%	%
Impairment allowances as a percentage of loans and advances ^{33,34}	0.11	0.70	1.49	1.91
	US\$m	US\$m	US\$m	US\$m
2009				
At 1 January	63	3,284	20,625	23,972
Amounts written off	(35)	(1,563)	(23,242)	(24,840)
Recoveries of loans and advances written off in previous years	6	128	756	890
Charge to income statement	70	4,388	20,484	24,942
Exchange and other movements	3	257	425	685
At 31 December	107	6,494	19,048	25,649
Customers				
Personal		572	16,517	17,089
Corporate and commercial		5,528	2,354	7,882
Financial		394	177	571
	%	%	%	%
Impairment allowances as a percentage of loans and advances ^{33,34}	0.09	0.75	2.21	2.63

For footnotes, see page 174.

Report of the Directors: Operating and Financial Review (continued)

Movement in impairment allowances by industry sector (Audited)

	2010 US\$m	2009 US\$m	2008 US\$m	2007 US\$m	2006 US\$m
Impairment allowances at 1 January	25,649	23,972	19,212	13,585	11,366
Amounts written off	(19,300)	(24,840)	(17,955)	(12,844)	(9,473)
Personal ²	(16,458)	(22,703)	(16,625)	(11,670)	(8,281)
– residential mortgages ²	(4,163)	(4,704)	(2,110)	(930)	(628)
– other personal ²	(12,295)	(17,999)	(14,515)	(10,740)	(7,653)
Corporate and commercial	(2,789)	(1,984)	(1,294)	(1,163)	(1,153)
– commercial, industrial and international trade	(1,050)	(1,093)	(789)	(897)	(782)
– commercial real estate and other property-related	(1,280)	(327)	(115)	(98)	(111)
– other commercial	(459)	(564)	(390)	(168)	(260)
Financial ³⁵	(53)	(153)	(36)	(11)	(39)
Recoveries of amounts written off in previous years	1,020	890	834	1,005	779
Personal	846	712	686	837	605
– residential mortgages	93	61	19	19	19
– other personal	753	651	667	818	586
Corporate and commercial	156	170	142	157	163
– commercial, industrial and international trade	92	123	76	74	88
– commercial real estate and other property-related	21	9	6	29	21
– other commercial	43	38	60	54	54
Financial ³⁵	18	8	6	11	11
Charge to income statement ³⁶	13,548	24,942	24,131	17,177	10,547
Personal	11,187	19,781	20,950	15,968	9,929
– residential mortgages	3,461	4,185	5,000	1,840	1,096
– other personal	7,726	15,596	15,950	14,128	8,833
Corporate and commercial	2,198	4,711	2,879	1,176	664
– commercial, industrial and international trade	909	2,392	1,573	897	503
– commercial real estate and other property-related	660	1,492	755	152	75
– other commercial	629	827	551	127	86
Financial ³⁵	163	450	302	36	(9)
Governments	–	–	–	(3)	(37)
Exchange and other movements	(676)	685	(2,250)	289	366
At 31 December²	20,241	25,649	23,972	19,212	13,585
Impairment allowances against banks:					
– individually assessed	158	107	63	7	7
Impairment allowances against customers:					
– individually assessed	6,457	6,494	3,284	2,699	2,565
– collectively assessed ²	13,626	19,048	20,625	16,506	11,013
At 31 December²	20,241	25,649	23,972	19,212	13,585
	%	%	%	%	%
Impairment allowances against customers as a percentage of loans and advances to customers:					
– individually assessed	0.66	0.70	0.34	0.27	0.29
– collectively assessed	1.39	2.07	2.16	1.65	1.25
At 31 December	2.05	2.77	2.50	1.92	1.54

For footnotes, see page 174.

Report of the Directors: Operating and Financial Review (continued)

Movement in impairment allowances by industry sector and by geographical region (Audited)

	2010						
	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Total US\$m
Impairment allowances at 1 January	6,227	804	996	1,393	13,676	2,553	25,649
Amounts written off	(3,001)	(265)	(678)	(386)	(12,601)	(2,369)	(19,300)
Personal	(1,447)	(150)	(561)	(375)	(12,070)	(1,855)	(16,458)
– residential mortgages	(49)	(1)	(10)	–	(4,027)	(76)	(4,163)
– other personal	(1,398)	(149)	(551)	(375)	(8,043)	(1,779)	(12,295)
Corporate and commercial	(1,539)	(109)	(110)	(11)	(507)	(513)	(2,789)
– commercial, industrial and international trade	(385)	(90)	(46)	(10)	(174)	(345)	(1,050)
– commercial real estate and other property-related	(1,022)	(18)	(18)	–	(194)	(28)	(1,280)
– other commercial	(132)	(1)	(46)	(1)	(139)	(140)	(459)
Financial ³⁵	(15)	(6)	(7)	–	(24)	(1)	(53)
Recoveries of amounts written off in previous years	287	39	188	57	182	267	1,020
Personal	251	32	168	53	134	208	846
– residential mortgages	29	4	3	–	30	27	93
– other personal	222	28	165	53	104	181	753
Corporate and commercial	33	7	7	4	46	59	156
– commercial, industrial and international trade	16	7	5	2	19	43	92
– commercial real estate and other property-related	6	–	–	–	11	4	21
– other commercial	11	–	2	2	16	12	43
Financial ³⁵	3	–	13	–	2	–	18
Charge to income statement ³⁶	2,532	137	428	623	8,304	1,524	13,548
Personal	1,263	78	297	226	8,138	1,185	11,187
– residential mortgages	153	(17)	11	46	3,189	79	3,461
– other personal	1,110	95	286	180	4,949	1,106	7,726
Corporate and commercial	1,080	72	146	304	269	327	2,198
– commercial, industrial and international trade	395	21	100	165	25	203	909
– commercial real estate and other property-related	360	(7)	12	117	178	–	660
– other commercial	325	58	34	22	66	124	629
Financial ³⁵	189	(13)	(15)	93	(103)	12	163
Exchange and other movements	(305)	(86)	25	(18)	(327)	35	(676)
At 31 December	5,740	629	959	1,669	9,234	2,010	20,241
Impairment allowances against banks:							
– individually assessed	77	–	–	17	64	–	158
Impairment allowances against customers:							
– individually assessed	3,563	345	629	1,163	390	367	6,457
– collectively assessed ³⁷	2,100	284	330	489	8,780	1,643	13,626
At 31 December	5,740	629	959	1,669	9,234	2,010	20,241
	%	%	%	%	%	%	%
Impairment allowances against customers as a percentage of loans and advances to customers:							
– individually assessed	0.81	0.24	0.57	4.43	0.20	0.61	0.66
– collectively assessed ³⁷	0.48	0.20	0.30	1.86	4.40	2.74	1.39
At 31 December	1.29	0.44	0.87	6.29	4.60	3.35	2.05

Report of the Directors: Operating and Financial Review (continued)

	2009						
	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Total US\$m
Impairment allowances at 1 January	3,922	733	813	414	16,090	2,000	23,972
Amounts written off	(2,781)	(357)	(850)	(384)	(17,792)	(2,676)	(24,840)
Personal	(1,876)	(240)	(787)	(376)	(17,204)	(2,220)	(22,703)
– residential mortgages	(41)	(1)	(9)	–	(4,610)	(43)	(4,704)
– other personal	(1,835)	(239)	(778)	(376)	(12,594)	(2,177)	(17,999)
Corporate and commercial	(810)	(117)	(63)	(8)	(534)	(452)	(1,984)
– commercial, industrial and international trade	(438)	(114)	(50)	(8)	(228)	(255)	(1,093)
– commercial real estate and other property-related	(148)	(1)	(3)	–	(163)	(12)	(327)
– other commercial	(224)	(2)	(10)	–	(143)	(185)	(564)
Financial ³⁵	(95)	–	–	–	(54)	(4)	(153)
Recoveries of amounts written off in previous years	265	34	132	27	93	339	890
Personal	200	32	123	25	60	272	712
– residential mortgages	28	6	1	–	7	19	61
– other personal	172	26	122	25	53	253	651
Corporate and commercial	57	2	9	2	33	67	170
– commercial, industrial and international trade	52	2	7	2	16	44	123
– commercial real estate and other property-related	5	–	1	–	2	1	9
– other commercial	–	–	1	–	15	22	38
Financial ³⁵	8	–	–	–	–	–	8
Charge to income statement ³⁶	4,409	450	874	1,333	15,372	2,504	24,942
Personal	1,995	206	654	593	14,390	1,943	19,781
– residential mortgages	158	(16)	14	20	3,955	54	4,185
– other personal	1,837	222	640	573	10,435	1,889	15,596
Corporate and commercial	2,163	244	220	706	818	560	4,711
– commercial, industrial and international trade	963	164	154	413	309	389	2,392
– commercial real estate and other property-related	958	70	29	106	288	41	1,492
– other commercial	242	10	37	187	221	130	827
Financial ³⁵	251	–	–	34	164	1	450
Exchange and other movements	412	(56)	27	3	(87)	386	685
At 31 December	6,227	804	996	1,393	13,676	2,553	25,649
Impairment allowances against banks: – individually assessed	92	–	–	15	–	–	107
Impairment allowances against customers: – individually assessed	3,742	490	508	688	650	416	6,494
– collectively assessed ³⁷	2,393	314	488	690	13,026	2,137	19,048
At 31 December	6,227	804	996	1,393	13,676	2,553	25,649
	%	%	%	%	%	%	%
Impairment allowances against customers as a percentage of loans and advances to customers: – individually assessed	0.84	0.49	0.63	2.84	0.29	0.83	0.70
– collectively assessed ³⁷	0.54	0.31	0.60	2.85	5.91	4.26	2.07
At 31 December	1.38	0.80	1.23	5.69	6.20	5.09	2.77

For footnotes, see page 174.

Report of the Directors: Operating and Financial Review (continued)**Impairment charge to the income statement**

*Individually and collectively assessed impairment charge to income statement by industry segment
(Unaudited)*

	2010			2009		
	Individually assessed US\$m	Collectively assessed US\$m	Total US\$m	Individually assessed US\$m	Collectively assessed US\$m	Total US\$m
Banks	12	–	12	70	–	70
Personal	180	11,007	11,187	316	19,465	19,781
Residential mortgages	137	3,324	3,461	171	4,014	4,185
Other personal	43	7,683	7,726	145	15,451	15,596
Corporate and commercial	2,190	8	2,198	3,699	1,012	4,711
Commercial, industrial and international trade	997	(88)	909	1,681	711	2,392
Commercial real estate and other property-related	680	(20)	660	1,330	162	1,492
Other commercial	513	116	629	688	139	827
Financial	243	(92)	151	373	7	380
Total charge to income statement	2,625	10,923	13,548	4,458	20,484	24,942

*Net loan impairment charge to the income statement
(Unaudited)*

	2010 US\$m	2009 US\$m	2008 US\$m	2007 US\$m	2006 US\$m
Individually assessed impairment allowances	2,625	4,458	2,064	796	458
New allowances	3,617	5,173	2,742	1,533	1,297
Release of allowances no longer required	(847)	(581)	(565)	(608)	(711)
Recoveries of amounts previously written off	(145)	(134)	(113)	(129)	(128)
Collectively assessed impairment allowances	10,923	20,484	22,067	16,381	10,089
New allowances net of allowance releases	11,798	21,240	22,788	17,257	10,740
Recoveries of amounts previously written off	(875)	(756)	(721)	(876)	(651)
Total charge for impairment losses	13,548	24,942	24,131	17,177	10,547
Banks	12	70	54	–	(3)
Customers	13,536	24,872	24,077	17,177	10,550
	%	%	%	%	%
Charge for impairment losses as a percentage of closing gross loans and advances	1.14	2.26	2.17	1.39	0.99
	US\$m	US\$m	US\$m	US\$m	US\$m
At 31 December					
Impaired loans ²	28,284	30,845	25,422	19,594	15,086
Impairment allowances ²	20,241	25,649	23,972	19,212	13,585

For footnote, see page 174.

Report of the Directors: Operating and Financial Review (continued)

Net loan impairment charge to the income statement by geographical region (Unaudited)

	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Total US\$m
2010							
Individually assessed impairment allowances	1,445	45	198	502	348	87	2,625
New allowances	1,874	111	311	561	580	180	3,617
Release of allowances no longer required	(394)	(54)	(84)	(55)	(196)	(64)	(847)
Recoveries of amounts previously written off	(35)	(12)	(29)	(4)	(36)	(29)	(145)
Collectively assessed impairment allowances	1,087	92	230	121	7,956	1,437	10,923
New allowances net of allowance releases	1,339	119	389	174	8,102	1,675	11,798
Recoveries of amounts previously written off	(252)	(27)	(159)	(53)	(146)	(238)	(875)
Total charge for impairment losses	2,532	137	428	623	8,304	1,524	13,548
Banks	2	–	–	2	8	–	12
Customers	2,530	137	428	621	8,296	1,524	13,536
	%	%	%	%	%	%	%
Charge for impairment losses as a percentage of closing gross loans and advances	0.49	0.08	0.29	1.75	3.79	1.74	1.14
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
At 31 December 2010							
Impaired loans	10,663	665	1,324	2,453	10,789	2,390	28,284
Impairment allowances	5,740	629	959	1,669	9,234	2,010	20,241
2009							
Individually assessed impairment allowances	2,248	242	244	580	916	228	4,458
New allowances	2,573	315	341	598	1,052	294	5,173
Release of allowances no longer required	(255)	(64)	(82)	(16)	(112)	(52)	(581)
Recoveries of amounts previously written off	(70)	(9)	(15)	(2)	(24)	(14)	(134)
Collectively assessed impairment allowances	2,161	208	630	753	14,456	2,276	20,484
New allowances net of allowance releases	2,356	233	747	778	14,525	2,601	21,240
Recoveries of amounts previously written off	(195)	(25)	(117)	(25)	(69)	(325)	(756)
Total charge for impairment losses	4,409	450	874	1,333	15,372	2,504	24,942
Banks	55	–	–	15	–	–	70
Customers	4,354	450	874	1,318	15,372	2,504	24,872
	%	%	%	%	%	%	%
Charge for impairment losses as a percentage of closing gross loans and advances	0.86	0.33	0.75	4.08	6.52	3.64	2.26
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
At 31 December 2009							
Impaired loans	10,873	846	1,201	1,666	13,308	2,951	30,845
Impairment allowances	6,227	804	996	1,393	13,676	2,553	25,649

Charge for impairment losses as a percentage of average gross loans and advances to customers² (Unaudited)

	2010 %	2009 %	2008 %	2007 %	2006 %
New allowances net of allowance releases	1.65	2.92	2.54	2.09	1.49
Recoveries	(0.12)	(0.10)	(0.09)	(0.12)	(0.10)
Total charge for impairment losses	1.53	2.82	2.45	1.97	1.39
Amount written off net of recoveries	2.08	2.71	1.75	1.36	1.15

For footnote, see page 174.

Report of the Directors: Operating and Financial Review (continued)

Charge for impairment losses as a percentage of average gross loans and advances to customers by geographical region
(Unaudited)

	Europe %	Hong Kong %	Rest of Asia- Pacific %	Middle East %	North America %	Latin America %	Total %
2010							
New allowances net of allowance releases	0.74	0.15	0.66	2.71	4.02	3.41	1.65
Recoveries	(0.07)	(0.03)	(0.20)	(0.23)	(0.09)	(0.51)	(0.12)
Total charge for impairment losses	0.67	0.12	0.46	2.48	3.93	2.90	1.53
Amount written off net of recoveries	0.71	0.19	0.53	1.32	5.89	4.01	2.08
2009							
New allowances net of allowance releases	1.19	0.49	1.31	5.25	6.24	6.11	2.92
Recoveries	(0.07)	(0.03)	(0.17)	(0.11)	(0.04)	(0.73)	(0.10)
Total charge for impairment losses	1.12	0.46	1.14	5.14	6.20	5.38	2.82
Amount written off net of recoveries	0.63	0.33	0.94	1.40	7.14	5.03	2.71

2010 compared with 2009 (Unaudited)

Loan impairment charges of US\$13.5bn declined by 46% on both a reported and an underlying basis compared with 2009. Reported impaired loans were US\$28.3bn at 31 December 2010, a decrease of 8% on both bases. The following commentary is on a constant currency basis.

New allowances for loan impairment charges were US\$15.4bn, a decline of 42% compared with 2009, while releases and recoveries of US\$1.9bn were 23% higher.

Impaired loans were 2.4% of total gross loans and advances at 31 December 2010, compared with 2.8% at 31 December 2009.

In **Europe**, new loan impairment allowances were US\$3.2bn, 34% lower than in 2009, reflecting a more stable credit environment across many countries in the region. Individually assessed loan impairment allowances declined, mainly in the UK, reflecting an improvement in credit conditions. Significantly, impairment charges in 2009 against specific customers in the property sector did not recur. Collectively assessed loan impairment allowances also declined due to a fall in delinquency levels as our customers continued to benefit from the low interest rate environment and the general improvement in economic conditions. In our personal lending portfolios, new collectively assessed loan impairment allowances declined, reflecting lower levels of unsecured lending and tightened underwriting criteria. Impaired loans of US\$10.7bn were 3% higher than at the end of 2009.

In Europe, releases and recoveries increased by 32% to US\$681m.

In **Hong Kong**, new loan impairment allowances declined by 58% to US\$230m and impaired loans fell by 21% from the end of 2009 to US\$665m. New loan impairment allowances declined in both the personal and commercial lending portfolios, reflecting the economic recovery and improvement in credit conditions in the territory and fewer customer downgrades, partly offset by an increase in lending balances.

Releases and recoveries in Hong Kong were US\$93m, 5% lower than in 2009.

New loan impairment allowances in **Rest of Asia-Pacific** declined by 40% to US\$700m. The decline reflected lower new collective impairment allowances in India due to improved delinquency rates and lower balances as certain unsecured portfolios and higher risk elements of the credit card portfolio were managed down. In addition, new individually assessed impairment allowances also declined, mainly in India, due to the non-recurrence of large impairments, notably on certain technology-related exposures. These were partly offset by a significant loan impairment charge against a single customer. Impaired loans in the region increased by 3% to US\$1.3bn at the end of 2010.

Releases and recoveries in the region rose by 19% due to releases in the construction and software industries in India and higher recoveries of amounts previously written off, notably in Australia.

In the **Middle East**, new loan impairment allowances were US\$735m, 47% lower than in 2009. The decrease was largely due to a decline in new collectively assessed loan impairment allowances net of allowance releases against the personal and commercial lending portfolios as delinquency rates improved, with a decline in personal balances in line

Report of the Directors: Operating and Financial Review (continued)

with the managing down of our exposure to higher risk unsecured personal lending. The lower allowances also reflected an overall improvement in economic conditions across the region. There were also declines in new individually assessed loan impairment charges as new charges for 2010 were restricted to a small number of large corporate exposures. Impaired loans rose by 47% from 31 December 2009 to US\$2.5bn due to credit deterioration in a small number of specific exposures, and debt restructuring in the UAE.

Releases and recoveries in the Middle East more than doubled from 2009 to US\$112m due to the release of judgemental impairment allowances reflecting improved economic conditions during 2010.

In **North America**, new loan impairment allowances declined markedly, reducing by 44% to US\$8.7bn. In our HSBC Finance portfolios, lower new loan impairment allowances in Card and Retail Services reflected a reduction in lending balances and an improvement in delinquency rates. In our Consumer Lending and Mortgage Services portfolios, new loan impairment allowances also fell as the portfolio continued to run-off. In addition, total loss severities on foreclosed loans improved compared with 2009 reflecting the increase in the number of properties for which we accepted a deed-in-lieu of foreclosure, or a short sale, both of which result in lower losses compared with loans which are subjected to a formal foreclosure process.

In our corporate and commercial portfolios in North America, new loan impairment allowances declined, reflecting lower balances due to customer deleveraging and improved credit quality which, along with the improved economy, resulted in credit upgrades on certain accounts and fewer customer downgrades.

In North America, impaired loans decreased by 19% from the end of 2009 to US\$10.8bn, while releases and recoveries rose by 80% compared with 2009 to US\$378m.

In **Latin America**, new loan impairment allowances declined by 42% to US\$1.9bn, while impaired loans declined by 23% to US\$2.4bn as economic conditions in the region improved. Lower new loan impairment allowances in the personal lending portfolios were due to lower credit card balances in Mexico as we repositioned the portfolio to target higher quality customers and, to a lesser extent, in Brazil, due to the managed reduction in consumer finance balances. In addition, in the commercial lending portfolios in Brazil lower new impairment allowances reflected an improvement in economic conditions.

Releases and recoveries in Latin America declined by 21% from 2009 to US\$331m.

For an analysis of loan impairment charges and other credit risk provisions by customer group, see pages 24 to 26.

Report of the Directors: Operating and Financial Review (continued)

2009 compared with 2008

(Unaudited)

Our loan impairment charges increased by 3% to US\$24.9bn from US\$24.1bn in 2008. The commentary on net loan impairment allowances is on a constant currency basis while the commentary on impaired loans is on a reported basis.

New allowances for loan impairment charges rose by 7% compared with 2008 to US\$26.4bn. Releases and recoveries of allowances increased by 17% to US\$1.5bn. Total impaired loans to customers at 31 December 2009 were US\$31bn, an increase of 21% compared with the end of 2008. Impaired loans remained at 3% of customer loans and advances at 31 December 2009.

In **Europe**, new loan impairment allowances increased by 37% to US\$4.9bn in 2009, driven by credit quality deterioration in individually impaired loans. Impaired loans increased by 59% to US\$10.9bn at 31 December 2009.

In the UK, higher new loan impairment allowances reflected a small number of large individually assessed impairments against corporate and commercial exposures, together with the effects of credit quality deterioration in the personal lending portfolio. In the unsecured portfolios, credit quality declined in the cards and personal loans portfolios reflecting the deterioration in the economic environment. In the residential mortgage portfolios, credit quality remained strong despite higher unemployment in the UK. Our exposure to this market remained well secured with typical loan-to-value ratios of below 60%.

In Europe, releases and recoveries were US\$520m, a decrease of 5% compared with 31 December 2008.

In **Hong Kong**, new loan impairment allowances were US\$548m, a decline of 12% compared with 2008. Credit quality within the commercial lending portfolios improved compared with 2008, when significant impairments were taken on some exporters due to the contraction in global trade. New loan impairment allowances increased in the unsecured personal portfolios, reflecting the rise in unemployment and bankruptcy filings. Impaired loans were broadly stable at US\$846m.

In **Rest of Asia-Pacific**, new loan impairment allowances rose by 18% to US\$1.1bn, mainly due to increased delinquencies on unsecured lending, particularly in the credit card and personal lending portfolios in India and, to a lesser extent, in Indonesia. In the corporate and commercial portfolios, new loan impairment allowances

increased, reflecting a deterioration in India's economic conditions. Impaired loans increased by 44% to US\$1.2bn.

Releases and recoveries in the Rest of Asia-Pacific region rose by 42% to US\$214m at 31 December 2009.

New loan impairment allowances in the **Middle East** increased significantly from a low base, to US\$1.4bn. The increase reflected higher charges in the UAE, largely in Dubai, due to a marked deterioration in credit quality which particularly affected the real estate and construction industries. Infrastructure projects were delayed or cancelled and unemployment levels increased. Delinquency rates rose as a result, particularly in the credit card and personal loan portfolios. Impaired loans increased by US\$1.4bn to US\$1.7bn.

New loan impairment allowances rose by 7% to US\$26.4bn despite falls of 12% in Hong Kong and 7% in North America.

In **North America**, new loan impairment allowances declined by 7% to US\$15.6bn against the backdrop of a widespread rise in unemployment, continued weakness in the US economy and housing markets, higher levels of personal bankruptcy filings and portfolio seasoning. This decline was the result of lower loan impairment charges in the Mortgage Services real estate secured, credit card and vehicle finance portfolios, partially offset by higher loan impairment charges in the branch-based Consumer Lending business. Apart from the changes made to the write-off period, the main contributing factors were as follows:

- new loan impairment allowances in the Mortgage Services business decreased in 2009 as the portfolio continued to run off. While loss severities increased compared with 2008, a higher percentage of impairment was in respect of first lien loans which have less severity than second lien loans;
- new loan impairment allowances in the vehicle finance loan portfolio decreased as a result of lower loan levels reflecting the discontinuance of vehicle finance originations in July 2008. In addition, loss severities decreased as prices on repossessed vehicles improved; and
- new loan impairment allowances in the branch-based Consumer Lending business increased in 2009, primarily in the unsecured portfolio due to the deterioration in the 2006 and 2007 vintages which were more pronounced in certain geographic regions and, to a lesser extent, first

Report of the Directors: Operating and Financial Review (continued)

lien real estate secured loans. These increases were partially offset by lower new loan impairment allowances for second lien real estate secured loans.

New loan impairment allowances in the Cards and Retail Services portfolios declined due to lower outstanding balances and management action taken in the past two years to constrain origination activities in riskier segments. In addition, impairment provisioning reflects an improved outlook on future loss estimates as the impact of higher unemployment rates on losses has not been as severe as initially expected due, in part, to lower fuel prices and the boost to cash flow provided by government stimulus programmes that meaningfully benefit non-prime customers. In HSBC Bank USA personal lending portfolios, new loan impairment allowances increased, mainly in prime residential mortgage lending.

New loan impairment allowances in the corporate and commercial lending portfolios increased as the weaker economy affected firms in the commercial real estate and construction sectors in the US. In Canada, our new loan impairment allowances were higher, primarily against exposures in the commercial real estate, manufacturing and trade sectors.

In North America, releases and recoveries increased by 14% to US\$205m at 31 December 2009 due to an increase in the repayment of loans previously impaired in the corporate, commercial and financial portfolios.

Impaired loans decreased by 7% to US\$13.3bn at 31 December 2009.

New loan impairment allowances in **Latin America** increased by 18% to US\$2.9bn, while impaired loans rose by 27% to US\$3.0bn. The increase in new loan impairment allowances in Brazil was driven by higher delinquencies, mainly in credit cards, overdrafts and payroll loans, due to higher unemployment. In the commercial portfolio, higher new loan impairment allowances reflected the challenging economic environment which particularly affected the business banking and mid-market business segments.

Releases and recoveries in Latin America increased by 56% to US\$391m at 31 December 2009.

For an analysis of loan impairment charges and other credit risk provisions by customer group, see page 49.

Report of the Directors: Operating and Financial Review (continued)

HSBC Holdings

(Audited)

Credit risk in HSBC Holdings primarily arises from transactions with Group subsidiaries and from guarantees issued in support of obligations assumed by certain Group operations in the normal conduct of their business.

These risks are reviewed and managed within regulatory and internal limits for exposures by our

HSBC Holdings – maximum exposure to credit risk

(Audited)

Cash at bank and in hand:	
– balances with HSBC undertakings	
Derivatives	
Loans and advances to HSBC undertakings	
Financial investments	
Financial guarantees and similar contracts	
Loan and other credit-related commitments	

All of the derivative transactions are with HSBC undertakings which are banking counterparties (2009: 100%).

The credit quality of the loans and advances to HSBC undertakings is assessed as strong/good, with 100% of the exposure being neither past due nor impaired (2009: 100%).

The credit ratings of the financial investments held by HSBC Holdings are within the Standard and Poor's ('S&P') ratings range of A to BBB+ (2009: A+ to A–).

Securitisation exposures and other structured products

(Audited)

The financial impact of the recent market disruption is lessening with net write-downs to the income statement of nil (2009: US\$1.9bn net write-downs) and a reduction in the available-for-sale ABSs reserve deficit by US\$5.8bn to US\$6.4bn.

Following the dislocation in markets which began in 2007, there was a modest recovery in the risk appetite of investors in 2009. However, the first half of 2010 saw renewed uncertainty and concerns over sovereign credit risk. As a result, the prices of many assets perceived to be of higher risk fell. In addition, the widespread downgrading of securitised assets continued in the first half of 2010 as rating agencies changed their methodologies, reducing the appetite for securitised assets among institutions subject to the Basel II framework.

Global Risk function, which provides high-level centralised oversight and management of our credit risks worldwide.

HSBC Holdings' maximum exposure to credit risk at 31 December 2010 is shown below. Its financial assets principally represent claims on Group subsidiaries in Europe and North America. No collateral or other credit enhancements were held by HSBC Holdings in respect of its transactions with subsidiaries.

2010 US\$m	2009 US\$m
459	224
2,327	2,981
21,238	23,212
2,025	2,455
46,988	35,073
2,720	3,240
75,757	67,185

Increased stability returned in the second half of 2010 following the interventions of the EU and the International Monetary Fund. A modest increase in house prices in some areas and the continued low interest rate environment contributed to a rise in the price of some securitised assets. As a result, the levels of write-downs and losses on our holdings of structured assets remained modest. Unrealised losses in our available-for-sale reserve continued to reduce due to increases in fair value and the principal amortisation of ABSs as repayments were received at par. Expectations of cash losses on available-for-sale ABSs remained consistent with our previous estimates.

Overview of exposure

(Audited)

Accounting policies

Our accounting policies for the classification and valuation of financial instruments are in accordance with the requirements of IAS 32 'Financial Instruments: Presentation' and IAS 39 'Financial Instruments: Recognition and Measurement', as described in Note 2 on the Financial Statements, and the use of assumptions and estimates in respect of valuation of financial instruments as described in Note 16 on the Financial Statements.

This section contains information about our exposure to the following:

- ABSs, including mortgage-backed securities ('MBS's) and related collateralised debt obligations ('CDO's);
- direct lending held at fair value through profit or loss;

Report of the Directors: Operating and Financial Review (continued)

- monolines;
- credit derivative product companies ('CDPC's);
- leveraged finance transactions; and
- representations and warranties related to

Overall exposure of HSBC (Audited)

	At 31 December 2010		At 31 December 2009	
	Carrying amount US\$bn	Including sub-prime and Alt-A US\$bn	Carrying amount US\$bn	Including sub-prime and Alt-A US\$bn
Asset-backed securities ('ABS's)	73.9	8.5	70.6	10.8
– fair value through profit or loss	10.8	0.3	12.1	0.7
– available for sale ³⁸	54.7	7.1	48.1	8.2
– held to maturity ³⁸	2.2	0.2	2.5	0.2
– loans and receivables	6.2	0.9	7.9	1.7
Loans at fair value through profit or loss	1.6	1.2	2.0	1.6
Total ABS and direct lending at fair value through profit or loss	75.5	9.7	72.6	12.4
Less securities mitigated by credit derivatives with monolines and other financial institutions	(8.3)	(0.4)	(10.2)	(1.0)
	67.2	9.3	62.4	11.4
Leveraged finance loans	4.9	–	6.2	–
– fair value through profit or loss	0.3	–	0.2	–
– loans and receivables	4.6	–	6.0	–
	72.1	9.3	68.6	11.4
Exposure including securities mitigated by credit derivatives with monolines and other financial institutions	80.4	9.7	78.8	12.4

For footnote, see page 174.

Asset-backed securities and leveraged finance

(Audited)

We are or have been involved in the following activities involving ABSs and leveraged finance:

- purchasing US mortgage loans with the intention of structuring and placing securitisations into the market;
- trading in ABSs, including MBSs, in secondary markets;
- holding MBSs and other ABSs in balance sheet management activities, with the intention of earning net interest income over the life of the securities;
- holding MBSs and other ABSs as part of investment portfolios, including securities investment conduits ('SIC's) and money market funds, as described in Note 43 on the Financial Statements, with the intention of earning net interest income and management fees;
- holding MBSs or other ABSs in the trading portfolio hedged through credit derivative protection, typically purchased from monolines, with the intention of earning the spread differential over the life of the instruments; and

mortgage sales and securitisation activities.

The following table summarises our exposure to these products.

- originating leveraged finance loans for the purposes of syndicating or selling them down in order to generate a trading profit or holding them in order to earn interest margin over their lives.

These activities are not a significant part of GB&M's on-going business, and GB&M is not reliant on them for any material aspect of its business operations or profitability. The purchase and securitisation of US mortgage loans and the secondary trading of US MBSs, which was conducted in our US MBS business, was discontinued in 2007.

Nature of HSBC's exposures

MBSs are securities that represent interests in groups of mortgages and provide investors with the right to receive cash from future mortgage payments (interest and/or principal). An MBS which references mortgages with different risk profiles is classified according to the highest risk class.

CDOs are securities backed by a pool of bonds, loans or other assets such as ABSs. CDOs may include exposure to sub-prime or Alt-A mortgage

Report of the Directors: Operating and Financial Review (continued)

assets where these are part of the underlying assets or reference assets. As there is often uncertainty surrounding the precise nature of the underlying collateral supporting CDOs, all CDOs supported by residential mortgage-related assets are classified as

sub-prime. Our holdings of ABSs and CDOs and direct lending positions, and the categories of mortgage collateral and lending activity, are described below.

Categories of ABSs and CDOs	Definition	Classification
Sub-prime	Loans to customers who have limited credit histories, modest incomes or high debt-to-income ratios or have experienced credit problems caused by occasional delinquencies, prior charge-offs, bankruptcy or other credit-related actions.	For US mortgages, standard US credit scores are primarily used to determine whether a loan is sub-prime; for non-US mortgages, management judgement is used.
US Home Equity Lines of Credit ('HELoC's)	A form of revolving credit facility provided to customers, which is supported by a first or second lien charge over residential property.	Holdings of HELoCs are classified as sub-prime.
US Alt-A	Lower risk loans than sub-prime, but they share higher risk characteristics than lending under fully conforming standard criteria.	US credit scores and the completeness of documentation held (such as proof of income), are considered when determining whether an Alt-A classification is appropriate. Non sub-prime mortgages in the US are classified as Alt-A if they are not eligible for sale to the major US Government sponsored mortgage agencies.
US Government agency and sponsored enterprises mortgage-related assets	Securities that are guaranteed by US Government agencies such as the Government National Mortgage Association ('Ginnie Mae'), or by US Government sponsored entities including the Federal National Mortgage Association ('Fannie Mae') and the Federal Home Loan Mortgage Corporation ('Freddie Mac').	Holdings of US Government agency and US Government sponsored enterprises' mortgage-related assets are classified as prime exposures.
UK non-conforming mortgages	UK mortgages that do not meet normal lending criteria. Examples include mortgages where the expected level of documentation is not provided (such as income with self-certification), or where poor credit history increases risk and results in pricing at a higher than normal lending rate.	UK non-conforming mortgages are treated as sub-prime exposures.
Other mortgages	Residential mortgages, including prime mortgages, that do not meet any of the classifications described above.	Prime residential mortgage-related assets are included in this category.

Our exposure to non-residential mortgage-related ABSs and direct lending includes securities with collateral relating to:

- commercial property mortgages;
- leveraged finance loans;
- student loans; and
- other assets, such as securities with other receivable-related collateral.

ABSs classified as available for sale

Our principal holdings of available-for-sale ABSs (see table below) are in GB&M through special purpose entities ('SPE's) which were established from the outset with the benefit of external investor first loss protection support, together with positions held directly and by Solitaire Funding Limited ('Solitaire'), where we have first loss risk.

The following table summarises our exposure to ABS's classified as available for sale:

Available-for-sale ABSs exposure (Audited)

	At 31 December 2010			At 31 December 2009		
	Directly held/ Solitaire ³⁹ US\$m	SPEs US\$m	Total US\$m	Directly held/ Solitaire ³⁹ US\$m	SPEs US\$m	Total US\$m
Total carrying amount of net principal exposure	41,106	13,586	54,692	34,040	14,021	48,061
Notional principal value of impaired securities	3,015	2,399	5,414	2,641	1,565	4,206
Carrying value of capital notes liability	–	(254)	(254)	–	(740)	(740)

Report of the Directors: Operating and Financial Review (continued)*Movement in the available-for-sale ('AFS') ABSs reserve*
(Audited)

	2010			2009		
	Directly held/ Solitaire ³⁹ US\$m	SPEs US\$m	Total US\$m	Directly held/ Solitaire ³⁹ US\$m	SPEs US\$m	Total US\$m
AFS reserve at 1 January	(7,349)	(4,864)	(12,213)	(11,528)	(7,204)	(18,732)
Increase in fair value of securities	2,175	1,543	3,718	3,419	704	4,123
Impairment charge:						
– borne by HSBC	444	–	444	1,422	–	1,422
– allocated to capital note holders ⁴⁰	–	531	531	–	666	666
Repayment of capital	540	187	727	431	668	1,099
Other movements	88	297	385	(1,093)	302	(791)
AFS reserve at 31 December	(4,102)	(2,306)	(6,408)	(7,349)	(4,864)	(12,213)

For footnotes, see page 174.

Securities investment conduits

(Audited)

The total carrying amount of ABSs held through SPEs in the above table represents holdings in which significant first loss protection is provided through capital notes issued by SICs, excluding Solitaire.

At each reporting date, we assess whether there is any objective evidence of impairment in the value of the ABSs held by SPEs. Impairment charges incurred on these assets are offset by a credit to the impairment line for the amount of the loss allocated to capital note holders.

The economic first loss protection remaining at 31 December 2010 amounted to US\$2.2bn (2009: US\$2.2bn). On an IFRSs accounting basis, the carrying value of the liability for the capital notes at 31 December 2010 amounted to US\$0.3bn (2009: US\$0.7bn). The impairment charge recognised during 2010 amounted to US\$531m (2009: US\$666m).

At 31 December 2010, the available-for-sale reserve in respect of securities held by the SICs was a deficit of US\$2.7bn (2009: US\$5.2bn). Of this, US\$2.3bn related to ABSs (2009: US\$4.9bn).

Impairments recognised during 2010 from assets held directly or within Solitaire, in recognition of the first loss protection of US\$1.2bn we provide through credit enhancement and from drawings against the liquidity facility we provide, were US\$444m (2009: US\$1.4bn). The reduction in impairment charges compared with 2009 was due to the stabilising of loss severities and delinquency roll rates which have resulted in lower losses in the underlying collateral pools. The level of impairment recognised in comparison with the deficit in the available-for-sale reserve was a

reflection of the credit quality and seniority of the assets held.

Sub-prime and Alt-A residential mortgage-backed securities

(Audited)

The assets which are most sensitive to possible future impairment are sub-prime and Alt-A residential MBSS. Available-for-sale holdings in these higher risk categories where HSBC does not benefit from significant first loss protection amounted to US\$3.8bn at 31 December 2010 (2009: US\$4.9bn). For these securities the cumulative fair value losses not recognised in the income statement at 31 December 2010 was US\$1.6bn (2009: losses of US\$3.2bn). Other holdings in these higher risk categories classified as available-for-sale are held in vehicles where third party first loss protection exists, as described in the section on securities investment conduits, above.

During 2010, the credit ratings on certain ABSs held directly by HSBC, Solitaire and the SICs were downgraded. A downgrade of a security's credit rating is not, of itself, evidence of impairment. Consequently, the actions of the rating agencies alone have no direct impact on the measurement of impairment losses. The impairment losses recognised on these securities at 31 December 2010 are set out above.

Impairment methodologies

(Audited)

The accounting policy for impairment and indicators of impairment is set out in Note 2j on the Financial Statements.

For available-for-sale ABSs, to identify objective evidence of impairment, an industry standard valuation model is normally applied which uses data with reference to the underlying asset

Report of the Directors: Operating and Financial Review (continued)

pools and models their projected future cash flows. The estimated future cash flows of the securities are assessed at the specific financial asset level to determine whether any of them are unlikely to be recovered as a result of loss events occurring on or before the reporting date.

The principal assumptions and inputs to the models are typically the delinquency status of the underlying loans, the probability of delinquent loans progressing to default, the prepayment profiles of the underlying assets and the loss severity in the event of default. However, the models utilise other variables relevant to specific classes of collateral to forecast future defaults and recovery rates. Management uses externally available data and applies judgement when determining the appropriate assumptions in respect of these factors. HSBC uses a modelling approach which incorporates historically observed progression rates to default, to determine if the decline in aggregate projected cash flows from the underlying collateral will lead to a shortfall in contractual cash flows. In such cases the security is considered to be impaired.

In respect of CDOs, expected future cash flows for the underlying collateral are assessed to determine whether there is likely to be a shortfall in the contractual cash flows of the CDO.

When a security benefits from a contract provided by a monoline insurer that insures payments of principal and interest, the expected recovery on the contract is assessed in determining the total expected credit support available to the ABS.

Impairment and cash loss projections

(Unaudited)

At 31 December 2009, management undertook an analysis to estimate further potential impairments and expected cash losses on the available-for-sale ABS portfolio. This exercise comprised a shift of projections of future loss severities, default rates and prepayment rates. The results of the analysis indicated that further impairment charges of some US\$1.1bn and expected cash losses of some US\$450m could arise over the next two to three years.

At 31 December 2010, management re-performed the stress test. After taking into account the cash losses experienced during 2010, the remaining cash loss projections of US\$250m were consistent with those as at 31 December 2009. However, the impairment charge projections showed an additional charge of US\$300m arising over the next two years in relation to the SICs, after taking into account the impairments recognised in 2010, resulting in future impairment charges of US\$950m, including the US\$300m relating to the SICs. This additional charge reflects where the accounting impairments will exceed the carrying amount of the capital notes held by third parties.

For the purposes of identifying impairment at the reporting date, the future projected cash flows reflect the effect of loss events that have occurred at or prior to the reporting date. For the purposes of performing stress tests to estimate potential future impairment charges, the projected future cash flows reflect additional assumptions about future loss events after the balance sheet date.

This analysis makes assumptions in respect of the future behaviour of loss severities, default rates and prepayment rates. Movements in the parameters are not independent of each other. For example, increased default rates and increased loss severities, which would imply greater impairments, generally arise under economic conditions that give rise to reduced levels of prepayment, reducing the potential for impairment charges. Conversely, economic conditions which increase the rates of prepayment are generally associated with reduced default rates and decreased loss severities.

At 31 December 2010, the incurred and projected impairment charges, measured in accordance with accounting requirements, significantly exceeded the expected cash losses on the securities. Over the lives of the available-for-sale ABSs the cumulative impairment charges will converge towards the level of cash losses. In respect of the SICs, in particular, the capital notes held by third parties are expected to absorb the cash losses arising in the vehicles.

Report of the Directors: Operating and Financial Review (continued)

Carrying amount of HSBC's consolidated holdings of ABSs, and direct lending held at fair value through profit or loss (Audited)

	Trading US\$m	Available for sale US\$m	Held to maturity US\$m	Designated at fair value through profit US\$m	Loans and receivables US\$m	Total US\$m	Of which held through consolidated SPEs US\$m
At 31 December 2010							
Mortgage-related assets							
Sub-prime residential	1,297	2,565	–	–	652	4,514	2,763
Direct lending	1,078	–	–	–	–	1,078	632
MBSs and MBS CDOs ⁴¹	219	2,565	–	–	652	3,436	2,131
US Alt-A residential	180	4,545	191	–	270	5,186	3,651
Direct lending	96	–	–	–	–	96	–
MBSs ⁴¹	84	4,545	191	–	270	5,090	3,651
US Government agency and sponsored enterprises MBSs ⁴¹	657	21,699	2,032	–	–	24,388	6
Other residential	1,075	4,024	–	–	1,111	6,210	2,669
Direct lending	417	–	–	–	–	417	–
MBSs ⁴¹	658	4,024	–	–	1,111	5,793	2,669
Commercial property MBSs and MBS CDOs ⁴¹	546	8,160	–	111	1,942	10,759	6,441
	3,755	40,993	2,223	111	3,975	51,057	15,530
Leveraged finance-related assets							
ABSs and ABS CDOs ⁴¹	392	5,418	–	–	414	6,224	3,886
Student loan-related assets							
ABSs and ABS CDOs ⁴¹	163	5,178	–	–	150	5,491	4,251
Other assets							
ABSs and ABS CDOs ⁴¹	1,936	3,103	–	6,017	1,710	12,766	2,526
	6,246	54,692	2,223	6,128	6,249	75,538	26,193
At 31 December 2009							
Mortgage-related assets							
Sub-prime residential	2,063	2,782	–	–	837	5,682	3,213
Direct lending	1,439	–	–	–	–	1,439	913
MBSs and MBS CDOs ⁴¹	624	2,782	–	–	837	4,243	2,300
US Alt-A residential	191	5,403	192	–	882	6,668	3,672
Direct lending	113	–	–	–	–	113	–
MBSs ⁴¹	78	5,403	192	–	882	6,555	3,672
US Government agency and sponsored enterprises MBSs ⁴¹	375	13,332	2,333	–	–	16,040	322
Other residential	1,646	4,582	–	335	1,401	7,964	3,160
Direct lending	452	–	–	–	–	452	–
MBSs ⁴¹	1,194	4,582	–	335	1,401	7,512	3,160
Commercial property MBSs and MBS CDOs ⁴¹	414	7,535	–	103	2,143	10,195	5,730
	4,689	33,634	2,525	438	5,263	46,549	16,097
Leveraged finance-related assets							
ABSs and ABS CDOs ⁴¹	555	5,150	–	–	484	6,189	4,144
Student loan-related assets							
ABSs and ABS CDOs ⁴¹	141	4,948	–	–	145	5,234	4,127
Other assets							
ABSs and ABS CDOs ⁴¹	2,302	4,329	–	6,025	1,987	14,643	2,696
	7,687	48,061	2,525	6,463	7,879	72,615	27,064

For footnote, see page 174.

The above table excludes leveraged finance transactions, which are shown separately on page 139.

Report of the Directors: Operating and Financial Review (continued)

HSBC's consolidated holdings of ABSs, and direct lending held at fair value through profit or loss
(Audited)

	2010				At 31 December 2010			
	Gross fair value movements		Realised gains/ (losses) in the income statement ⁴⁵ US\$m	Reclassi- fied ⁴⁶ US\$m	Gross principal ⁴⁷ US\$m	Credit default swap gross protection ⁴⁸ US\$m	Net principal exposure ⁴⁹ US\$m	Carrying Amount ⁵⁰ US\$m
	Income Statement ⁴³ US\$m	Other compre- hensive income ⁴⁴ US\$m						
Mortgage-related assets								
Sub-prime residential								
Direct lending	(35)	–	(20)	–	2,233	–	2,233	1,078
MBSs ⁴¹	58	313	14	385	5,104	336	4,768	3,135
– high grade ⁴²	6	151	5	52	1,996	292	1,704	1,458
– rated C to A	52	162	7	333	3,006	44	2,962	1,645
– not publicly rated	–	–	2	–	102	–	102	32
MBS CDOs ⁴¹	–	7	–	(3)	90	12	78	17
– high grade ⁴²	–	–	–	–	2	–	2	1
– rated C to A	–	6	–	(3)	86	12	74	14
– not publicly rated	–	1	–	–	2	–	2	2
	23	320	(6)	382	7,427	348	7,079	4,230
US Alt-A residential								
Direct lending	(1)	–	–	–	108	–	108	96
MBSs ⁴¹	4	575	3	1,564	9,957	100	9,857	5,013
– high grade ⁴²	–	35	3	45	660	100	560	473
– rated C to A	4	539	–	1,520	9,254	–	9,254	4,503
– not publicly rated	–	1	–	(1)	43	–	43	37
	3	575	3	1,564	10,065	100	9,965	5,109
US Government agency and sponsored enterprises								
MBSs ⁴¹								
– high grade ⁴²	3	226	(11)	(43)	23,739	–	23,739	24,388
Other residential								
Direct lending	63	–	35	–	424	–	424	417
MBSs ⁴¹	6	163	4	(7)	6,571	–	6,571	5,793
– high grade ⁴²	5	149	4	(7)	5,841	–	5,841	5,256
– rated C to A	1	14	–	–	648	–	648	450
– not publicly rated	–	–	–	–	82	–	82	87
	69	163	39	(7)	6,995	–	6,995	6,210
Commercial property								
MBS and MBS CDOs ⁴¹	45	1,366	6	112	12,625	421	12,204	10,493
– high grade ⁴²	5	540	4	71	6,341	15	6,326	5,791
– rated C to A	40	826	2	36	6,201	406	5,795	4,637
– not publicly rated	–	–	–	5	83	–	83	65
Leveraged finance-related assets								
ABSs and ABS CDOs ⁴¹	5	453	–	18	7,148	788	6,360	5,721
– high grade ⁴²	3	308	–	(8)	6,078	351	5,727	5,148
– rated C to A	2	145	–	26	971	437	534	472
– not publicly rated	–	–	–	–	99	–	99	101
Student loan-related assets								
ABSs and ABS CDOs ⁴¹	7	230	3	(6)	7,161	100	7,061	5,459
– high grade ⁴²	9	44	3	(4)	4,080	–	4,080	3,626
– rated C to A	(2)	157	–	(2)	2,620	100	2,520	1,663
– not publicly rated	–	29	–	–	461	–	461	170
Other assets								
ABS and ABS CDOs ⁴¹	2	385	1	67	15,497	7,765	7,732	5,622
– high grade ⁴²	–	188	–	1	10,947	7,447	3,500	2,884
– rated C to A	2	188	1	46	4,059	318	3,741	2,379
– not publicly rated	–	9	–	20	491	–	491	359
Total	157	3,718	35	2,087	90,657	9,522	81,135	67,232

Report of the Directors: Operating and Financial Review (continued)

	2009				At 31 December 2009			
	Gross fair value movements		Realised gains/(losses) in the income statement ⁴⁵ US\$m	Reclassified ⁴⁶ US\$m	Gross principal ⁴⁷ US\$m	Credit default swap gross protection ⁴⁸ US\$m	Net principal exposure ⁴⁹ US\$m	Carrying Amount ⁵⁰ US\$m
Income Statement ⁴³ US\$m	Other comprehensive income ⁴⁴ US\$m							
Mortgage-related assets								
Sub-prime residential								
Direct lending	(227)	–	(40)	–	1,703	–	1,703	1,439
MBSs ⁴¹	(44)	187	(130)	795	7,483	1,248	6,235	3,419
– high grade ⁴²	(16)	177	1	134	2,762	603	2,159	1,719
– rated C to A	(25)	10	(131)	661	4,616	645	3,971	1,700
– not publicly rated	(3)	–	–	–	105	–	105	–
MBS CDOs ⁴¹	(2)	(9)	–	2	138	15	123	29
– high grade ⁴²	–	(1)	–	–	36	15	21	17
– rated C to A	(1)	(8)	–	2	89	–	89	10
– not publicly rated	(1)	–	–	–	13	–	13	2
	(273)	178	(170)	797	9,324	1,263	8,061	4,887
US Alt-A residential								
Direct lending	–	–	–	–	129	–	129	113
MBSs ⁴¹	95	661	(143)	1,693	13,546	491	13,055	6,427
– high grade ⁴²	(9)	361	1	317	1,625	428	1,197	1,237
– rated C to A	103	300	(144)	1,376	11,885	63	11,822	5,176
– not publicly rated	1	–	–	–	36	–	36	14
	95	661	(143)	1,693	13,675	491	13,184	6,540
US Government agency and sponsored enterprises								
MBSs ⁴¹								
– high grade ⁴²	116	252	(2)	(123)	15,827	–	15,827	16,040
Other residential								
Direct lending	79	–	70	–	463	–	463	452
MBSs ⁴¹	71	625	37	50	8,741	91	8,650	7,443
– high grade ⁴²	76	617	37	75	7,884	91	7,793	6,440
– rated C to A	(5)	10	–	(34)	773	–	773	941
– not publicly rated	–	(2)	–	9	84	–	84	62
	150	625	107	50	9,204	91	9,113	7,895
Commercial property								
MBS and MBS CDOs ⁴¹	35	702	(8)	(104)	13,734	395	13,339	9,954
– high grade ⁴²	72	683	(8)	(90)	9,805	264	9,541	7,537
– rated C to A	(37)	17	–	(12)	3,860	131	3,729	2,365
– not publicly rated	–	2	–	(2)	69	–	69	52
Leveraged finance-related assets								
ABSs and ABS CDOs ⁴¹	(1)	721	–	(40)	7,516	895	6,621	5,612
– high grade ⁴²	14	758	–	(41)	6,620	414	6,206	5,301
– rated C to A	(15)	(37)	–	1	881	481	400	295
– not publicly rated	–	–	–	–	15	–	15	16
Student loan-related assets								
ABSs and ABS CDOs ⁴¹	(6)	569	2	32	7,192	224	6,968	5,122
– high grade ⁴²	2	630	–	32	6,690	30	6,660	5,019
– rated C to A	(8)	(61)	2	–	477	194	283	76
– not publicly rated	–	–	–	–	25	–	25	27
Other assets								
ABS and ABS CDOs ⁴¹	74	415	(17)	91	17,608	8,797	8,811	6,327
– high grade ⁴²	18	288	10	31	12,846	8,607	4,239	3,564
– rated C to A	40	152	(29)	85	4,126	190	3,936	2,245
– not publicly rated	16	(25)	2	(25)	636	–	636	518
Total	190	4,123	(231)	2,396	94,080	12,156	81,924	62,377

For footnotes, see page 174.

Report of the Directors: Operating and Financial Review (continued)**Analysis of exposures and significant movements***(Audited)***Sub-prime residential mortgage-related assets**

Sub-prime residential mortgage-related assets included US\$3.1bn (2009: US\$3.7bn) related to US-originated assets and US\$1.1bn (2009: US\$1.1bn) relating to UK non-conforming residential mortgage-related assets. Of the non-high grade assets held of US\$1.7bn (2009: US\$1.7bn), US\$1.5bn (2009: US\$1.6bn) related to US-originated assets, reflecting the higher quality of the UK-originated assets.

A modest increase in observable values of our sub-prime assets took place in 2010. Further net impairment of US\$48m on assets classified as available for sale was recognised in 2010 (2009: US\$559m) as losses were incurred under current accounting impairment rules. Our expectation of cash losses on the underlying assets did not increase from that at 31 December 2009. Of the above impairment, US\$54m (2009: US\$312m) occurred in the SICs and was borne by the capital note holders.

*Vintages of US sub-prime and Alt-A mortgage-backed securities**(Audited)***Mortgage vintage**

Pre-2006
2006
2007

*For footnote, see page 174.***US Government agency and sponsored enterprises mortgage-related assets**

During 2010, we increased our holdings of US Government agency and sponsored enterprises mortgage-related assets by US\$8.3bn.

Other residential mortgage-related assets

The majority of our other residential mortgage-related assets were originated in the UK (2010: US\$3.9bn; 2009: US\$4.7bn). No impairments were recognised in respect of these UK originated assets in 2010 (2009: nil), reflecting credit support within the asset portfolio.

US Alt-A residential mortgage-related assets

During 2010, spreads on Alt-A mortgage-related assets tightened modestly from the levels seen in 2009. Further impairments of US\$884m (2009: US\$1,372m) were recorded in respect of Alt-A mortgage-related assets as losses were incurred under the accounting rules described in the paragraph above, without reference to the amount of expected loss. Our expectation of losses in the underlying assets did not increase from that at 31 December 2009. Of the impairment above, US\$450m (2009: US\$346m) occurred in the SICs and was borne by the capital note holders.

The downgrade of our US Alt-A residential MBSs is reflected in the disclosure of fair value movements in the above tables as if the downgrade had taken effect on 1 January 2010.

The following table shows the vintages of the collateral assets supporting our holdings of US sub-prime and Alt-A MBSs. Market prices for these instruments generally incorporate higher discounts for later vintages. The majority of our holdings of US sub-prime MBSs originated pre-2007; holdings of US Alt-A MBSs are more evenly distributed between pre-2007 vintages and those from 2007 onwards.

Gross principal ⁴⁷ of US sub-prime mortgage-backed securities at 31 December		Gross principal ⁴⁷ of US Alt-A mortgage-backed securities at 31 December	
2010 US\$m	2009 US\$m	2010 US\$m	2009 US\$m
1,061	1,748	1,159	2,108
1,822	2,827	5,147	6,225
979	1,187	3,651	5,213
3,862	5,762	9,957	13,546

Commercial property mortgage-related assets

Of our total of US\$10.5bn (2009: US\$10.0bn) of commercial property mortgage-related assets, US\$5.2bn related to US originated assets (2009: US\$4.3bn). Spreads tightened on both US and non-US commercial property mortgage-related assets during 2010. Impairments of US\$5m (2009: US\$88m) were recognised in 2010.

Leveraged finance-related assets

The majority of these assets related to US-originated exposures; 90% (2009: 94%) were high grade with no impairments recorded in the year (2009: nil).

Report of the Directors: Operating and Financial Review (continued)

Student loan-related assets

Our holdings in student loan-related assets were US\$5.5bn (2009: US\$5.1bn). No impairments were recorded on student loan-related assets in 2010 (2009: nil).

Transactions with monoline insurers

(Audited)

HSBC's exposure to derivative transactions entered into directly with monolines

Our principal exposure to monolines is through a number of OTC derivative transactions, mainly credit default swaps ('CDS's). We entered into these CDSs primarily to purchase credit protection against securities held at the time within the trading portfolio.

During 2010, the notional value of derivative contracts with monolines and our overall credit exposure to monolines decreased as a number of transactions were commuted, others matured, and credit spreads narrowed. The table below sets out the fair value, essentially the replacement cost, of the

remaining derivative transactions at 31 December 2010, and hence the amount at risk if the CDS protection purchased were to be wholly ineffective because, for example, the monoline insurer was unable to meet its obligations. In order to further analyse that risk, the value of protection purchased is shown subdivided between those monolines that were rated by S&P at 'BBB- or above' at 31 December 2010, and those that were 'below BBB-' (BBB- is the S&P cut-off for an investment grade classification). The 'Credit risk adjustment' column indicates the valuation adjustment taken against the net exposures, and reflects our best estimate of the likely loss of value on purchased protection arising from the deterioration in creditworthiness of the monolines. These valuation adjustments, which reflect a measure of the irrecoverability of the protection purchased, have been charged to the income statement. During 2010, the credit risk adjustment on derivative contracts with monolines decreased as a number of transactions commuted and others matured.

HSBC's exposure to derivative transactions entered into directly with monoline insurers

(Audited)

At 31 December 2010

Derivative transactions with monoline counterparties
 Monoline – investment grade (BBB- or above)
 Monoline – sub-investment grade (below BBB-)

At 31 December 2009

Derivative transactions with monoline counterparties
 Monoline – investment grade (BBB- or above)
 Monoline – sub-investment grade (below BBB-)

Notional amount US\$m	Net exposure before credit risk adjustment ⁵¹ US\$m	Credit risk Adjustment ⁵² US\$m	Net exposure after credit risk adjustment US\$m
5,179	876	(88)	788
2,290	648	(431)	217
7,469	1,524	(519)	1,005
5,623	997	(100)	897
4,400	1,317	(909)	408
10,023	2,314	(1,009)	1,305

For footnotes, see page 174.

The above table can be analysed as follows. HSBC has derivative transactions referenced to underlying securities with a notional value of US\$7.5bn (2009: US\$10.0bn), whose value at 31 December 2010 indicated a potential claim against the protection purchased from the monolines of some US\$1.5bn (2009: US\$2.3bn). On the basis of a credit assessment of the monolines, a provision of US\$519m has been taken (2009: US\$1.0bn), leaving US\$1.0bn exposed (2009: US\$1.3bn), of which US\$788m is recoverable from monolines rated investment grade at 31 December 2010 (2009: US\$897m). The provisions taken imply in aggregate that 90 cents in the dollar will be recoverable from investment

grade monolines and 33 cents in the dollar from non-investment grade monolines (2009: 90 cents and 31 cents, respectively).

For the CDSs, market prices are generally not readily available. Therefore the CDSs are valued on the basis of market prices of the referenced securities.

The credit risk adjustment against monolines is determined by one of a number of methodologies, dependent upon the internal credit rating of the monoline. Our assignment of internal credit

Report of the Directors: Operating and Financial Review (continued)

ratings is based upon detailed credit analysis, and may differ from external ratings.

Credit risk adjustments for monolines

- For highly-rated monolines, the standard credit risk adjustment methodology (as described on page 312) applies, with the exception that the future exposure profile is deemed to be constant (equal to the current market value) over the weighted average life of the referenced security, and the credit risk adjustment cannot fall below 10% of the mark-to-market exposure.
- In respect of monolines, where default has either occurred or there is a strong possibility of default in the near term, the adjustment is determined based on the estimated probabilities of various potential scenarios, and the estimated recovery in each case.
- For other monoline exposures, the credit risk adjustment follows the methodology for highly-rated monolines, adjusted to include the probability of a claim arising in respect of the referenced security, and applies implied probabilities of default where the likelihood of a claim is believed to be high.

As described above, HSBC's monoline credit risk adjustment calculation utilises a range of approaches dependent upon the credit quality of the monoline. The net impact of utilising the methodology adopted for 'highly-rated' monolines across all monolines would be a reduction in credit risk adjustment of US\$94m. The net impact of utilising a methodology based on credit default swap spreads would be an increase in credit risk adjustment of US\$8m.

At 31 December 2010, US\$1.4bn (2009: US\$2.6bn) notional value of securities referenced by monoline CDS transactions with a market value of US\$1.0bn (2009: US\$1.9bn) were held in the loans and receivables category, having been included in the reclassification of financial assets described in Note 18 on the Financial Statements. At the date of reclassification, the market value of the remaining assets was US\$1.2bn. The reclassification resulted in an accounting asymmetry between the CDSs, which continue to be held at fair value through profit and loss, and the reclassified securities, which are accounted for on an amortised cost basis. If the reclassifications had not occurred, the impact on the income statement for 2010 would have been a decrease in profit of US\$3m (2009: increase in profit of US\$5m). This amount represents the difference between the increase in market value of the securities during 2010 and the accretion recognised under the amortised cost method in 2010.

HSBC's exposure to direct lending and irrevocable commitments to lend to monolines

HSBC had no liquidity facilities to monolines at 31 December 2010 (2009: minimal).

HSBC's exposure to debt securities which benefit from guarantees provided by monolines

Within both the trading and available-for-sale portfolios, we hold bonds that are 'wrapped' with a credit enhancement from a monoline. As the bonds are traded explicitly with the benefit of this enhancement, any deterioration in the credit profile of the monoline is reflected in market prices and, therefore, in the carrying amount of these securities at 31 December 2010. For wrapped bonds held in our trading portfolio, the mark-to-market movement has been reflected through the income statement. For wrapped bonds held in the available-for-sale portfolio, the mark-to-market movement is reflected in equity unless there is objective evidence of impairment, in which case the impairment loss is reflected in the income statement. No wrapped bonds were included in the reclassification of financial assets described in Note 18 on the Financial Statements.

HSBC's exposure to Credit Derivative Product Companies

(Audited)

Credit Derivative Product Companies ('CDPC's) are independent companies that specialise in selling credit default protection on corporate exposures. OTC derivative exposure to CDPCs became a focus during the second half of 2008 as the spreads widened, but these exposures reduced during 2009 as the spreads tightened again. At 31 December 2010, HSBC had purchased from CDPCs credit protection with a notional value of US\$4.9bn (2009: US\$5.0bn) which had a fair value of US\$0.2bn (2009: US\$0.3bn), against which a credit risk adjustment (a provision) of US\$0.1bn (2009: US\$0.1bn) was held. At 31 December 2010, none of the exposure was to CDPCs with investment grade ratings (2009: 83%). The deterioration reflects rating downgrades and withdrawals during 2010.

Leveraged finance transactions

(Audited)

Leveraged finance transactions include sub-investment grade acquisition or event-driven financing. The following table shows our exposure to leveraged finance transactions arising from primary transactions. Our additional exposure to leveraged finance loans through holdings of ABSs from our trading and investment activities is shown in the table on page 133.

Report of the Directors: Operating and Financial Review (continued)*HSBC's exposure to leveraged finance transactions*
(Audited)

	At 31 December 2010			At 31 December 2009		
	Funded Exposures ⁵³ US\$m	Unfunded exposures ⁵³ US\$m	Total exposures US\$m	Funded Exposures ⁵³ US\$m	Unfunded exposures ⁵³ US\$m	Total exposures US\$m
Europe	3,337	298	3,635	3,790	368	4,158
Rest of Asia-Pacific	17	22	39	70	22	92
North America	1,066	185	1,251	1,713	188	1,901
	4,420	505	4,925	5,573	578	6,151
Held within:						
– loans and receivables	4,199	393	4,592	5,569	386	5,955
– fair value through profit or loss	221	112	333	4	192	196

For footnotes, see page 174.

We held leveraged finance commitments of US\$5.1bn at 31 December 2010 (2009: US\$6.5bn), of which US\$4.6bn (2009: US\$5.9bn) was funded.

As described in Note 18 on the Financial Statements, certain leveraged finance loans were reclassified from held for trading to loans and receivables. As a result, these loans are held at amortised cost subject to impairment and are not marked to market, and net gains of US\$0.1bn (2009: net gains of US\$1.2bn) were not taken to the income statement in 2010.

At 31 December 2010, our principal exposures were to companies in two sectors: US\$2.8bn to data processing (2009: US\$3.8bn) and US\$1.8bn to communications and infrastructure (2009: US\$1.9bn). During 2010, 99% of the total fair value movement not recognised was against exposures in these two sectors (2009: 99%).

Representations and warranties related to mortgage sales and securitisation activities
(Audited)

We have been involved in various activities related to the sale and securitisation of residential mortgages, which are not recognised on our balance sheet. These activities include:

- the purchase of US\$24bn of third party originated mortgages by HSBC Bank USA and securitisation of these by HSBC Securities (USA) Inc. ('HSI') between 2005 and 2007;
- HSI acting as underwriter for third party issuance of private label MBSs with an original issuance value of US\$37bn, most of which were sub-prime, as well as underwriting US\$6bn of MBSs issued by HSBC Finance; and
- the origination and sale by HSBC Bank USA of mortgage loans, primarily to government sponsored entities.

In sales and securitisations of mortgage loans, various representations and warranties regarding the loans may be made to purchasers of the mortgage loans and MBSs. In respect of the purchase and securitisation of third party originated mortgages and the underwriting of third party MBSs, the obligation to repurchase loans in the event of a breach of loan level representations and warranties resides predominantly with the organisation that originated the loan. While certain of these originators are or may become financially impaired, and therefore, unable to fulfil their repurchase obligations, we do not believe we have significant exposure for repurchases on these loans.

At 31 December 2010, a liability of US\$262m was recognised in respect of various representations and warranties, relating to the origination and sale by HSBC Bank USA of mortgage loans, primarily to government sponsored entities (2009: US\$66m). These relate to, among other things, the ownership of the loans, the validity of the liens, the loan selection and origination process, and the compliance to the origination criteria established by the agencies. In the event of a breach of our representations and warranties, HSBC Bank USA may be obliged to repurchase the loans with identified defects or to indemnify the buyers. The liability is estimated based on the level of outstanding repurchase demands, the level of outstanding requests for loan files and estimated future demands in respect of mortgages sold to date which are either two or more payments delinquent or expected to become delinquent at an estimated conversion rate. Repurchase demands of US\$115m were outstanding at 2010 (2009: US\$123m).

Report of the Directors: Operating and Financial Review (continued)

Upon receipt of a repurchase demand, we perform a detailed evaluation of the request. In many cases, we ultimately are not required to repurchase a loan as we are able to resolve the purported defect. From initial inquiry to ultimate resolution, a typical case takes roughly 12 months. Acceptance of a repurchase demand will involve either a) repurchase of the loan at the unpaid principal balance plus accrued interest or b) reimbursement for any realised loss on the sale of a property ('make-whole' payment).

To date, repurchase demands we have received primarily relate to prime loans sourced during 2004

through 2008 from the legacy broker channel which we exited in late 2008. Loans sold to GSEs and other third parties originated in 2004 through 2008 subject to representations and warranties for which we may be liable had an outstanding principal balance of approximately US\$23.0bn at 31 December 2010, including US\$14.3bn of loans sourced from our legacy broker channel.

The trend in repurchase demands received on loans sold to GSEs and other third parties by loan origination vintage, outstanding repurchase demands and movement in repurchase liabilities are as follows:

Trend in repurchase demands received by loans sold to GSEs and other third parties by origination vintage

	2010 US\$m	2009 US\$m
Pre-2004	14	8
2004	31	9
2005	24	10
2006	41	21
2007	161	59
2008	112	53
Post-2008	34	5
Total repurchase demands received	417	165

Outstanding repurchase demands received from GSEs and other third parties

	At 31 December	
	2010 US\$m	2009 US\$m
GSEs	92	104
Others	23	19
Total	115	123

Movement in repurchase liability for loans sold to GSEs and other third parties

	At 31 December	
	2010 US\$m	2009 US\$m
At 1 January	66	13
Increase in liability recorded through earnings	341	65
Realised losses	(145)	(12)
At 31 December	262	66

Because the level of mortgage loan repurchase losses are dependent upon economic factors, investor demand strategies and other external risk factors such as housing market trends that may change, the level of the liability for a mortgage loan repurchase requires significant judgement. Because these estimates are influenced by factors outside our control, there is uncertainty inherent in them, making it reasonably possible that the estimates could change.

Risk elements in the loan portfolio

(Unaudited)

The disclosure of credit risk elements in this section reflects US accounting practice and classifications. The purpose of the disclosure is to present within the US disclosure framework those elements of the loan portfolios with a greater risk of loss. The three main classifications of credit risk elements presented are:

- impaired loans;

Report of the Directors: Operating and Financial Review (continued)

- unimpaired loans contractually past due 90 days or more as to interest or principal; and
- troubled debt restructurings not included in the above.

In the following tables, we present information on our impaired loans and advances in accordance with the classification approach described on page 114.

Interest forgone on impaired loans

Interest income that would have been recognised under the original terms of impaired and restructured loans amounted to approximately US\$2.2bn in 2010 (2009: US\$2.7bn). Interest income from such loans of approximately US\$1.2bn was recorded in 2010 (2009: US\$1.4bn).

Impaired loans

Loans are classified as impaired when there is objective evidence that not all contractual cash flows will be received. In accordance with IFRSs, we recognise interest income on assets after they have been written down as a result of an impairment loss.

Unimpaired loans past due 90 days or more

Loans that are subject to individual impairment assessment and are over 90 days past due as regards principal and/or interest are classified as unimpaired loans when we expect to recover the contractual cash flows in full.

Troubled debt restructurings

The SEC requires separate disclosure of any loans not included in the previous two categories whose terms have been modified to grant concessions other than are warranted by market conditions because of problems with the borrower. These are classified as

'troubled debt restructurings' ('TDR's). The definition of TDRs differs from the 'Renegotiated loans that would otherwise be past due or impaired' quantified on page 139(c) insofar as for TDRs, the delinquency status of the loan following restructuring may continue to be past due not impaired or, where appropriate, impaired. In addition, where a restructure is on market terms, the classification of a loan as a TDR may be discontinued after the first year if the debt performs in accordance with the new terms.

TDRs decreased by 3% in 2010, reflecting the movement in loan balances where long-term modifications were offered to customers experiencing payment difficulties, particularly in the real estate secured portfolios in the US.

Potential problem loans

Credit risk elements also cover potential problem loans. These are loans where information on possible credit problems among borrowers causes management to seriously doubt their ability to comply with the loan repayment terms. There are no potential problem loans other than those identified in the table of risk elements set out below, and as discussed in 'Areas of special interest' on page 103. 'Areas of special interest' includes further disclosure about certain homogeneous groups of loans which are collectively assessed for impairment, and represent the Group's most significant exposures to potential problem loans, including ARMs and stated-income products. Collectively assessed loans and advances, as set out on page 119, although not classified as impaired until more than 90 days, are assessed collectively for losses that have been incurred but have not yet been individually identified. This policy is further described on page 94.

Analysis of risk elements in the loan portfolio by geographical region (Unaudited)

	31 Dec 09 as reported US\$m	Constant currency effect US\$m	31 Dec 09 at 31 Dec 10 exchange rates US\$m	Movement on a constant currency basis US\$m	31 Dec 10 as reported US\$m	Reported change %	Movement on a constant currency basis %
Europe	11,418	(554)	10,864	150	11,014	(4)	1
Hong Kong	1,096	(1)	1,095	(216)	879	(20)	(20)
Rest of Asia-Pacific	1,380	101	1,481	86	1,567	14	6
Middle East	1,986	(1)	1,985	784	2,769	39	39
North America	24,643	56	24,699	(2,479)	22,220	(7)	(10)
Latin America	4,662	210	4,872	(1,039)	3,833	(18)	(21)
	45,185	(189)	44,996	(2,714)	42,282	(6)	(6)

Report of the Directors: Operating and Financial Review (continued)*Analysis of risk elements in the loan portfolio by geographical region
(Unaudited)*

	At 31 December				
	2010 US\$m	2009 US\$m	2008 US\$m	2007 US\$m	2006 US\$m
Impaired loans					
Europe	10,663	10,873	6,844	6,266	5,858
Hong Kong	665	846	852	433	454
Rest of Asia-Pacific	1,324	1,201	835	779	807
Middle East	2,453	1,666	279	309	381
North America ²	10,789	13,308	14,285	9,662	6,108
Latin America	2,390	2,951	2,327	2,145	1,478
	28,284	30,845	25,422	19,594	15,086
Unimpaired loans contractually past due 90 days or more as to principal or interest					
Europe	64	57	635	202	237
Hong Kong	7	4	43	49	79
Rest of Asia-Pacific	40	36	84	94	75
Middle East	264	215	190	62	3
North America	265	217	108	24	78
Latin America	3	40	21	421	165
	643	569	1,081	852	637
Troubled debt restructurings (not included in the classifications above)					
Europe	240	436	366	648	360
Hong Kong	205	236	165	146	189
Rest of Asia-Pacific	198	135	90	23	56
Middle East	50	103	29	11	17
North America	9,670	9,613	5,618	3,322	1,712
Latin America	1,319	1,518	1,067	848	915
	11,682	12,041	7,335	4,998	3,249
Trading loans classified as in default					
North America	412	798	561	675	127
Risk elements on loans					
Europe	10,967	11,366	7,845	7,116	6,455
Hong Kong	877	1,086	1,060	628	722
Rest of Asia-Pacific	1,562	1,372	1,009	896	938
Middle East	2,767	1,984	498	382	401
North America	21,136	23,936	20,572	13,683	8,025
Latin America	3,712	4,509	3,415	3,414	2,558
	41,021	44,253	34,399	26,119	19,099
Assets held for resale					
Europe	47	52	81	59	30
Hong Kong	2	10	26	29	42
Rest of Asia-Pacific	5	8	11	5	15
Middle East	2	2	2	2	2
North America	1,084	707	1,758	1,172	999
Latin America	121	153	113	101	91
	1,261	932	1,991	1,368	1,179
Total risk elements					
Europe	11,014	11,418	7,926	7,175	6,485
Hong Kong	879	1,096	1,086	657	764
Rest of Asia-Pacific	1,567	1,380	1,020	901	953
Middle East	2,769	1,986	500	384	403
North America	22,220	24,643	22,330	14,855	9,024
Latin America	3,833	4,662	3,528	3,515	2,649
	42,282	45,185	36,390	27,487	20,278
	%	%	%	%	%
Loan impairment allowances as a percentage of risk elements on loans ⁷³	49.8	59.0	70.8	75.5	71.6

For footnotes, see page 174.

Report of the Directors: Operating and Financial Review (continued)

Liquidity and funding

(Audited)

HSBC expects its operating entities to manage liquidity and funding risk on a standalone basis employing a centrally imposed framework and limit structure which is adapted to variations in business mix and underlying markets. Our operating entities are required to maintain strong liquidity positions and to manage the liquidity profiles of their assets, liabilities and commitments with the objective of ensuring that their cash flows are balanced under various severe stress scenarios and that all their anticipated obligations can be met when due. The objective of our liquidity framework is to be very conservative and adaptable to changing business models, markets and regulation.

The objective of our liquidity and funding management framework is to ensure that all foreseeable funding commitments can be met when due, and that access to the wholesale markets is co-ordinated and cost-effective. To this end, we maintain a diversified funding base comprising core retail and corporate customer deposits and institutional balances. We augment this with wholesale funding and portfolios of highly liquid assets diversified by currency and maturity which are held to enable us to respond quickly and smoothly to unforeseen liquidity requirements.

We adapt our liquidity and funding risk management framework in response to changes in the mix of business that we undertake, and to changes in the nature of the markets in which we operate. We also seek to continuously evolve and strengthen our liquidity and funding risk management framework. As part of this process, we have refined the way in which we characterise core deposits. The characterisation takes into account the activities and operating environment in the entity originating the deposit, the nature of the customer and the size and pricing of the deposit. This exercise has resulted in a revised internal calculation of advances to core funding ratio (discussed more fully below), and comparatives have been restated accordingly. While total core deposits at the Group consolidated level have not changed materially, there have been some revisions to individual entities.

We employ a number of measures to monitor liquidity risk. The emphasis on the 'ratio of net liquid assets to customer deposits', as reported in the

Annual Report and Accounts 2009, has been reduced and a 'stressed one month coverage ratio', an extension of our projected cash flow scenario analysis, is now used as a simple and more useful metric to express liquidity risk. The bank also manages its intra-day liquidity positions so that it is able to meet payment and settlement obligations on a timely basis. Payment flows in real time gross settlement systems, expected peak payment flows and large time-critical payments are monitored during the day and the intra-day collateral position is managed so that there is liquidity available to meet payments.

Policies and procedures

(Audited)

The management of liquidity and funding is primarily undertaken locally in our operating entities in compliance with practices and limits set by the Risk Management Meeting. These limits vary according to the depth and liquidity of the market in which the entities operate. It is our policy that each banking entity should be self-sufficient when funding its own operations. Exceptions are permitted for certain short-term treasury requirements and start-up operations or for branches which do not have access to local deposit markets. These entities are funded from our largest banking operations and within clearly defined internal and regulatory guidelines and limits. The limits place formal restrictions on the transfer of resources between our entities and reflect the broad range of currencies, markets and time zones within which we operate.

Elements of our liquidity and funding management process

- projecting cash flows by major currency under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet liquidity and advances to core funding ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with back-up facilities;
- managing the concentration and profile of debt maturities;
- managing contingent liquidity commitment exposures within pre-determined caps;
- maintaining debt financing plans;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises, while minimising adverse long-term implications for the business.

Report of the Directors: Operating and Financial Review (continued)

Primary sources of funding

(Audited)

Current accounts and savings deposits payable on demand or at short notice form a significant part of our funding, and we place considerable importance on maintaining their stability. For deposits, stability depends upon preserving depositor confidence in our capital strength and liquidity, and on competitive and transparent pricing.

We also access professional markets in order to provide funding for non-banking subsidiaries that do not accept deposits, to align asset and liability maturities and currencies and to maintain a presence in local money markets. Market disruption continued to have adverse effects on the liquidity and funding risk profile of the banking system in 2010. Despite

these challenges, we have continued to have good access to debt capital markets. Group entities issued US\$26bn of term debt securities in the public capital markets in 2010.

In aggregate, our banking entities are liquidity providers to the interbank market, placing significantly more funds with other banks than they themselves borrow. Our main operating subsidiary that does not accept deposits is HSBC Finance, which is funded principally by taking term funding in the professional markets and securitising assets. At 31 December 2010, US\$65bn (2009: US\$82bn) of HSBC Finance's liabilities were drawn from professional markets, utilising a range of products, maturities and currencies.

Cash flows payable by HSBC under financial liabilities by remaining contractual maturities

(Audited)

	On demand US\$m	Due within 3 months US\$m	Due between 3 and 12 months US\$m	Due between 1 and 5 years US\$m	Due after 5 years US\$m
At 31 December 2010					
Deposits by banks	42,481	70,072	8,393	7,949	1,346
Customer accounts	881,575	244,501	89,557	23,209	3,483
Trading liabilities	300,703	–	–	–	–
Financial liabilities designated at fair value	7,421	3,786	7,825	35,583	61,575
Derivatives	255,046	531	1,143	2,065	942
Debt securities in issue	1,320	48,062	41,939	62,148	16,255
Subordinated liabilities	34	1,491	1,863	10,001	51,293
Other financial liabilities	24,834	24,378	7,944	2,184	824
	1,513,414	392,821	158,664	143,139	135,718
Loan and other credit-related commitments	524,394	51,732	14,023	11,964	400
Financial guarantees and similar contracts	18,491	9,233	12,231	7,082	2,399
	2,056,299	453,786	184,918	162,185	138,517
At 31 December 2009					
Deposits by banks	39,484	85,922	18,925	6,180	1,359
Customer accounts	800,199	277,071	71,243	45,561	7,911
Trading liabilities	268,130	–	–	–	–
Financial liabilities designated at fair value	6,628	1,050	5,976	36,185	67,209
Derivatives	245,027	300	1,002	467	320
Debt securities in issue	124	49,493	38,445	66,661	22,663
Subordinated liabilities	43	481	3,020	8,660	52,304
Other financial liabilities	22,500	25,123	5,732	2,354	1,103
	1,382,135	439,440	144,343	166,068	152,869
Loan and other credit-related commitments ⁵⁴	494,269	36,726	11,810	12,495	2,750
Financial guarantees and similar contracts ⁵⁴	16,561	11,169	12,737	9,096	3,688
	1,892,965	487,335	168,890	187,659	159,307

For footnote, see page 174.

The balances in the above table will not agree directly with those in our consolidated balance sheet as the table incorporates, on an undiscounted basis, all cash flows relating to principal and future coupon payments (except for trading liabilities and trading derivatives). In addition, loan and other credit-related commitments and financial guarantees and

similar contracts are generally not recognised on our balance sheet. Trading liabilities and trading derivatives are included in the 'On demand' time bucket, and not by contractual maturity, because trading liabilities are typically held for short periods of time. We classify the undiscounted cash flows payable under hedging derivative liabilities

Report of the Directors: Operating and Financial Review (continued)

according to their contractual maturities. The undiscounted cash flows potentially payable under financial guarantees and similar contracts are classified on the basis of the earliest date they can be called.

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

The management of liquidity risk

(Audited)

We use a number of principal measures to manage liquidity risk, as described below.

Advances to core funding ratio

We emphasise the importance of core customer deposits as a source of funds to finance lending to customers, and discourage reliance on short-term professional funding. This is achieved by placing limits on banking entities which restrict their ability to increase loans and advances to customers without

HSBC's principal banking entities – the management of liquidity risk

(Audited)

	Advances to core funding ratio during:		Stressed one month coverage ratio during:	
	2010 %	2009 %	2010 %	2009 %
HSBC Bank plc ⁵⁵				
Year-end	103.0	105.0	111.1	103.2
Maximum	109.7	116.0	111.3	108.1
Minimum	102.6	105.0	103.2	101.3
Average	106.0	110.6	108.2	103.9
The Hongkong and Shanghai Banking Corporation ⁵⁵				
Year-end	70.3	55.5	144.6	153.2
Maximum	70.3	62.0	165.4	153.2
Minimum	55.5	55.5	132.6	134.3
Average	63.6	57.5	148.8	144.8
HSBC Bank USA				
Year-end	98.3	101.0	108.5	105.3
Maximum	104.3	111.1	118.5	128.0
Minimum	94.2	99.5	105.3	105.3
Average	98.0	106.1	112.3	118.7
Total of HSBC's other principal banking entities ⁵⁶				
Year-end	89.1	85.9	119.6	124.8
Maximum	89.1	89.2	126.5	124.8
Minimum	85.7	81.2	118.1	116.3
Average	87.0	85.9	122.2	120.5

For footnotes, see page 174.

Stressed one month coverage ratio

The stressed one month coverage ratios tabulated above are derived from these scenario analyses, and express the stressed cash inflows as a percentage of stressed cash outflows over a one month time

corresponding growth in their core customer deposits or long-term debt funding. This measure is referred to as the 'advances to core funding' ratio. Previously, we utilised the 'advances to deposits' ratio.

Advances to core funding ratio limits are set by the Risk Management Meeting and monitored by Group Finance. The ratio expresses current loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year. Loans and advances to customers which are part of reverse repurchase arrangements, and where we receive securities which are deemed to be liquid, are excluded from the advances to core funding ratio.

The three principal banking entities listed in the table below represented 62% of our total core deposits at 31 December 2010 (31 December 2009: 63%). The table shows that loans and advances to customers in our principal banking entities are overwhelmingly financed by reliable and stable sources of funding. We would meet any unexpected net cash outflows by selling securities and accessing additional funding sources such as interbank or collateralised lending markets.

horizon. Our entities are required to target a ratio of 100% or greater.

Projected cash flow scenario analysis

We use a number of standard projected cash flow

Report of the Directors: Operating and Financial Review (continued)

scenarios designed to model combinations of both Group-specific and market-wide liquidity crises, in which the rate and timing of deposit withdrawals and drawdowns on committed lending facilities are varied, and the ability to access interbank funding and term debt markets and to generate funds from asset portfolios is restricted. The scenarios are modelled by all our banking entities and by HSBC Finance. The appropriateness of the assumptions under each scenario is regularly reviewed. In addition to our standard projected cash flow scenarios, individual entities are required to design their own scenarios to reflect specific local market conditions, products and funding bases.

Limits for cumulative net cash flows under stress scenarios are set for each banking entity and for HSBC Finance. Both ratio and cash flow limits reflect the local market place, the diversity of funding sources available and the concentration risk from large depositors. Compliance with entity level limits is monitored centrally by Group Finance and reported regularly to the Risk Management Meeting.

HSBC Finance

As HSBC Finance is unable to accept standard retail customer deposits, it takes funding from the professional markets. HSBC Finance uses a range of measures to monitor funding risk, including projected cash flow scenario analysis and caps placed on the amount of unsecured term funding that can mature in any rolling three-month and rolling 12-month periods. HSBC Finance also maintains access to committed sources of secured funding and has in place committed backstop lines for short-term refinancing commercial paper ('CP') programmes. A CP programme is a short-term, unsecured funding tool used to manage day to day cash flow needs. In agreement with the rating agencies, issuance under this programme will not exceed 100% of committed bank backstop lines.

The Group's contractual exposures at 31 December monitored under the contingent liquidity risk limit structure (Audited)

	HSBC Bank		HSBC Bank USA		HSBC Bank Canada		The Hongkong and Shanghai Banking Corporation	
	2010 US\$bn	2009 US\$bn	2010 US\$bn	2009 US\$bn	2010 US\$bn	2009 US\$bn	2010 US\$bn	2009 US\$bn
Conduits								
Client-originated assets ⁵⁸								
– total lines	7.8	7.4	4.0	6.4	0.2	0.3	–	0.3
– largest individual lines	0.7	0.8	0.4	0.4	0.1	0.1	–	0.3
HSBC-managed assets ⁵⁹	25.6	29.1	–	–	–	–	–	–
Other conduits ⁶⁰	–	–	1.4	1.3	–	–	–	–
Single-issuer liquidity facilities								
– five largest ⁶¹	4.2	4.3	5.3	6.1	2.0	2.0	1.4	1.2
– largest market sector ⁶²	8.4	7.9	4.9	4.7	3.8	2.9	2.4	1.5

For footnotes, see page 174.

The need for HSBC Finance to refinance maturing term funding is mitigated by the continued run-down of its balance sheet.

HSBC Finance – funding (Audited)

	At 31 December	
	2010 US\$bn	2009 US\$bn
Maximum amounts of unsecured term funding maturing in any rolling:		
– 3 month period	5.1	5.2
– 12 month period	10.8	12.3
Unused committed sources of secured funding ⁵⁷	0.5	0.4
Committed backstop lines from non-Group entities in support of CP programmes	4.3	5.3

For footnote, see page 174.

Contingent liquidity risk (Audited)

In the normal course of business, we provide customers with committed facilities, including committed backstop lines to conduit vehicles sponsored by HSBC and standby facilities to corporate customers. These facilities increase our funding requirements when customers choose to raise drawdown levels over and above their normal utilisation rates. The liquidity risk consequences of increased levels of drawdown are analysed in the form of projected cash flows under different stress scenarios. The Risk Management Meeting also sets limits for non-cancellable contingent funding commitments by Group entity after due consideration of each entity's ability to fund them. The limits are split according to the borrower, the liquidity of the underlying assets and the size of the committed line.

Report of the Directors: Operating and Financial Review (continued)

HSBC Holdings

(Audited)

HSBC Holdings' primary sources of cash are dividends received from subsidiaries, interest on and repayment of intra-group loans and interest earned on its own liquid funds. HSBC Holdings also raises ancillary funds in the debt capital markets through subordinated and senior debt issuance. Cash is primarily used for the provision of capital to subsidiaries, interest payments to debt holders and dividend payments to shareholders.

HSBC Holdings is also subject to contingent liquidity risk by virtue of loan and other credit-related commitments and guarantees and similar contracts issued. Such commitments and guarantees are only issued after due consideration of HSBC

Holdings' ability to finance the commitments and guarantees and the likelihood of the need arising.

HSBC Holdings actively manages the cash flows from its subsidiaries to optimise the amount of cash held at the holding company level. The ability of subsidiaries to pay dividends or advance monies to HSBC Holdings depends on, among other things, their respective regulatory capital requirements, statutory reserves, and financial and operating performance. The wide range of our activities means that HSBC Holdings is not dependent on a single source of profits to fund its dividend payments to shareholders. During 2010, HSBC Holdings continued to have full access to debt capital markets at market rates and issued US\$5.0bn of capital instruments (2009: US\$5.3bn).

Cash flows payable by HSBC Holdings under financial liabilities by remaining contractual maturities

(Audited)

	On demand US\$m	Due within 3 months US\$m	Due between 3 and 12 months US\$m	Due between 1 and 5 years US\$m	Due after 5 years US\$m
At 31 December 2010					
Amounts owed to HSBC undertakings	–	163	1,332	1,453	–
Financial liabilities designated at fair value	–	219	658	5,810	24,215
Derivatives	827	–	–	–	–
Debt securities in issue	–	35	106	2,110	1,559
Subordinated liabilities	–	219	657	3,504	28,670
Other financial liabilities	–	1,782	–	–	–
	827	2,418	2,753	12,877	54,444
Loan commitments	2,720	–	–	–	–
Financial guarantees and similar contracts	46,988	–	–	–	–
	50,535	2,418	2,753	12,877	54,444
At 31 December 2009					
Amounts owed to HSBC undertakings	–	292	25	3,477	–
Financial liabilities designated at fair value	–	229	687	6,205	26,152
Derivatives	362	–	–	–	–
Debt securities in issue	–	37	112	2,346	1,698
Subordinated liabilities	–	243	728	3,881	32,232
Other financial liabilities	–	1,239	–	–	–
	362	2,040	1,552	15,909	60,082
Loan commitments	3,240	–	–	–	–
Financial guarantees and similar contracts	35,073	–	–	–	–
	38,675	2,040	1,552	15,909	60,082

The balances in the above table will not agree directly with those in the balance sheet of HSBC Holdings as the table incorporates, on an undiscounted basis, all cash flows relating to principal and future coupon payments (except for trading derivatives).

In addition, loan and other credit-related commitments and financial guarantees and similar

contracts are generally not recognised on the balance sheet. Trading derivatives are included in the 'On demand' time bucket, and not by contractual maturity, because trading derivatives are typically held for short periods of time. The undiscounted cash flows potentially payable under financial guarantees and similar contracts are classified on the basis of the earliest date they can be called.

Report of the Directors: Operating and Financial Review (continued)

Market risk

(Audited)

Market risk is the risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios.

We separate exposures to market risk into trading and non-trading portfolios. Trading portfolios include positions arising from market-making, position-taking and others designated as marked to market.

Non-trading portfolios include positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, financial investments designated as available for sale and held to maturity, and exposures arising from our insurance operations.

Market risk arising in our insurance businesses is discussed in 'Risk management of insurance operations' on pages 155 to 171.

Monitoring and limiting market risk exposure

(Audited)

Our objective is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with our status as one of the world's largest banking and financial services organisations.

The management of market risk is principally undertaken in Global Markets using risk limits approved by the GMB. Limits are set for portfolios, products and risk types, with market liquidity being a primary factor in determining the level of limits set. Group Risk, an independent unit within GMO, is responsible for our market risk management policies and measurement techniques. Each major operating entity has an independent market risk management and control function which is responsible for measuring market risk exposures in accordance with the policies defined by Group Risk, and monitoring and reporting these exposures against the prescribed limits on a daily basis.

Each operating entity is required to assess the market risks arising on each product in its business and to transfer them to either its local Global Markets unit for management, or to separate books managed under the supervision of the local Asset and Liability Management Committee ('ALCO'). Our aim is to ensure that all market risks are consolidated within operations that have the necessary skills, tools, management and governance to manage them

professionally. In certain cases where the market risks cannot be fully transferred, we use simulation modelling to identify the impact of varying scenarios on valuations and net interest income.

We employ a range of tools to monitor and limit market risk exposures. These include sensitivity analysis, value at risk ('VAR') and stress testing.

Sensitivity analysis

(Unaudited)

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

Value at risk

(Audited)

VAR is a technique that estimates the potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence.

The VAR models we use are based predominantly on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates such as interest rates and foreign exchange rates. The models also incorporate the effect of option features on the underlying exposures.

Our historical simulation models assess potential market movements with reference to data from the past two years and calculate VAR to a 99% confidence level and for a one-day holding period.

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

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

Report of the Directors: Operating and Financial Review (continued)

We routinely validate the accuracy of our VAR models by back-testing the actual daily profit and loss results, adjusted to remove non-modelled items such as fees and commissions, against the corresponding VAR numbers. Statistically, we would expect to see losses in excess of VAR only 1% of the time over a one-year period. The actual number of excesses over this period can therefore be used to gauge how well the models are performing.

Stress testing

(Audited)

In recognition of VAR's limitations, we augment it with stress testing to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. The process is governed by the Stress Testing Review Group forum which, in conjunction with regional risk managers, determines the scenarios to be applied at portfolio and consolidated levels, as follows:

- sensitivity scenarios consider the impact of any single risk factor or set of factors that are unlikely to be captured within the VAR models, such as the break of a currency peg;
- technical scenarios consider the largest move in each risk factor, without consideration of any underlying market correlation;
- hypothetical scenarios consider potential macro economic events, for example, a global flu pandemic; and
- historical scenarios incorporate historical observations of market movements during previous periods of stress which would not be captured within VAR.

Stress testing results provide senior management with an assessment of the financial effect such events would have on our profit.

Trading and non-trading portfolios

(Audited)

The following table provides an overview of the reporting of risks within this section:

Risk type	Portfolio	
	Trading	Non-trading
Foreign exchange and commodity	VAR	VAR ⁶³
Interest rate	VAR	VAR ⁶⁴
Equity	VAR	Sensitivity
Credit spread	VAR	VAR ⁶⁵

For footnotes, see page 174.

Value at risk of the trading and non-trading portfolios

Our Group VAR, both trading and non-trading, was as follows:

Value at risk (excluding credit spread VAR)

(Audited)

	2010 US\$m	2009 US\$m
At 31 December	266.6	204.5
Average	199.8	156.1
Minimum	139.5	105.7
Maximum	285.7	204.5

The rise in interest rate volatility, coupled with a modest increase in underlying interest rate exposure, resulted in a higher VAR and higher maximum VAR at the end of 2010 compared with the end of 2009. The volatility in the other asset classes in 2010 was lower than in 2009.

Our Group daily VAR, both trading and non-trading, was as follows:

Daily VAR (excluding credit spread) (US\$m)

(Unaudited)



The major contributor to our Group trading and non-trading VAR was Global Markets.

The histogram below illustrates the frequency of daily revenue arising from Global Markets' trading, balance sheet management and other trading activities.

Daily revenue

(Unaudited)

	2010 US\$m	2009 US\$m
Average daily revenue	49.3	59.9
Standard deviation ⁶⁶	37.8	38.4

For footnote, see page 174.

An analysis of the frequency distribution of daily revenue shows that there were nine days with negative revenues during 2010 compared with

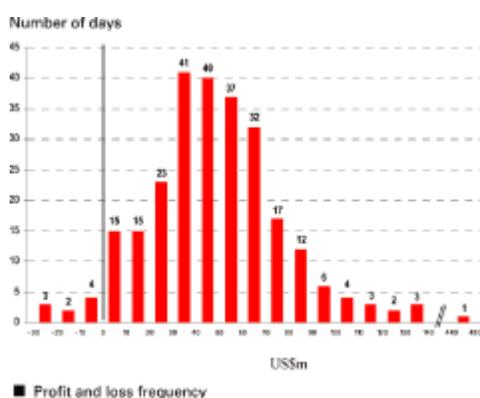
Report of the Directors: Operating and Financial Review (continued)

11 days in the same period ended 31 December 2009. The most frequent result was daily revenue of between US\$30m and US\$40m with 41 occurrences, compared with between US\$30m and US\$40m and between US\$40m and US\$50m with 29 occurrences each in 2009.

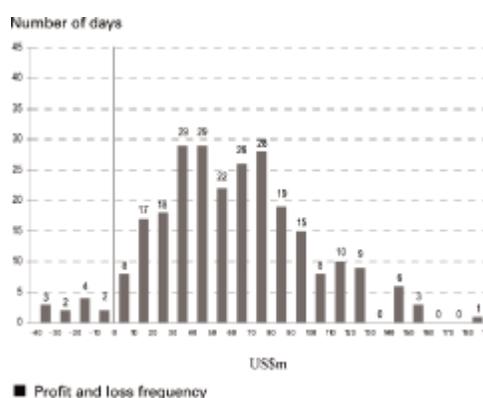
On 9 May 2010, the International Monetary Fund and the 16 member states of the euro area announced stabilisation measures for the eurozone. The period prior to this announcement was volatile, leading to a number of negative revenue days. The maximum daily revenue of US\$450m arose on 10 May 2010 which in large part reflected a recovery of these negative revenues days.

Daily distribution of Global Markets' trading, balance sheet management and other trading revenues⁶⁷
(Unaudited)

2010



2009



For footnote, see page 174.

Trading portfolios (Audited)

Risk measurement and control

Our control of market risk in the trading portfolios is based on a policy of restricting individual operations to trading within a list of permissible instruments authorised for each site by Group Risk, of enforcing rigorous new product approval procedures, and of

restricting trading in the more complex derivative products only to offices with appropriate levels of product expertise and robust control systems.

The VAR for trading intent activity within Global Markets at 31 December 2010 was US\$80.8m (2009: US\$95.1m). This is analysed below by risk type:

VAR by risk type for trading intent activities⁶⁸
(Audited)

	Foreign exchange and commodity US\$m	Interest rate US\$m	Equity US\$m	Credit spread ⁶⁹ US\$m	Total ⁷⁰ US\$m
At 31 December 2010	24.9	49.5	13.0	39.1	80.8
At 31 December 2009	19.5	42.6	17.5	59.3	95.1
Average					
2010	27.2	51.6	9.2	62.0	113.4
2009	20.6	51.3	11.3	58.0	85.3
Minimum					
2010	8.0	34.7	2.9	33.7	55.0
2009	11.1	35.6	4.9	31.9	54.3
Maximum					
2010	62.9	88.9	21.6	102.5	212.2
2009	46.7	78.0	18.7	94.3	132.5

For footnotes, see page 174.

Report of the Directors: Operating and Financial Review (continued)

The VAR for overall trading intent activity as at 31 December 2010 was lower than at the end of 2009, because of reduced volatility in various asset classes. However, the wider band in VAR observed in 2010 was driven by an increase in client-led transactions and reduced portfolio diversification benefit, which resulted in occasionally higher VAR utilisation, as reflected in the above summary statistics.

Credit spread risk (Audited)

The risk associated with movements in credit spreads is primarily managed through sensitivity limits, stress testing and VAR for those portfolios on which it is calculated.

At 31 December 2010, the Group credit spread VAR was US\$41.9m (2009: US\$72.7m). The decrease arose from the effect of volatile credit spread scenarios rolling off from the VAR calculation.

Credit spread risk also arises on credit derivative transactions entered into by Global Banking in order to manage the risk concentrations within our corporate loan portfolio and so enhance capital efficiency. The mark-to-market of these transactions is reflected in the income statement. At 31 December 2010, the credit VAR on the credit derivatives transactions entered into by Global Banking was US\$12.3m (2009: US\$13.8m).

Gap risk

Even for transactions that are structured to render the risk to HSBC negligible under a wide range of market conditions or events, there exists a remote possibility that a significant gap event could lead to loss. A gap event could arise from a significant change in market price with no accompanying trading opportunity, with the result that the threshold is breached beyond which the risk profile changes from no risk to full exposure to the underlying structure. Such movements may occur, for example, when, in reaction to an adverse event or unexpected news announcement, the market for a specific investment becomes illiquid, making hedging impossible.

Given their characteristics, these transactions make little or no contribution to VAR or to traditional market risk sensitivity measures. We capture their risks within our stress testing scenarios and monitor gap risk on an ongoing basis. We regularly consider the probability of gap loss, and fair value adjustments are booked against this risk. We did not incur any material gap loss in respect of

such transactions in 2010.

Non-trading portfolios (Audited)

Risk measurement and control

The principal objective of market risk management of non-trading portfolios is to optimise net interest income. Interest rate risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts.

Our control of market risk in the non-trading portfolios is based on transferring the risks to the books managed by Global Markets or the local ALCO. The net exposure is typically managed through the use of interest rate swaps within agreed limits. The VAR for these portfolios is included within the Group VAR (see 'Value at risk of the trading and non-trading portfolios' on page 146).

Credit spread risk

The risk associated with movements in credit spreads is primarily managed through sensitivity limits, stress testing, and VAR for those portfolios where VAR is calculated. We have introduced credit spread as a separate risk type within our VAR models on a global basis. The VAR shows the effect on income from a one-day movement in credit spreads over a two-year period, calculated to a 99% confidence interval.

At 31 December 2010, the sensitivity of equity capital to the effect of movements in credit spreads, based on credit spread VAR, on our available-for-sale debt securities was US\$264m (2009: US\$535m). After including the gross exposure for the SICs consolidated within our balance sheet, this exposure rose to US\$299m (2009: US\$549m). This sensitivity is calculated before taking into account losses which would have been absorbed by the capital note holders. At 31 December 2010, the capital note holders can absorb the first US\$2.2bn (2009: US\$2.2bn) of any losses incurred by the SICs before we incur any equity losses.

The decrease in this sensitivity at 31 December 2010 compared with 31 December 2009 can be explained by the effect of lower volatility in credit spread scenarios observed during 2010.

Report of the Directors: Operating and Financial Review (continued)**Equity securities classified as available for sale**

Market risk arises on equity securities classified as available for sale. The fair value of these securities

Fair value of equity securities classified as available for sale (Audited)

Private equity holdings⁷¹
Funds invested for short-term cash management
Investment to facilitate ongoing business⁷²
Other strategic investments

For footnotes, see page 174.

The fair value of the constituents of equity securities classified as available for sale can fluctuate considerably. A 10% reduction in their value at 31 December 2010 would have reduced our equity by US\$0.8bn (2009: US\$0.9bn). For details of the impairment incurred on available-for-sale equity securities, see 'Securitisation exposures and other structured products' on page 128.

Structural foreign exchange exposures
(Unaudited)

Structural foreign exchange exposures represent net investments in subsidiaries, branches and associates, the functional currencies of which are currencies other than the US dollar. An entity's functional currency is the currency of the primary economic environment in which the entity operates.

Exchange differences on structural exposures are recognised in other comprehensive income. We use the US dollar as our presentation currency in our consolidated financial statements because the US dollar and currencies linked to it form the major currency bloc in which we transact and fund our business. Our consolidated balance sheet is, therefore, affected by exchange differences between the US dollar and all the non-US dollar functional currencies of underlying subsidiaries.

We hedge structural foreign exchange exposures only in limited circumstances. Our structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that our consolidated capital ratios and the capital ratios of individual banking subsidiaries are largely protected from the effect of changes in exchange rates. This is usually achieved by ensuring that, for each subsidiary bank, the ratio of structural exposures in a given currency to risk-weighted assets denominated in that currency is broadly equal to the capital ratio of the subsidiary in question.

at 31 December 2010 was US\$8.0bn (2009: US\$9.1bn).

2010 US\$bn	2009 US\$bn
2.8	4.0
0.5	0.8
1.0	1.2
3.7	3.1
8.0	9.1

We may also transact hedges where a currency in which we have structural exposures is considered to be significantly overvalued and it is possible in practice to transact a hedge. Any hedging is undertaken using forward foreign exchange contracts which are accounted for under IFRSs as hedges of a net investment in a foreign operation, or by financing with borrowings in the same currencies as the functional currencies involved. No forward foreign exchange hedges were in place during 2010 in respect of our consolidated Group structural foreign exchange position.

For details of structural foreign exchange exposures see Note 36 on the Financial Statements.

Sensitivity of net interest income
(Unaudited)

A principal element of our management of market risk in non-trading portfolios is monitoring the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). We aim to mitigate the effect of prospective interest rate movements which could reduce future net interest income, while balancing the cost of such hedging activities on the current net revenue stream.

For simulation modelling, our businesses use a combination of scenarios relevant to them and their local markets and standard scenarios which are required throughout HSBC. The standard scenarios are consolidated to illustrate the combined pro forma effect on our consolidated portfolio valuations and net interest income.

The table below sets out the effect on future net interest income of incremental 25 basis point parallel falls or rises in all yield curves worldwide at the beginning of each quarter during the 12 months from 1 January 2011.

Report of the Directors: Operating and Financial Review (continued)

Assuming no management actions, a sequence of such rises would increase planned net interest income for 2011 by US\$882m (2010: US\$695m), while a sequence of such falls would decrease

planned net interest income by US\$1,525m (2010: US\$1,563m). These figures incorporate the effect of any option features in the underlying exposures.

Sensitivity of projected net interest income⁷³ (Unaudited)

	US dollar bloc US\$m	Rest of Americas bloc US\$m	Hong Kong dollar bloc US\$m	Rest of Asia bloc US\$m	Sterling bloc US\$m	Euro bloc US\$m	Total US\$m
Change in 2011 projected net interest income arising from a shift in yield curves of:							
+25 basis points at the beginning of each quarter	164	72	191	245	292	(82)	882
-25 basis points at the beginning of each quarter	(550)	(68)	(280)	(143)	(546)	62	(1,525)
Change in 2010 projected net interest income arising from a shift in yield curves of:							
+25 basis points at the beginning of each quarter	13	92	416	112	363	(301)	695
-25 basis points at the beginning of each quarter	(382)	(46)	(507)	(133)	(689)	194	(1,563)

For footnote, see page 174.

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

The figures represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and our current interest rate risk profile. This effect, however, does not incorporate actions that would be taken by Balance Sheet Management within Global Markets or in the business units to mitigate the impact of this interest rate risk; in reality, Balance Sheet Management seeks proactively to change the interest rate risk profile to minimise losses and optimise net revenues. The projections above also assume that interest rates of all maturities move by the same amount and, therefore, do not reflect the potential effect on net interest income of some rates changing while others remain unchanged. In addition, the projections take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates linked to other bases (such as Central Bank rates or product rates over which the entity has discretion in terms of the timing and extent of rate changes). The projections make other simplifying assumptions too, including that all positions run to maturity.

Projecting the movement in net interest income from prospective changes in interest rates is a complex interaction of structural and managed exposures. Our exposure to the effect of movements

in interest rates on our net interest income arises in two main areas, core deposit franchises and Balance Sheet Management:

- core deposit franchises are exposed to changes in the cost of deposits raised and spreads on wholesale funds. The net interest income benefit of core deposits increases as interest rates rise and decreases as interest rates fall. This risk is asymmetrical in a very low interest rate environment, however, as there is limited room to lower deposit pricing in the event of interest rate reductions; and
- residual interest rate risk is managed within Balance Sheet Management, under our policy of transferring interest rate risk to Balance Sheet Management to be managed within defined limits and with flexibility as to the instruments used.

The table above reflects the fact that our deposit taking businesses will generally benefit from rising rates which will be partially offset by increased funding costs in Balance Sheet Management given our simplifying assumption of unchanged Balance Sheet Management positioning. Additionally, the benefit to deposit taking businesses of rising rates is also offset by the increased funding cost of trading assets, which is recorded in 'Net interest income' and therefore captured in the above table, whereas the income from such assets is recorded in 'Net trading income'.

Report of the Directors: Operating and Financial Review (continued)

The main drivers of the year on year changes in the sensitivity of the Group's net interest income to the change in rates shown in the table were lower implied yield curves, changes in Balance Sheet Management positioning, and changed expectations for deposit pricing for some currencies in a rising rate environment.

We monitor the sensitivity of reported reserves to interest rate movements on a monthly basis by

Sensitivity of reported reserves to interest rate movements (Unaudited)

At 31 December 2010

+ 100 basis point parallel move in all yield curves
As a percentage of total shareholders' equity

– 100 basis point parallel move in all yield curves
As a percentage of total shareholders' equity

At 31 December 2009

+ 100 basis point parallel move in all yield curves
As a percentage of total shareholders' equity

– 100 basis point parallel move in all yield curves
As a percentage of total shareholders' equity

The sensitivities are illustrative only and are based on simplified scenarios. The table shows the potential sensitivity of reserves to valuation changes in available-for-sale portfolios and from cash flow hedges following the pro forma movements in interest rates. These particular exposures form only a part of our overall interest rate exposures. The accounting treatment under IFRSs of our remaining interest rate exposures, while economically largely offsetting the exposures shown in the above table, does not require revaluation movements to go to reserves.

The year-on-year increase in sensitivity of reserves is due to an increase in government bonds held in Balance Sheet Management, which are accounted for on an available-for-sale basis.

Defined benefit pension schemes

(Audited)

Market risk arises within our defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows. Pension scheme obligations fluctuate with changes in long-term interest rates, inflation, salary levels and the longevity of scheme members. Pension scheme assets include equities and debt securities, the cash flows of which change as equity prices and interest

rates vary. There is a risk that market movements in equity prices and interest rates could result in asset values which, taken together with regular ongoing contributions, are insufficient over time to cover the level of projected obligations and these, in turn, could increase with a rise in inflation and members living longer. Management, together with the trustees who act on behalf of the pension scheme beneficiaries, assess these risks using reports prepared by independent external actuaries, take action and, where appropriate, adjust investment strategies and contribution levels accordingly.

assessing the expected reduction in valuation of available-for-sale portfolios and cash flow hedges due to parallel movements of plus or minus 100 basis points in all yield curves. The table below describes the sensitivity of our reported reserves to these movements at the end of 2010 and 2009 and the maximum and minimum month-end figures during these years:

US\$m	Maximum impact US\$m	Minimum impact US\$m
(6,162)	(6,162)	(3,096)
(4.2%)	(4.2%)	(2.1%)
6,174	6,174	3,108
4.2%	4.2%	2.1%
(3,096)	(3,438)	(2,715)
(2.4%)	(2.7%)	(2.1%)
3,108	3,380	2,477
2.4%	2.6%	1.9%

rates vary. There is a risk that market movements in equity prices and interest rates could result in asset values which, taken together with regular ongoing contributions, are insufficient over time to cover the level of projected obligations and these, in turn, could increase with a rise in inflation and members living longer. Management, together with the trustees who act on behalf of the pension scheme beneficiaries, assess these risks using reports prepared by independent external actuaries, take action and, where appropriate, adjust investment strategies and contribution levels accordingly.

HSBC's defined benefit pension schemes (Audited)

	2010 US\$m	2009 US\$m
Liabilities (present value)	32.6	30.6
	%	%
Assets:		
Equities	20	21
Debt securities	66	67
Other (including property)	14	12
	100	100

For details of our defined benefit schemes, see Note 7 on the Financial Statements, and for pension risk management, see page 172.

Report of the Directors: Operating and Financial Review (continued)**HSBC Holdings***(Audited)*

As a financial services holding company, HSBC Holdings has limited market risk activity. Its activities predominantly involve maintaining sufficient capital resources to support the Group's diverse activities; allocating these capital resources across our businesses; earning dividend and interest income on its investments in our businesses; providing dividend payments to HSBC Holdings' equity shareholders and interest payments to providers of debt capital; and maintaining a supply of short-term cash resources. It does not take proprietary trading positions.

The main market risks to which HSBC Holdings is exposed are interest rate risk and foreign currency risk. Exposure to these risks arises from short-term cash balances, funding positions held, loans to subsidiaries, investments in long-term financial assets and financial liabilities including debt capital issued. The objective of HSBC Holdings' market risk management strategy is to reduce exposure to these risks and minimise volatility in economic income, cash flows and distributable reserves. Market risk for HSBC Holdings is monitored by the Holdings ALCO (formerly the Structural Positions Review Group).

HSBC Holdings has entered into a number of cross-currency swaps to manage the market risk arising on certain long-term debt capital issues for which hedge accounting has not been applied.

Changes in the market values of these swaps are recognised directly in the income statement. HSBC Holdings expects that these swaps will be held to final maturity with the accumulated changes in market value consequently trending to zero.

Certain loans to subsidiaries of a capital nature that are not denominated in the functional currency of either the provider or the recipient are accounted for as financial assets. Changes in the carrying amount of these assets due to exchange differences are taken directly to the income statement. These loans, and the associated foreign exchange exposures, are eliminated on a Group consolidated basis.

The principal tools used in the management of market risk are the projected sensitivity of HSBC Holdings' net interest income to future changes in yield curves and interest rate gap re-pricing tables for interest rate risk, and VAR for foreign exchange rate risk.

Sensitivity of net interest income*(Unaudited)*

HSBC Holdings monitors net interest income sensitivity over a 5-year time horizon reflecting the longer-term perspective on interest rate risk management appropriate to a financial services holding company. The table below sets out the effect on HSBC Holdings' future net interest income over a 5-year time horizon of incremental 25 basis point parallel falls or rises in all yield curves worldwide at the beginning of each quarter during the 12 months from 1 January 2011.

Sensitivity of HSBC Holdings' net interest income to interest rate movements⁷³
*(Unaudited)***Change in projected net interest income as at 31 December arising from a shift in yield curves****2010**

of + 25 basis points at the beginning of each quarter
0-1 year
2-3 years
4-5 years

of – 25 basis points at the beginning of each quarter
0-1 year
2-3 years
4-5 years

2009

of + 25 basis points at the beginning of each quarter
0-1 year
2-3 years
4-5 years

of – 25 basis points at the beginning of each quarter
0-1 year
2-3 years
4-5 years

	US dollar bloc US\$m	Sterling bloc US\$m	Euro bloc US\$m	Total US\$m
of + 25 basis points at the beginning of each quarter				
0-1 year	(6)	19	11	24
2-3 years	(56)	75	62	81
4-5 years	(79)	71	58	50
of – 25 basis points at the beginning of each quarter				
0-1 year	6	(19)	(11)	(24)
2-3 years	56	(75)	(62)	(81)
4-5 years	79	(71)	(58)	(50)
of + 25 basis points at the beginning of each quarter				
0-1 year	(13)	18	11	16
2-3 years	(172)	75	19	(78)
4-5 years	(165)	105	6	(54)
of – 25 basis points at the beginning of each quarter				
0-1 year	12	(18)	(11)	(17)
2-3 years	172	(75)	(19)	78
4-5 years	165	(105)	(6)	54

For footnote, see page 174.

Report of the Directors: Operating and Financial Review (continued)

The interest rate sensitivities tabulated above are illustrative only and are based on simplified scenarios. The figures represent the effect of pro forma movements in net interest income based on our projected yield curve scenarios, HSBC Holdings' current interest rate risk profile and assumed changes to that profile during the next five years. Changes to assumptions concerning the risk profile over the next five years can have a significant impact on the net interest income sensitivity for that period. The figures do not take into account the effect of actions that could be taken to mitigate this interest rate risk, however.

Repricing gap analysis of HSBC Holdings (Audited)

	Total US\$m	Up to 1 year US\$m	1-5 years US\$m	5-10 years US\$m	More than 10 years US\$m	Non- interest bearing US\$m
At 31 December 2010						
Cash at bank and in hand:						
– balances with HSBC undertakings	459	339	–	–	–	120
Derivatives	2,327	–	–	–	–	2,327
Loans and advances to HSBC undertakings	21,238	19,351	–	290	605	992
Financial investments	2,025	–	300	900	731	94
Investments in subsidiaries	92,899	1,785	875	1,164	–	89,075
Other assets	393	–	–	–	–	393
Total assets	119,341	21,475	1,175	2,354	1,336	93,001
Amounts owed to HSBC undertakings	(2,932)	(2,266)	–	–	–	(666)
Financial liabilities designated at fair values	(16,288)	–	(7,184)	(4,740)	(3,509)	(855)
Derivatives	(827)	–	–	–	–	(827)
Debt securities in issue	(2,668)	–	(1,664)	–	(1,004)	–
Other liabilities	(1,232)	–	–	–	–	(1,232)
Subordinated liabilities	(13,313)	(750)	(1,579)	(2,140)	(8,680)	(164)
Total equity	(81,331)	–	–	(7,450)	–	(73,881)
Other non-interest bearing liabilities	(750)	–	–	–	–	(750)
Total liabilities and equity	(119,341)	(3,016)	(10,427)	(14,330)	(13,193)	(78,375)
Off-balance sheet items attracting interest rate sensitivity	–	(15,302)	7,221	4,403	3,409	269
Net interest rate risk gap	–	3,157	(2,031)	(7,573)	(8,448)	14,895
Cumulative interest rate gap	–	3,157	1,126	(6,447)	(14,895)	–
At 31 December 2009						
Cash at bank and in hand:						
– balances with HSBC undertakings	224	224	–	–	–	–
Derivatives	2,981	–	–	–	–	2,981
Loans and advances to HSBC undertakings	23,212	16,980	3,084	–	1,896	1,252
Financial investments	2,455	–	–	300	1,610	545
Investments in subsidiaries	86,247	1,866	1,217	–	875	82,289
Other assets	674	–	–	–	–	674
Total assets	115,793	19,070	4,301	300	4,381	87,741
Amounts owed to HSBC undertakings	(3,711)	(2,898)	–	–	–	(813)
Financial liabilities designated at fair values	(16,909)	–	(6,108)	(5,017)	(5,015)	(769)
Derivatives	(362)	–	–	–	–	(362)
Debt securities in issue	(2,839)	–	(1,784)	–	(1,055)	–
Other liabilities	(1,257)	–	–	–	–	(1,257)
Subordinated liabilities	(14,406)	(2,850)	(865)	(3,117)	(7,382)	(192)
Total equity	(75,876)	–	–	–	(3,650)	(72,226)
Other non-interest bearing liabilities	(433)	–	–	–	–	(433)
Total liabilities and equity	(115,793)	(5,748)	(8,757)	(8,134)	(17,102)	(76,052)
Off-balance sheet items attracting interest rate sensitivity	–	(15,302)	6,275	6,306	4,051	(1,330)
Net interest rate risk gap	–	(1,980)	1,819	(1,528)	(8,670)	10,359
Cumulative interest rate gap	–	(1,980)	(161)	(1,689)	(10,359)	–

Interest repricing gap table

The interest rate risk on the fixed-rate securities issued by HSBC Holdings is not included within the Group VAR but is managed on a repricing gap basis. The interest rate repricing gap table below analyses the full term structure of interest rate mismatches within HSBC Holdings' balance sheet. The year-on-year movement in the repricing gap was mainly due to the refinancing of maturing interest bearing capital liabilities with perpetual fixed rate issues.

Report of the Directors: Operating and Financial Review (continued)

Value at risk

Total foreign exchange VAR arising within HSBC Holdings in 2010 and 2009 was as follows:

HSBC Holdings – foreign exchange VAR
(Audited)

	Foreign exchange	
	2010 US\$m	2009 US\$m
At 31 December	40.4	83.2
Average	56.6	76.6
Minimum	40.2	55.2
Maximum	83.2	190.8

The foreign exchange risk largely arises from loans to subsidiaries of a capital nature that are not denominated in the functional currency of either the provider or the recipient and which are accounted for as financial assets. Changes in the carrying amount of these loans due to foreign exchange rate differences are taken directly to HSBC Holdings' income statement. These loans, and the associated foreign exchange exposures, are eliminated on a Group consolidated basis.

Operational risk

(Unaudited)

Operational risk is relevant to every aspect of our business and covers a wide spectrum of issues. Losses arising through fraud, unauthorised activities, errors, omission, inefficiency, systems failure or from external events all fall within the definition of operational risk.

The objective of our operational risk management is to manage and control operational risk in a cost effective manner within targeted levels of operational risk consistent with our risk appetite, as defined by the GMB.

A formal governance structure provides oversight over the management of operational risk. A Global Operational Risk and Control Committee, which reports to the Risk Management Meeting, meets at least quarterly to discuss key risk issues and review the effective implementation of our operational risk management framework.

In each of our subsidiaries, business managers are responsible for maintaining an acceptable level of internal control, commensurate with the scale and nature of operations. They are responsible for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The operational risk management framework helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

A centralised database is used to record the results of the operational risk management process. Operational risk self-assessments are input and maintained by business units. To ensure that operational risk losses are consistently reported and monitored at Group level, all Group companies are required to report individual losses when the net loss is expected to exceed US\$10,000.

Further details of our approach to Operational Risk Management can be found in *Pillar 3 Disclosures 2010* which is published as a separate document on www.hsbc.com.

Legal risk

(Unaudited)

Each operating company is required to implement procedures to manage legal risk that conform to our standards. Legal risk falls within the definition of operational risk and includes contractual risk, dispute risk, legislative risk and non-contractual rights risk.

- Contractual risk is the risk that the rights and/or obligations of an HSBC company within a contractual relationship are defective.
- Dispute risk consists of the risks that an HSBC company is subject to when it is involved in or managing a potential or actual dispute.
- Legislative risk is the risk that an HSBC company fails to adhere to the laws of the jurisdictions in which it operates.
- Non-contractual rights risk is the risk that an HSBC company's assets are not properly owned or are infringed by others, or an HSBC company infringes another party's rights.

We have a global legal function to assist management in controlling legal risk. The function provides legal advice and support in managing claims against our companies, as well as in respect of non-routine debt recoveries or other litigation against third parties.

The GMO Legal department oversees the global legal function and is headed by the Group General Counsel. There are legal departments in 58 of the countries in which we operate. There are also regional legal functions in each of Europe, North America, Latin America, the Middle East, and Asia-Pacific headed by Regional General Counsels.

Our operating companies must notify the appropriate legal department immediately any litigation is either threatened or commenced against HSBC or an employee. Any claims which exceed US\$1.5m or equivalent must be advised to the

Report of the Directors: Operating and Financial Review (continued)

appropriate regional legal department and the regional legal department must immediately advise the GMO Legal department if any such claim exceeds US\$5m. The appropriate regional legal department must also be immediately advised (and must in turn immediately advise the GMO Legal department) of any action by a regulatory authority, where the proceedings are criminal, or where the claim might materially affect our reputation. Insofar as matters relate to GB&M or GPB, notification should also be made to GB&M Legal in London. All such matters are then reported to the Risk Management Meeting in a monthly paper.

In addition, our operating companies are required to submit semi-annual returns detailing outstanding claims where the claim (or group of similar claims) exceeds US\$10m, where the action is by a regulatory authority, where the proceedings are criminal, where the claim might materially affect our reputation, or, where the GMO Legal department has requested returns be completed for a particular claim. These returns are used for reporting to the Risk Management Meeting, the Group Audit Committee and the Board, and disclosure in the *Annual Report and Accounts* and *Interim Report*, if appropriate.

Compliance risk

(Unaudited)

Compliance risk falls within the definition of operational risk. All Group companies are required to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice. These rules, regulations, other standards and Group policies include those relating to anti-money laundering, counter terrorist financing and sanctions compliance.

The Group Compliance function supports line management in ensuring that there are adequate policies and procedures, and is responsible for maintaining adequate resources to mitigate compliance risk. The GMO Compliance department oversees the global compliance function and is headed by the Head of Group Compliance who in turn reports to the Group Chief Risk Officer. There are compliance teams in all of the countries where we operate. These compliance teams are principally overseen by Regional Compliance Officers located in Europe, North America, Latin America, the Middle East and Asia-Pacific.

Group Compliance policies and procedures require the prompt identification and escalation to GMO Compliance of all actual or suspected breaches of any law, rule, regulation, Group policy or other relevant requirement. These escalation

procedures are supplemented by a requirement for the submission of compliance certificates at the half-year and year-end by all Group companies detailing any known breaches as above. The contents of these escalation and certification processes are used for reporting to the Risk Management Meeting, the Group Risk Committee and the Board and disclosure in the *Annual Report and Accounts* and *Interim Report*, if appropriate.

Group security and fraud risk

(Unaudited)

Security and fraud risk issues are managed at Group level by Group Security and Fraud Risk. This unit, which has responsibility for physical risk, fraud, information and contingency risk, and security and business intelligence, is fully integrated within the central GMO Risk function. This enables management to identify and mitigate the effect of the permutations of these and other non-financial risks on our business lines across the jurisdictions in which we operate.

Risk management of insurance operations

(Audited)

We operate a bancassurance model which provides insurance products for customers with whom we have a banking relationship. Insurance products are sold to all customer groups, mainly utilising retail branches, the internet and phone centres. PFS customers attract the majority of sales and comprise the majority of policyholders.

Many of these insurance products are manufactured by our subsidiaries. This allows us to retain the risks and rewards associated with writing insurance contracts as both the underwriting profit and the commission paid by the manufacturer to the bank distribution channel are kept within the Group.

Where we consider it operationally more effective, third parties are engaged to manufacture insurance products for sale through our banking network. We work with a limited number of market-leading partners to provide the products. These arrangements earn us a commission.

Our bancassurance business operates in all six of our geographical regions with over 30 legal entities, the majority of which are subsidiaries of banking legal entities, manufacturing insurance products.

The insurance contracts we sell primarily relate to core underlying banking activities, such as savings and investment products, and credit life products.

Report of the Directors: Operating and Financial Review (continued)

Our manufacturing business concentrates on personal lines, e.g. contracts written for individuals. This focus on the higher volume, lower individual value personal lines contributes to diversifying risk.

Overview of insurance products

(Audited)

The main contracts we manufacture are listed below:

Life insurance business

- Life insurance contracts with discretionary participation features ('DPF');
- credit life insurance business;
- annuities;
- term assurance and critical illness policies;
- linked life insurance;
- investment contracts with DPF;
- unit-linked investment contracts; and
- other investment contracts (including pension contracts written in Hong Kong).

Non-life insurance business

Non-life insurance contracts include motor, fire and other damage to property, accident and health, repayment protection and commercial insurance.

Credit non-life insurance is concentrated in North America and Europe, and is originated in conjunction with the provision of loans. Following a decision taken to close the Consumer Lending network in the US, insurance products written in conjunction with this business are being run off.

In December 2007, we decided to stop selling payment protection insurance ('PPI') products in the UK and a phased withdrawal was completed across the HSBC, first direct and M&S Money brands during 2008. HFC ceased selling single premium PPI in 2008 and sales of regular premium PPI will reduce as HFC exits its remaining retail relationships. HSBC continues to distribute its UK short-term income protection ('STIP') product. In January 2009, the Competition Commission ('CC') published its report into the PPI market in which it stipulated that STIP products will also be subject to their remedies when sold in conjunction with or as a result of a referral following the sale of a loan or similar credit product. We have undertaken an analysis of the required changes to the STIP product and its sales processes resulting from the CC's remedies. Following an appeal to the Competition Appeal Tribunal, the CC had to reconsider whether a ban on firms selling PPI at the point of sale of the credit product was an appropriate and justified remedy for the deficiencies it identified in the PPI

market. On 14 October 2010, the CC confirmed that it intended to proceed with a point of sale ban. It is anticipated that the Order implementing the CC's remedies will be made in late March or early April, and that the point of sale ban will then come into effect 12 months after the date of the Order.

Nature and extent of risks

(Audited)

The majority of the risk in our insurance business derives from manufacturing activities and can be categorised as insurance risk and financial risks. The following sections describe how these risks are managed. Financial risks include market risk, credit risk and liquidity risk. The assets of insurance manufacturing subsidiaries are included within the consolidated credit risk disclosures on pages 93 to 128, although separate disclosures in respect of insurance manufacturing subsidiaries are provided below. The consolidated liquidity risk and market risk disclosures focus on banking entities and disclosures specific to the insurance manufacturing subsidiaries are provided in the sections below. Operational risk is covered by the Group's overall operational risk management process.

The insurance manufacturers set their own control procedures in addition to complying with guidelines issued by the Group Insurance Head Office. The control framework for monitoring risk includes the Group Insurance Risk Committee, which oversees the status of the significant risk categories in the insurance operations. Five sub-committees of this Committee focus on products and pricing, market and liquidity risk, credit risk, operational risk and insurance risk, respectively. Similar risk committees exist at regional and entity levels. Any issues requiring escalation from the Group Insurance Risk Committee would be reported to the GMB via the Risk Management Meeting.

In addition, local ALCOs and Risk Management Committees monitor certain risk exposures, mainly for life business where the duration and cash flow matching of insurance assets and liabilities are reviewed.

All insurance products, whether manufactured internally or by a third party, are subjected to a product approval process. Approval is provided by the Regional Insurance Head Office or Group Insurance Head Office depending on the type of product and its risk profile. The approval process is formalised through the Product and Pricing Committee, which comprise the heads of the relevant risk functions within insurance.

Report of the Directors: Operating and Financial Review (continued)

Insurance risk

(Audited)

Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to the issuer (HSBC). The principal insurance risk we face is that, over time, the cost of acquiring and administering a contract, claims and benefits may exceed the aggregate amount of premiums received and investment income.

The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, lapse and surrender rates and, if the policy has a savings element, the performance of the assets held to support the liabilities.

Life and non-life business insurance risks are controlled by high-level policies and procedures set centrally, taking into account where appropriate local market conditions and regulatory requirements.

Analysis of life insurance risk – liabilities to policyholders⁷⁴

(Audited)

	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	North America US\$m	Latin America US\$m	Total US\$m
At 31 December 2010						
Life (non-linked)	1,679	17,989	789	1,004	2,122	23,583
Insurance contracts with DPF ⁷⁵	327	17,203	278	–	–	17,808
Credit life	565	–	72	36	2	675
Annuities	471	–	31	760	1,622	2,884
Term assurance and other long-term contracts	316	786	408	208	498	2,216
Life (linked)	2,274	3,235	485	–	4,502	10,496
Investment contracts with DPF ^{75,76}	22,052	–	22	–	–	22,074
Insurance liabilities to policyholders	26,005	21,224	1,296	1,004	6,624	56,153
At 31 December 2009						
Life (non-linked)	2,998	14,456	526	1,026	1,973	20,979
Insurance contracts with DPF ⁷⁵	1,128	14,095	227	–	–	15,450
Credit life	953	–	20	50	–	1,023
Annuities	452	–	28	777	1,554	2,811
Term assurance and other long-term contracts	465	361	251	199	419	1,695
Life (linked)	2,125	2,896	437	–	3,528	8,986
Investment contracts with DPF ^{75,76}	20,979	–	35	–	–	21,014
Insurance liabilities to policyholders	26,102	17,352	998	1,026	5,501	50,979

For footnotes, see page 174.

Our most significant life insurance products are investment contracts with DPF issued in France, insurance contracts with DPF issued in Hong Kong and unit-linked contracts issued in Hong Kong, Latin America and the UK.

The principal drivers of our insurance risk are described below. The liabilities for long-term contracts are set by reference to a range of

Formal underwriting, reinsurance and claims-handling procedures designed to ensure compliance with regulations are applied, supplemented with stress testing.

As well as exercising underwriting controls, we use reinsurance as a means of mitigating exposure to insurance risk, in particular to aggregations of catastrophe risk. When we manage our exposure to insurance risk through the use of third-party reinsurers, the associated revenue and manufacturing profit is ceded to them. Although reinsurance provides a means of managing insurance risk, such contracts expose us to credit risk, the risk of default by the reinsurer (see page 165).

The following tables analyse our insurance risk exposures by geographical region and by type of business.

assumptions around these drivers. These typically reflect the issuers' own experiences. The type and quantum of insurance risk arising from life insurance depends on the type of business, and varies considerably.

- *mortality and morbidity*: the main contracts which generate exposure to these risks are term assurance, whole life products, critical illness

Report of the Directors: Operating and Financial Review (continued)

and income protection contracts and annuities. The risks are monitored on a regular basis, and are primarily mitigated by underwriting controls and reinsurance and by retaining the ability in certain cases to amend premiums in the light of experience;

- *lapses and surrenders*: the risks associated with this are generally mitigated by product design, the application of surrender charges and management actions, for example, managing the level of bonus payments to policyholders. A detailed persistency analysis at a product level is carried out at least on an annual basis; and

- *expense risk* is mitigated by pricing, for example, retaining the ability in certain cases to amend premiums and/or policyholder charges based on experience, and cost management discipline.

Economic assumptions, such as investment returns and interest rates, are usually based on observable market data. Clearly, liabilities are affected by changes in assumptions (see 'Sensitivity of HSBC's insurance subsidiaries to risk factors' on page 165 and 'Sensitivity analysis' on page 171).

Analysis of non-life insurance risk – net written insurance premiums^{74,77} (Audited)

	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	North America US\$m	Latin America US\$m	Total US\$m
2010						
Accident and health	78	174	8	3	37	300
Motor	–	15	28	–	267	310
Fire and other damage	38	29	11	16	22	116
Liability	–	20	4	–	2	26
Credit (non-life)	25	–	–	53	2	80
Marine, aviation and transport	3	10	4	–	18	35
Other non-life insurance contracts	20	39	1	9	84	153
Total net written insurance premiums	164	287	56	81	432	1,020
Net insurance claims incurred and movement in liabilities to policyholders	(169)	(117)	(25)	(13)	(201)	(525)
2009						
Accident and health	94	160	7	3	23	287
Motor	123	14	20	–	234	391
Fire and other damage	72	22	8	16	22	140
Liability	–	15	4	–	2	21
Credit (non-life)	35	–	–	86	–	121
Marine, aviation and transport	7	9	4	–	17	37
Other non-life insurance contracts	24	32	1	12	58	127
Total net written insurance premiums	355	252	44	117	356	1,124
Net insurance claims incurred and movement in liabilities to policyholders	(748)	(107)	(17)	(96)	(155)	(1,123)
2008						
Accident and health	14	155	5	3	27	204
Motor	350	15	14	–	273	652
Fire and other damage	150	26	3	4	22	205
Liability	–	14	4	–	34	52
Credit (non-life)	99	–	–	144	–	243
Marine, aviation and transport	–	11	4	–	24	39
Other non-life insurance contracts	49	28	–	15	29	121
Total net written insurance premiums	662	249	30	166	409	1,516
Net insurance claims incurred and movement in liabilities to policyholders	(553)	(121)	(13)	(98)	(176)	(961)

For footnotes, see page 174.

Report of the Directors: Operating and Financial Review (continued)

(Audited)

Our motor business is written predominantly in Latin America. The run-off of the UK motor book continued in 2010. Accident and health is written in all regions but mainly in Hong Kong. We write fire and other damage to property contracts in all major markets, most significantly in Europe. Credit non-life insurance, which is originated in conjunction with the provision of loans, is concentrated in the US and Europe.

The main risks associated with non-life business are:

- underwriting: the risk that premiums are not appropriate for the cover provided; and
- claims experience: the risk that claims exceed expectations.

We manage these risks through pricing (for example, imposing restrictions and deductibles in the

policy terms and conditions), product design, risk selection, claims handling, investment strategy and reinsurance policy. The majority of our non-life insurance contracts are renewable annually, providing added flexibility to the underwriting terms and conditions.

Balance sheet of insurance manufacturing subsidiaries

(Audited)

A principal tool we use to manage our exposure to insurance risk, in particular for life insurance contracts, is asset and liability matching.

The tables below show the composition of assets and liabilities by contract and by geographical region and demonstrate that there were sufficient assets to cover the liabilities to policyholders in each case at the end of 2010.

Balance sheet of insurance manufacturing subsidiaries by type of contract (Audited)

	Insurance contracts					Investment contracts			Other assets ⁷⁹ US\$m	Total US\$m
	With DPF US\$m	Unit-linked US\$m	Annuities US\$m	Term assurance ⁷⁸ US\$m	Non-life US\$m	With DPF ⁷² US\$m	Unit-linked US\$m	Other US\$m		
At 31 December 2010										
Financial assets	17,665	9,763	2,615	2,671	2,231	21,511	8,338	3,927	7,157	75,878
– trading assets	–	–	–	–	11	–	–	–	–	11
– financial assets designated at fair value	1,206	9,499	413	523	180	5,961	7,624	1,486	1,452	28,344
– derivatives	53	–	1	6	–	229	7	1	4	301
– financial investments	14,068	–	1,847	1,661	692	14,465	–	1,804	4,495	39,032
– other financial assets	2,338	264	354	481	1,348	856	707	636	1,206	8,190
Reinsurance assets	10	760	400	263	432	–	–	–	79	1,944
PVIF ⁸⁰	–	–	–	–	–	–	–	–	3,440	3,440
Other assets and investment properties	189	6	21	398	213	565	14	56	712	2,174
Total assets	17,864	10,529	3,036	3,332	2,876	22,076	8,352	3,983	11,388	83,436
Liabilities under investment contracts:										
– designated at fair value	–	–	–	–	–	–	8,321	3,379	–	11,700
– carried at amortised cost	–	–	–	–	–	–	–	439	–	439
Liabilities under insurance contracts	17,808	10,496	2,884	2,891	2,456	22,074	–	–	–	58,609
Deferred tax	11	–	20	4	6	–	–	1	793	835
Other liabilities	–	–	–	–	–	–	–	–	2,075	2,075
Total liabilities	17,819	10,496	2,904	2,895	2,462	22,074	8,321	3,819	2,868	73,658
Total equity	–	–	–	–	–	–	–	–	9,778	9,778
Total equity and liabilities⁸¹	17,819	10,496	2,904	2,895	2,462	22,074	8,321	3,819	12,646	83,436

Report of the Directors: Operating and Financial Review (continued)

Balance sheet of insurance manufacturing subsidiaries by type of contract (continued)

	Insurance contracts					Investment contracts				Total US\$m
	With DPF US\$m	Unit-linked US\$m	Annuities US\$m	Term assurance ⁷⁸ US\$m	Non-life US\$m	With DPF ⁷⁶ US\$m	Unit-linked US\$m	Other US\$m	Other assets ⁷⁹ US\$m	
At 31 December 2009										
Financial assets	15,322	8,204	2,567	2,053	2,290	20,501	7,366	4,008	7,252	69,563
– trading assets	–	–	–	–	10	–	–	–	–	10
– financial assets designated at fair value	599	7,837	446	482	63	5,498	6,572	1,582	2,085	25,164
– derivatives	16	1	–	3	–	144	299	2	3	468
– financial investments	13,013	–	1,511	1,033	742	13,948	–	1,701	3,901	35,849
– other financial assets	1,694	366	610	535	1,475	911	495	723	1,263	8,072
Reinsurance assets	6	831	376	389	467	–	–	–	60	2,129
PVIF ⁸⁰	–	–	–	–	–	–	–	–	2,780	2,780
Other assets and investment properties	165	5	25	634	242	516	13	56	601	2,257
Total assets	15,493	9,040	2,968	3,076	2,999	21,017	7,379	4,064	10,693	76,729
Liabilities under investment contracts:										
– designated at fair value	–	–	–	–	–	–	7,347	3,518	–	10,865
– carried at amortised cost	–	–	–	–	–	–	–	417	–	417
Liabilities under insurance contracts	15,450	8,986	2,811	2,718	2,728	21,014	–	–	–	53,707
Deferred tax	6	–	22	1	7	1	–	2	750	789
Other liabilities	–	–	–	–	–	–	–	–	2,371	2,371
Total liabilities	15,456	8,986	2,833	2,719	2,735	21,015	7,347	3,937	3,121	68,149
Total equity	–	–	–	–	–	–	–	–	8,580	8,580
Total equity and liabilities⁸²	15,456	8,986	2,833	2,719	2,735	21,015	7,347	3,937	11,701	76,729

For footnotes, see page 174.

Balance sheet of insurance manufacturing subsidiaries by geographical region⁷⁴
(Audited)

	Europe US\$m	Hong Kong US\$m	Rest of Asia-Pacific US\$m	North America US\$m	Latin America US\$m	Total US\$m
At 31 December 2010						
Financial assets	36,233	26,278	1,651	2,548	9,168	75,878
– trading assets	–	–	–	–	11	11
– financial assets designated at fair value	16,133	5,550	1,106	–	5,555	28,344
– derivatives	238	50	12	–	1	301
– financial investments	16,758	17,299	247	2,006	2,722	39,032
– other financial assets	3,104	3,379	286	542	879	8,190
Reinsurance assets	974	770	33	23	144	1,944
PVIF ⁸⁰	1,102	1,734	165	141	298	3,440
Other assets and investment properties	1,060	743	26	9	336	2,174
Total assets	39,369	29,525	1,875	2,721	9,946	83,436
Liabilities under investment contracts:						
– designated at fair value	7,359	4,300	41	–	–	11,700
– carried at amortised cost	–	–	–	–	439	439
Liabilities under insurance contracts	27,475	21,515	1,381	1,169	7,069	58,609
Deferred tax	375	298	39	–	123	835
Other liabilities	1,354	289	58	12	362	2,075
Total liabilities	36,563	26,402	1,519	1,181	7,993	73,658
Total equity	2,806	3,123	356	1,540	1,953	9,778
Total equity and liabilities⁸¹	39,369	29,525	1,875	2,721	9,946	83,436

Report of the Directors: Operating and Financial Review (continued)

	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	North America US\$m	Latin America US\$m	Total US\$m
At 31 December 2009						
Financial assets	35,704	22,337	1,330	2,582	7,610	69,563
– trading assets	–	–	–	–	10	10
– financial assets designated at fair value	14,756	4,758	877	–	4,773	25,164
– derivatives	446	18	3	–	1	468
– financial investments	16,940	14,771	133	2,037	1,968	35,849
– other financial assets	3,562	2,790	317	545	858	8,072
Reinsurance assets	1,100	849	25	19	136	2,129
PVIF ⁸⁰	1,022	1,248	113	138	259	2,780
Other assets and investment properties	1,380	498	23	40	316	2,257
Total assets	39,206	24,932	1,491	2,779	8,321	76,729
Liabilities under investment contracts:						
– designated at fair value	6,500	4,299	66	–	–	10,865
– carried at amortised cost	–	–	–	–	417	417
Liabilities under insurance contracts	27,845	17,618	1,072	1,268	5,904	53,707
Deferred tax	334	220	27	82	126	789
Other liabilities	1,744	284	54	3	286	2,371
Total liabilities	36,423	22,421	1,219	1,353	6,733	68,149
Total equity	2,783	2,511	272	1,426	1,588	8,580
Total equity and liabilities⁸²	39,206	24,932	1,491	2,779	8,321	76,729

For footnotes, see page 174.

Financial risks

(Audited)

Our insurance businesses are exposed to a range of financial risks, including market risk, credit risk and liquidity risk. Market risk includes interest rate risk, equity risk and foreign exchange risk. The nature and management of these risks is described below.

Manufacturing subsidiaries are exposed to financial risks when, for example, the proceeds from financial assets are not sufficient to fund the obligations arising from non-linked insurance and investment contracts. In many jurisdictions, local regulatory requirements prescribe the type, quality

and concentration of assets that these subsidiaries must maintain to meet insurance liabilities. These requirements complement Group-wide policies.

The following table analyses the assets held in our insurance manufacturing subsidiaries at 31 December 2010 by type of contract, and provides a view of the exposure to financial risk. For linked contracts, which pay benefits to policyholders which are determined by reference to the value of the investments supporting the policies, we typically designate assets at fair value; for non-linked contracts, the classification of the assets is driven by the nature of the underlying contract.

Report of the Directors: Operating and Financial Review (continued)

Financial assets held by insurance manufacturing subsidiaries (Audited)

	Life linked Contracts ⁸³ US\$m	Life non-linked contracts ⁸⁴ US\$m	Non-life insurance ⁸⁵ US\$m	Other assets ⁷⁹ US\$m	Total US\$m
At 31 December 2010					
Trading assets					
Debt securities	–	–	11	–	11
Financial assets designated at fair value	17,123	9,589	180	1,452	28,344
Treasury bills	10	119	–	10	139
Debt securities	6,660	3,281	180	847	10,968
Equity securities	10,453	6,189	–	595	17,237
Financial investments					
Held-to-maturity:					
– debt securities	–	16,015	152	908	17,075
Available-for-sale:	–	17,830	540	3,587	21,957
– Treasury bills	–	10	–	31	41
– other eligible bills	–	36	140	217	393
– debt securities	–	17,776	391	3,210	21,377
– equity securities	–	8	9	129	146
Derivatives	7	290	–	4	301
Other financial assets ⁸⁶	971	4,665	1,348	1,206	8,190
Total financial assets⁸¹	18,101	48,389	2,231	7,157	75,878
At 31 December 2009					
Trading assets					
Debt securities	–	–	10	–	10
Financial assets designated at fair value	14,409	8,607	63	2,085	25,164
Treasury bills	46	174	–	3	223
Debt securities	5,086	3,428	63	1,220	9,797
Equity securities	9,277	5,005	–	862	15,144
Financial investments					
Held-to-maturity:					
– debt securities	–	13,995	186	670	14,851
Available-for-sale:	–	17,211	556	3,231	20,998
– Treasury bills	–	–	211	86	297
– other eligible bills	–	26	127	126	279
– debt securities	–	17,169	199	2,787	20,155
– equity securities	–	16	19	232	267
Derivatives	300	165	–	3	468
Other financial assets ⁸⁶	861	4,473	1,475	1,263	8,072
Total financial assets⁸²	15,570	44,451	2,290	7,252	69,563

For footnotes, see page 174.

Approximately 65.1% of financial assets were invested in debt securities at 31 December 2010 (2009: 64.4%) with 22.9% (2009: 22.2%) invested in equity securities.

In life linked insurance, premium income less charges levied is invested in a portfolio of assets. We manage the financial risks of this product on behalf of the policyholders by holding appropriate assets in segregated funds or portfolios to which the liabilities are linked. These assets represented 23.9% of the total financial assets of our insurance manufacturing subsidiaries at the end of 2010 (2009: 22.4%).

Market risk

(Audited)

Market risk arises when mismatches occur between product liabilities and the investment assets which back them. For example, mismatches between asset and liability yields and maturities give rise to interest rate risk.

Description of market risk

(Audited)

The main features of products manufactured by our insurance manufacturing subsidiaries which generate market risk, and the market risk to which these

Report of the Directors: Operating and Financial Review (continued)

features expose the subsidiaries, are discussed below.

Long-term insurance or investment products may incorporate benefits that are guaranteed. The table below shows, in respect of each category of guarantee, the total liabilities to policyholders established for guaranteed products manufactured by our insurance subsidiaries. The table also shows the range of investment returns (net of operating costs) on the assets supporting these products and the implied investment returns that would enable the business to meet the guarantees.

Liabilities to policyholders⁸⁷

(Audited)

	2010			2009		
	Amount of reserve US\$m	Investment returns implied by guarantee ⁸¹ %	Current yields %	Amount of reserve US\$m	Investment returns implied by guarantee ⁸² %	Current yields %
Annuities in payment	1,491	0.0 – 8.5	1.5 – 16.2	1,299	0.0 – 7.5	1.3 – 16.7
Deferred annuities	642	0.0 – 6.0	2.1 – 16.8	569	0.0 – 6.0	0.9 – 15.1
Immediate annuities	532	6.0 – 9.0	5.5 – 5.5	553	6.0 – 9.0	5.4 – 5.4
Annual return	19,980	0.0 – 4.5	0.0 – 5.9	17,147	0.0 – 4.5	0.8 – 6.2
Annual return	841	4.5 – 6.0	6.1 – 8.5	497	4.5 – 6.0	5.1 – 6.5
Capital	15,445	–	2.0 – 4.0	15,866	–	2.4 – 4.3

For footnotes, see page 174.

Interest rate risk arises to the extent that yields on the assets are lower than the investment returns implied by the guarantees payable to policyholders by insurance manufacturing subsidiaries. When this happens, we may discontinue products.

The proceeds from insurance and investment products with DPF are primarily invested in bonds with a proportion allocated to other asset classes in order to provide customers with the potential for enhanced returns. Subsidiaries with portfolios of such products are exposed to the risk of falls in market prices which cannot be fully reflected in the discretionary bonuses. An increase in market volatility could also result in an increase in the value of the guarantee to the policyholder.

Long-term insurance and investment products typically permit the policyholder to surrender the policy or let it lapse at any time. When the surrender value is not linked to the value realised from the sale of the associated supporting assets, the subsidiary is exposed to market risk. In particular, when customers seek to surrender their policies when asset values are falling, assets may have to be sold at a loss to fund redemptions.

Categories of guaranteed benefits

- annuities in payment;
- deferred/immediate annuities: these consist of two phases – the savings and investing phase and the retirement income phase;
- annual return: the annual return is guaranteed to be no lower than a specified rate. This may be the return credited to the policyholder every year, or the average annual return credited to the policyholder over the life of the policy, which may occur on the maturity date or the surrender date of the contract; and
- capital: policyholders are guaranteed to receive no less than the premiums paid plus declared bonuses less expenses.

A subsidiary holding a portfolio of long-term insurance and investment products, especially with DPF, may attempt to reduce exposure to its local market by investing in assets in countries other than that in which it is based. These assets may be denominated in currencies other than the subsidiary's local currency. It is often not cost effective for the subsidiary to hedge the foreign exchange exposure associated with these assets, and this exposes it to the risk that its local currency will strengthen against the currency of the related assets.

For unit-linked contracts, market risk is substantially borne by the policyholder, but we typically remain exposed to market risk as the market value of the linked assets influences the fees we earn for managing them.

Asset and liability matching

It may not always be possible to achieve a complete matching of asset and liability durations, partly because there is uncertainty over policyholder behaviour, which introduces uncertainty over the receipt of all future premiums and the timing of claims, and partly because the duration of liabilities may exceed the duration of the longest available dated fixed interest investments.

Report of the Directors: Operating and Financial Review (continued)

We use models to assess the effect of a range of future scenarios on the values of financial assets and associated liabilities, and ALCOs employ the outcomes in determining how the assets and liabilities should be matched. The scenarios include stresses applied to factors which affect insurance risk such as mortality and lapse rates. Of particular importance is matching the expected pattern of cash inflows with the benefits payable on the underlying contracts, which can extend for many years.

Our current portfolio of assets includes debt securities issued at a time when yields were higher than those observed in the current market. As a result, yields on extant holdings of debt securities exceed those which may be obtained on current issues. We reduced short-term bonus rates paid to policyholders on certain participating contracts to manage the immediate strain on the business. Should interest rates and yield curves remain low for prolonged periods, further such steps may be needed.

How market risk is managed

(Audited)

All our insurance manufacturing subsidiaries have market risk mandates which specify the investment instruments in which they are permitted to invest and the maximum quantum of market risk which they are permitted to retain. They manage market risk by using some or all of the techniques listed below, depending on the nature of the contracts they write.

Techniques for managing market risk

- for products with DPF, adjusting bonus rates to manage the liabilities to policyholders. The effect is that a significant portion of the market risk is borne by the policyholder;
- as far as possible, matching assets to liabilities;
- using derivatives to a limited extent;
- for new products with investment guarantees, considering the cost when determining the level of premiums or the price structure;
- periodically reviewing products identified as higher risk, which contain investment guarantees and embedded optionality features linked to savings and investment products;
- including features designed to mitigate market risk in new products, such as charging surrender penalties to recoup losses incurred when policyholders surrender their policies; and
- exiting, to the extent possible, investment portfolios whose risk is considered unacceptable.

In the product approval process, the risks embedded in new products are identified and assessed. When, for example, options and guarantees are embedded in new products, the due diligence process ensures that complete and appropriate risk management procedures are in place. For all but the simplest of guaranteed benefits the assessment is

undertaken by Group Insurance Head Office. Management reviews certain exposures more frequently when markets are more volatile to ensure that any matters arising are dealt with in a timely fashion.

How the exposure to market risk is measured

(Audited)

Our insurance manufacturing subsidiaries monitor exposures against mandated limits regularly and report them to Group Insurance Head Office. Exposures are aggregated and reported on a quarterly basis to senior risk management forums in the Group, including the Group Insurance Market and Liquidity Risk Committee, Group Insurance Risk Committee and the Group Stress Test Review Group.

Standard measures for quantifying market risks

- for interest rate risk, the sensitivities of the net present values of asset and expected liability cash flows, in total and by currency, to a one basis point parallel shift in the discount curves used to calculate the net present values;
- for equity price risk, the total market value of equity holdings and the market value of equity holdings by region and country; and
- for foreign exchange risk, the total net short foreign exchange position and the net foreign exchange positions by currency.

The standard measures are relatively straightforward to calculate and aggregate, but they have limitations. The most significant one is that a parallel shift in yield curves of one basis point does not capture the non-linear relationships between the values of certain assets and liabilities and interest rates. Non-linearity arises, for example, from investment guarantees and product features which enable policyholders to surrender their policies. We bear the shortfall if the yields on investments held to support contracts with guaranteed benefits are less than the investment returns implied by the guaranteed benefits.

We recognise these limitations and augment our standard measures with stress tests which examine the effect of a range of market rate scenarios on the aggregate annual profits and total equity of our insurance manufacturing subsidiaries, after taking into consideration tax and accounting treatments where material and relevant. The results of these tests are reported to Group Insurance Head Office and risk committees every quarter.

The following table illustrates the effects of various interest rate, equity price, foreign exchange rate and credit spread scenarios on our profit for the year and total equity of our insurance manufacturing subsidiaries:

Report of the Directors: Operating and Financial Review (continued)*Sensitivity of HSBC's insurance manufacturing subsidiaries to risk factors*
(Audited)

	2010		2009	
	Effect on profit for the year US\$m	Effect on total equity US\$m	Effect on profit for the year US\$m	Effect on total equity US\$m
+ 100 basis points parallel shift in yield curves	72	(132)	68	(82)
- 100 basis points parallel shift in yield curves	(86)	131	(69)	92
10% increase in equity prices	76	76	19	19
10% decrease in equity prices	(76)	(76)	(20)	(20)
10% increase in US dollar exchange rate compared to all currencies	21	21	20	20
10% decrease in US dollar exchange rate compared to all currencies	(21)	(21)	(20)	(20)
Sensitivity to credit spread increases	(31)	(74)	(36)	(91)

Where appropriate, we include the impact of the stress on the PVIF in the results of the stress tests. The relationship between the values of certain assets and liabilities and the risk factors may be non-linear and, therefore, the results disclosed cannot be extrapolated to measure sensitivities to different levels of stress. The sensitivities are stated before allowance for the effect of management actions which may mitigate changes in market rates, and for any factors such as policyholder behaviour that may change in response to changes in market risk.

Credit risk
(Audited)**Description of credit risk**

Credit risk can give rise to losses through default and can lead to volatility in our income statement and balance sheet figures through movements in credit spreads, principally on the US\$43.3bn (2009: US\$40.5bn) non-linked bond portfolio.

As tabulated above, the sensitivity of the net profit after tax of our insurance subsidiaries to the effects of increases in credit spreads is a fall of US\$31m (2009: US\$36m fall). This is small because 51.4% of the financial assets held by our insurance subsidiaries are classified as either held to maturity or available for sale, and consequently any changes in the fair value of these financial investments, absent impairment, would have no impact on the profit after tax. We calculate the sensitivity using simplified assumptions based on a one-day movement in credit spreads over a two-year period. A confidence level of 99%, consistent with our Group VAR, is applied. While credit spreads have generally widened from the levels observed at the end of 2009, the volatility experienced during 2010 was lower than that seen in 2009, leading to a reduction in our sensitivity to credit spread movements.

We used to sell certain unit-linked life insurance contracts which were reinsured with a third-party counterparty, who also underwrote market return guarantees. We are exposed to credit risk to the extent that the counterparty is unable to meet the terms of the guaranteed benefits. The cost to us of market return guarantees increases when interest rates fall, equity markets fall or market volatility increases. In addition, when determined by reference to a discounted cash flow model in which the discount rate is based on current interest rates, guarantee costs increase in a falling interest rate environment. The sale of these contracts ceased in 2008, reflecting our adjusted risk appetite.

How credit risk is managed

Our exposure to credit risk products is included in the tables showing exposures to life and non-life insurance risk on pages 157 to 159. Our insurance manufacturing subsidiaries are responsible for the credit risk, quality and performance of their investment portfolios. Our assessment of the creditworthiness of issuers and counterparties is based primarily upon internationally recognised credit ratings and other publicly available information.

Investment credit exposures are monitored against limits by our local insurance manufacturing subsidiaries, and are aggregated and reported to Group Credit Risk, the Group Insurance Credit Risk Meeting and the Group Insurance Risk Committee. Stress testing is performed by Group Insurance Head Office on the investment credit exposures using credit spread sensitivities and default probabilities. The stresses are reported to the Group Insurance Risk Committee.

We use a number of tools to manage and monitor credit risk. These include an Early Warning Report and a watch list of investments with current credit concerns which are circulated fortnightly to

Report of the Directors: Operating and Financial Review (continued)

senior management in Group Insurance Head Office and the Regional Chief Risk Officers to identify investments which may be at risk of future impairment.

Credit quality

(Audited)

The following table presents an analysis of treasury bills, other eligible bills and debt securities within

our insurance business by measures of credit quality. The five credit quality classifications are defined on page 114. Only assets supporting non-linked liabilities are included in the table as financial risk on assets supporting linked liabilities is predominantly borne by the policyholder. 90.5% (2009: 90.9%) of the assets included in the table are invested in investments rated as 'Strong'.

Treasury bills, other eligible bills and debt securities in HSBC's insurance manufacturing subsidiaries
(Audited)

	Neither past due nor impaired					Total US\$m
	Strong US\$m	Good US\$m	Satisfactory US\$m	Sub- standard US\$m	Impaired ⁸⁸ US\$m	
At 31 December 2010						
Supporting liabilities under non-linked insurance and investment contracts						
Trading assets – debt securities	9	–	2	–	–	11
Financial assets designated at fair value	3,126	88	330	36	–	3,580
– treasury and other eligible bills	118	–	1	–	–	119
– debt securities	3,008	88	329	36	–	3,461
Financial investments	32,164	1,948	250	158	–	34,520
– treasury and other similar bills	–	–	10	–	–	10
– other eligible bills	176	–	–	–	–	176
– debt securities	31,988	1,948	240	158	–	34,334
	35,299	2,036	582	194	–	38,111
Supporting shareholders' funds⁸⁹						
Financial assets designated at fair value	492	286	75	4	–	857
– treasury and other eligible bills	10	–	–	–	–	10
– debt securities	482	286	75	4	–	847
Financial investments	3,443	740	101	82	–	4,366
– treasury and other similar bills	–	–	31	–	–	31
– other eligible bills	217	–	–	–	–	217
– debt securities	3,226	740	70	82	–	4,118
	3,935	1,026	176	86	–	5,223
Total⁸¹						
Trading assets – debt securities	9	–	2	–	–	11
Financial assets designated at fair value	3,618	374	405	40	–	4,437
– treasury and other eligible bills	128	–	1	–	–	129
– debt securities	3,490	374	404	40	–	4,308
Financial investments	35,607	2,688	351	240	–	38,886
– treasury and other similar bills	–	–	41	–	–	41
– other eligible bills	393	–	–	–	–	393
– debt securities	35,214	2,688	310	240	–	38,452
	39,234	3,062	758	280	–	43,334

Report of the Directors: Operating and Financial Review (continued)

	Neither past due nor impaired				Impaired ⁸⁸ US\$m	Total US\$m
	Strong US\$m	Good US\$m	Satisfactory US\$m	Sub- standard US\$m		
At 31 December 2009						
Supporting liabilities under non-linked insurance and investment contracts						
Trading assets – debt securities	8	–	2	–		10
Financial assets designated at fair value	2,812	80	704	69		3,665
– treasury and other eligible bills	174	–	–	–		174
– debt securities	2,638	80	704	69		3,491
Financial investments	30,126	1,509	130	148	–	31,913
– treasury and other similar bills	211	–	–	–	–	211
– other eligible bills	153	–	–	–	–	153
– debt securities	29,762	1,509	130	148	–	31,549
	<u>32,946</u>	<u>1,589</u>	<u>836</u>	<u>217</u>	<u>–</u>	<u>35,588</u>
Supporting shareholders' funds ⁸⁹						
Financial assets designated at fair value	527	506	180	10		1,223
– treasury and other eligible bills	3	–	–	–		3
– debt securities	524	506	180	10		1,220
Financial investments	3,335	312	16	6	–	3,669
– treasury and other similar bills	82	–	4	–	–	86
– other eligible bills	126	–	–	–	–	126
– debt securities	3,127	312	12	6	–	3,457
	<u>3,862</u>	<u>818</u>	<u>196</u>	<u>16</u>	<u>–</u>	<u>4,892</u>
Total ⁸²						
Trading assets – debt securities	8	–	2	–		10
Financial assets designated at fair value	3,339	586	884	79		4,888
– treasury and other eligible bills	177	–	–	–		177
– debt securities	3,162	586	884	79		4,711
Financial investments	33,461	1,821	146	154	–	35,582
– treasury and other similar bills	293	–	4	–	–	297
– other eligible bills	279	–	–	–	–	279
– debt securities	32,889	1,821	142	154	–	35,006
	<u>36,808</u>	<u>2,407</u>	<u>1,032</u>	<u>233</u>	<u>–</u>	<u>40,480</u>

For footnotes, see page 174.

Issuers of treasury bills, other eligible bills and debt securities in HSBC's insurance manufacturing subsidiaries
(Audited)

	Treasury bills US\$m	Other eligible bills US\$m	Debt securities US\$m	Total US\$m
At 31 December 2010				
Governments	170	121	9,401	9,692
Local authorities	–	–	915	915
Asset-backed securities	–	–	60	60
Corporates and other	–	272	32,395	32,667
	<u>170</u>	<u>393</u>	<u>42,771</u>	<u>43,334</u>
At 31 December 2009				
Governments	342	6	8,548	8,896
Local authorities	–	–	886	886
Asset-backed securities	–	–	54	54
Corporates and other	132	273	30,239	30,644
	<u>474</u>	<u>279</u>	<u>39,727</u>	<u>40,480</u>

Report of the Directors: Operating and Financial Review (continued)

Credit risk also arises when part of the insurance risk we incur is assumed by reinsurers. The split of liabilities ceded to reinsurers and outstanding reinsurance recoveries, analysed by credit quality,

is shown below. Our exposure to third parties under the reinsurance agreements described in the Credit Risk section above is included in this table.

Reinsurers' share of liabilities under insurance contracts (Audited)

	Neither past due nor impaired				Past due but not impaired US\$m	Total US\$m
	Strong US\$m	Good US\$m	Satisfactory US\$m	Sub- standard US\$m		
At 31 December 2010						
Linked insurance contracts	44	716	–	–	–	760
Non-linked insurance contracts	997	11	76	12	9	1,105
Total⁸¹	1,041	727	76	12	9	1,865
Reinsurance debtors	30	8	30	1	10	79
At 31 December 2009						
Linked insurance contracts	27	804	–	–	–	831
Non-linked insurance contracts	1,133	10	90	5	–	1,238
Total⁸²	1,160	814	90	5	–	2,069
Reinsurance debtors	24	2	11	6	17	60

For footnotes, see page 174.

Liquidity risk (Audited)

Description of liquidity risk

It is an inherent characteristic of almost all insurance contracts that there is uncertainty over the amount of claims liabilities that may arise and the timing of their settlement, and this creates liquidity risk.

There are three aspects to liquidity risk. The first arises in normal market conditions and is referred to as funding liquidity risk; specifically, the capacity to raise sufficient cash when needed to meet payment obligations. Secondly, market liquidity risk arises when the size of a particular holding may be so large that a sale cannot be completed around the market price. Finally, standby liquidity risk refers to the capacity to meet payment terms in abnormal conditions.

How liquidity risk is managed

Our insurance manufacturing subsidiaries primarily fund cash outflows arising from claim liabilities from the following sources of cash inflows:

- premiums from new business, policy renewals and recurring premium products;
- interest and dividends on investments and principal repayments of maturing debt investments;
- cash resources; and
- the sale of investments.

They manage liquidity risk by utilising some or all of the following techniques:

- matching cash inflows with expected cash outflows using specific cash flow projections or more general asset and liability matching techniques such as duration matching;
- maintaining sufficient cash resources;
- investing in good credit-quality investments with deep and liquid markets to the degree to which they exist;
- monitoring investment concentrations and restricting them where appropriate, for example, by debt issues or issuers; and
- establishing committed contingency borrowing facilities.

Each of these techniques contributes to mitigating the three types of liquidity risk described above.

Every quarter, our insurance manufacturing subsidiaries are required to complete and submit liquidity risk reports to Group Insurance Head Office for collation and review by the Group Insurance Market and Liquidity Risk Meeting. Liquidity risk is assessed in these reports by measuring changes in expected cumulative net cash flows under a series of stress scenarios designed to determine the effect of reducing expected available liquidity and accelerating cash outflows. This is achieved, for example, by assuming new business or renewals are

Report of the Directors: Operating and Financial Review (continued)

lower, and surrenders or lapses are greater, than expected.

The following tables show the expected undiscounted cash flows for insurance contract liabilities and the remaining contractual maturity of investment contract liabilities at 31 December 2010. A significant proportion of our non-life insurance business is viewed as short-term, with the settlement of liabilities expected to occur within one year of the

Expected maturity of insurance contract liabilities (Audited)

At 31 December 2010

Non-life insurance
Life insurance (non-linked)
Life insurance (linked)

Total⁸¹

At 31 December 2009

Non-life insurance
Life insurance (non-linked)
Life insurance (linked)

Total⁸²

	Expected cash flows (undiscounted)				Total US\$m
	Within 1 year US\$m	1-5 years US\$m	5-15 years US\$m	Over 15 years US\$m	
Non-life insurance	1,140	1,157	83	76	2,456
Life insurance (non-linked)	2,463	11,178	18,839	21,093	53,573
Life insurance (linked)	485	2,557	6,366	10,724	20,132
Total⁸¹	4,088	14,892	25,288	31,893	76,161
Non-life insurance	1,318	1,277	123	10	2,728
Life insurance (non-linked)	2,393	10,098	17,253	18,231	47,975
Life insurance (linked)	522	2,290	4,483	6,899	14,194
Total⁸²	4,233	13,665	21,859	25,140	64,897

For footnote, see page 174.

Remaining contractual maturity of investment contract liabilities (Audited)

At 31 December 2010

Remaining contractual maturity:⁸¹
– due within 1 year
– due between 1 and 5 years
– due between 5 and 10 years
– due after 10 years
– undated⁹⁰

At 31 December 2009

Remaining contractual maturity:⁸²
– due within 1 year
– due between 1 and 5 years
– due between 5 and 10 years
– due after 10 years
– undated⁹⁰

	Liabilities under investment contracts by insurance manufacturing subsidiaries			Total US\$m
	Linked investment contracts US\$m	Other investment contracts US\$m	Investment contracts with DPF US\$m	
– due within 1 year	391	446	11	848
– due between 1 and 5 years	940	–	11	951
– due between 5 and 10 years	1,182	–	–	1,182
– due after 10 years	2,133	–	–	2,133
– undated ⁹⁰	3,675	3,372	22,052	29,099
Total	8,321	3,818	22,074	34,213
– due within 1 year	477	443	14	934
– due between 1 and 5 years	904	–	20	924
– due between 5 and 10 years	693	–	–	693
– due after 10 years	2,093	–	–	2,093
– undated ⁹⁰	3,180	3,492	20,980	27,652
Total	7,347	3,935	21,014	32,296

For footnotes, see page 174.

Report of the Directors: Operating and Financial Review (continued)

Present value of in-force long-term insurance business (Audited)

Our life insurance business is accounted for using the embedded value approach which, *inter alia*, provides a comprehensive risk and valuation framework. The present value of our in-force long-term ('PVIF') asset at 31 December 2010 was

US\$3.4bn (2009: US\$2.8bn), representing the present value of the shareholders' interest in the profits expected to emerge from the book of in-force policies at that date.

The following table shows the movements recorded during the year in respect of total equity and PVIF of insurance operations:

Movements in total equity and PVIF of insurance operations (Audited)

	2010		2009	
	Total equity US\$m	PVIF included in total equity US\$m	Total equity US\$m	PVIF included in total equity US\$m
At 1 January	8,580	2,780	7,577	2,033
Value of new business written during the year ⁹¹	737	737	600	600
Movements arising from in-force business:				
– expected return	(85)	(85)	(123)	(123)
– experience variances ⁹²	20	20	(44)	(44)
– change in operating assumptions	58	58	48	48
Investment return variances	19	19	16	16
Changes in investment assumptions	(38)	(38)	19	19
Return on net assets	858	–	522	–
Exchange differences and other	(222)	(51)	(83)	231
Capital transactions	(149)	–	48	–
At 31 December	9,778	3,440	8,580	2,780

For footnotes, see page 174.

Key assumptions used in the computation of PVIF for main life insurance operations

	2010			2009		
	UK %	Hong Kong %	France %	UK %	Hong Kong %	France %
Risk free rate	3.46	3.10	3.15	3.50	2.58	3.46
Risk discount rate	7.00	11.00	8.00	7.00	11.00	8.00
Expenses inflation	3.76	3.00	2.00	3.50	3.00	2.00

The calculation of the PVIF is based upon assumptions that take into account risk and uncertainty. To project these cash flows, a variety of assumptions regarding future experience is made by each insurance operation which reflects local market conditions and management's judgement of local future trends. Some of the Group's insurance operations incorporate risk margins separately in the projection assumptions for each product, while others incorporate risk margins into the overall discount rate. Both factors are reflected in the wide range of risk discount rates applied.

Economic assumptions (Audited)

The following table shows the effect on the PVIF of reasonably possible changes in the main economic

assumptions, namely the risk-free and risk discount rates, across all insurance manufacturing subsidiaries.

Due to certain characteristics of the contracts, the relationships may be non-linear and the results of the stress-testing should not be extrapolated to higher levels of stress. In calculating the various scenarios, all assumptions are held stable except when testing the effect of the shift in the risk-free rate, when resultant changes to investment returns, risk discount rates and bonus rates are also incorporated. The sensitivities shown are before actions that could be taken by management to mitigate effects and before resultant changes in policyholder behaviour.

Report of the Directors: Operating and Financial Review (continued)

Sensitivity of PVIF to changes in economic assumptions (Audited)

	PVIF at 31 December	
	2010 US\$m	2009 US\$m
+ 100 basis point shift in risk-free rate	231	212
- 100 basis point shift in risk-free rate	(190)	(145)
+ 100 basis point shift in risk discount rate	(179)	(140)
- 100 basis point shift in risk discount rate	205	162

Non-economic assumptions

(Audited)

We determine the policyholder liabilities and PVIF by reference to non-economic assumptions which include, for non-life manufacturers, claims costs and expense rates and, for life manufacturers, mortality and/or morbidity, lapse rates and expense rates. The table below shows the sensitivity of profit for 2010 and total equity at 31 December 2010 to reasonably possible changes in these non-economic assumptions at that date across all our insurance manufacturing subsidiaries, with comparatives for 2009.

The cost of claims is a risk associated with non-life insurance business. An increase in claims costs

Sensitivity analysis

(Audited)

	Effect on profit for the year to 31 December			Effect on total equity at 31 December		
	Life US\$m	Non-life US\$m	Total US\$m	Life US\$m	Non-life US\$m	Total US\$m
2010						
20% increase in claims costs	-	(211)	(211)	-	(211)	(211)
20% decrease in claims costs	-	211	211	-	211	211
10% increase in mortality and/or morbidity rates	(55)	-	(55)	(55)	-	(55)
10% decrease in mortality and/or morbidity rates	66	-	66	66	-	66
50% increase in lapse rates	(203)	-	(203)	(203)	-	(203)
50% decrease in lapse rates	363	-	363	363	-	363
10% increase in expense rates	(63)	(11)	(74)	(63)	(11)	(74)
10% decrease in expense rates	63	11	74	63	11	74
2009						
20% increase in claims costs	-	(191)	(191)	-	(191)	(191)
20% decrease in claims costs	-	190	190	-	190	190
10% increase in mortality and/or morbidity rates	(51)	-	(51)	(51)	-	(51)
10% decrease in mortality and/or morbidity rates	62	-	62	62	-	62
50% increase in lapse rates	(162)	-	(162)	(162)	-	(162)
50% decrease in lapse rates	408	-	408	408	-	408
10% increase in expense rates	(52)	(11)	(63)	(52)	(11)	(63)
10% decrease in expense rates	52	11	63	52	11	63

would have a negative effect on profit. Our main exposures to this scenario are in the UK, Hong Kong, Latin America and Bermuda.

Mortality and morbidity risk is typically associated with life insurance contracts. The effect on profit of an increase in mortality or morbidity depends on the type of business being written. Our largest exposures to mortality and morbidity risk exist in France, Hong Kong, the UK and the US.

Sensitivity to lapse rates depends on the type of contracts being written. For insurance contracts, claims are funded by premiums received and income earned on the investment portfolio supporting the liabilities. For a portfolio of term assurance, an increase in lapse rates typically has a negative effect on profit due to the loss of future premium income on the lapsed policies. France, Hong Kong, the UK and the US are where we are most sensitive to a change in lapse rates.

Expense rate risk is the exposure to a change in expense rates. To the extent that increased expenses cannot be passed on to policyholders, an increase in expense rates will have a negative impact on our profits.

Report of the Directors: Operating and Financial Review (continued)

Other material risks

Reputational risk

(Unaudited)

The safeguarding of our reputation is of paramount importance to our continued prosperity and is the responsibility of every member of staff.

We regularly review our policies and procedures for safeguarding against reputational and operational risks. This is an evolutionary process which takes account of relevant developments and industry guidance such as The Association of British Insurers' guidance on best practice when responding to environmental, social and governance ('ESG') risks.

We have always aspired to the highest standards of conduct and, as a matter of routine, take account of reputational risks to our business. Reputational risks can arise from a wide variety of causes, including ESG issues and operational risk events. As a banking group, our good reputation depends upon the way in which we conduct our business, but it can also be affected by the way in which clients, to whom we provide financial services, conduct themselves. The training of Directors on appointment includes reputational matters.

Group functions with responsibility for activities that attract reputational risk are represented at the Group Reputational Risk Committee ('GRRC'), which is chaired by the Group Chairman. The primary role of the GRRC is to consider areas and activities presenting significant reputational risk and, where appropriate, to make recommendations to the Risk Management Meeting and the GMB for policy or procedural changes to mitigate such risk. Reputational Risk Committees have been established in each of the Group's regions. These committees are required to ensure that reputational risks are considered at a regional as well as Group level. Minutes from the regional committees are tabled at GRRC.

Standards on all major aspects of business are set for HSBC and for individual subsidiaries, businesses and functions. Reputational risks, including ESG matters, are considered and assessed by the Board, the GMB, the Risk Management Meeting, subsidiary company boards, Board committees and senior management during the formulation of policy and the establishment of our standards. These policies, which form an integral part of the internal control system (see page 202), are communicated through manuals and statements of policy and are promulgated through internal

communications and training. The policies cover ESG issues and set out operational procedures in all areas of reputational risk, including money laundering deterrence, counter-terrorist financing, environmental impact, anti-corruption measures and employee relations. The policy manuals address risk issues in detail and co-operation between GMO departments and businesses is required to ensure a strong adherence to our risk management system and our sustainability practices.

Pension risk

(Unaudited)

We operate a number of pension plans throughout the world, as described in Note 7 on the Financial Statements. Some of them are defined benefit plans, of which the largest is the HSBC Bank (UK) Pension Scheme ('the principal plan').

In order to fund the benefits associated with these plans, sponsoring Group companies (and, in some instances, employees) make regular contributions in accordance with advice from actuaries and in consultation with the scheme's trustees (where relevant). The defined benefit plans invest these contributions in a range of investments designed to meet their long-term liabilities.

The level of these contributions has a direct impact on HSBC's cash flow and would normally be set to ensure that there are sufficient funds to meet the cost of the accruing benefits for the future service of active members. However, higher contributions will be required when plan assets are considered insufficient to cover the existing pension liabilities as a deficit exists. Contribution rates are typically revised annually or triennially, depending on the plan. The agreed contributions to the principal plan are revised triennially.

A deficit in a defined benefit plan may arise from a number of factors, including

- investments delivering a return below that required to provide the projected plan benefits. This could arise, for example, when there is a fall in the market value of equities, or when increases in long-term interest rates cause a fall in the value of fixed income securities held;
- the prevailing economic environment leading to corporate failures, thus triggering write-downs in asset values (both equity and debt);
- a change in either interest rates or inflation which causes an increase in the value of the scheme liabilities; and
- scheme members living longer than expected (known as longevity risk).

A plan's investment strategy is determined after taking into consideration the market risk inherent in the investments and its consequential impact on potential future contributions. The long-term

Report of the Directors: Operating and Financial Review (continued)

investment objectives of both HSBC and, where relevant and appropriate, the trustees are:

- to limit the risk of the assets failing to meet the liabilities of the plans over the long-term; and
- to maximise returns consistent with an acceptable level of risk so as to control the long-term costs of the defined benefit plans.

In pursuit of these long-term objectives, a benchmark is established for the allocation of the defined benefit plan assets between asset classes. In addition, each permitted asset class has its own benchmarks, such as stock market or property valuation indices and, where relevant, desired levels of out-performance. The benchmarks are reviewed at least triennially within 18 months of the date at which an actuarial valuation is made, or more frequently if required by local legislation or circumstances. The process generally involves an extensive asset and liability review.

Ultimate responsibility for investment strategy rests with either the trustees or, in certain circumstances, a Management Committee. The degree of independence of the trustees from HSBC varies in different jurisdictions. For example, the principal plan, which accounts for approximately 70% of the obligations of our defined benefit pension plans, is overseen by a corporate trustee who regularly monitors the market risks inherent in the scheme.

The principal plan holds a diversified portfolio of investments to meet future cash flow liabilities arising from accrued benefits as they fall due to be paid. The trustee of the principal plan is required to produce a written Statement of Investment Principles which governs decision-making about how investments are made.

The DBS principal plan – asset allocation

	2010	2006
	%	%
Equities	15.5	15.0
Bonds	56.5	50.0
Alternative assets ⁹³	10.5	10.0
Property	9.0	10.0
Cash	8.5	15.0
	100.0	100.0

For footnote, see page 174.

In 2006, HSBC and the trustee of the principal plan agreed to change the investment strategy in order to reduce the investment risk. The target asset allocations for this strategy at that time and as revised in 2010 are shown above. The strategy is to

hold the majority of assets in bonds, with the remainder in a more diverse range of investments, and includes a commitment to undertake a programme of swap arrangements (see Note 45 on the Financial Statements) by which the principal plan makes LIBOR-related interest payments in exchange for the receipt of cash flows which are based on projected future benefit payments to be made from the principal plan.

Sustainability risk

(Unaudited)

Assessing the environmental and social impacts of providing finance to our customers has been firmly embedded into our overall risk management processes.

Sustainability risks arise from the provision of financial services to companies or projects which run counter to the needs of sustainable development; in effect this risk arises when the environmental and social effects outweigh economic benefits. Within GMO, a separate function, Group Corporate Sustainability, is mandated to manage these risks globally working through local offices as appropriate. Sustainability Risk Managers have regional or national responsibilities for advising on and managing environmental and social risks.

Group Corporate Sustainability's risk management responsibilities include:

- formulating sustainability risk policies. This includes oversight of our sustainability risk standards, management of the Equator Principles for project finance lending, and sector-based sustainability policies covering those sectors with high environmental or social impacts (forestry, freshwater infrastructure, chemicals, energy, mining and metals, and defence-related lending); undertaking an independent review of transactions where sustainability risks are assessed to be high, and supporting our operating companies to assess similar risks of a lower magnitude;
- building and implementing systems-based processes to ensure consistent application of policies, reduce the costs of sustainability risk reviews and capture management information to measure and report on the effect of our lending and investment activities on sustainable development; and
- providing training and capacity building within our operating companies to ensure sustainability risks are identified and mitigated consistently to either our own standards, international standards or local regulations, whichever is higher.

Report of the Directors: Operating and Financial Review (continued)

Residual value risk

(Unaudited)

A significant part of a lessor's return from operating leases is dependent upon its management of residual value risk. This arises from operating lease transactions to the extent that the values recovered from disposing of leased assets or re-letting them at

the end of the lease terms (the 'residual values') differ from those projected at the inception of the leases.

The sale of our rail finance business 'Eversholt Rail Group' during the year has significantly reduced our exposure to residual value risk.

Footnotes to Risk

Credit risk

- 1 The amount of the loan commitments reflects, where relevant, the expected level of take-up of pre-approved loan offers made by mailshots to personal customers. In addition to those amounts, there is a further maximum possible exposure to credit risk of US\$220.2bn (2009: US\$62.3bn), reflecting the full take-up of such irrevocable loan commitments. The take-up of such offers is generally at modest levels.
- 2 A change in the write-off period in North America during 2009 resulted in an acceleration of write-offs which reduced residential mortgages by US\$1.9bn, other personal loans by US\$1.3bn and total personal lending by US\$3.3bn, with a corresponding reduction in impairment allowances. There was no significant effect on net loans and advances or loan impairment charges.
- 3 Residential mortgages include Hong Kong Government Home Ownership Scheme loans of US\$3.5bn at 31 December 2010 (2009: US\$3.5bn). Where disclosed, earlier comparatives were 2008: US\$3.9bn; 2007: US\$3.9bn; 2006: US\$4.1bn.
- 4 Other personal loans and advances include second lien mortgages and other property-related lending.
- 5 Other commercial loans and advances include advances in respect of agriculture, transport, energy and utilities.
- 6 Included within 'Total gross loans and advances to customers' ('TGLAC') is credit card lending of US\$62bn (2009: US\$68bn). Where disclosed, earlier comparatives were 2008: US\$75bn; 2007: US\$83bn; 2006: US\$75bn.
- 7 The above numbers for North America include a reclassification within the corporate and commercial lending category to reflect a more accurate presentation of lending in the region.
- 8 The impairment allowances on loans and advances to banks relate to the geographical regions, Europe, Middle East and North America.
- 9 These balances were between 0.75% and 1% of total assets. All other balances were above 1%.
- 10 We do not have material retail exposures in any of the eurozone countries listed in this table.
- 11 Includes balances at central banks. Lending to banks comprises non-trading loans and advances to banks including reverse repurchase transactions.
- 12 Derivative assets net of collateral and derivative liabilities for which a legally enforceable right of offset exists.
- 13 Includes residential mortgages of HSBC Bank USA and HSBC Finance.
- 14 Comprising Hong Kong, Rest of Asia-Pacific, Middle East and Latin America.
- 15 Negative equity arises when the value of the property used to secure a loan is below the balance outstanding on the loan, generally based on values at the balance sheet date.
- 16 Loan-to-value ratios are generally based on values at the balance sheet date.
- 17 HSBC Finance lending is shown on a management basis and includes loans transferred to HSBC USA Inc. which are managed by HSBC Finance.
- 18 Interest-only (affordability mortgages) are loans which are classified as 'interest only' for initial period before reverting to repayment. As a consequence, in the table 'Mortgage lending products' on page 109 these balances are included in the category 'Affordability mortgages, including ARMs'.
- 19 Stated income lending forms a subset of total mortgage services lending across all categories.
- 20 By states which individually account for 5% or more of HSBC Finance's US customer loan portfolio.
- 21 The average loss on sale of foreclosed properties is calculated as cash proceeds after deducting selling costs, commissions and other ancillary costs, minus the book value of the property when it was moved to assets held for sale, divided by the book value of the property when it was moved to assets held for sale.
- 22 The average total loss on foreclosed properties sold includes both the loss on sale (see footnote 21) and the cumulative write-downs recognised on the loans up to and upon classification as assets held for sale. This average total loss on foreclosed properties is expressed as a percentage of the book value of the property prior to its transfer to assets held for sale.
- 23 Percentages are expressed as a function of the relevant loans and receivables balance.
- 24 At 31 December 2010 and 2009, real estate secured delinquency included US\$4.2bn and US\$3.3bn, respectively, of loans that we carried at the lower of cost on net realisable value.
- 25 We observe the disclosure convention that, in addition to those classified as EL9 to EL10, retail accounts classified EL1 to EL8 that are delinquent by 90 days or more are considered impaired, unless individually they have been assessed as not impaired (see page 117, 'Past due but not impaired gross financial instruments').
- 26 The EL percentage is derived through a combination of PD and LGD, and may exceed 100% in circumstances where the LGD is above 100% reflecting the cost of recoveries.
- 27 Impairment allowances are not reported for financial instruments whereby the carrying amount is reduced directly for impairment and not through the use of an allowance account.
- 28 Impairment is not measured for assets held in trading portfolios or designated at fair value as assets in such portfolios are managed according to movements in fair value, and the fair value movement is taken directly to the income statement. Consequently, we report all such balances under 'Neither past due nor impaired'.
- 29 Loans and advances to customers includes asset-backed securities that have been externally rated as strong (2010: US\$4.1bn; 2009: US\$5.7bn), good (2010: US\$627m; 2009: US\$881m), satisfactory (2010: US\$452m; 2009: US\$311m), sub-standard (2010: US\$669m; 2009: US\$468m) and impaired (2010: US\$29m; 2009: US\$460m).
- 30 Impaired loans and advances are those classified as CRR 9, CRR 10, EL 9 or EL 10 and all retail loans 90 days or more past due, unless individually they have been assessed as not impaired (see page 117, 'Past due but not impaired gross financial instruments').

Report of the Directors: Operating and Financial Review (continued)

- 31 Collectively assessed loans and advances comprise homogeneous groups of loans that are not considered individually significant, and loans subject to individual assessment where no impairment has been identified on an individual basis, but on which a collective impairment allowance has been calculated to reflect losses which have been incurred but not yet identified.
- 32 Collectively assessed loans and advances not impaired are those classified as CRR1 to CRR8 and EL1 to EL8 but excluding retail loans 90 days past due.
- 33 Net of repo transactions, settlement accounts and stock borrowings.
- 34 As a percentage of loans and advances to banks and loans and advances to customers, as applicable.
- 35 Includes movement in impairment allowances against banks.
- 36 See table below 'Net loan impairment charge to the income statement by geographical region'.
- 37 Collectively assessed impairment allowances are allocated to geographical segments based on the location of the office booking the allowances or provisions. Consequently, the collectively assessed impairment allowances booked in Hong Kong may cover assets booked in branches located outside Hong Kong, principally in Rest of Asia-Pacific, as well as those booked in Hong Kong.
- 38 Total includes holdings of ABSs issued by Freddie Mac and Fannie Mae.
- 39 'Directly held' includes assets held by Solitaire where we provide first loss protection and assets held directly by the Group.
- 40 Impairment charges allocated to capital note holders represent impairments where losses would be borne by external third-party investors in the structures.
- 41 Mortgage-backed securities ('MBS's), asset-backed securities ('ABS's) and collateralised debt obligations ('CDO's).
- 42 High grade assets rated AA or AAA.
- 43 Gains or losses on the net principal exposure (footnote 49) recognised in the income statement as a result of changes in the fair value of the asset.
- 44 Fair value gains and losses on the net principal exposure (footnote 49) recognised in other comprehensive income as a result of the changes in the fair value of available-for-sale assets.
- 45 Realised fair value gains and losses on the net principal exposure (footnote 49) recognised in the income statement as a result of the disposal of assets or the receipt of cash flows from assets.
- 46 Reclassified from equity on impairment, disposal or payment. This includes impairment losses recognised in the income statement in respect of the net principal exposure (footnote 49) of available-for-sale assets. Payments are the contractual cash flows received on the assets.
- 47 The gross principal is the redemption amount on maturity or, in the case of an amortising instrument, the sum of the future redemption amounts through the residual life of the security.
- 48 A credit default swap ('CDS') gross protection is the gross principal of the underlying instrument that is protected by CDSs.
- 49 Net principal exposure is the gross principal amount of assets that are not protected by CDSs. It includes assets that benefit from monoline protection, except where this protection is purchased with a CDS.
- 50 Carrying amount of the net principal exposure.
- 51 Net exposure after legal netting and any other relevant credit mitigation prior to deduction of the credit risk adjustment.
- 52 Cumulative fair value adjustment recorded against exposures to OTC derivative counterparties to reflect their creditworthiness.
- 53 Funded exposures represent the loan amount advanced to the customer, less any fair value write-downs, net of fees held on deposit. Unfunded exposures represent the contractually committed loan facility amount not yet drawn down by the customer, less any fair value write-downs, net of fees held on deposit.

Liquidity and funding

- 54 2009 comparative data have been re-presented in line with the classification used in 2010. This resulted in an increase in the 'On demand' time band of US\$273,078m for 'Loan and other credit-related commitments' and US\$10,450m for 'Financial guarantees and similar contracts'. There was an equivalent reduction across the other time bands.
- 55 Figures provided for HSBC Bank plc and The Hongkong and Shanghai Banking Corporation incorporate all overseas branches. Subsidiaries of these entities are not included unless there is unrestricted transferability of liquidity between the subsidiaries and the parent.
- 56 This comprises our other main banking subsidiaries and, as such, includes businesses spread across a range of locations, in many of which we may require a higher ratio of net liquid assets to customer liabilities to reflect local market conditions.
- 57 Unused committed sources of secured funding for which eligible assets were held.
- 58 Client-originated asset exposures relate to consolidated multi-seller conduits (see page 363). These vehicles provide funding to our customers by issuing debt secured by a diversified pool of customer-originated assets.
- 59 HSBC-managed asset exposures relate to consolidated securities investment conduits, primarily Solitaire and Mazarin (see page 362). These vehicles issue debt secured by ABSs which are managed by HSBC. Of the total contingent liquidity risk under this category, US\$8.1bn was already funded on-balance sheet at 31 December 2010 (2009: US\$7.6bn) leaving a net contingent exposure of US\$17.5bn (2009: US\$21.5bn).
- 60 Other conduit exposures relate to third-party sponsored conduits (see page 364).
- 61 The five largest committed liquidity facilities provided to customers other than facilities to conduits.
- 62 The total of all committed liquidity facilities provided to the largest market sector, other than facilities to conduits.

Market risk

- 63 The structural foreign exchange risk is monitored using sensitivity analysis (see page 351). The reporting of commodity risk is consolidated with foreign exchange risk and is not applicable to non-trading portfolios.
- 64 The interest rate risk on the fixed-rate securities issued by HSBC Holdings is not included in the Group VAR. The management of this risk is described on page 148.
- 65 Credit spread sensitivity is reported separately for insurance operations (see page 165).
- 66 The standard deviation measures the variation of daily revenues about the mean value of those revenues.
- 67 The effect of any month-end adjustments, not attributable to a specific daily market move, is spread evenly over the days in the month in question.
- 68 Trading intent portfolios include positions arising from market-making and position taking.
- 69 Trading credit spread VAR was previously reported in the Group trading credit VAR. See page 148.
- 70 The total VAR is non-additive across risk types due to diversification effects. It incorporates credit spread VAR.

Report of the Directors: Operating and Financial Review (continued)

- 71 *Investments in private equity are primarily made through managed funds that are subject to limits on the amount of investment. Potential new commitments are subject to risk appraisal to ensure that industry and geographical concentrations remain within acceptable levels for the portfolio as a whole. Regular reviews are performed to substantiate the valuation of the investments within the portfolio.*
- 72 *Investments held to facilitate ongoing business include holdings in government-sponsored enterprises and local stock exchanges.*
- 73 *Instead of assuming that all interest rates move together, HSBC groups its interest rate exposures into currency blocs whose rates are considered likely to move together.*

Risk management of insurance operations

- 74 *HSBC has no insurance manufacturing subsidiaries in the Middle East.*
- 75 *Insurance contracts and investment contracts with discretionary participation features ('DPF') can give policyholders the contractual right to receive, as a supplement to their guaranteed benefits, additional benefits that may be a significant portion of the total contractual benefits, but whose amount and timing are determined by HSBC. These additional benefits are contractually based on the performance of a specified pool of contracts or assets, or the profit of the company issuing the contracts.*
- 76 *Although investment contracts with DPF are financial investments, HSBC continues to account for them as insurance contracts as permitted by IFRS 4.*
- 77 *Net written insurance premiums represent gross written premiums less gross written premiums ceded to reinsurers.*
- 78 *Term assurance includes credit life insurance.*
- 79 *Other assets comprise shareholder assets.*
- 80 *Present value of in-force long-term insurance contracts and investment contracts with DPF.*
- 81 *Does not include associated insurance companies, Ping An Insurance, SABB Takaful Company and Bao Viet, or joint venture insurance companies, Hana Life and Canara HSBC Oriental Bank of Commerce Life Insurance Company Limited.*
- 82 *Does not include associated insurance companies, Ping An Insurance and SABB Takaful Company or joint venture insurance companies, Hana Life and Canara HSBC Oriental Bank of Commerce Life Insurance Company Limited.*
- 83 *Comprise life linked insurance contracts and linked long-term investment contracts.*
- 84 *Comprise life non-linked insurance contracts and non-linked long-term investment contracts.*
- 85 *Comprises non-life insurance contracts.*
- 86 *Comprise mainly loans and advances to banks, cash and intercompany balances with other non-insurance legal entities.*
- 87 *The table excludes contracts where the risk is 100% reinsured.*
- 88 *Impairment is not measured for debt securities held in trading portfolios or designated at fair value, as assets in such portfolios are managed according to movements in fair value, and the fair value movement is taken directly to the income statement. Consequently, we report all such balances under 'neither past due nor impaired'.*
- 89 *Shareholders' funds comprise solvency and unencumbered assets.*
- 90 *In most cases, policyholders have the option to terminate their contracts at any time and receive the surrender values of their policies. These may be significantly lower than the amounts shown above.*
- 91 *Value of net new business during the year is the present value of the projected stream of profits from the business.*
- 92 *Experience variances include the effect of the difference between demographic, expense and persistency assumptions used in the previous PVIF calculation and actual experience observed during the year.*

Pension risk

- 93 *In 2010, alternative assets include ABSs, MBSs and infrastructure assets. In 2006, alternative assets included loans and infrastructure assets.*

Report of the Directors: Operating and Financial Review (continued)

Capital

Capital management

(Audited)

Our approach to capital management is driven by our strategic and organisational requirements, taking into account the regulatory, economic and commercial environment in which we operate.

It is our objective to maintain a strong capital base to support the development of our business and to meet regulatory capital requirements at all times. To achieve this, our policy is to hold capital in a range of different forms and from diverse sources, and all capital raising is agreed with major subsidiaries as part of their individual and the Group's overall capital management processes.

Our policy is underpinned by a capital management framework, which enables us to manage our capital in a consistent and aligned manner. The framework, which is approved by the GMB, incorporates a number of different capital measures including market capitalisation, invested capital, economic capital and regulatory capital.

Capital measures

- market capitalisation is the stock market value of the company;
- invested capital is the equity capital invested in HSBC by our shareholders;
- economic capital is the internally calculated capital requirement which we deem necessary to support the risks to which we are exposed at a confidence level consistent with a target credit rating of AA; and
- regulatory capital is the capital which we are required to hold in accordance with the rules established by the FSA for the consolidated Group and by our local regulators for individual Group companies.

The following risks managed through the capital management framework have been identified as material: credit, market, operational, interest rate risk in the banking book, pension fund, insurance and residual risks.

We incorporate stress testing in the capital management framework, and it is important in understanding the sensitivities of the core assumptions in our capital plans to the adverse effect of extreme, but plausible, events. Stress testing allows us to formulate our response, including risk mitigation actions, in advance of conditions starting to exhibit the stress scenarios identified. The actual market stresses which occurred throughout the financial system during recent years have been used

to inform our capital planning process and further develop the stress scenarios we employ.

In addition to our internal stress tests, others are carried out, both at the request of regulators and by the regulators themselves using their prescribed assumptions. We take into account the results of all such regulatory stress testing when undertaking our internal capital management assessment.

The responsibility for global capital allocation principles and decisions rests with the GMB. Through our structured internal governance processes, we maintain discipline over our investment and capital allocation decisions and seek to ensure that returns on investment are adequate after taking account of capital costs. Our strategy is to allocate capital to businesses on the basis of their economic profit generation, regulatory and economic capital requirements and cost of capital.

Our capital management process is articulated in the annual Group capital plan which is approved by the Board. The plan is drawn up with the objective of maintaining both an appropriate amount of capital and an optimal mix between the different components of capital. HSBC Holdings and its major subsidiaries raise non-equity tier 1 capital and subordinated debt in accordance with our guidelines on market and investor concentration, cost, market conditions, timing, effect on composition and maturity profile. Each of the subsidiaries manages its own capital to support its planned business growth and meet its local regulatory requirements within the context of the approved annual Group capital plan. In accordance with our capital management framework, capital generated by subsidiaries in excess of planned requirements is returned to HSBC Holdings, normally by way of dividends.

HSBC Holdings is the primary provider of capital to its subsidiaries and these investments are substantially funded by HSBC Holdings' own capital issuance and profit retention. As part of its capital management process, HSBC Holdings seeks to maintain a prudent balance between the composition of its capital and that of its investment in subsidiaries.

The tier 1 ratio (unaudited) increased to 12.1% at 31 December 2010 (2009: 10.8%). It is our belief that this enhanced ratio is appropriate in light of our current evolution of the regulatory framework.

Report of the Directors: Operating and Financial Review (continued)

Capital measurement and allocation

(Unaudited)

The FSA supervises HSBC on a consolidated basis and therefore receives information on the capital adequacy of, and sets capital requirements for, the Group as a whole. Individual banking subsidiaries are directly regulated by their local banking supervisors, who set and monitor their capital adequacy requirements.

We calculate capital at a Group level using the Basel II framework of the Basel Committee on Banking Supervision. However, local regulators are at different stages of implementation and local reporting may still be on a Basel I basis, notably in the US. In most jurisdictions, non-banking financial subsidiaries are also subject to the supervision and capital requirements of local regulatory authorities.

Basel II is structured around three ‘pillars’: minimum capital requirements, supervisory review process and market discipline. The Capital Requirements Directive (‘CRD’) implemented Basel II in the EU and the FSA then gave effect to the CRD by including the latter’s requirements in its own rulebooks.

Regulatory capital

Our capital is divided into two tiers:

- tier 1 capital is divided into core tier 1 and other tier 1 capital. Core tier 1 capital comprises shareholders’ equity and related non-controlling interests. The book values of goodwill and intangible assets are deducted from core tier 1 capital and other regulatory adjustments are made for items reflected in shareholders’ equity which are treated differently for the purposes of capital adequacy. Qualifying capital instruments such as non-cumulative perpetual preference shares and hybrid capital securities are included in other tier 1 capital; and
- tier 2 capital comprises qualifying subordinated loan capital, related non-controlling interests, allowable collective impairment allowances and unrealised gains arising on the fair valuation of equity instruments held as available for sale. Tier 2 capital also includes reserves arising from the revaluation of properties.

To ensure the overall quality of the capital base, the FSA’s rules set limits on the amount of hybrid capital instruments that can be included in tier 1 capital relative to core tier 1 capital, and also limits overall tier 2 capital to no more than tier 1 capital.

Regulatory and accounting consolidations

The basis of consolidation for financial accounting purposes is described on page 251 and differs from that used for regulatory purposes. Investments in banking associates are equity accounted in the financial accounting consolidation, whereas their exposures are proportionally consolidated for regulatory purposes. Subsidiaries and associates engaged in insurance and non-financial activities are excluded from the regulatory consolidation and are deducted from regulatory capital. The regulatory consolidation does not include SPEs where significant risk has been transferred to third parties. Exposures to these SPEs are risk-weighted as securitisation positions for regulatory purposes.

Pillar 1 capital requirements

Pillar 1 covers the capital resources requirements for credit risk, market risk and operational risk. Credit risk includes counterparty credit risk and securitisation requirements. These requirements are expressed in terms of risk-weighted assets (‘RWA’s).

Credit risk capital requirements

Basel II applies three approaches of increasing sophistication to the calculation of pillar 1 credit risk capital requirements. The most basic, the standardised approach, requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties and group other counterparties into broad categories and apply standardised risk weightings to these categories. The next level, the internal ratings-based (‘IRB’) foundation approach, allows banks to calculate their credit risk capital requirements on the basis of their internal assessment of the probability that a counterparty will default (‘PD’), but subjects their quantified estimates of exposure at default (‘EAD’) and loss given default (‘LGD’) to standard supervisory parameters. Finally, the IRB advanced approach allows banks to use their own internal assessment in both determining PD and quantifying EAD and LGD.

The capital resources requirement, which is intended to cover unexpected losses, is derived from a formula specified in the regulatory rules, which incorporates these factors and other variables such as maturity and correlation. Expected losses under the IRB approaches are calculated by multiplying PD by EAD and LGD. Expected losses are deducted from capital to the extent that they exceed accounting impairment allowances.

For credit risk, with the FSA’s approval, we have adopted the IRB advanced approach for the majority of our business, with the remainder on either IRB foundation or standardised approaches.

Report of the Directors: Operating and Financial Review (continued)

For consolidated group reporting, the FSA's rules permit the use of other regulators' standardised approaches where they are considered equivalent. The use of other regulators' IRB approaches is subject to the agreement of the FSA. Under our Basel II rollout plans, a number of our Group companies and portfolios are in transition to advanced IRB approaches. At December 2010, portfolios in much of Europe, Hong Kong, Rest of Asia-Pacific and North America were on advanced IRB approaches. Others remain on the standardised or foundation approaches under Basel II, pending definition of local regulations or model approval, or under exemptions from IRB treatment.

Counterparty credit risk

Counterparty credit risk arises for OTC derivatives and securities financing transactions. It is calculated in both the trading and non-trading books and is the risk that the counterparty to a transaction may default before completing the satisfactory settlement of the transaction. Three approaches to calculating counterparty credit risk and determining exposure values are defined by Basel II: standardised, mark-to-market and internal model method. These exposure values are used to determine capital requirements under one of the credit risk approaches: standardised, IRB foundation and IRB advanced.

We use the mark-to-market and internal model method approaches for counterparty credit risk. Our longer-term aim is to migrate more positions from the mark-to-market to the internal model method approach.

Securitisation

Basel II specifies two methods for calculating credit risk requirements for securitisation positions in the non-trading book, being the standardised and IRB approaches. Both approaches rely on the mapping of rating agency credit ratings to risk weights, which range between 7% and 1,250%. Positions that would otherwise be weighted at 1,250% are deducted from capital.

Within the IRB approach, we use the Ratings Based Method for the majority of our non-trading book securitisation positions, and the Internal Assessment Approach for unrated liquidity facilities and programme-wide enhancements for asset-backed securitisations. We use the IRB approach for the majority of our non-trading book securitisation positions, while those in the trading book are treated like other market risk positions.

Market risk capital requirement

The market risk capital requirement is measured, with FSA permission, using VAR models, or the standard rules prescribed by the FSA.

We use both VAR and standard rules approaches for market risk. Our aim is to migrate more positions from standard rules to VAR.

Operational risk capital requirement

Basel II includes a capital requirement for operational risk, again utilising three levels of sophistication. The capital required under the basic indicator approach is a simple percentage of gross revenues, whereas under the standardised approach it is one of three different percentages of gross revenues allocated to each of eight defined business lines. Both these approaches use an average of the last three financial years' revenues. Finally, the advanced measurement approach uses banks' own statistical analysis and modelling of operational risk data to determine capital requirements.

We have adopted the standardised approach in determining our operational risk capital requirements.

Pillar 2 capital requirements

The second pillar of Basel II (Supervisory Review and Evaluation Process) involves both firms and regulators taking a view on whether a firm should hold additional capital against risks not covered in pillar 1. Part of the pillar 2 process is the Internal Capital Adequacy Assessment Process which is the firm's self assessment of the levels of capital that it needs to hold. The pillar 2 process culminates in the FSA providing firms with Individual Capital Guidance ('ICG'). The ICG is set as a capital resources requirement higher than that required under pillar 1. In 2011, this will be supplemented by an additional Capital Planning Buffer, set by the FSA, to cover capital demand should economic conditions worsen considerably against the current outlook.

Pillar 3 disclosure requirements

Pillar 3 of Basel II is related to market discipline and aims to make firms more transparent by requiring them to publish specific, prescribed details of their risks, capital and risk management under the Basel II framework. Our pillar 3 disclosures for the year ended 31 December 2010 are published as a separate document on the Group Investor Relations website.

Report of the Directors: Operating and Financial Review (continued)

Capital structure at 31 December

	2010 US\$m	2009 US\$m
Composition of regulatory capital		
<i>(Audited)</i>		
Tier 1 capital		
Shareholders' equity	142,746	135,252
Shareholders' equity per balance sheet ¹	147,667	128,299
Preference share premium	(1,405)	(1,405)
Other equity instruments	(5,851)	(2,133)
Deconsolidation of special purpose entities ²	2,335	10,491
Non-controlling interests	3,917	3,932
Non-controlling interest per balance sheet	7,248	7,362
Preference share non-controlling interests	(2,426)	(2,395)
Non-controlling interest transferred to tier 2 capital	(501)	(678)
Non-controlling interest in deconsolidated subsidiaries	(404)	(357)
Regulatory adjustments to the accounting basis	1,794	164
Unrealised losses on available-for-sale debt securities ³	3,843	906
Own credit spread	(889)	(1,050)
Defined benefit pension fund adjustment ⁴	1,676	2,508
Reserves arising from revaluation of property and unrealised gains on available-for-sale equities	(3,121)	(2,226)
Cash flow hedging reserve	285	26
Deductions	(32,341)	(33,088)
Goodwill capitalised and intangible assets	(28,001)	(28,680)
50% of securitisation positions	(1,467)	(1,579)
50% of tax credit adjustment for expected losses	241	546
50% of excess of expected losses over impairment allowances	(3,114)	(3,375)
Core tier 1 capital	116,116	106,260
Other tier 1 capital before deductions	17,926	15,798
Preference share premium	1,405	1,405
Preference share non-controlling interests	2,426	2,395
Hybrid capital securities	14,095	11,998
Deductions	(863)	99
Unconsolidated investments ⁵	(1,104)	(447)
50% of tax credit adjustment for expected losses	241	546
Tier 1 capital	133,179	122,157
Tier 2 capital		
Total qualifying tier 2 capital before deductions	52,713	50,075
Reserves arising from revaluation of property and unrealised gains on available-for-sale equities	3,121	2,226
Collective impairment allowances ⁶	3,109	4,120
Perpetual subordinated debt	2,781	2,987
Term subordinated debt	43,402	40,442
Non-controlling interest in tier 2 capital	300	300
Total deductions other than from tier 1 capital	(18,337)	(16,503)
Unconsolidated investments ⁵	(13,744)	(11,547)
50% of securitisation positions	(1,467)	(1,579)
50% of excess of expected losses over impairment allowances	(3,114)	(3,375)
Other deductions	(12)	(2)
Total regulatory capital	167,555	155,729
Risk-weighted assets		
<i>(Unaudited)</i>		
Credit risk	890,696	903,518
Counterparty credit risk	50,175	51,892
Market risk	38,679	51,860
Operational risk	123,563	125,898
Total	1,103,113	1,133,168

Report of the Directors: Operating and Financial Review (continued)

	2010 %	2009 %
Capital ratios		
<i>(Unaudited)</i>		
Core tier 1 ratio	10.5	9.4
Tier 1 ratio	12.1	10.8
Total capital ratio	15.2	13.7

For footnotes, see page 182.

Source and application of tier 1 capital

	2010 US\$m	2009 US\$m
Movement in tier 1 capital		
<i>(Audited)</i>		
Opening tier 1 capital	122,157	95,336
Contribution to tier 1 capital from profit for the year	13,218	10,247
Consolidated profits attributable to shareholders of the parent company	13,159	5,834
Removal of own credit spread net of tax	59	4,413
Net dividends	(3,827)	(3,969)
Dividends	(6,350)	(5,639)
Add back: shares issued in lieu of dividends	2,523	1,670
Decrease/(increase) in goodwill and intangible assets deducted	679	(1,819)
Ordinary shares issued	180	18,399
Rights issue (net of expenses) ⁷	–	18,326
Other	180	73
Hybrid capital securities issued net of redemptions	2,368	–
Foreign currency translation differences	(526)	4,837
Other	(1,070)	(874)
Closing tier 1 capital	133,179	122,157
Movement in risk-weighted assets		
<i>(Unaudited)</i>		
At 1 January	1,133,168	1,147,974
Movements	(30,055)	(14,806)
At 31 December	1,103,113	1,133,168

For footnotes, see page 182.

Movement in tier 1 capital

(Audited)

HSBC complied with the FSA's capital adequacy requirements throughout 2010 and 2009. Profits attributable to shareholders of the parent company increased capital by US\$13.2bn, offset by net dividends of US\$3.8bn after taking account of shares issued in lieu of dividends. Hybrid capital securities issued, net of redemptions, increased tier 1 capital by US\$2.4bn.

Movement in risk-weighted assets

(Unaudited)

RWAs decreased by US\$30.1bn or 3% in 2010. Of this reduction, US\$12.8bn was due to credit risk, reflecting decreases in North America and Europe offset by increases in Asia and Latin America. There has been a decline in some North American retail portfolio exposures as a result of run off. However, the deterioration in the US economy and housing market in recent years has resulted in increases in the

average risk weighting applicable to those portfolios as we progressively captured the effects of these events within the various Basel II model parameters. Market risk RWAs decreased by US\$13.2bn, primarily due to reduced market volatility and continuing exposure management.

Future developments

(Unaudited)

The regulation and supervision of financial institutions continues to undergo significant change in response to the global financial crisis. In December 2010, the Basel Committee issued final rules in two documents: *A global regulatory framework for more resilient banks and banking systems* and *International framework for liquidity risk measurement, standards and monitoring*, which together are commonly referred to as 'Basel III'. The new minimum capital requirements will be phased in from 1 January 2013, with full implementation required by 1 January 2019. The minimum common

Report of the Directors: Operating and Financial Review (continued)

equity tier 1 requirement of 4.5% and additional capital conservation buffer requirement of 2.5% will be phased in sequentially from 1 January 2013, becoming fully effective on 1 January 2019. Any additional countercyclical capital buffer requirements will also be phased in, starting in 2016, in parallel with the capital conservation buffer to a maximum level of 2.5% effective on 1 January 2019, although individual jurisdictions may choose to implement larger countercyclical capital buffers. The leverage ratio will be subject to a supervisory monitoring period, which commenced on 1 January 2011, and a parallel run period which will run from 1 January 2013 until 1 January 2017. Further calibration of the leverage ratio will be carried out in the first half of 2017, with a view to migrating to a pillar 1 requirement from 1 January 2018. The Basel Committee has increased the capital requirements for the trading book and complex securitisation exposures which are due to be implemented on 31 December 2011. They will continue to conduct the fundamental review of the trading book, which is targeted for completion by the end of 2011. In addition to the reforms discussed above, institutions designated as G-SIFIs may be subjected to additional requirements, which have yet to be proposed by regulators. The Basel Committee will provide the approach to defining G-SIFIs by the end of 2011. On 13 January 2011, the Basel Committee issued further minimum requirements to ensure that all classes of capital instruments fully absorb losses at the point of non-viability before taxpayers are exposed to loss. Instruments issued on or after 1 January 2013 may only be included in regulatory capital if the new requirements are met. The capital treatment of securities issued prior to this date will be phased out over a 10-year period commencing 1 January 2013.

Impact of Basel III (Unaudited)

In order to provide some insight into the possible effects of the new Basel III rules on HSBC, we have estimated the pro forma common equity tier 1 ratio of the Group on the basis of our interpretation of those rules, as they would apply at 1 January 2019, but based on the position at 31 December 2010.

Footnotes to Capital

- 1 Includes externally verified profits for the year to 31 December 2010.
- 2 Mainly comprises unrealised losses on available-for-sale debt securities within special purpose entities which are excluded from the regulatory consolidation.
- 3 Under FSA rules, unrealised gains/losses on debt securities net of tax must be excluded from capital resources.
- 4 Under FSA rules, the defined benefit liability may be substituted with the additional funding that will be paid into the relevant schemes over the following five year period.
- 5 Mainly comprise investments in insurance entities.
- 6 Under FSA rules, collective impairment allowances on loan portfolios on the standardised approach are included in tier 2 capital.
- 7 Rights issue excludes US\$493m of losses arising on derivative contracts and certain fees, which are recognised in the income statement.

We have estimated that the application of the full Basel III rules on a pro forma basis would result in a common equity tier 1 ratio which is lower than the Basel II core tier 1 ratio by some 250—300 basis points. However, as the new rules will be phased in between 1 January 2013 and 1 January 2019, their impact will be gradual over that period. This estimate does not, however, take account of any future retained earnings, nor any management actions to reduce RWAs. The Basel III changes relate to increased capital deductions, new regulatory adjustments and increases in RWAs. The majority of the increase in RWAs relates to Basel III changes which are scheduled to come into effect on 1 January 2013, in particular to changes to counterparty credit risk capital charges and amounts for securitisation positions that were previously deducted from capital that will now be risk-weighted instead. Other increases in RWAs will begin to be phased in from 1 January 2014, including the majority of the unconsolidated investments that were previously deducted from capital. The remainder of the RWA increase arises from increases in trading book capital requirements which take effect on 31 December 2011, primarily relating to changes in market risk.

The estimated impact of Basel III is subject to change as regulators develop their requirements around the practical application and interpretation of the new rules, in particular the counterparty credit risk capital charge. Further uncertainty remains regarding any capital requirements which may be imposed on the Group over the period to 1 January 2019 in respect of the countercyclical capital buffer and any additional regulatory requirements for G-SIFIs. Under the Basel III rules as they will apply from 1 January 2019, we believe that ultimately the level for the common equity tier 1 ratio of the Group may lie in the range 9.5% to 10.5%. This exceeds the minimum requirement for common equity tier 1 capital plus the capital conservation buffer. HSBC has a strong track record of capital generation and actively manages its RWAs. Before these new rules come into force, we will take appropriate management action over the implementation period to 1 January 2019 to reduce the quantum of increase in RWAs that would have occurred if the new rules had been in effect at 31 December 2010.

Report of the Directors: Governance

Governance

Corporate Governance Report	183
Directors	183
Secretary	187
Adviser to the Board	187
Group Managing Directors	187
Board of Directors	189
The Board	189
Corporate governance codes	194
Board committees	194
Group Management Board	194
Group Audit Committee	195
Group Risk Committee	197
Remuneration Committee	201
Nomination Committee	201
Corporate Sustainability Committee	202
Internal control	202
Going concern basis	204
Directors' interests	204
Employees	206
Employment of disabled persons	207
Remuneration policy	207
Employee share plans	207
Subsidiary company share plans	209
Employee compensation and benefits	211
Bank payroll tax	212
Corporate sustainability	212
Sustainability governance	213
Sustainability risk	213
Health and safety	214
Supplier payment policy	214
Share capital	214
Issued share capital	214
Rights and obligations attaching to shares	214
Share capital during 2010	216
Dividends, shareholders and meetings	217
Dividends for 2010	217
Dividends for 2011	218
Communication with shareholders	218
Notifiable interests in share capital	218
Dealings in HSBC Holdings shares	218
Annual General Meeting	219

Corporate Governance Report

The statement of corporate governance practices set out on pages 183 to 233 constitutes the Corporate Governance Report of HSBC Holdings.

Directors

D J Flint, CBE, Group Chairman

Age 55. Group Chairman and chairman of the Nomination Committee with effect from 3 December 2010. Joined HSBC as Group Finance Director in 1995 and served as Chief Financial Officer, Executive Director, Risk and Regulation from 1 February 2010 until 3 December 2010. A non-executive director of BP p.l.c. since January 2005 and chairman of its Audit Committee since April 2010 but will retire at the BP AGM in April 2011. Director of The Hong Kong Association with effect from 6 February 2011. Co-chairman of the Counterparty Risk Management Policy Group III in 2008. Chaired the Financial Reporting Council's review of the Turnbull Guidance on Internal Control in 2004. Served on the Accounting Standards Board and the Standards Advisory Council of the International Accounting Standards Board from 2001 to 2004. Served on the Large Business Forum on Tax and Competitiveness and the Consultative Committee of the Large Business Advisory Board of HM Revenue and Customs. A former partner in KPMG.

Mr Flint has extensive governance experience gained through membership of the Boards of HSBC and BP as well as considerable knowledge of finance and risk management in banking, multinational financial reporting, treasury and securities trading operations. In 2006 he was honoured with a CBE in recognition of his services to the finance industry. He is a member of the Institute of Chartered Accountants of Scotland and the Association of Corporate Treasurers and he is a Fellow of The Chartered Institute of Management Accountants.

S T Gulliver, Group Chief Executive

Age 51. Group Chief Executive and chairman of the Group Management Board since 1 January 2011. An executive Director since 2008. Joined HSBC in 1980. Appointed a Group General Manager in 2000 and a Group Managing Director in 2004. Chairman of The Hongkong and Shanghai Banking Corporation Limited with effect from 1 January 2011. Chairman of HSBC France since January 2009 and of HSBC Private Banking Holdings (Suisse) SA since 25 February 2010. Deputy chairman of HSBC Trinkaus & Burkhardt AG since 2007 and a member of its Supervisory Board since 2006. Chairman, Europe, Middle East and Global Businesses until 31 December 2010. Chairman of HSBC Bank plc from 21 April 2010 to 31 December 2010 and of HSBC Bank Middle East Limited from 15 February 2010 to 31 December 2010. Head of Global Banking and Markets from 2006 to 2010 and co-head from 2003 to 2006. Head of Global Markets from 2002 to 2003. Head of Treasury and Capital Markets in Asia-Pacific from 1996 to 2002.

Report of the Directors: Governance (continued)

Mr Gulliver is a career banker with over 30 years' international experience with HSBC. He has held a number of key roles in the Group's operations worldwide, including in London, Hong Kong, Tokyo, Kuala Lumpur and the United Arab Emirates. He played a leading role in developing and expanding Global Banking and Markets, the wholesale banking division of the Group with operations in over 65 countries and territories.

† S A Catz

Age 49. President of Oracle Corporation. A non-executive Director since 2008. Managing Director of Donaldson, Lufkin & Jenrette from 1997 to 1999. Joined Oracle in 1999 and appointed to the Board of Directors in 2001.

Ms Catz brings to the Board a background in international business leadership, having helped transform Oracle into the second biggest producer of management software and the world's leading supplier of software for information management.

† L M L Cha, GBS (Appointed 1 March 2011)

Age 61. Non-executive Deputy Chairman of The Hongkong and Shanghai Banking Corporation Limited. A non-executive Director with effect from 1 March 2011. A non-official member of the Executive Council of Hong Kong SAR. Director of Hong Kong Exchanges and Clearing Limited, Tata Consultancy Services Limited and China Telecom Corporation Limited. Chairman of the ICAC Advisory Committee on Corruption and of the University Grants Committee in Hong Kong. Vice-chairman of the International Advisory Council of the China Securities Regulatory Commission and a Hong Kong delegate to the 11th National People's Congress of China. A member of the Advisory Board of the Yale School of Management, and Millstein Center of Corporate Governance and Performance at Yale University and a Senior International Advisor for Foundation Asset Management Sweden AG. Former appointments include: non-executive director of Bank of Communications Co., Ltd from 2006 to 19 August 2010, Baoshan Iron and Steel Co. Limited and Johnson Electric Holdings Limited. A member of the State Bar of California. She was awarded a Silver Bauhinia Star in 2001 and a Gold Bauhinia Star in 2009 by the Hong Kong Government for her public service.

Mrs Cha has worked in the US and Asia and has extensive regulatory and policy making experience in the finance and securities sector in Hong Kong and mainland China. Mrs Cha was Vice Chairman of the China Securities Regulatory Commission ('CSRC') from January 2001 to September 2004. She was appointed to the post by the State Council and became the first person outside mainland China to join the Central Government of the People's Republic of China at the vice-ministerial rank. Prior to her post at the CSRC, Mrs Cha worked in the Securities and Futures Commission in Hong Kong from 1991 to 2000, becoming its Deputy Chairman in 1998.

V H C Cheng, GBS, OBE

Age 62. Chairman of HSBC Bank (China) Company Limited and, since 21 January 2010, of HSBC Bank (Taiwan) Limited. An executive Director since 2008 and a member of the Corporate Sustainability Committee since 28 May 2010. Joined HSBC in 1978. Appointed a Group General Manager in 1995 and a Group Managing Director in 2005. An independent non-executive director of Great Eagle Holdings Limited and MTR Corporation Limited. Vice chairman of the China Banking Association. A member of the National Committee of the 11th Chinese People's Political Consultative Conference ('CPPCC') and a senior adviser to the 11th Beijing Municipal Committee of the CPPCC. Ceased to be chairman and a director of The Hongkong and Shanghai Banking Corporation Limited on 1 February 2010 and of HSBC Global Asset Management (Hong Kong) Limited on 4 February 2010. Ceased to be a director of HSBC Bank Australia Limited and a member of the Exchange Fund Advisory Committee of the Hong Kong Monetary Authority on 1 February 2010 and of HSBC Bank (Vietnam) Limited on 11 November 2010. A non-executive director of Swire Pacific Limited from 2005 to 2008. Awarded the Gold Bauhinia Star by the Hong Kong Government in 2005.

Mr Cheng is a career banker with extensive international business experience particularly in Asia. Mr Cheng is Vice President of the Hong Kong Institute of Bankers and was chairman of the Process Review Panel for the Securities and Futures Commission and of the Standing Committee on Directorate Salaries and Conditions of Service of the Hong Kong Government. Chairman of the Council of the Chinese University of Hong Kong since October 2009. He was seconded to the Hong Kong Government's Central Policy Unit from 1989 to 1991 serving as an adviser to the Governor of Hong Kong.

† M K T Cheung, GBS, OBE

Age 63. Non-executive chairman of the Airport Authority Hong Kong. A non-executive Director since February 2009 and a member of the Group Audit Committee since 1 March 2010. A non-executive director of Hang Seng Bank Limited, HKR International Limited and Hong Kong Exchanges and Clearing Limited. A non-official member of the Executive Council of the Hong Kong Special Administrative Region. Non-executive chairman of the Council of the Hong Kong University of Science and Technology. A director of The Association of Former Council Members of The Stock Exchange of Hong Kong Limited and The Hong Kong International Film Festival Society Limited. Ceased to be a non-executive director of Sun Hung Kai Properties Limited in December 2009. Chairman and Chief Executive Officer of KPMG Hong Kong from

Report of the Directors: Governance (continued)

1996 to 2003. A Council Member of the Open University of Hong Kong until June 2009. Awarded the Gold Bauhinia Star by the Hong Kong Government in 2008.

Dr Cheung brings to the Board a background in international business and financial accounting, particularly in Greater China and the wider Asian economy. He retired from KPMG Hong Kong in 2003 after more than 30 years' distinguished service with the firm. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

† J D Coombe

Age 65. Non-executive chairman of Hogg Robinson Group plc. A non-executive Director since 2005 and chairman of the Group Audit Committee since 30 July 2010. A member of the Remuneration Committee and, since 26 February 2010, of the Group Risk Committee. A non-executive director of Home Retail Group plc. A trustee of the Royal Academy Trust. Former appointments include: executive director and Chief Financial Officer of GlaxoSmithKline plc; non-executive director of GUS plc; a member of the Supervisory Board of Siemens AG; chairman of The Hundred Group of Finance Directors, and a member of the Accounting Standards Board.

Mr Coombe brings to the Board a background in international business, financial accounting and the pharmaceutical industry. As Chief Financial Officer of GlaxoSmithKline he had responsibility for the Group's financial operations globally. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

† R A Fairhead

Age 49. Chairman, Chief Executive Officer and a director of Financial Times Group Limited. A non-executive Director since 2004. Chairman of the Group Risk Committee since 26 February 2010. A member of the Group Audit Committee, having ceased to be chairman on 30 July 2010. A member of the Nomination Committee. A director of Pearson plc and a non-executive director of The Economist Newspaper Limited. A director of the UK Cabinet Office since 16 December 2010. Ceased to be chairman and a director of Interactive Data Corporation on 30 July 2010. Former appointments include Executive Vice President, Strategy and Group Control of Imperial Chemical Industries plc and Finance Director of Pearson plc.

Mrs Fairhead brings to the Board a background in international industry, publishing, finance and general management. As the former Finance Director of Pearson plc she oversaw the day to day running of the finance function and was directly responsible for global financial reporting and control, tax and treasury. She has a Master's in Business Administration from the Harvard Business School.

A A Flockhart, CBE

Age 59. Chairman, Europe, Middle East, Africa, Latin America, Commercial Banking and Chairman of HSBC Bank plc with effect from 1 January 2011. An executive Director since 2008. Joined HSBC in 1974. Appointed a Group General Manager in 2002 and a Group Managing Director in 2006. Chairman of HSBC Latin America Holdings (UK) Limited since December 2009. A director of HSBC Bank Australia Limited. A member of the Visa Asia Pacific Senior Advisory Council, Visa Inc. Chairman, Personal and Commercial Banking and Insurance until 31 December 2010. Chairman of HSBC Bank Malaysia Berhad from 2007 to 5 February 2010. Chief Executive Officer of The Hongkong and Shanghai Banking Corporation Limited from 2007 to 1 February 2010. Ceased to be a director of HSBC Bank (China) Company Limited on 28 February 2010 and of Hang Seng Bank Limited on 31 December 2010. Ceased to be vice chairman and a director of HSBC Bank (Vietnam) Limited on 16 June 2010. President and Group Managing Director Latin America and the Caribbean from 2006 to 2007. Chief Executive Officer, Mexico from 2002 to 2006. Senior Executive Vice-President, Commercial Banking, HSBC Bank USA, N.A. from 1999 to 2002. Managing Director of The Saudi British Bank from 1997 to 1999.

Mr Flockhart is a career banker, being an emerging markets specialist with over 35 years' experience with HSBC across Latin America, the Middle East, US and Asia. In 2007 he was honoured with a CBE in recognition of his services to British business and charitable services and institutions in Mexico.

† J W J Hughes-Hallett, SBS

Age 60. Chairman of John Swire & Sons Limited. A non-executive Director since 2005. A member of the Nomination Committee and, since 26 February 2010, of the Group Risk Committee. A member of the Group Audit Committee until 1 March 2010. A non-executive director and former chairman of Cathay Pacific Airways Limited and Swire Pacific Limited. A non-executive director of The Hongkong and Shanghai Banking Corporation Limited from 1999 to 2004. A trustee of the Dulwich Picture Gallery and the Esmée Fairbairn Foundation. A member of The Hong Kong Association and the Governing Board of the Courtauld Institute of Art. Awarded the Silver Bauhinia Star by the Hong Kong Government in 2004.

Mr Hughes-Hallett brings to the Board a background in financial accounting and the management of a broad range of businesses in a number of international industries, including aviation, insurance, property, shipping, manufacturing and trading in the Far East, UK, US and Australia. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

Report of the Directors: Governance (continued)

† W S H Laidlaw

Age 55. Chief Executive Officer of Centrica plc. A non-executive Director since 2008. A member of the Remuneration Committee. Former appointments include: Executive Vice President of Chevron Corporation; non-executive director of Hanson PLC; Chief Executive Officer of Enterprise Oil plc; and President and Chief Operating Officer of Amerada Hess Corporation.

Mr Laidlaw brings to the Board significant international experience, particularly in the energy sector, having had responsibility for businesses in four continents. He has a Master's in Business Administration from INSEAD. He is a member of the UK Prime Minister's Business Advisory Group and is the Senior Independent Director of the Department for Transport.

† J R Lomax

Age 65. Former Deputy Governor, Monetary Stability, at the Bank of England and a member of the Monetary Policy Committee. A non-executive Director since 2008. A member of the Group Audit Committee since March 2009 and of the Group Risk Committee since 26 February 2010. A non-executive director of The Scottish American Investment Company PLC and Reinsurance Group of America Inc., and since 7 July 2010, of Arcus European Infrastructure Fund GP LLP. A non-executive director of BAA Limited since 24 November 2010. A director of the Council of Imperial College, London and a member of the Board of the Royal National Theatre. A member of the Business Advisory Group to the UK Secretary of State for Business since 18 May 2010. Former appointments include: Deputy Governor of the Bank of England from 2003 to 2008; Permanent Secretary at the UK Government Departments for Transport and Work and Pensions and at the Welsh Office from 1996 to 2003; and Vice President and Chief of Staff to the President of the World Bank from 1995 to 1996.

Ms Lomax brings to the Board business experience in both the public and private sectors and a deep knowledge of the operation of the UK government and the financial system.

I J Mackay, Group Finance Director

Age 49. An executive Director since 3 December 2010. Joined HSBC in 2007. A Director of Hang Seng Bank Limited until 31 December 2010. Chief Financial Officer, Asia Pacific from September 2009 to 3 December 2010 and Chief Financial Officer, North America from 2007 to September 2009. Former appointments include: Vice President and Chief Financial Officer of GE Consumer Finance and Vice President and Chief Financial Officer of GE Healthcare — Global Diagnostic Imaging.

Mr Mackay has extensive financial and international experience. He has worked in London, Paris, US and Asia. He is a member of the Institute of Chartered Accountants of Scotland.

† G Morgan, CM

Age 65. Non-executive Chairman of SNC-Lavalin Group Inc. A non-executive Director since 2006. A member of the Remuneration Committee. A member of the Board of Trustees of The Fraser Institute and the Manning Centre for Building Democracy. A non-executive director of HSBC Bank Canada from 1996 to 2006. Former appointments include Founding President, Chief Executive Officer and Vice Chairman of EnCana Corporation; director of Alcan Inc.; and director of Lafarge North America, Inc.

Mr Morgan brings to the Board a background in technical, operational, financial and management positions and has led large international companies in the energy and engineering sectors. He has been recognised as Canada's most respected Chief Executive Officer in a national poll of Chief Executives. He is currently a business columnist for Canada's largest national newspaper. He was appointed a Member of the Order of Canada on 30 December 2010 for his contributions as a business and community leader and as a philanthropist.

† N R N Murthy, CBE

Age 64. Chairman and Chief Mentor and former Chief Executive Officer of Infosys Technologies Limited. A non-executive Director since 2008. Chairman of the Corporate Sustainability Committee since 28 May 2010. A director of the United Nations Foundation. Ceased to be a director of Unilever plc on 12 May 2010. Former appointments include: a non-executive director of DBS Group Holdings Limited, DBS Bank Limited and New Delhi Television Limited.

Mr Murthy brings to the Board experience in information technology, corporate governance and education, particularly in India. He founded Infosys Technologies Limited in India in 1981 and was its Chief Executive Officer for 21 years. Under his leadership, Infosys established a global footprint and was listed on NASDAQ in 1999. During his career he has worked in France and India.

† Sir Simon Robertson, Deputy Chairman, senior independent non-executive Director

Age 69. Non-executive chairman of Rolls-Royce Group plc and the founder member of Simon Robertson Associates LLP. A non-executive Director since 2006. Senior independent non-executive Director since 2007 and Deputy Chairman since 1 December 2010. A member of the Nomination Committee. A non-executive director of Berry Bros. & Rudd Limited, The Economist Newspaper Limited and Royal Opera House Covent Garden Limited. A trustee of the Eden Project Trust and of the Royal Opera House Endowment Fund.

Report of the Directors: Governance (continued)

Former appointments include Managing Director of Goldman Sachs International and chairman of Dresdner Kleinwort Benson.

Sir Simon brings to the Board a background in international corporate advisory with a wealth of experience in mergers and acquisitions, merchant banking, investment banking and financial markets. During his career he has worked in France, Germany, the UK and the US. In June 2010 he was honoured with a knighthood in recognition of his services to business.

† J L Thornton

Age 57. A non-executive Director since 2008. Chairman of the Remuneration Committee since 28 May 2010. Non-executive chairman and a director of HSBC North America Holdings Inc since 2008. Professor and director of the Global Leadership Program at the Tsinghua University School of Economics and Management. Chairman of the Brookings Institution Board of Trustees. A non-executive director of Ford Motor Company, News Corporation, Inc. and China Unicom (Hong Kong) Limited. A director of National Committee on United States-China Relations and a Trustee of Asia Society, China Institute, The China Foreign Affairs University, the Palm Beach Civic Association and the United World College of East Africa Trust. A member of the Council on Foreign Relations, the China Securities Regulatory Commission International Advisory Committee and China Reform Forum International Advisory Committee. Former appointments include: a non-executive director of Industrial and Commercial Bank of China Limited from 2005 to 2008; Intel Corporation, Inc. from 2003 to 18 May 2010; and President of the Goldman Sachs Group, Inc. from 1999 to 2003.

Mr Thornton brings to the Board experience that bridges developed and developing economies and the public and private sectors. He has a deep knowledge of financial services and education systems, particularly in Asia. During his 23 year career with Goldman Sachs, he played a key role in the firm's global development and was Chairman of Goldman Sachs Asia.

† Sir Brian Williamson, CBE

Age 66. A non-executive Director since 2002. A member of the Nomination Committee, having ceased to be its chairman on 26 February 2010. A director of NYSE Euronext. Chairman of Electra Private Equity plc until 24 May 2010. Former appointments include: chairman of London International Financial Futures and Options Exchange and Gerrard Group plc; a director of Climate Exchange plc; and a non-executive director of Resolution plc, the Financial Services Authority and the Court of The Bank of Ireland.

Sir Brian brings to the Board extensive experience in money and bond markets, insurance, private equity, futures, options and commodities trading internationally. He established the London International Financial Futures and Options Exchange in the 1980s and led the Exchange's development of its electronic trading platform in the mid-1990s. He was the first chairman of Resolution plc, established to consolidate life assurance business in the UK. He is a member of the Guild for International Bankers.

† Independent non-executive Director

Secretary

R G Barber

Age 60. Group Company Secretary since 1986. Appointed a Group General Manager in 2006. Joined HSBC in 1980. Company Secretary of HSBC Holdings plc since 1990. Chairman of the Disclosure Committee. A member of the Listing Authority Advisory Committee of the Financial Services Authority and of the Primary Markets Group of the London Stock Exchange. Corporation Secretary of The Hongkong and Shanghai Banking Corporation Limited from 1986 to 1992 and Company Secretary of HSBC Bank plc from 1994 to 1996.

Adviser to the Board

D J Shaw

Age 64. An Adviser to the Board since 1998. Solicitor. A former partner in Norton Rose. A director of HSBC Bank Bermuda Limited, HSBC Private Banking Holdings (Suisse) SA and HSBC Private Bank (Suisse) SA. An independent non-executive director of Kowloon Development Company Limited and Shui On Land Limited.

Group Managing Directors

A Almeida

Age 54. Group Head of Human Resources. A Group Managing Director since 2008. Joined HSBC in 1992. Appointed a Group General Manager in 2007. Former appointments include Global Head of Human Resources for Global Banking and Markets, Global Private Banking, Global Transaction Banking and HSBC Amanah from 1996 to 2007.

E Alonso

Age 55. Group Managing Director and Head of HSBC Latin America and the Caribbean. A Group Managing Director since 2008. Joined HSBC in 1997. Appointed a Group General Manager in 2006. Chairman Grupo Financiero HSBC, S.A. de C.V. and HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC. President of the Board of Directors of HSBC Bank (Panamá) S.A. A director

Report of the Directors: Governance (continued)

of HSBC Latin America Holdings (UK) Limited and HSBC Argentina Holdings S.A. A director of HSBC Bank Brasil S.A. — Banco Múltiplo and Managing Director of HSBC Serviços e Participações Ltda from 2004 to 2008. Managing Director of HSBC (Brasil) Administradora de Consorcio Ltda. from 2001 to 2008.

S Assaf

Age 50. Chief Executive, Global Banking and Markets. A Group Managing Director since 1 January 2011. Joined HSBC France in 1994. Appointed a Group General Manager in 2008. A director of HSBC Bank Egypt S.A.E. since 22 June 2010 and a director of HSBC Global Asset Management Limited. Head of Global Markets from 2008 to 31 December 2010. Deputy Head of Global Markets from 2007 to 2008. Head of Global Markets for Europe, Middle East and Africa from 2006 to 2007.

N S K Booker

Age 52. Chief Executive Officer, HSBC North America Holdings Inc. A Group Managing Director since 1 August 2010. Joined HSBC in 1981. Appointed a Group General Manager in 2004. Chairman of HSBC Bank USA, National Association, HSBC Financial Corporation and HSBC USA Inc. since 31 July 2010. Chief Executive Officer of HSBC Finance Corporation from 2008 to July 2010. Deputy Chairman and Chief Executive Officer of HSBC Bank Middle East Limited from 2006 to 2007. Chief Executive Officer, India from 2002 to 2006.

A M Keir

Age 52. Global Head of Commercial Banking. A Group Managing Director since 1 January 2011. Joined HSBC in 1981. Appointed a Group General Manager in 2006. A director of HSBC Bank A.S. Group General Manager, Commercial Banking, Europe and Global Co-Head, Global Commercial Banking from 2008 to 31 December 2010. Global Co-Head of the Group's commercial banking activities from 2003 to 2008.

M M Moses

Age 53. Group Chief Risk Officer. A Group Managing Director since 3 December 2010. Joined HSBC in 2005. Appointed a Group General Manager on 27 May 2010. A director of HSBC Insurance (Bermuda) Limited since 2 December 2010. Chief Financial and Risk Officer, Global Banking and Markets from 2005 to 2 December 2010.

B Robertson

Age 56. Chief Executive, HSBC Bank plc since 3 December 2010. A Group Managing Director since 2008. Joined HSBC in 1975. Appointed a Group General Manager in 2003. Chairman of HSBC Life (UK) Limited and a director of HSBC Bank plc since 3 December 2010. Group Chief Risk Officer from 2007 to 2 December 2010. Group General Manager, Group Credit and Risk from 2005 to 2007 and Head of Global Banking and Markets for North America from 2003 to 2005.

P A Thurston

Age 57. Chief Executive, Retail Banking and Wealth Management with effect from 1 March 2011. A Group Managing Director since 2008. Joined HSBC in 1975. Appointed a Group General Manager in 2003. A director of HSBC Bank plc. Chief Executive of HSBC Bank plc from April 2009 to 3 December 2010. Chairman of HSBC Life (UK) Limited from 24 March 2010 to 30 November 2010.

P T S Wong

Age 59. Chief Executive, The Hongkong and Shanghai Banking Corporation Limited. A Group Managing Director since 1 February 2010. Joined HSBC and appointed a Group General Manager in 2005. Deputy Chairman of HSBC Bank (China) Company Limited. Chairman of HSBC Bank Malaysia Berhad since 5 February 2010. Vice Chairman of HSBC Bank (Vietnam) Ltd since 16 June 2010. A director of Hang Seng Bank Limited, Bank of Communications Co., Ltd. and Ping An Insurance (Group) Company of China, Ltd. A non-executive director of Cathay Pacific Airways Limited. A director of HSBC Bank Australia Limited from 1 February 2010 to 1 February 2011.

Report of the Directors: Governance (continued)

Board of Directors

The Board

The purpose of HSBC's management structures, headed by the Board of Directors of HSBC Holdings (the 'Board') and led by the Group Chairman, is to deliver sustainable value to our shareholders. The Board sets the strategy for the Group and approves the risk appetite, capital and operating plans presented by management for the achievement of the strategic objectives it has set. This ensures the efficient application of our resources for the achievement of these objectives. Implementation of the strategy set by the Board is delegated to the Group Management Board ('GMB') led by the Group Chief Executive.

HSBC Holdings has a unitary Board. The authority of each Director is exercised in Board meetings where the Board acts collectively. At 28 February 2011, the Board comprises the Group Chairman, Group Chief Executive, three other executive Directors and 12 non-executive Directors. Their names and brief biographical particulars are listed on pages 183 to 187. The Group Chairman, Group Chief Executive and three other executive Directors are employees. Non-executive Directors are not HSBC employees and do not participate in the daily business management of HSBC; they bring an external perspective, constructively challenge and help develop proposals on strategy, scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. The non-executive Directors bring experience from a number of industries and business sectors, including the leadership of large complex multinational enterprises. The roles of non-executive Directors as members of Board committees are described on pages 194 to 198 and on pages 201 and 202.

The Board has determined that the time commitment expected of non-executive Directors to be not less than 24 days per annum and not less than 30 days per annum in total for non-executive Directors appointed to the Group Audit Committee, Group Risk Committee or Remuneration Committee and for the Deputy Chairman and senior independent non-executive director. The time commitment of each non-executive Director is set out in the Director's letter of appointment.

The terms and conditions of appointment of non-executive Directors are available for inspection at 8 Canada Square, London E14 5HQ and will be made available for 15 minutes before the Annual General Meeting and during the Meeting itself.

The Board is responsible for managing the business of HSBC Holdings and, in doing so, may exercise its powers, subject to any relevant laws and regulations and to the Articles of Association. In particular, the Board may exercise all the powers of the Company to borrow money and to mortgage or charge all or any part of the undertaking, property or assets (present or future) of HSBC Holdings and may also exercise any of the powers conferred on it by the Companies Act 2006 and/or by shareholders. The Board is able to delegate and confer on certain Directors holding executive office any of its powers, authorities and discretions (including the power to sub-delegate) for such time and on such terms as it thinks fit. In addition, the Board may establish any local or divisional boards or agencies for managing the business of HSBC Holdings in any specified locality and delegate and confer on any local or divisional board, manager or agent so appointed any of its powers, authorities and discretions (including the power to sub-delegate) for such time and on such terms as it thinks fit. The Board may also, by power of attorney or otherwise, appoint any person or persons to be the agent of HSBC Holdings and may delegate to any such person or persons any of its powers, authorities and discretions (including the power to sub-delegate) for such time and on such terms as it thinks fit.

The Board delegates the management and day-to-day running of HSBC to the GMB but retains to itself approval of certain matters including operating plans, risk appetite and performance targets, procedures for monitoring and controlling of operations, the authority or the delegation of authority to approve credit, market risk limits, acquisitions, disposals, investments, capital expenditure or realisation or creation of a new venture, specified senior appointments and any substantial change in balance sheet management policy.

The Directors who served during the year were S A Catz, V H C Cheng, M K T Cheung, J D Coombe, J L Durán (retired 28 May 2010), R A Fairhead, D J Flint, A A Flockhart, W K L Fung (retired 28 May 2010), M F Geoghegan (retired 31 December 2010), Lord Green (retired 3 December 2010), S T Gulliver, J W J Hughes-Hallett, W S H Laidlaw, J R Lomax, I J Mackay (appointed 3 December 2010), Sir Mark Moody-Stuart (retired 28 May 2010), G Morgan, N R N Murthy, Sir Simon Robertson, J L Thornton and Sir Brian Williamson.

HSBC Holdings was registered in Hong Kong under part IX of the Companies Ordinance on 17 January 1991.

Report of the Directors: Governance (continued)

Nine Board meetings and a two-day strategy meeting were held in 2010. At least one Board meeting each year is held in a key strategic location outside the UK. During 2010, a Board meeting was held in Shanghai.

The table below shows each Director's attendance at meetings of the Board, Group Audit Committee, Group Risk Committee, Nomination Committee, Remuneration Committee and Corporate Sustainability Committee held whilst he or she was a Director or member of the relevant committee during 2010. Two meetings of the Board and of the Remuneration Committee were held at short notice. Not all Directors who were entitled to attend were able to attend these meetings.

Attendance record

	Meetings attended in 2010					
	Board	Group Audit Committee	Group Risk Committee ¹	Nomination Committee	Remuneration Committee	Corporate Sustainability Committee
Number of meetings held	9	6	4	3	9	5
S A Catz	8	–	–	–	–	–
V H C Cheng	7	–	–	–	–	1 ²
M K T Cheung	8	4 ³	–	–	–	–
J D Coombe	9	6	4	–	9	–
J L Durán ⁴	2	–	–	–	–	–
R A Fairhead	8	5	3	2	–	–
D J Flint	9	–	–	– ⁵	–	–
A A Flockhart	9	–	–	–	–	–
W K L Fung ⁶	4	–	–	–	–	3
M F Geoghegan	8	–	–	–	–	–
Lord Green ⁷	8	–	–	2	–	–
S T Gulliver	9	–	–	–	–	–
J W J Hughes-Hallett	8	2 ⁸	2	3	–	–
W S H Laidlaw	9	–	–	–	9	–
J R Lomax	8	6	4	–	–	–
I J Mackay ⁹	–	–	–	–	–	–
Sir Mark Moody-Stuart ¹⁰	4	–	–	–	4	2
G Morgan	7	–	–	–	6	–
N R N Murthy	7	–	–	–	–	5
Sir Simon Robertson	9	–	–	3	–	–
J L Thornton	8	–	–	–	9	–
Sir Brian Williamson	8	–	–	3	–	–

1 All members appointed on 26 February 2010 when the Committee was established. All members eligible to attend 4 Committee Meetings.

2 Appointed a member on 28 May 2010 – eligible to attend 2 Committee Meetings.

3 Appointed a member on 1 March 2010 – eligible to attend 4 Committee Meetings.

4 Retired as a Director on 28 May 2010 – eligible to attend 4 Board Meetings.

5 Appointed a member on 3 December 2010 – not eligible to attend any Committee Meetings.

6 Retired as a Director on 28 May 2010 – eligible to attend 4 Board Meetings and 3 Committee Meetings.

7 Appointed a member of the Nomination Committee on 26 February 2010 and retired as a Director on 3 December 2010 – eligible to attend 8 Board Meetings and 2 Committee Meetings.

8 Ceased to be a member on 1 March 2010 – eligible to attend 2 Committee Meetings.

9 Appointed a Director on 3 December 2010 – eligible to attend one Board Meeting.

10 Retired as a Director on 28 May 2010 – eligible to attend 4 Board Meetings, 4 Remuneration Committee Meetings and 3 Corporate Sustainability Committee Meetings.

Report of the Directors: Governance (continued)

Group Chairman and Group Chief Executive

The roles of Group Chairman and Group Chief Executive are separate and held by experienced full-time Directors.

D J Flint succeeded S K Green (who on 22 November 2010 became Lord Green of Hurstpierpoint and is referred to in this document as Lord Green) as Group Chairman on 3 December 2010. S T Gulliver succeeded M F Geoghegan as Group Chief Executive on 1 January 2011.

The appointment of D J Flint, made by a unanimous decision of the Board, was the culmination of a comprehensive succession process begun in the first half of the year under the leadership of the senior independent non-executive Director. When considering the choice of Group Chairman, the Nomination Committee, assisted by an external consultant, took a number of factors into account, including the need to contribute to the unprecedented regulatory and public policy debate on the future shape of the banking industry and, in particular, systemically important financial institutions operating globally with a universal banking model; the full-time demands of this engagement; the personal standing to represent HSBC at the highest levels; a deep understanding and experience of international financial services; and extensive experience of Board governance and stakeholder engagement. The Nomination Committee came to the unanimous conclusion that D J Flint was the best person for the position, meeting all the core criteria and having led our regulatory engagement at Board level through 2010.

S T Gulliver has worked for us throughout his career serving across Asia, in Europe and in the Middle East. The Board considers S T Gulliver ideally qualified for the role of Group Chief Executive. He has built and managed a global business in over 65 countries and has a deep knowledge of and strong reputation in Asia where he worked for over 20 years. S T Gulliver has been responsible for managing complex risks for many years and shepherded and enhanced the Group's liquidity through the economic crisis. He also has had responsibility for all of HSBC's operations in the UK, Europe and the Middle East. As Group Chief Executive, S T Gulliver's principal office is located in Hong Kong.

Sir Simon Robertson became Deputy Chairman with effect from 1 December 2010. As Deputy Chairman his role is to deputise for the Group Chairman at meetings of the Board or shareholders and to support the Group Chairman in his role.

The Board believes strongly that these appointments, which were made by unanimous decision, are in HSBC's best interests. There is a clear division of responsibilities at the head of the Company between the running of the Board and the executive responsibility for running HSBC's business. The Group Chairman's responsibilities include, in addition to the leadership of the Board and ensuring its effectiveness, the development of relationships with governments, regulators and investors; leading the Group's interactions on matters of public policy and regulatory reform with regard to the banking and financial services industry; maintaining corporate reputation and character; and performance management of the Group Chief Executive. Subject to the Group Chief Executive's recommendation, the Group Chairman approves risk, capital allocation and capital investment decisions within authorities delegated by the Board.

The Group Chief Executive has responsibility for developing, and delivering performance against, business plans. He is responsible for developing Group strategy in agreement with the Group Chairman and for recommendation to the Board. As chairman of the GMB, the Group Chief Executive is responsible for driving performance within strategic goals and commercial objectives agreed by the Board.

Board balance and independence of Directors

The Board includes a strong presence of both executive and non-executive Directors and no individual or small group can dominate its decision making. The size of the Board is appropriate given the complexity and geographical spread of our business and the significant time demands placed on the non-executive Directors, particularly those who serve as members of Board committees.

The Nomination Committee regularly reviews the structure, size and composition necessary (including the skills, knowledge and experience required of Directors) to address and challenge adequately key risks and decisions that confront, or may confront, the Board and makes recommendations to the Board with regard to any changes. The Nomination Committee maintains a forward-looking schedule of potential candidates as Directors that takes into account the needs and developments of the Group's businesses and the anticipated retirement dates of existing Directors.

Sir Simon Robertson's role as the senior independent non-executive Director is to act as an intermediary for other non-executive Directors when

Report of the Directors: Governance (continued)

necessary, to lead the non-executive Directors in the oversight of the Group Chairman and to ensure there is a clear division of responsibility between the Group Chairman and Group Chief Executive.

The Board considers all of the non-executive Directors to be independent in character and judgement. The Board has determined S A Catz, L M L Cha, M K T Cheung, J D Coombe, R A Fairhead, J W J Hughes-Hallett, W S H Laidlaw, J R Lomax, G Morgan, N R N Murthy, Sir Simon Robertson, J L Thornton and Sir Brian Williamson to be independent. When determining independence the Board considers that calculation of the length of service of a non-executive Director begins on the date of his or her first election by shareholders as a Director of HSBC Holdings. Given the complexity and geographical spread of our business, the experience of previous service on a subsidiary company board can be a considerable benefit and does not detract from a Director's independence. In reaching its determination of each non-executive Director's independence the Board has concluded that there are no relationships or circumstances which are likely to affect a Director's judgement and any relationships or circumstances which could appear to do so were considered not to be material.

In accordance with the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, each non-executive Director determined by the Board to be independent has provided an annual confirmation of his or her independence to HSBC Holdings.

Information, induction and ongoing development

The Board regularly reviews reports on progress against financial objectives, business developments and investor and external relations and receives reports from the chairmen of Board committees and from the Group Chief Executive. The Board receives regular reports and presentations on strategy and developments in the customer groups, global businesses and principal geographical areas. Regular reports are also provided to the Board, the Group Audit Committee, the Group Risk Committee and the Risk Management Meeting of the GMB on credit exposures and the loan portfolio, asset, liability and risk management, liquidity, litigation and finance, compliance and reputational issues. The agenda and supporting papers are distributed in advance of all Board and committee meetings to allow time for appropriate review and to facilitate full discussion at the meetings. All Directors have full and timely

access to all relevant information and may take independent professional advice if necessary.

The Directors have free and open contact with management at all levels. Group Managing Directors and Group General Managers meet informally with Directors after Board meetings. Board offsite visits are made each year to enable Directors to see at first hand the business operations in local environments and to meet management, employees and customers.

Full, formal and tailored induction programmes, with particular emphasis on the systems of risk management and internal controls, are arranged by the Group Company Secretary for newly appointed Directors. The programmes consist of a series of meetings with other Directors and senior executives to enable new Directors to receive information and familiarise themselves with our strategy, risk appetite, operations and internal controls. As part of the induction process the Group Company Secretary will coordinate the production of a development programme based on the individual Director's needs. Directors receive comprehensive guidance on the duties and liabilities of a Director of HSBC Holdings before appointment and opportunities to update and develop their skills and knowledge, through externally run seminars and briefings by senior executives, throughout their directorship.

Induction programmes are also arranged for newly appointed members of committees and appropriate training is provided on an ongoing basis.

A personalised approach to training and development of Directors is applied. Development plans and records of development activities are maintained by the Group Company Secretary for annual review by the Group Chairman with the Director concerned. The Group Company Secretary coordinates the delivery of any training required. Focused in-house development programmes to enhance business awareness are arranged in conjunction with scheduled Board Meetings. Directors have access online to internal training and development resources.

Non-executive Directors have an open invitation to attend meetings of the GMB to further enhance their understanding and awareness of our businesses and the senior leadership team.

Performance evaluation

In November 2010, Oliver Wyman was commissioned to review and report on the effectiveness of the Board and its principal committees with a particular focus on risk management and governance responsibilities. Oliver

Report of the Directors: Governance (continued)

Wyman's report was prepared following interviews with Directors and senior members of management and a review of relevant documents. Factors assessed during Oliver Wyman's review included experience and skills of individual Directors, breadth and mix of skills and expertise across the Board and its committees, decision making processes, group culture and dynamics and interaction between the Board and the executive.

The Oliver Wyman report concluded that the Board operates effectively with a number of important strengths. The report identified some areas where effectiveness could be enhanced.

The report was used by the Board in its annual evaluation of its own performance and the performance of its committees and individual Directors. The Board will monitor implementation of actions to address issues arising from its 2010 performance evaluation. All actions arising from the Board's 2009 performance evaluation have been implemented.

It is the intention of the Board to continue to undertake an evaluation of its performance and that of its committees and individual Directors annually, with external input to the process at least every third year.

Formal evaluation of the individual performance of each Director is undertaken annually by the Chairman using the findings of the performance evaluation process undertaken by the Board. The Group Chairman has confirmed that all of the non-executive Directors continue to perform effectively and to demonstrate commitment to their roles.

The non-executive Directors, led by the senior independent non-executive Director, are responsible for the evaluation of the performance of the Group Chairman.

Oliver Wyman has provided and continues to provide strategic consultancy services to the Group.

Appointment, retirement and re-election of Directors

The Board may at any time appoint any person who is willing to act as a Director, either to fill a vacancy or as an addition to the existing Board, but the total number of Directors shall not exceed twenty-five. Any Director so appointed by the Board shall retire at the Annual General Meeting following his or her appointment and shall be eligible for re-election but is not taken into account in determining the number of Directors who are to retire by rotation at such meeting. The Board may appoint any Director to hold any employment or executive office and may

revoke or terminate any such appointment. Shareholders may, by ordinary resolution, appoint a person as a Director or remove any Director before the expiration of his period of office. On the recommendation of the Nomination Committee and in compliance with provision B.7.1 of the UK Corporate Governance Code, which replaces the Combined Code on Corporate Governance for financial years beginning on or after 29 June 2010, the Board has decided that all of the Directors should be subject to annual re-election by shareholders. Accordingly, all of the Directors will retire at the forthcoming Annual General Meeting and with the exception of V H C Cheng, who is to retire, offer themselves for re-election. All the executive Directors are employed on rolling contracts which require 12 months' notice to be given by either party. None of the non-executive Directors has a service contract with HSBC.

Brief biographical particulars of all Directors are given on pages 183 to 187.

Relations with shareholders

The Board ensures all Directors develop an understanding of the views of major shareholders. Non-executive Directors are invited to attend analyst presentations and other meetings with institutional investors and their representative bodies. Directors also meet representatives of institutional shareholders annually to discuss corporate governance matters.

All executive Directors and other senior executives hold regular meetings with institutional investors and report to the Board on those meetings. Our corporate brokers give bi-annual presentations to the Board on market views and investor relations. The Board receives a regular Investor Relations activity report which provides feedback from institutional shareholders and brokers, analysts' forecasts, information from research reports and share price performance data.

During 2010, Sir Simon Robertson, Deputy Chairman and senior independent non-executive Director, J L Thornton and other non-executive Directors met and corresponded with institutional investors and their representatives to discuss strategy, remuneration policy, succession and governance. As senior independent non-executive Director, Sir Simon Robertson is available to shareholders should they have concerns which contact through the normal channels of Group Chairman, Group Chief Executive, Group Finance Director or other executives has failed to resolve or for which such contact would be inappropriate. He

Report of the Directors: Governance (continued)

may be contacted through the Group Company Secretary at 8 Canada Square, London E14 5HQ.

Conflicts of interest, indemnification of Directors, relevant audit information and contracts of significance

The Board has authority to approve Directors' conflicts and potential conflicts of interest and has adopted a policy and procedures for the determination of terms of authorisation for such situations. The Board's powers to authorise conflicts are operating effectively and the procedures are being followed. A review of situational conflicts which have been authorised from time to time and the terms of those authorisations is undertaken by the Board annually.

Our Articles of Association provide that Directors are entitled to be indemnified out of the assets of HSBC Holdings against claims from third parties in respect of certain liabilities arising in connection with the performance of their functions pursuant to the provisions of the Companies Act 2006. Such indemnity provisions have been in place during the financial year but have not been utilised by the Directors.

Each person who is a Director at the date of approval of this report confirms that so far as he or she is aware, there is no relevant audit information of which the auditor is unaware and the Director has taken all the steps that he or she ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information. This confirmation is given pursuant to section 418 of the Companies Act 2006 and should be interpreted in accordance therewith and subject to the provisions thereof.

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 any HSBC company.

Corporate governance codes

We are committed to high standards of corporate governance. We have complied throughout the year with the applicable code provisions of the Combined Code on Corporate Governance issued by the Financial Reporting Council, save for code provision A.2.2 as D J Flint, who had previously served as Chief Financial Officer, Executive Director, Risk and Regulation, did not meet the independence criteria of the Combined Code on Corporate Governance when he was appointed Group Chairman on 3 December 2010. The Board's

explanation of its decision to appoint D J Flint is set out on page 191. We have complied throughout the year with all applicable code provisions of the Code on Corporate Governance Practices in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. The Combined Code on Corporate Governance is available at www.frc.org.uk and the Code on Corporate Governance Practices is available at www.hkex.com.hk.

The Board has adopted a code of conduct for transactions in HSBC Group securities by Directors. The code of conduct complies with The Model Code in the Listing Rules of the FSA and with The Model Code for Securities Transactions by Directors of Listed Issuers ('Hong Kong Model Code') set out in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, save that The Stock Exchange of Hong Kong Limited has granted certain waivers from strict compliance with the Hong Kong Model Code. The waivers granted by The Stock Exchange of Hong Kong Limited primarily take into account accepted practices in the UK, particularly in respect of employee share plans. Following a specific enquiry, each Director has confirmed he or she has complied with the code of conduct for transactions in HSBC Group securities throughout the year.

Board committees

The Board has appointed a number of committees consisting of certain Directors, Group Managing Directors and, in the case of the Corporate Sustainability Committee, certain co-opted non-director members. Information in relation to the principal committees is set out below:

Group Management Board

The GMB, an executive management committee, meets frequently and operates as a general management committee under the direct authority of the Board. The objective of the GMB is to maintain a reporting and control structure whereby all of our line operations are accountable to individual members of the GMB who report to the Group Chief Executive who in turn reports to the Group Chairman. The Board has set objectives and measures for the GMB. These align senior executives' objectives and measures with the strategy and operating plans throughout HSBC.

The members of the GMB are S T Gulliver (Chairman), A A Flockhart and I J Mackay, who are executive Directors, and A Almeida, E Alonso, S Assaf, N S K Booker, A M Keir, M M Moses,

Report of the Directors: Governance (continued)

B Robertson, P A Thurston and P T S Wong, all of whom are Group Managing Directors.

The GMB exercises the powers, authorities and discretions of the Board in so far as they concern the management and day-to-day running of HSBC Holdings. Matters reserved for approval by the Board are described on page 189.

The Group Chief Executive reports to each meeting of the Board on the activities of the GMB.

Group Audit Committee

The Report of the Group Audit Committee is set out below.

Role and membership of the Group Audit Committee

The Group Audit Committee ('GAC'), whose members are all independent non-executive Directors, is responsible for advising the Board on the effectiveness of our systems of internal controls and compliance in relation to financial matters and on meeting financial reporting obligations. The GAC also has responsibilities in relation to risk governance and oversight and internal controls.

The members of the Committee throughout 2010 were J D Coombe (Chairman), R A Fairhead and J R Lomax. On 1 March 2010, M K T Cheung was appointed a member of the Committee in succession to J W J Hughes-Hallett. On 30 July 2010, J D Coombe was appointed chairman of the Committee in succession to R A Fairhead who remains a member of the Committee.

Appointments to the Committee are made for periods of up to three years, extendable by no more than two additional three-year periods, so long as members continue to be independent.

The Board has determined that M K T Cheung, J D Coombe, R A Fairhead and J R Lomax are independent according to SEC criteria and may be regarded as audit committee financial experts for the purposes of section 407 of the Sarbanes-Oxley Act and have recent and relevant financial experience.

The terms of reference of the Committee, which are reviewed annually, are available at www.hsbc.com/boardcommittees.

To ensure consistency of scope and approach by subsidiary company audit committees, the GAC has established core terms of reference to guide subsidiary companies when adopting terms of reference for their audit committees. The Committee's endorsement is required for any proposed changes to subsidiary audit committee terms of reference and for appointments to such committees. The chairmen of our principal subsidiary audit committees attended a forum in November 2010 led by the chairman of the GAC to ensure a common understanding and approach to the way in which subsidiary audit committees operate throughout the Group; understand and share the key issues we face as an organisation and as audit committee members; and discuss current market conditions and the lessons to be learned from the financial crisis.

Historically the GAC has provided non-executive oversight of risk as well as financial reporting. The Group Risk Committee ('GRC') was established in February 2010 to focus on risk governance and to provide an increasingly forward-looking view of risks and their mitigation. The GAC currently has certain responsibilities in relation to risk governance and oversight of internal controls in order to comply with the Hong Kong and UK Corporate Governance Codes.

There is therefore currently a degree of overlap between the responsibilities of the GAC and the GRC in relation to risk matters. For example, a review of the effectiveness of our systems of risk management and internal controls was undertaken by the GAC and by the GRC. Each of the committees is reviewing its terms of reference with the aim of minimising the overlap.

The governance structure for the oversight of our financial reporting and governance is set out below:

Report of the Directors: Governance (continued)

Authority	Membership	Responsibilities
The Board	<ul style="list-style-type: none"> Executive and non-executive Directors 	<ul style="list-style-type: none"> Approves financial statements Appoints senior financial officers Delegates authorities in relation to financial matters
The GAC	<ul style="list-style-type: none"> Independent non-executive Directors 	<ul style="list-style-type: none"> Advises the Board on: <ul style="list-style-type: none"> – ensuring an effective system of internal control and compliance over financial reporting; and – meeting its external financial reporting obligations Responsible for selection, oversight and remuneration of the external auditor
Boards and audit committees of principal subsidiaries	<ul style="list-style-type: none"> In relation to boards, executive and non-executive directors. Committees may have additional members who are not directors. 	<ul style="list-style-type: none"> Provide bi-annual certificates to the GAC or intermediate audit committees relating to financial statements and internal control procedures of relevant subsidiary

Committee's activities

The Committee held six meetings in 2010 — see page 190 for details of Directors' attendance at these meetings. Following each meeting the Committee reports to the Board on its activities.

The Committee undertook the following activities in the discharge of its responsibilities:

- the Committee satisfied itself that the system of internal control and compliance over financial reporting was effective through regular reports from the Group Finance Director, the Group Chief Accounting Officer, and the Group Head of Internal Audit; presentations from other functional and business heads on the financial control framework; review of minutes of meetings of the GMB, the GRC, Risk Management Meetings, the Group Reputational Risk Committee and the Disclosure Committee; reports on US compliance; and through the processes described in more detail on page 202 in relation to internal controls. The Committee also reviewed the adequacy of resources, qualifications and experience of staff in the finance function. The Group Head of Compliance and the Group Chief Risk Officer regularly attended Committee meetings and other senior financial, internal audit, legal and compliance executives attended as appropriate. The Committee had regular dialogue with the external auditor and the Group Head of Internal Audit, with opportunities at each meeting for dialogue to take place without management present;
- the Committee satisfied itself that the internal audit function was effective and adequately resourced through regular meetings with and reports from the Group Head of Internal Audit on internal audit issues and review of an annual report on the activities of the internal audit

function and planned activities for the following year;

- the Committee received regular updates on the application of changes in law, regulation and accounting policies and practices including financial reporting pursuant to the Sarbanes-Oxley Act, Basel II compliance and changes to the FSA's large exposure rules;
- the Committee provided oversight of the external auditor through regular meetings with the external auditor, reviewing the auditor's strategy paper in relation to the audit and receiving reports on the effectiveness and progress of the audit of financial statements. The Committee has approved policies on the provision of non-audit services by the auditor and its affiliates and on the employment by HSBC of former employees of the auditor or its affiliates. The Committee reviewed the independence and objectivity of the auditor through meetings with the auditor, annual reports on employment of former employees of the auditor and its affiliates and quarterly reports on provision of non-audit services. The external auditor provided written confirmation of its independence under industry standards. The Committee approved the remuneration and terms of engagement of the auditor;
- the Committee advised the Board on meeting its external financial reporting obligations through a review of financial statements and interim statements prior to approval by the Board; endorsement of the inclusion of the going concern statement in financial statements; review of the disclosure of the results of the EU-wide stress test conducted by the Committee of European Banking Supervisors; a presentation from the Head of Group Planning and Tax on the Group's tax position; review of accounting

Report of the Directors: Governance (continued)

policies and practices, including approval of the critical accounting policies; reports on proposed changes to the Group's disclosures in the financial statements; reports from the Disclosure Committee; reports on the adequacy of procedures to identify transactions and matters requiring disclosure under certain accounting standards; and reports on the audit process; and

- the Committee undertook a review of its terms of reference and its effectiveness.

Some of the activities of the GRC described on page 200 were carried out by the GAC prior to the establishment of the GRC in February 2010. Since February 2010 some of those activities are carried out by the GRC and the GAC. The description of these activities is not repeated in the list above.

Arrangements relating to the external auditor

The Committee has recommended to the Board that KPMG Audit Plc be reappointed auditor at the forthcoming Annual General Meeting.

An analysis of the remuneration paid in respect of audit and non-audit services provided by KPMG Audit Plc and its affiliates ('KPMG') for each of the past three years is disclosed in Note 8 on the Financial Statements.

The Board has approved, on the recommendation of the Committee, a policy for the employment by us of former employees of KPMG and an annual report is received by the Committee on such former employees who are employed by us and the number of such former employees who are employed by us in senior positions. This report enables the Committee to consider whether there has been any impairment, or appearance of impairment, of the auditor's judgement or independence in respect of the audit.

The policies for the pre-approval of specific services that may be provided by the principal auditor are kept under review by the Committee and amended as necessary to meet the dual objectives of ensuring that we benefit in a cost effective manner from the cumulative knowledge and experience of our auditor, while also ensuring that our auditor maintains the necessary degree of independence and objectivity. These pre-approval policies apply to all services where any HSBC company pays for the service, or is a beneficiary or addressee of the service and has selected or influenced the choice of KPMG. All services provided by KPMG during 2010 were pre-approved by the Committee or were

entered into under pre-approval policies established by the Committee.

The pre-approved services relate to regulatory reviews, agreed-upon procedures reports, other types of attestation reports, the provision of advice and other non-audit services allowed under SEC independence rules. They fall into the categories of audit services, audit-related services, tax services and other services.

Group Risk Committee

The Report of the Group Risk Committee is set out below.

Role and membership of the Group Risk Committee

The GRC, whose members are all independent non-executive Directors, is responsible for advising the Board on material risk matters and providing non-executive oversight of risk. The Committee was established in February 2010 following publication of the final recommendations of Sir David Walker's *Review of Corporate Governance in UK Banks and other Financial Industry Entities*, to focus on risk governance and to provide an increasingly forward-looking view of risks and their mitigation.

Historically the GAC has provided non-executive oversight of risk as well as financial reporting. As noted in the section headed 'Group Audit Committee' above there is currently a degree of overlap between responsibilities of the GAC and the GRC in relation to risk governance and oversight matters and internal controls. Each committee is reviewing its terms of reference with the aim of minimising the overlap.

The members of the GRC are R A Fairhead (Chairman), J D Coombe, J W J Hughes-Hallett and J R Lomax.

The Committee's terms of reference, which are reviewed annually, are available at www.hsbc.com/boardcommittees.

To ensure consistency of scope and approach by subsidiary company committees, the GRC has established core terms of reference to guide subsidiary companies when adopting terms of reference for their risk committees (or their audit committees if those committees are also responsible for risk oversight). The Committee's endorsement is required for any proposed changes to the terms of reference of any subsidiary committee relating to risk oversight and for appointments to such committees.

Report of the Directors: Governance (continued)

The chairmen of committees of principal subsidiaries with responsibility for oversight of risk attended the forum referred to on page 195. One of the purposes of the forum was to ensure a common understanding and approach to the way in which subsidiary committees operate in relation to risk oversight throughout the Group; to understand and share the key risk issues we face as an organisation and the issues faced by members of committees responsible for oversight of risk; and to discuss the lessons to be learned from the financial crisis.

Risk governance

All of HSBC's activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risk or combinations of risks. The Board, advised by the Committee, ensures that the Group has a strong risk governance culture which shapes the Group's risk strategy. The Board and the Committee ensure that a strong risk management framework is maintained, via the continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions.

The Committee is responsible for overseeing the Group's risk governance structure and monitoring the effectiveness of the Group's risk management and internal control systems. The Committee monitors top and emerging risks and reviews the outcome of internal and external stress tests.

In carrying out its responsibilities the Committee is closely supported by the Group Chief Risk Officer, who ensures that top and emerging risks are reported to and considered by the Committee. The Committee receives regular presentations from the Group Head of Internal Audit and other business, function and risk heads on risks within their respective areas of responsibility and regular reports from the Risk Management Meeting of the GMB, which is the executive body responsible for overseeing risk.

The governance structure for the management of risk at HSBC is set out below. Appropriate governance arrangements are in place in regional and operating subsidiaries.

Authority	Membership	Responsibilities
The Board	Executive and non-executive Directors	<ul style="list-style-type: none"> Approves risk appetite, plans and performance targets for the Group Appoints senior risk officers Delegates authorities for risk management
The GRC	Independent non-executive Directors	<ul style="list-style-type: none"> Advises the Board on: <ul style="list-style-type: none"> risk appetite, tolerance and strategy; stress testing; systems of risk management, internal control and compliance used to identify, measure, monitor, control and report risks; the alignment of the Board's risk appetite with strategy and reward; and the maintenance and development of a supportive culture in relation to the management of risk.
Risk Management Meeting of the GMB	Group Chief Executive Group Chief Risk Officer Group Finance Director Senior management	<ul style="list-style-type: none"> Formulates high-level Group risk policy Exercises delegated risk authorities Oversees implementation of risk appetite and controls Monitors all categories of risk and determines action
Global Risk Management Board	Group Chief Risk Officer Chief Risk Officers of HSBC's regions Heads of risk disciplines within Group Management Office	<ul style="list-style-type: none"> Supports the Risk Management Meeting and the Group Chief Risk Officer in providing strategic direction for the Global Risk function, sets priorities and oversees their execution Oversees consistent risk approach to accountability and control across the Global Risk function

Risk appetite

Risk appetite is central to HSBC's management of risk. The Board, advised by the GRC, approves the Group's risk appetite which describes the types and

levels of risk that the Group is prepared to accept in executing our strategy. Our risk appetite is underpinned by the following core characteristics:

Report of the Directors: Governance (continued)

Risk appetite: core characteristics

- Strong balance sheet
- Strong brand
- Healthy capital position
- Conservative liquidity management
- Risk must be commensurate with returns
- Robust Group structure of separate legal entities
- The customer group and global product mix should produce sustainable long term earnings growth
- Risk diversification

The GRC monitors the Group’s risk appetite and satisfies itself that executive management has taken account of the future macroeconomic and financial environment in identifying top and emerging risks.

From the core characteristics of the Group’s risk appetite (see table above), our strategic and operational objectives are determined which are consistent with the Group’s risk appetite. These objectives are summarised in the table below:

Strategic and operational objectives	
Earnings	1. Generate sustainable economic profit commensurate with the risks taken
Capital and liquidity	2. Maintain capital in excess of regulatory requirements and a long term debt rating of AA
	3. Maintain a strong tier 1 ratio comprising a high proportion of core tier 1
	4. Maintain a well diversified funding structure with a particular focus on advances to core funding ratios
	5. Off balance sheet vehicles should not be material in size relative to the total balance sheet
Impairments and expected losses	6. Manage impairments and expected losses within the Group’s tolerance
Risk category and diversification	7. Manage all risk categories within the risk appetite
	8. Harness benefits from business diversification to generate non-volatile and sustainable earnings
	9. Compete for business with international customers where market connectivity is critical; businesses with local customers where we have local scale, and products where global scale is critical to effectiveness
Scenario and stress testing	10. Use robust and appropriate scenario stress testing to assess the potential impact on the Group’s capital adequacy and strategic plans

Top and emerging risks

Identifying and monitoring top and emerging risks is integral to HSBC’s approach to risk management. We define a ‘top risk’ as being a current, visible risk which has the potential to have a material impact on our financial results, reputation or the sustainability of our long-term business model. An ‘emerging risk’ is one which has large unknown components which,

if they were to crystallise, could have material impact on our long-term strategy.

Current top and emerging risks are viewed as falling under four broad categories: challenges to business operations; challenges to governance and internal control; macro-economic and geopolitical; and macro-prudential and regulatory. These are summarised below:

Categories / definitions	Top and emerging risks
Challenges to our business operations	<ul style="list-style-type: none"> • Challenges to our operating model in an economic downturn (in developed economies) and rapid growth (in emerging markets) • Internet crime and fraud
Challenges to our governance and internal control systems	<ul style="list-style-type: none"> • Operational complexity associated with high levels of change • Information security risk
Macro-economic and geopolitical risk	<ul style="list-style-type: none"> • Potential emerging markets asset bubble • Increased geopolitical risk in the Middle East, with possible contagion
Macro-prudential and regulatory risks to our business model	<ul style="list-style-type: none"> • Regulatory change impacting business model and Group profitability • Regulatory requirements affecting conduct of business

Report of the Directors: Governance (continued)

Stress testing

HSBC's scenario analysis and stress testing programme is central to the identification and monitoring of top and emerging risks. It highlights the vulnerabilities of our business and capital plans to the adverse effects of extreme but plausible events. The GRC reviews the outcome of the stress tests performed.

There are three main classifications of scenario and stress tests: regulatory scenarios; Group level business scenarios; and local business scenarios. The GRC uses the outcome of the programme to assess the potential impact of the relevant scenarios on the demand for regulatory capital compared with its supply. Management develops action plans to mitigate the risks identified. The extent to which those action plans are implemented depends on management's evaluation of the risks and their potential consequences, taking into account HSBC's risk appetite.

Committee activities

The Committee held four meetings in 2010 – see page 190 for details of Directors' attendance. Following each meeting the Committee reports to the Board on its activities.

John Trueman, a non-executive director of HSBC Bank plc and chairman of its risk and audit committees has been invited by the Committee to attend its meetings. His experience of risk related matters in the financial services industry is valued by the Committee.

The GRC undertook the following key activities in the discharge of its responsibilities:

- the Committee provided oversight of executive risk management through regular reports from the Group Chief Risk Officer and the Risk Management Meeting of the GMB; review of minutes of meetings of the GMB, the Risk Management Meeting, the Remuneration Committee and the Group Reputational Risk Committee; reports from the Group General Counsel on substantial litigation; a report from the Remuneration Committee on risk related matters; and updates on the Swiss data theft referred to on page 83. The Group Finance Director and the Group Chief Accounting Officer regularly attended committee meetings and other senior financial, risk, internal audit, legal and compliance executives attended as appropriate;
- the Committee reviewed the effectiveness of internal controls through a cycle of

presentations from the Group Chief Risk Officer and other business and functional heads on the risk control framework; reports from the Group Head of Internal Audit on the internal audit process and weaknesses identified in internal controls and reports of the external auditor and regulators relating to the internal control system; updates from the Group Head of Compliance; and reports from the Group General Counsel and other senior executives on US compliance matters. The Committee undertook an annual review of the effectiveness of HSBC's system of internal control, which is described on page 202. The Committee had regular dialogue with the external auditor and the Group Head of Internal Audit, with opportunities at each meeting for dialogue to take place without management present;

- the Committee considered the Group's risk appetite and the alignment of strategy with risk appetite through reviewing the Group's risk appetite statement and reports on liquidity and capital management; receiving reports from the Chief Risk Officer; and considering the outcomes of the scenario and stress testing programme;
- the Committee considered the alignment of reward structures with the Group's risk appetite through a report from the Group Head of HR on procedures to be used when determining an individual's variable pay award for the 2010 performance period. These procedures include making assessments of the profitability of the business area in which an individual works and the performance of that business area when compared to the approved risk appetite in respect of that business. The performance of the individual is also assessed taking into account the extent to which that individual has adhered to the Group's policies and procedures for risk related matters and has achieved specified performance targets or objectives (such as a revenue or profit target). These procedures were considered by the Remuneration Committee in early 2011. An update was also provided on a review of variable pay plans throughout the Group;
- in monitoring top and emerging risks the Committee satisfied itself that it understood and took into account the views of senior management; reviewed minutes of executive committee meetings including meetings of the GMB, the Risk Management Meeting and Group Reputational Risk Committee; received reports from the Group Chief Risk Officer and

Report of the Directors: Governance (continued)

the Group Head of Compliance as well as other members of senior management on developments in the Group's business; and received regular presentations on global market risk and liquidity and the impact of the tightening of liquidity in the money markets;

- the Committee considered risk issues relating to a proposed strategic acquisition and discussed a report from the Group Head of Mergers and Acquisitions and other members of senior management involved in the proposed acquisition; and
- the Committee undertook a review of its terms of reference and its effectiveness.

External advice on US-related compliance matters was provided to the GRC by US law firm Cahill Gordon & Reindel and by Promontory Financial Group, US financial consultants.

Some of the activities referred to above were carried out by the GAC prior to the establishment of the GRC in February 2010. Since February 2010 some of those activities are carried out by the GRC and the GAC.

Remuneration Committee

The role of the Remuneration Committee and its membership are set out in the Directors' Remuneration Report on page 222.

Nomination Committee

Role and membership of the Nomination Committee

The Nomination Committee is responsible for leading the process for Board appointments and for identifying and nominating, for approval by the Board, candidates for appointment to the Board. Before recommending an appointment to the Board, the Committee evaluates the balance of skills, knowledge and experience on the Board and, in the light of this, and taking into account the needs of the Group's businesses, identifies the role and capabilities required for a particular appointment. Candidates are considered on merit against these criteria. Care is taken to ensure that appointees have enough time to devote to us. Prospective Directors are asked to identify any significant other commitments and confirm they have sufficient time to discharge what is expected of them.

The members of the Nomination Committee throughout 2010 were Sir Brian Williamson, R A Fairhead, Sir Simon Robertson and J W J Hughes-Hallett, all independent non-executive

Directors. Lord Green succeeded Sir Brian Williamson as chairman of the Nomination Committee on 26 February 2010 and served until his retirement on 3 December 2010 when he was succeeded by D J Flint, upon his appointment as Group Chairman. Lord Green did not chair any meeting of the Nomination Committee when it was dealing with the appointment of the successor to the chairmanship. The selection process for Lord Green's successor as Group Chairman, was led by the senior independent non-executive Director.

The terms of reference of the Committee, which are reviewed annually, are available at www.hsbc.com/boardcommittees.

The appointments of D J Flint as Group Chairman, S T Gulliver as Group Chief Executive and I J Mackay as an executive Director were made on the advice and recommendation of the Nomination Committee. An external consultancy was used in connection with the appointments.

Committee activities

The Committee held three meetings in 2010 — see page 190 for details of Directors' attendance at these meetings. Following each meeting the Committee reports to the Board on its activities.

The Committee undertook the following key activities in the discharge of its responsibilities:

- under the chairmanship of the senior independent non-executive Director, the Committee led the succession process for the Group Chairman and the Group Chief Executive. The process is described on page 191;
- the Committee leads the process for Board appointments, with the support of external consultants as appropriate, and has satisfied itself that appropriate plans are in place for orderly succession to the Board reflecting an appropriate balance of skills and experience on the Board;
- the Committee maintains a forward-looking schedule of potential candidates for appointment to the Board that takes into account the needs and developments of the Group's businesses and the anticipated retirement dates of current Directors. On the recommendation of the Committee, the Board has appointed L M L Cha as a non-executive Director with effect from 1 March 2011;
- the Committee monitored the size, structure and composition of the Board through consideration

Report of the Directors: Governance (continued)

of the skills, knowledge and experience required of the Board and the skills, knowledge and experience of the current Directors. The Committee reviewed the time commitment required from non-executive Directors taking into account the recommendations of Sir David Walker's review of corporate governance relating to board and board committee matters and made appropriate recommendations to the Board. The Committee considered the re-election of Directors at the annual general meeting and on the recommendation of the Committee, the Board has decided that all Directors should be subject to re-election by shareholders in 2011;

- the Committee provided oversight of other matters relating to directors including considering a proposed appointment of a Director to an external body and discussing and providing guidance on FSA interactions; and
- the Committee undertook a review of its terms of reference. The effectiveness of the Committee was reviewed as part of the Board's performance evaluation.

Corporate Sustainability Committee

The role of the Corporate Sustainability Committee and its membership are set out on page 213.

Internal control

The Directors are responsible for internal control in HSBC 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 and usefulness 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 misstatement, errors, losses or fraud. The procedures also enable HSBC Holdings to discharge its obligations under the Handbook of Rules and Guidance issued by the FSA, HSBC's lead regulator.

The key procedures that the Directors have established are designed to provide effective internal control within HSBC and accord with the Internal Control: Revised Guidance for Directors on the Combined Code on Corporate Governance issued by the Financial Reporting Council. Such procedures for the ongoing identification, evaluation and management of the significant risks faced by HSBC have been in place throughout the year and up to

28 February 2011, the date of approval of the *Annual Report and Accounts 2010*. In the case of companies acquired during the year, the internal controls in place are being reviewed against HSBC's benchmarks and integrated into HSBC's processes.

Key internal control procedures include the following:

- authority to operate the various subsidiaries and responsibilities for financial performance against plans and for capital expenditure are delegated to their respective chief executive officers within limits set by the Board. Delegation of authority from the Board to individuals requires those individuals to maintain a clear and appropriate apportionment of significant responsibilities and to oversee the establishment and maintenance of systems of control appropriate to the business. The appointment of executives to the most senior positions within HSBC requires the approval of the Board;
- functional, operating, financial reporting and certain management reporting standards are established by GMB management committees, for application across the whole of HSBC. These are supplemented by operating standards set by functional and local management as required for the type of business and geographical location of each subsidiary;
- systems and procedures are in place in HSBC to identify, control and report on the major risks including credit, market, liquidity and operational risk (including accounting, tax, legal, compliance, fiduciary, information, physical security, business continuity, fraud, systems and people risk). Exposure to these risks is monitored by risk management committees, asset and liability committees and executive committees in subsidiaries and, for HSBC as a whole, by the GMB. A Risk Management Meeting of the GMB, chaired by the Group Chief Risk Officer, is held in each month (except August) to address asset, liability and risk management issues. The minutes of this meeting are submitted to the GAC, the GRC and the Board;
- the Global Operational Risk and Control Committee ('GORCC'), which reports to the Risk Management Meeting of the GMB, meets at least quarterly to monitor HSBC's operational risk profile and review the effective implementation of the Group's operational risk management framework. The GORCC receives quarterly reports on the Group's operational risk

Report of the Directors: Governance (continued)

profile, including top risks, control issues, internal and external operational loss events and key risk indicators. The GORCC communicates the lessons learned from operational events both within HSBC and in the wider industry;

- a Disclosure Committee has been established to review material public disclosures made by HSBC Holdings for any material errors, misstatements or omissions. The membership of the Disclosure Committee, which is chaired by the Group Company Secretary, includes the heads of the Finance, Legal, Risk, Compliance, Corporate Communications, Investor Relations and Internal Audit functions and representatives from the principal regions, customer groups and global businesses. The integrity of disclosures is underpinned by structures and processes within the Finance and Risk functions that support expert and rigorous analytical review of financial reporting;
- the group financial reporting process for preparing the consolidated *Annual Report and Accounts 2010* is controlled using documented accounting policies and reporting formats, supported by a chart of accounts with detailed instructions and guidance on reporting requirements, issued by Group Finance to all reporting entities within the Group in advance of each reporting period end. The submission of financial information from each reporting entity to Group Finance is subject to certification by the responsible financial officer, and analytical review procedures at reporting entity and Group levels;
- processes are in place to identify new risks from changes in market conditions/practices or customer behaviours, which could expose HSBC to heightened risk of loss or reputational damage. During 2010, attention was focused on refinement and operation of the stress testing framework; the roll-out of enhanced counterparty risk aggregation, risk management information, portfolio and crisis management processes; the mitigation of information risks; enhancement of policies and practices relevant to the prevention of financial crimes; and changes in the regulation of and public policy towards the financial services industry. From January 2011, risk review and audit functions have increased their focus on global thematic risks;
- periodic strategic plans are prepared for key customer groups, global product groups, support functions and certain geographies within the

framework of the Group Strategic Plan. Rolling operating plans, informed by detailed analysis of risk appetite describing the types and quantum of risk that HSBC is prepared to take in executing its strategy, are prepared and adopted by all major HSBC operating companies and set out the key business initiatives and the likely financial effects of those initiatives;

- governance arrangements are in place to provide oversight of, and advice to the Board on, material risk-related matters including assurance that risk analytical models are fit for purpose, used accordingly and complemented by both model-specific and enterprise-wide stress tests that evaluate the impact of severe yet plausible events and other unusual circumstances not fully captured by quantitative models;
- centralised functional control is exercised over all IT developments and operations. Common systems are employed for similar business processes wherever practicable. Credit and market risks are measured and reported on in subsidiaries and aggregated for review of risk concentrations on a Group-wide basis;
- functional management in GMO is responsible for setting policies, procedures and standards for the following risks: credit; market; liquidity; operations; IT; fraud; business continuity; security; information; insurance; accounting; tax; legal; regulatory compliance; fiduciary; human resources; reputational; sustainability; residual value; shariah and strategic risks.

Authorities to enter into credit and market risk exposures are delegated with limits to line management of Group companies. The concurrence of GMO is required, however, to credit proposals with specified higher risk characteristics;

- policies to guide subsidiary companies and management at all levels in the conduct of business to safeguard the Group's reputation are established by the Board and the GMB, subsidiary company boards, Board committees and senior management. Reputational risks can arise from environmental, social or governance issues, or as a consequence of operational risk events. As a banking group, HSBC'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 or use financial products and services;
- the establishment and maintenance of appropriate systems of internal control is

Report of the Directors: Governance (continued)

primarily the responsibility of business management. The Internal Audit function, which is centrally controlled, monitors the effectiveness of internal control structures across the whole of HSBC focusing on the areas of greatest risk to HSBC as determined by a risk-based grading approach. The head of this function reports to the Group Chairman, the Group Chief Executive, the GRC and the GAC; and

- executive management is responsible for ensuring that recommendations made by the Internal Audit function are implemented within an appropriate and agreed timetable. Confirmation to this effect must be provided to Internal Audit. Executive management must also confirm annually as part of the Internal Audit process that offices under their control have taken, or are in the process of taking, the appropriate actions to deal with all significant recommendations made by external auditors in management letters or by regulators following regulatory inspections.

Historically the GAC has provided oversight of internal controls and risk as well as oversight of financial reporting. Currently there is a degree of overlap between the responsibilities of the GAC and the GRC in relation to internal controls and risk governance. Each committee is reviewing its terms of reference with the aim of minimising the overlap.

The GRC and the GAC have kept under review the effectiveness of this system of internal control and have reported regularly to the Board. The key processes used by the GRC and the GAC in carrying out their reviews include: regular business and operational risk assessments; regular reports from the heads of key risk functions including Internal Audit and Compliance; the production annually of reviews of the internal control framework applied at GMO and major operating subsidiary levels measured against HSBC benchmarks, which cover all internal controls, both financial and non-financial; semi-annual confirmations from chief executives of principal subsidiary companies as to whether there have been any material losses, contingencies or uncertainties caused by weaknesses in internal controls; internal audit reports; external audit reports; prudential reviews; and regulatory reports. The GRC and the GAC keep under review a risk map of the status of key risk areas which impact the Group and considers whether the mitigating actions put in place are appropriate. In addition, when unexpected losses have arisen or when incidents have occurred which indicate gaps in the control framework or in adherence to Group policies,

the GRC and the GAC review special reports, prepared at the instigation of management, which analyse the cause of the issue, the lessons learned and the actions proposed by management to address the issue.

The Directors, through the GRC and the GAC, have conducted an annual review of the effectiveness of HSBC's system of internal control covering all material controls, including financial, operational and compliance controls and risk management systems and the adequacy of resources, qualifications and experience of staff of the issuer's accounting and financial reporting function, and their training programmes and budget. The review does not extend to joint ventures or associates. The GRC and the GAC have received confirmation that executive management has taken or is taking the necessary actions to remedy any failings or weaknesses identified through the operation of HSBC's framework of controls.

Going concern basis

The Financial Statements are prepared on a going concern basis, as the Directors are satisfied that the Group and parent company have the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows and capital resources. Further information relevant to the assessment is provided elsewhere in this Report. In particular, HSBC's principal activities, strategic direction and challenges and uncertainties are described in the Operating and Financial Review; a financial summary, including a review of the consolidated income statement and consolidated balance sheet, is provided in the Operating and Financial Review and HSBC's objectives, policies and processes for managing credit, liquidity and market risk, and its approach to capital management and allocation, are described in the Risk section.

Directors' interests

Pursuant to the requirements of the UK Listing Rules and according to the register of Directors' interests maintained by HSBC Holdings pursuant to section 352 of the Securities and Futures Ordinance of Hong Kong, the Directors of HSBC Holdings at 31 December 2010 had the following interests, all beneficial unless otherwise stated, in the shares and loan capital of HSBC Holdings and its associated corporations:

Report of the Directors: Governance (continued)

Directors' interests

HSBC Holdings ordinary shares of US\$0.50

	At 31 December 2010					Total interests ¹
	At 1 January 2010	Beneficial owner	Child under 18 or spouse	Jointly with another person	Trustee	
V H C Cheng	466,165	485,493	189,072	–	–	674,565
J D Coombe	19,676	20,341	–	–	–	20,341
R A Fairhead	21,300	–	–	21,300	–	21,300
D J Flint	177,101	144,915	–	–	33,766 ²	178,681
A A Flockhart	269,008	–	–	–	230,112	230,112
S T Gulliver	2,731,057	2,553,592	177,485	–	–	2,731,077
J W J Hughes-Hallett	67,755	–	–	–	39,577 ²	39,577
W S H Laidlaw	30,948	29,532	–	–	1,416 ²	30,948
I J Mackay	34,217 ³	34,217	–	–	–	34,217
G Morgan	78,515	81,166	–	–	–	81,166
Sir Simon Robertson	140,093	8,623	–	–	167,750 ²	176,373
J L Thornton	–	–	10,250 ⁴	–	–	10,250
Sir Brian Williamson	36,378	37,607	–	–	–	37,607

¹ Details of executive Directors' other interests in HSBC Holdings ordinary shares of US\$0.50 arising from the HSBC Holdings savings-related share option plans and the HSBC Share Plan are set out in the Directors' Remuneration Report on pages 232 and 233. At 31 December 2010, the aggregate interests under the Securities and Futures Ordinance of Hong Kong in HSBC Holdings ordinary shares of US\$0.50, including interests arising through employee share plans were: V H C Cheng – 1,546,752; D J Flint – 968,179; A A Flockhart – 1,231,453; S T Gulliver – 4,349,161 and I J Mackay – 289,250. Each Director's total interests represents less than 0.02% of the shares in issue.

² Non-beneficial.

³ Interest at 3 December 2010 – date of appointment.

⁴ Interest in listed American Depositary Shares, which are categorised as equity derivatives under Part XV of the Securities and Futures Ordinance of Hong Kong.

As a director of HSBC France during 2010, S T Gulliver has an interest as beneficial owner in one share of €5 in that company (representing less than 0.01% of the shares in issue). He has waived his rights to receive dividends on this share and has undertaken to transfer it to HSBC on ceasing to be a director of HSBC France.

V H C Cheng has an interest as beneficial owner in RMB1,960,000 of retail bonds issued by HSBC Bank (China), which he held throughout the year.

No Directors held any short position as defined in the Securities and Futures Ordinance of Hong

Kong in the shares and loan capital of HSBC Holdings and its associated corporations. Save as stated above, none of the Directors had an interest in any shares or debentures of HSBC Holdings or any associated corporation at the beginning or at the end of the year, and none of the Directors or members of their immediate families were awarded or exercised any right to subscribe for any shares or debentures in any HSBC corporation during the year. Since the end of the year, the aggregate interests of the following Directors have increased by the number of HSBC Holdings ordinary shares shown against their names:

Increase in Directors' interests since 31 December 2010

HSBC Holdings ordinary shares of US\$0.50

	Beneficial owner	Child under 18 or spouse	Trustee
V H C Cheng	10,384 ¹	1,446 ¹	–
J D Coombe	156 ¹	–	–
D J Flint	6,074 ²	–	258 ¹
A A Flockhart	7,624 ¹	–	1,759 ¹
S T Gulliver	12,376 ¹	4 ¹	–
J W J Hughes-Hallett	–	–	3,742 ³
I J Mackay	1,939 ¹	–	–
G Morgan	620 ¹	–	–
Sir Simon Robertson	65 ¹	–	–
Sir Brian Williamson	288 ¹	–	–

¹ Scrip dividend.

² Comprises scrip dividend, the automatic reinvestment of dividend income by an Individual Savings Account manager (38 shares), the acquisition of shares in the HSBC Holdings UK Share Incentive Plan through regular monthly contributions (18 shares) and the automatic reinvestment of dividend income on shares held in the plan (17 shares).

³ Non-beneficial.

Report of the Directors: Governance (continued)

There have been no other changes in the share and loan capital interests of the Directors from 31 December 2010 to the date of this Report. Any subsequent changes up to the last practicable date before the publication of the *Notice of Annual General Meeting* will be set out in the notes to that Notice.

At 31 December 2010, Directors and Senior Management (being members of the Group Management Board) held, in aggregate, beneficial interests in 13,152,010 HSBC Holdings ordinary shares (0.07% of the issued ordinary shares).

At 31 December 2010, executive Directors and Senior Management held, in aggregate, options to subscribe for 602,019 of HSBC Holdings ordinary shares under the HSBC Holdings savings-related share option plans, HSBC Holdings Group Share Option Plan and HSBC Finance: 1996 Long-Term Executive Incentive Compensation Plan. These options are exercisable between 2011 and 2015 at prices ranging from £3.3116 to £7.9606 and US\$11.8824 to US\$18.6226 per ordinary share.

Employees

At 31 December 2010, HSBC employed 307,000 full-time and part-time employees worldwide, compared with 302,000 at 31 December 2009 and 325,000 at 31 December 2008. The main centres of employment were the UK with approximately 52,000 employees, India 34,000, Hong Kong 30,000, the US 27,000, Brazil 24,000, Mexico 20,000, mainland China 16,000 and France 11,000.

Engaged employees are an important enabler of a high-performance culture. We encourage managers to foster open and honest communication and promote active employee involvement in decision making. Employment issues and the financial and economic factors affecting HSBC's performance are regularly shared with our employees. An employee engagement target was included in the 2010 performance objectives of senior managers.

In 2010, we conducted our fourth Group-wide Global People Survey, which achieved a participation rate of 90%. The survey gives employees the opportunity to provide systematic feedback on their experience of HSBC and involvement in identifying actions to improve their experience. While employee engagement fell 3 percentage points from 71% in 2009 to 68% in 2010, this was 6 percentage points higher than the external global average and 3 percentage points above the financial services sector average.

Key themes emerging from the 2010 survey included the strength of our corporate sustainability effort; those who participate in corporate sustainability initiatives exhibit higher levels of engagement. The view that we have a diverse and fair culture has become stronger. Perceptions of organisational strategy and vision, reputation and Group Values all remain above global industry best in class. In 2011, we aim to improve personal development and strengthen relationships between employees and their direct managers by increasing employee involvement, recognising individual contribution and demonstrating specific behaviours which exemplify our Group Values.

Our approach to reward is meritocratic and market competitive, is underpinned by an ethical performance culture and aligns the interests of our employees and shareholders. See Employee share plans on page 207.

We negotiate with recognised unions. The five highest concentrations of union membership are in Argentina, Brazil, mainland China, Malta and Mexico. It is HSBC's policy to maintain well-developed communications and consultation programmes with unions and there have been no material disruptions to our operations from labour disputes during the past five years.

Our deep roots in many geographical regions and an international mindset inform our perspective on diversity: ethnicity, age and gender diversity are areas of strategic focus. We remain committed to meritocracy, which requires a diverse and inclusive culture where employees believe that their views are heard, their concerns are attended to and they work in an environment where bias, discrimination and harassment are not tolerated and where advancement is based on objectivity. Our inclusive culture helps us to respond to our increasingly diverse global customer base, while creating and retaining a secure supply of skilled and committed employees.

In 2010, we increased executive management sponsorship and responsibility for the promotion of inclusive working practices. Oversight of related activities resides with the Group Diversity Committee, supported by local People / Diversity Committees.

The role of our Group Values in daily operating practice has taken on increased significance in the context of the global financial crisis with changes to regulatory policy, investor confidence and society's view of the role of banks.

Report of the Directors: Governance (continued)

Our Group Values comprise being: open to different ideas and cultures; connected with our customers, community and each other; dependable and doing the right thing. We have strengthened our values-led culture by embedding our Group Values into the Group's operating standards, training, development and employee induction, and through the personal sponsorship of senior executives. These initiatives will continue in 2011.

The development of talented employees in both developed and emerging markets is essential to the future strength of our business. We have therefore implemented a systematic approach to identifying and deploying talented people across the organisation in order to ensure an appropriate supply of high calibre individuals with the necessary skills, diversity and experience for current and future senior management positions.

In 2010, we improved both the quality of training and the access that all employees have to relevant programmes through globally consistent technology. Specific areas covered were risk, compliance, customer orientation and performance management.

Employment of disabled persons

We believe in providing equal opportunities for all employees. The employment of disabled persons is included in this commitment and the recruitment, training, career development and promotion of disabled persons is based on the aptitudes and abilities of the individual. Should employees become disabled during their employment with us, efforts are made to continue their employment and, if necessary, appropriate training is provided.

Remuneration policy

As the quality and commitment of its human capital is deemed fundamental to our success, the Board's stated strategy is to attract, retain and motivate the very best people. This strategy is referenced to the overall business strategy and the commercial environment.

In a business that is based on trust and relationships, our broad policy is to recruit those who are committed to making a long-term career with the organisation since trust and relationships are built over time.

Remuneration is an important component in an individual's decision about which organisation to join and to stay with but, in our experience, it is not the overriding one. We seek to attract people who wish to work for an organisation with strong and

sound values, one which is meritocratic and competitive, and which offers challenging career development. In line with the overall principles applied to executive Directors by the Remuneration Committee described on page 222:

- employees' salaries are reviewed annually in the context of business performance, market practice and internal relativities. Allowances and benefits are largely determined by local market practice;
- employees participate in various variable pay arrangements. Discretionary variable pay is dependent on the achievement of objectives which derive from those determined at Group level. Since 2008, these objectives have typically been categorised in four segments – financial, customer, process and people. Financial and non-financial metrics are used to measure performance against the objectives, which include profitability, expense control, customer recommendation, employee engagement, adherence to our ethical standards, lending guidelines and internal controls and procedures. From 2010, we have used a risk appetite framework which describes the quantum and types of risks that we are prepared to take in executing our strategy. The risk appetite framework is approved by the Board of HSBC Holdings and helps to ensure effective risk management is emphasised to maintain a strong and secure operating platform, and that influences employee remuneration. Actual levels of variable pay depend on the performance of the Group, its constituent businesses and the individual, taking into account competitive market practice and relevant regulator requirements; and
- to ensure that our interests and those of our employees are aligned with those of our shareholders, that our approach to risk management supports the interests of all stakeholders and that remuneration is consistent with effective risk management, we require a proportion of variable pay awards above certain thresholds to be deferred into awards of Restricted Shares. In addition, employees are encouraged to participate in our savings-related share option plans and local share ownership arrangements.

Employee share plans

To help align the interests of employees with those of shareholders, share options are granted under all-employee share plans and discretionary awards of

Report of the Directors: Governance (continued)

Performance Shares and Restricted Shares are made under the HSBC Share Plan. The following are particulars of outstanding employee share options, including those held by employees working under employment contracts that are regarded as 'continuous contracts' for the purposes of the Hong Kong Employment Ordinance. The options were granted at nil consideration. No options have been granted to substantial shareholders, suppliers of goods or services, or in excess of the individual limit for each share plan. No options were cancelled by HSBC during the period. A summary for each scheme of the total number of the options which were awarded, exercised or lapsed during 2010 is shown in the tables below. Further details required to be disclosed pursuant to Chapter 17 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited are available on our website at www.hsbc.com by selecting 'Investor Relations', then 'Share Plans', and on the website of The Stock Exchange of Hong Kong Limited at www.hkex.com.hk or can be obtained upon request from the Group Company Secretary, 8 Canada

Square, London E14 5HQ. Particulars of options held by Directors of HSBC Holdings are set out on page 232.

All-employee share option plans

All employees employed within the Group on the first working day of the year may be granted options to acquire HSBC Holdings ordinary shares under shareholder-approved all-employee share option plans. Options under the plans are usually exercisable after one, three or five years.

The exercise of the options may be advanced to an earlier date in certain circumstances, for example on retirement, and may be extended in certain circumstances, for example on the death of a participant, the executors may exercise the option up to six months beyond the normal exercise period. The middle market closing price per HSBC Holdings ordinary share quoted on the London Stock Exchange, as derived from the Daily Official List on 20 April 2010, the day before options were awarded in 2010, was £6.917.

HSBC Holdings Savings-Related Share Option Plan

HSBC Holdings ordinary shares of US\$0.50

Dates of award		Exercise price (£)		Exercisable		At 1 Jan 2010	Awarded during year	Exercised during year ¹	Lapsed during year	At 31 Dec 2010
from	to	from	to	from	to					
21 Apr 2004	21 Apr 2010	3.3116	6.6870	1 Aug 2009	31 Jan 2016	76,566,328	6,183,303	4,536,734	10,475,032	67,737,865

¹ The weighted average closing price of the shares immediately before the dates on which options were exercised was £6.57.

HSBC Holdings Savings-Related Share Option Plan: International

HSBC Holdings ordinary shares of US\$0.50

Dates of award		Exercise price		Exercisable		At 1 Jan 2010	Awarded during year	Exercised during year ¹	Lapsed during year	At 31 Dec 2010
from	to	from	to	from	to					
21 Apr 2004	21 Apr 2010	(£)	(£)	1 Aug 2009	31 Jan 2016	29,664,282	7,585,594	5,260,044	3,328,890	28,660,942
26 Apr 2006	21 Apr 2010	(US\$)	(US\$)	1 Aug 2009	31 Jan 2016	12,073,216	2,535,387	1,418,224	2,290,964	10,899,415
26 Apr 2006	21 Apr 2010	(€)	(€)	1 Aug 2009	31 Jan 2016	3,283,710	555,803	356,578	354,427	3,128,508
26 Apr 2006	21 Apr 2010	(HK\$)	(HK\$)	1 Aug 2009	31 Jan 2016	50,938,242	5,157,129	5,258,144	3,408,335	47,428,892

¹ The weighted average closing price of the shares immediately before the dates on which options were exercised was £6.50.

Discretionary Share Plans

Discretionary share options were awarded under employee share plans until 2005. There have been no awards of discretionary options since 30 September 2005 save for an award by HSBC InvestDirect (India) Limited before it was acquired by HSBC as

set out below. The exercise period of the options awarded under discretionary share incentive plans may be advanced to an earlier date in certain circumstances, for example on the sale of a business. Note 9 on the Financial Statements gives details on share-based payments, including awards of Restricted Shares made in 2010.

Report of the Directors: Governance (continued)**HSBC Holdings Executive Share Option Scheme¹**

HSBC Holdings ordinary shares of US\$0.50

Date of award	Exercise price (£)	Exercisable		At 1 Jan 2010	Exercised during year ²	Lapsed during year	At 31 Dec 2010
		from	to				
3 Apr 2000	6.5009	3 Apr 2003	3 Apr 2010	6,706,848	4,228,503	2,478,345	–

1 The HSBC Holdings Executive Share Option Scheme expired on 26 May 2000. No options have been granted under the Scheme since that date.

2 The weighted average closing price of the shares immediately before the dates on which options were exercised was £6.85.

HSBC Holdings Group Share Option Plan¹

HSBC Holdings ordinary shares of US\$0.50

Dates of award		Exercise price (£)		Exercisable		At 1 Jan 2010	Exercised during year ²	Lapsed during year	At 31 Dec 2010
from	to	from	to	from	to				
4 Oct 2000	20 Apr 2005	6.0216	8.4024	4 Oct 2003	20 Apr 2015	157,719,485	1,015,349	3,946,021	152,758,115

1 The HSBC Holdings Group Share Option Plan expired on 26 May 2005. No options have been granted under the Plan since that date.

2 The weighted average closing price of the shares immediately before the dates on which options were exercised was £6.80.

HSBC Share Plan

HSBC Holdings ordinary shares of US\$0.50

Date of award	Exercise price (£)	Exercisable		At 1 Jan 2010	Exercised during year	Lapsed during year	At 31 Dec 2010
		from	to				
30 Sep 2005	7.9911	30 Sep 2008	30 Sep 2015	86,046	–	–	86,046

Subsidiary company share plans**HSBC France and subsidiary company**

When it was acquired in 2000, HSBC France and one of its subsidiary companies, HSBC Private Bank France, operated employee share option plans under

which options could be granted over their respective shares. No further options will be granted under either of these companies' plans. The following are details of outstanding options to acquire shares in HSBC France and HSBC Private Bank France.

HSBC France

Shares of €5

Date of award	Exercise price (€)	Exercisable		At 1 Jan 2010	Exercised during year	Lapsed during year	At 31 Dec 2010
		from	to				
12 Apr 2000	142.50	1 Jan 2002	12 Apr 2010	604,250	–	604,250	–

HSBC Private Bank France

Shares of €2

Dates of award		Exercise price (€)		Exercisable		At 1 Jan 2010	Exercised during year ¹	Lapsed during year	At 31 Dec 2010 ¹
from	to	from	to	from	to				
10 Mar 2000	1 Oct 2002	12.44	22.22	27 Jun 2004	1 Oct 2012	291,520	4,420	–	287,100

1 Following exercise of the options, the HSBC Private Bank France shares will be exchanged for HSBC Holdings ordinary shares in the ratio of 2.099984 HSBC Holdings ordinary shares for each HSBC Private Bank France share. At 31 December 2010, The CCF Employee Benefit Trust 2001 held 989,502 HSBC Holdings ordinary shares which may be exchanged for HSBC Private Bank France shares arising from the exercise of these options.

Report of the Directors: Governance (continued)

HSBC Finance

Following the acquisition of HSBC Finance in 2003, all outstanding options and equity-based awards over HSBC Finance common shares were converted into rights to receive HSBC Holdings ordinary shares in the same ratio as the share exchange offer for the acquisition of HSBC Finance (2.675 HSBC Holdings ordinary shares for each HSBC Finance common share) and the exercise prices per share were adjusted accordingly. No further options will be granted under the plans.

All outstanding options and other equity-based awards over HSBC Finance common shares granted

HSBC Finance: 1996 Long-Term Executive Incentive Compensation Plan HSBC Holdings ordinary shares of US\$0.50

Dates of award		Exercise price (US\$)		Exercisable	
from	to	from	to	from	to
8 Feb 2000	20 Nov 2002	9.29	18.62	8 Feb 2001	20 Nov 2012

1 The weighted average closing price of the shares immediately before the dates on which options were exercised was £6.44.

HSBC Bank Bermuda

Following the acquisition of HSBC Bank Bermuda in 2004, all outstanding options over HSBC Bank Bermuda shares were converted into rights to receive HSBC Holdings ordinary shares based on the consideration of US\$40 for each HSBC Bank Bermuda share and the average closing price of HSBC Holdings ordinary shares, derived from the London Stock Exchange Daily Official List, for the five business days preceding the closing date of the

HSBC Bank Bermuda: Executive Share Option Plan 1997 HSBC Holdings ordinary shares of US\$0.50

Dates of award		Exercise price (US\$)		Exercisable	
from	to	from	to	from	to
4 Feb 2000	11 Jan 2001	6.13	12.44	4 Feb 2001	11 Jan 2011

1 The weighted average closing price of the shares immediately before the dates on which options were exercised was £6.89.

HSBC Bank Bermuda: Share Option Plan 2000 HSBC Holdings ordinary shares of US\$0.50

Dates of award		Exercise price (US\$)		Exercisable	
from	to	from	to	from	to
11 Jan 2001	21 Apr 2003	9.32	15.99	11 Jan 2002	21 Apr 2013

before 14 November 2002, being the date the transaction was announced, vested on completion of the acquisition. Options granted after 14 November 2002 are exercisable on their original terms, save that they were adjusted to reflect the exchange ratio.

The following are details of options to acquire shares in HSBC Holdings.

At 31 December 2010, the HSBC (Household) Employee Benefit Trust 2003 held 2,335,315 HSBC Holdings ordinary shares and 1,455 American Depositary Shares, each of which represents five HSBC Holdings ordinary shares, which may be used to satisfy the exercise of employee share options.

At 1 Jan 2010	Exercised during year ¹	Lapsed during year	At 31 Dec 2010
18,105,959	306,964	6,681,169	11,117,826

acquisition. No further options will be granted under any of these plans.

All outstanding options over HSBC Bank Bermuda shares vested on completion of the acquisition. The following are details of options to acquire shares in HSBC Holdings. At 31 December 2010, the HSBC (Bank of Bermuda) Employee Benefit Trust 2004 held 2,108,830 HSBC Holdings ordinary shares which may be used to satisfy the exercise of employee share options.

At 1 Jan 2010	Exercised during year ¹	Lapsed during year	At 31 Dec 2010
190,221	4,781	123,539	61,901

Report of the Directors: Governance (continued)

HSBC Bank Bermuda: Directors' Share Option Plan

HSBC Holdings ordinary shares of US\$0.50

Dates of award		Exercise price (US\$)		Exercisable		At 1 Jan 2010	Exercised during year	Lapsed during year	At 31 Dec 2010
from	to	from	to	from	to				
28 Mar 2001	30 Apr 2003	10.66	13.95	28 Mar 2002	30 Apr 2013	40,515	–	14,349	26,166

HSBC InvestDirect (India) Limited

When it was acquired in 2008, HSBC InvestDirect (India) Limited, formerly IL&FS Investsmart Limited, operated an employee share option plan. Under the plan, the options vested one year from the

date of grant in equal tranches over three years. The exercise period is a maximum of seven years from the date of vesting. Following the acquisition, all outstanding options vested on 18 November 2008. No further options will be granted under this plan.

HSBC InvestDirect (India) Limited: Employee Stock Option Scheme 2006

HSBC InvestDirect (India) ordinary shares of Rs10

Date of award	Exercise price (Rs)	Exercisable		At 1 Jan 2010	Exercised during year ¹	Lapsed during year	At 31 Dec 2010
		from	to				
19 Nov 2007	180	18 Nov 2002	17 Nov 2015	873,000	873,000	–	–

¹ The weighted average closing price of the shares, as quoted on the Bombay Stock Exchange Limited and the National Stock Exchange of India Limited, immediately before the dates on which options were exercised was Rs298.76 and Rs297.73 respectively for those shares exercised before trading in the shares ceased on 8 July 2010. The Company was delisted from the Bombay Stock Exchange Limited and the National Stock Exchange of India Limited on 15 July 2010.

Employee compensation and benefits

Note 7 on the Financial Statements gives details about employee compensation and benefits including pension plans.

Set out below is information in respect of the five individuals (including two Directors of HSBC Holdings) whose emoluments were the highest in HSBC for the year ended 31 December 2010.

Emoluments of 5 highest paid employees

	£000
Basic salaries, allowances and benefits in kind	3,874
Pension contributions	807
Bonuses paid or receivable	29,339
Inducements to join paid or receivable	288
Compensation for loss of office	–
Total	34,308
Total (US\$000)	52,983

Their emoluments were within the following bands:

	Number of employees
£6,300,001 – £6,400,000	3
£6,800,001 – £6,900,000	1
£8,400,001 – £8,500,000	1

In accordance with the agreement made between the major UK banks and the UK Government on 9 February 2011 (Project Merlin), set out below is information in respect of the five highest paid senior executives (who are members of the GMB, but not Directors of HSBC Holdings plc) for the year ended 31 December 2010.

Report of the Directors: Governance (continued)*Emoluments of 5 highest paid senior executives*

	Employee				
	1	2	3	4	5
	£000	£000	£000	£000	£000
Fixed					
Cash based	283	623	421	400	467
Total fixed	283	623	421	400	467
Variable¹					
Cash	493	393	404	406	337
Non-deferred shares ²	493	393	404	406	337
Deferred cash	740	590	605	608	505
Deferred shares	740	590	605	608	505
Total variable pay	2,467	1,967	2,018	2,028	1,683
Total remuneration	2,750	2,590	2,439	2,428	2,150
	US\$000	US\$000	US\$000	US\$000	US\$000
Total remuneration	4,247	4,000	3,767	3,750	3,320

1 Variable pay in respect of performance year 2010.

2 Vested shares, subject to a 6-month retention period.

The aggregate remuneration of Directors and Senior Management (being members of the Group Management Board) for the year ended 31 December 2010 was US\$67,760,722.

The aggregate amount set aside or accrued to provide pension, retirement or similar benefits for Directors and Senior Management for the year ended 31 December 2010 was US\$3,348,298.

Executive Directors and members of Senior Management are generally subject to notice periods of up to 12 months and a normal retirement age of 65.

Bank payroll tax

In December 2009, the governments of the UK and France introduced one-off taxes in respect of certain bonuses payable by banks and banking groups. In both countries the tax was levied at 50% on bonuses awarded during a certain period and over a threshold amount. The taxes are liabilities of the employer and are payable on awards of both cash and shares. The amount payable and paid in respect of the relevant tax was US\$282m in the UK and US\$42m in France.

Corporate sustainability

At HSBC, we recognise that environmental, social and economic issues can affect the Group's long-term success as a business. For us, corporate sustainability means achieving sustainable profit growth so that we can continue to reward shareholders and employees, build long-lasting relationships with customers and suppliers, pay taxes

and duties in those countries where we operate, and invest in communities for future growth.

Our continuing financial success depends, in part, on our ability to identify and address certain factors which present risks or opportunities for the business. These can affect our reputation, drive employee engagement, help manage the risks of lending, leverage savings through eco-efficiency and secure new revenue streams. They generally fall into one or more of the four broad areas discussed below.

Business finance

We aim to build long-term customer relationships around the world through the provision of a consistent and high-quality service and customer experience. We use the benefits of our scale, financial strength, geographical reach and strong brand value to achieve this.

We aim to take advantage of the opportunities and manage the risks presented by emerging global trends by leading the development of sustainable business models to address them. We understand that the world is changing, with significant examples being increased longevity, a widening gap in the relative growth rates of emerging and mature economies and the need to move to a lower-carbon economy in order to mitigate some of the effects of climate change. Over the long term, we anticipate playing a leading role in shaping the market response to these challenges and we are among those financial institutions identifying how business can adapt in ways that bring both social and environmental benefits, while providing viable economic returns.

Report of the Directors: Governance (continued)

Operational environmental management

We focus our environmental initiatives primarily on addressing and responding to issues associated with climate change, including energy use, water and waste management. Climate change has the potential to materially affect our customers and, by extension, our long-term success, introducing new risks to business activity. However, it also has the potential to stimulate a new era of low carbon growth, innovation and development. In 2010, we continued to deepen our understanding of the likely effects that climate change and the responses to it will have upon our business and those of our customers. For example, the HSBC Climate Vulnerability Assessment, which maps risks for the G20 in 2020, indicates the impact of climate change on food production, water availability and health. An understanding of the scale of the issues helps the Group – and our customers – to focus on how best to respond.

Community investment

We have a long-standing commitment to the communities in which we operate. Many of our key markets are emerging economies. Our operations bring benefits to our host countries through tax contributions, and to local people and businesses through employment, training, purchasing and investment. Beyond our core business, we aim to encourage social and economic opportunity through community investment activities.

Our focus is on education and the environment because we believe they are essential building blocks for the development of communities and are prerequisites for economic growth. Global education programmes such as Future First, JA More Than Money™ and Eco-Schools focus on helping disadvantaged children, promoting financial literacy and environmental education and understanding. Our flagship environmental programme is the HSBC Climate Partnership, a US\$100m commitment to working with The Climate Group, Earthwatch, Smithsonian Tropical Research Institute and WWF on tackling climate change.

In 2010, we donated a total of US\$108m to community investment projects (2009: US\$100m).

Employee issues

'Employee engagement' describes employees' emotional and intellectual commitment to their organisation and its success and is critical to the long-term ability of the Group to deliver the highest quality of financial services. Our annual Global People Survey shows that employees value our

commitment to sustainable business practices and view us as being a leader in this regard. In 2010, 81% of colleagues said they were satisfied with the actions HSBC is taking to embed sustainability (e.g. environmental and social issues) into the way we run our business.

Sustainability governance

The Corporate Sustainability Committee, a committee of the Board, is responsible for advising the Board, committees of the Board and executive management on corporate sustainability policies, including environmental, social and ethical issues.

The terms of reference of the Corporate Sustainability Committee, which are reviewed annually, are available at www.hsbc.com/boardcommittees.

The members of the Committee during 2010 were N R N Murthy, a non-executive Director (appointed Chairman on 28 May 2010), V H C Cheng, an executive Director (appointed 28 May 2010), W K L Fung (retired 28 May 2010), Sir Mark Moody-Stuart (retired 28 May 2010) and G V I Davis, Lord May and Dame Mary Marsh, who are non-director members of the Committee. The Corporate Sustainability Committee held five meetings in 2010. The table on page 190 gives details of Directors' attendance at these meetings. Following each meeting, the Committee reports to the Board on its activities.

We report on progress in developing and implementing our sustainability strategy annually in the HSBC Sustainability Report, which is independently verified and prepared using the Global Reporting Initiative. PricewaterhouseCoopers verified the Group's commitment to carbon neutrality and adherence to the Equator Principles. The *HSBC Sustainability Report 2010* will be issued on 27 May 2011 and will be available at www.hsbc.com/sustainability.

We have a Corporate Sustainability department within the Group Management Office and in each of our major regions and countries of operation. At an operational level, implementation of our sustainability policies is managed primarily by Group Corporate Sustainability, Group Human Resources, Group Risk and Group Compliance.

Sustainability risk

Our approach to managing sustainability risk is detailed on page 173.

Report of the Directors: Governance (continued)

Health and safety

The maintenance of appropriate health and safety standards remains a key responsibility of all managers and we are committed to proactively managing all health and safety risks associated with our business. Our objectives are to identify, remove, reduce or control material risks of fires and of accidents or injuries to employees and visitors.

Group standards, instructions and related policies and procedures are set by Group Corporate Real Estate. Implementation in-country is coordinated through Health, Safety and Fire Co-ordinators based in each country in which we operate. They may call upon regional and Group resources by way of support at any time.

Group Security provides regular risk assessments in areas of increased risk to assist management in judging the level of terrorist threat. Regional security functions conduct regular security reviews to ensure measures to protect our staff, buildings, assets and information are appropriate for the level of threat. We remain committed to maintaining our preparedness and to ensuring the highest standards of health and safety wherever in the world we operate.

Supplier payment policy

We do not currently subscribe to any code or standard on payment practice. Our policy is to settle terms of payment with suppliers when agreeing the terms of each transaction, to ensure that those suppliers are made aware of the terms of payment, and to abide by the terms of payment.

It is our practice to organise payment to our suppliers through a central accounts payable function operated by our subsidiary, HSBC Bank. Included in the balance with HSBC Bank is the amount due to trade creditors which, at 31 December 2010, represented 27 days' average daily purchases of goods and services received from such creditors, calculated in accordance with the Companies Act 2006, as amended by Statutory Instrument 2008 No. 410.

Share capital

Issued share capital

The nominal value of our issued share capital paid up at 31 December 2010 was US\$8,843,092,451 divided into 17,686,155,902 ordinary shares of US\$0.50 each, 1,450,000 non-cumulative preference shares of US\$0.01 each and 1 non-cumulative preference share of £0.01.

The percentage of the nominal value of our total issued share capital paid up at 31 December 2010 represented by the ordinary shares of US\$0.50 each, non-cumulative preference shares of US\$0.01 each and the non-cumulative preference share of £0.01 was approximately 99.9998, 0.0002, and 0%, respectively.

Rights and obligations attaching to shares

The rights and obligations attaching to each class of shares in our share capital are set out in our Articles of Association subject to certain rights and obligations that attach to each class of preference share as determined by the Board prior to allotment of the relevant preference shares. Set out below is a summary of the rights and obligations attaching to each class of shares with respect to voting, dividends, capital and, in the case of the preference shares, redemption.

To be registered, a transfer of shares must be in relation to shares which are fully paid up and on which we have no lien and to one class of shares denominated in the same currency. The transfer must be in favour of a single transferee or no more than four joint transferees and it must be duly stamped (if required). The transfer must be delivered to our registered office or our Registrars accompanied by the certificate to which it relates or such other evidence that proves the title of the transferor.

If a shareholder or any person appearing to be interested in our shares has been sent a notice under section 793 of the Companies Act 2006 (which confers upon public companies the power to require information from any person whom we know or have reasonable cause to believe to be interested in the shares) and has failed in relation to any shares (the 'default shares') to supply the information requested within the period set out in the notice, then the member, unless the Board otherwise determines, is not entitled to be present at or to vote the default shares at any general meeting or to exercise any other right conferred by being a shareholder. If the default shares represent at least 0.25% in nominal value of the issued shares of that class, unless the Board otherwise determines, any dividend shall be withheld by the Company without interest, no election may be made for any scrip dividend alternative, and no transfer of any shares held by the member will be registered except in limited circumstances.

Ordinary shares

Subject to the Companies Act 2006 and the Articles of Association, we may, by ordinary resolution,

Report of the Directors: Governance (continued)

declare dividends to be paid to the holders of ordinary shares, though no dividend shall exceed the amount recommended by the Board. The Board may pay interim dividends as appears to the Board to be justified by the profits available for distribution. All dividends shall be apportioned and paid proportionately to the percentage of the nominal amount paid up on the shares during any portion or portions of the period in respect of which the dividend is paid, but if any share is issued on terms providing that it shall rank for dividend as from a particular date, it shall rank for dividend accordingly. Subject to the Articles of Association, the Board may, with the prior authority of an ordinary resolution passed by the shareholders and subject to such terms and conditions as the Board may determine, offer to any holders of ordinary shares the right to elect to receive ordinary shares of the same or a different currency, credited as fully paid, instead of cash in any currency in respect of the whole (or some part, to be determined by the Board) of any dividend specified by the ordinary resolution. At the 2007 Annual General Meeting shareholders gave authority to the Directors to determine to offer a scrip dividend alternative until the conclusion of the Annual General Meeting in 2012.

Preference shares

There are three classes of preference shares in the share capital of HSBC Holdings, non-cumulative preference shares of US\$0.01 each (the 'Dollar Preference Shares'), non-cumulative preference shares of £0.01 each (the 'Sterling Preference Shares') and non-cumulative preference shares of €0.01 (the 'Euro Preference Shares'). The Dollar Preference Shares in issue are Series A Dollar Preference Shares and the Sterling Preference Share in issue is a Series A Sterling Preference Share. There are no Euro Preference Shares in issue.

Dollar Preference Shares

Holders of the Dollar Preference Shares are only entitled to attend and vote at general meetings if any dividend payable on the relevant preference shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full or in such other circumstances, and upon and subject to such terms, as the Board may determine prior to allotment of the relevant preference shares. In the case of the Dollar Preference Shares in issue at 28 February 2011 the relevant period determined by the Board is four consecutive dividend payment dates. Whenever holders of the Dollar Preference Shares are entitled

to vote on a resolution at a general meeting, on a show of hands every such holder who is present in person or by proxy shall have one vote and on a poll every such holder who is present in person or by proxy shall have one vote per preference share held by him or her or such number of votes per share as the Board shall determine prior to allotment of such share.

Subject to the Articles of Association, holders of the Dollar Preference Shares have the right to a non-cumulative preferential dividend at such rate, on such dates and on such other terms and conditions as may be determined by the Board prior to allotment thereof in priority to the payment of any dividend to the holders of ordinary shares and any other class of shares of HSBC Holdings in issue (other than (i) the other preference shares in issue and any other shares expressed to rank *pari passu* therewith as regards income; and (ii) any shares which by their terms rank in priority to the relevant preference shares as regards income). A dividend of US\$62.00 per annum is payable on each Dollar Preference Share in issue at 28 February 2011. The dividend is paid at the rate of US\$15.50 per quarter at the sole and absolute discretion of the Board.

A dividend will not be declared or paid on the Dollar Preference Shares if payment of the dividend would cause HSBC Holdings not to meet the applicable capital adequacy requirements of the FSA or the profit of HSBC Holdings available for distribution as dividends is not sufficient to enable HSBC Holdings to pay in full both dividends on the relevant preference shares and dividends on any other shares that are scheduled to be paid on the same date and that have an equal right to dividends. Dividends will not be declared or paid on any class of shares of HSBC Holdings ranking lower in the right to dividends than the Dollar Preference Shares nor redeem nor purchase in any manner any of its other shares ranking equal with or lower than the Dollar Preference Shares unless it has paid in full, or set aside an amount to provide for payment in full, the dividends on the Dollar Preference Shares for the then-current dividend period.

The Dollar Preference Shares carry no rights to participate in the profits or assets of HSBC Holdings other than as set out in the Articles of Association and subject to the Companies Act 2006, do not confer any right to participate in any offer or invitation by way of rights or otherwise to subscribe for additional shares in HSBC Holdings, do not confer any right of conversion and do not confer any right to participate in any issue of bonus shares or shares issued by way of capitalisation of reserves.

Report of the Directors: Governance (continued)

Subject to the relevant insolvency laws and the Articles of Association of HSBC Holdings, holders of the Dollar Preference Shares have the right in a winding up of HSBC Holdings to receive out of the assets of HSBC Holdings available for distribution to its shareholders, in priority to any payment to the holders of the ordinary shares and any other class of shares of HSBC Holdings in issue (other than (i) the other relevant preference shares and any other shares expressed to rank *pari passu* therewith as regards repayment of capital; and (ii) any shares which by their terms rank in priority to the relevant preference shares as regards repayment of capital), a sum equal to any unpaid dividend on the Dollar Preference Shares which is payable as a dividend in accordance with or pursuant to the Articles of Association and the amount paid up or credited as paid up on the Dollar Preference Shares together with such premium (if any) as may be determined by the Board prior to allotment thereof. In the case of the Dollar Preference Shares in issue at 28 February 2011, the premium is US\$9,999.99 per Dollar Preference Share.

The Dollar Preference Shares may be redeemed in accordance with the Articles of Association and the terms on which Dollar Preference Shares were issued and allotted. In the case of the Dollar Preference Shares in issue at 28 February 2011, HSBC Holdings may redeem such shares in whole at any time on or after 16 December 2010, subject to prior notification to the FSA.

Sterling Preference Shares

The Sterling Preference Shares carry the same rights and obligations under the Articles of Association as the Dollar Preference Shares, save in respect of certain rights and obligations that attach to Sterling Preference Shares to be determined by the Board prior to allotment of the relevant preference shares and the timing and payment of proceeds from the redemption of each class of share. The one Sterling Preference Share in issue at 28 February 2011 carries the same rights and obligations as the Dollar Preference Shares in issue at 28 February 2011 to the extent described in the section above save as follows:

1. the holder of the Sterling Preference Share is not entitled to attend or vote at general meetings;
2. the Sterling Preference Share may be redeemed in whole on any date as may be determined by the Board; and

3. the exceptions to the circumstances in which a dividend will not be declared or paid do not apply.

A dividend of £0.04 per annum is payable on the Sterling Preference Share in issue at 28 February 2011. The dividend is paid at the rate of £0.01 per quarter at the sole and absolute discretion of the Board.

Euro Preference Shares

The Euro Preference Shares carry the same rights and obligations under the Articles of Association as the Dollar Preference Shares, save in respect of certain rights and obligations that attach to Euro Preference Shares which are to be determined by the Board prior to allotment of the relevant preference shares and the timing and payment of proceeds from the redemption of each class of share.

Share capital during 2010

The following events occurred during the year in relation to the ordinary share capital of HSBC Holdings:

Scrip dividends

1. 13,135,446 ordinary shares were issued at par in January 2010 to shareholders who elected to receive new shares in lieu of the third interim dividend for 2009. The market value per share used to calculate shareholders' entitlements to new shares was US\$12.2112, being the US dollar equivalent of £7.3900.
2. 81,996,589 ordinary shares were issued at par in May 2010 to shareholders who elected to receive new shares in lieu of the fourth interim dividend for 2009. The market value per share used to calculate shareholders' entitlements to new shares was US\$10.2149, being the US dollar equivalent of £6.8154.
3. 83,004,992 ordinary shares were issued at par in July 2010 to shareholders who elected to receive new shares in lieu of the first interim dividend for 2010. The market value per share used to calculate shareholders' entitlements to new shares was US\$8.9918, being the US dollar equivalent of £6.2990.
4. 74,810,373 ordinary shares were issued at par in October 2010 to shareholders who elected to receive new shares in lieu of the second interim dividend for 2010. The market value per share used to calculate shareholders' entitlements to new shares was US\$9.8237, being the US dollar equivalent of £6.3832.

Report of the Directors: Governance (continued)

All-Employee share plans

5. In connection with the exercise of options under the HSBC Holdings savings-related share option plans: 9,796,778 ordinary shares were issued at prices ranging from £3.3116 to £6.6870 per share; 5,258,144 ordinary shares were issued at prices ranging from HK\$37,8797 to HK\$94.5057 per share; 1,418,224 ordinary shares were issued at prices ranging from US\$4.8876 to US\$12.0958 per share; and 356,578 ordinary shares were issued at prices ranging from €3.6361 to €9.5912 per share. Options over 19,857,648 ordinary shares lapsed.
6. 2,928,158 ordinary shares were issued at €6.1884 per share in connection with a Plan d'Epargne Entreprise for the benefit of non-UK resident employees of HSBC France and its subsidiaries.
7. Options over 22,017,216 ordinary shares were granted at nil consideration under the HSBC Holdings savings-related share option plans on 21 April 2010 in response to applications from approximately 44,500 applications received from HSBC employees resident in over 75 countries and territories.

Discretionary share incentive plans

8. 4,228,503 ordinary shares were issued at a price of £6.5009 per share in connection with the exercise of options under the HSBC Holdings Executive Share Option Scheme. Options over 2,478,345 ordinary shares lapsed.
9. 1,015,349 ordinary shares were issued at prices ranging from £6.0216 to £7.3244 per share in connection with the exercise of options under the HSBC Holdings Group Share Option Plan. Options over 3,946,021 ordinary shares lapsed.
10. No options were exercised under and no ordinary shares were issued in connection with the HSBC Share Plan. No options over ordinary shares lapsed.

Cancellation of Deferred Shares and issue of one Series A Sterling Preference Share

11. HSBC Holdings acquired and cancelled its 301,500 non-voting deferred shares of £1 each as part of a technical capital reorganisation necessitated by the amended EU Capital Requirements Directive 2. To facilitate the cancellation of the deferred shares and comply with the provisions of the Companies (Authorised Minimum) Regulations 2009,

HSBC Holdings issued one Sterling Preference Share of £0.01 to Tooley Street View Limited for £1.00 on 29 December 2010.

Authority to allot shares

12. At the Annual General Meeting in 2010, shareholders renewed the general authority for the Directors to allot new shares. The general authority is to allot up to 3,484,638,000 ordinary shares, 10,000,000 non-cumulative preference shares of £0.01 each, 8,550,000 non-cumulative preference shares of US\$0.01 each and 10,000,000 non-cumulative preference shares of €0.01 each. Within this, the Directors have authority to allot up to a maximum of 871,159,500 ordinary shares wholly for cash to persons other than existing shareholders.

Other than as described above, the Directors did not allot any shares during 2010.

Treasury Shares

In accordance with the terms of a waiver granted by the Hong Kong Stock Exchange on 19 December 2005, HSBC Holdings will comply with the applicable law and regulation in the UK in relation to the holding of any shares in treasury and with the conditions of the waiver in connection with any shares it may hold in treasury. No shares are currently held in treasury.

Dividends, shareholders and meetings

Dividends for 2010

First, second and third interim dividends for 2010, each of US\$0.08 per ordinary share, were paid on 7 July 2010, 6 October 2010 and 12 January 2011 respectively. Note 11 on the Financial Statements gives more information on the dividends declared in 2010. On 28 February 2011, the Directors declared a fourth interim dividend for 2010 of US\$0.12 per ordinary share in lieu of a final dividend, which will be payable on 5 May 2011 in cash in US dollars, or in sterling or Hong Kong dollars at exchange rates to be determined on 27 April 2011, with a scrip dividend alternative. As the fourth interim dividend for 2010 was declared after 31 December 2010 it has not been included in the balance sheet of HSBC as a debt. The reserves available for distribution at 31 December 2010 were US\$36,013m.

A quarterly dividend of US\$15.50 per 6.20% non-cumulative US Dollar Preference Share, Series A ('Series A Dollar Preference Share'), (equivalent

Report of the Directors: Governance (continued)

to a dividend of US\$0.3875 per Series A American Depositary Share, each of which represents one-fortieth of a Series A Dollar Preference Share), was paid on 15 March, 15 June, 15 September and 15 December 2010.

Dividends for 2011

The proposed timetable for interim dividends in respect of 2011 on the ordinary shares of US\$0.50 is set out in the Shareholder Information section on page 371.

Quarterly dividends of US\$15.50 per Series A Dollar Preference Share (equivalent to a dividend of US\$0.3875 per Series A American Depositary Share, each of which represents one-fortieth of a Series A Dollar Preference Share) and £0.01 per Series A Sterling Preference Share were declared on 8 February 2011 for payment on 15 March 2011.

Communication with shareholders

Communication with shareholders is given high priority. Extensive information about our activities is provided in the *Annual Report and Accounts*, *Annual Review* and the *Interim Report* to shareholders which are available on www.hsbc.com. There is regular dialogue with institutional investors and enquiries from individuals on matters relating to their shareholdings and our business are welcomed and are dealt with in an informative and timely manner. All shareholders are encouraged to attend the Annual General Meeting or the informal meeting of shareholders held in Hong Kong to discuss our progress.

Notifiable interests in share capital

At 31 December 2010, we had received the following disclosures (which have not been subsequently amended or withdrawn) of major holdings of voting rights pursuant to the requirements of the FSA Disclosure and Transparency Rule 5:

- Legal & General Group Plc gave notice on 3 March 2010 that it had a direct interest on 2 March 2010 in 696,986,631 HSBC Holdings ordinary shares, representing 4% of the total voting rights at that date and gave notice on 9 March 2010 that on 8 March 2010 its holding of HSBC ordinary shares fell to 3.99% of the total voting rights at that date.
- BlackRock, Inc. gave notice on 9 December 2009 that it had a direct interest on 7 December 2009 in 1,143,379,437 HSBC Holdings ordinary shares, representing 6.57% of the total voting rights at that date.

As at 31 December 2010, according to the register maintained by HSBC Holdings pursuant to section 336 of the Securities and Futures Ordinance of Hong Kong:

- JPMorgan Chase & Co. gave notice on 29 November 2010 that on 23 November 2010 it had the following interests in HSBC Holdings ordinary shares: a long position of 1,200,117,042 ordinary shares, a short position of 71,496,203 ordinary shares and a lending pool of 826,263,258 ordinary shares, each representing 6.79%, 0.40% and 4.67% respectively of the ordinary shares in issue at that date. Since 31 December 2010, JPMorgan Chase & Co gave notice on 15 February 2011 that on 8 February 2011 it had a long position of 1,250,550,419 ordinary shares, a short position of 58,458,752 ordinary shares and a lending pool of 880,975,655 ordinary shares, each representing 7.06%, 0.33% and 4.98% respectively of the ordinary shares in issue at that date.
- BlackRock, Inc. gave notice on 2 December 2010 that on 26 November 2010 it had the following interests in HSBC Holdings ordinary shares: a long position of 1,060,061,018 ordinary shares and a short position of 12,888,242 ordinary shares, each representing 5.99% and 0.01% respectively of the ordinary shares in issue at that date. Since 31 December 2010, Blackrock, Inc. gave notice on 21 January 2011 that on 17 January 2011 it had a long position of 1,057,501,184 ordinary shares and a short position of 11,749,901 ordinary shares, representing 5.97% and 0.07% respectively of the ordinary shares in issue at that date.

In compliance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited at least 25% of the total issued share capital has been held by the public at all times during 2010 and up to the date of this Report.

Dealings in HSBC Holdings shares

Except for dealings as intermediaries by HSBC Bank, HSBC Financial Products (France) and The Hongkong and Shanghai Banking Corporation, which are members of a European Economic Area exchange, neither we nor any of our subsidiaries has purchased, sold or redeemed any of our listed securities during the year ended 31 December 2010.

Report of the Directors: Governance (continued)**Annual General Meeting**

Our Annual General Meeting will be held at the Barbican Hall, Barbican Centre, London EC2 on 27 May 2011 at 11.00am.

An informal meeting of shareholders will be held at 1 Queen's Road Central, Hong Kong on Thursday 19 May 2011 at 4.30pm.

Resolutions to receive the *Annual Report and Accounts*, approve the Directors' Remuneration Report, re-elect Directors and reappoint KPMG Audit Plc as Auditor will be submitted to the Annual General Meeting. KPMG Audit Plc has expressed its willingness to continue in office and the Group Audit Committee and the Board has recommended that KPMG Audit Plc be reappointed. Resolutions will also be submitted to the Annual General Meeting to renew the authorities for the allotment of shares and the disapplication of pre-emption rights and seek approval to increase the fees payable to non-executive Directors; and approve general meetings (other than Annual General Meetings) being called on 14 days' notice.

The Remuneration Committee is consulting with major shareholders about how HSBC can continue to improve the alignment between shareholders and senior management with regard to incentivising long-term sustainable performance. If any material changes to our approach result from this consultation, a resolution will be submitted to the Annual General Meeting.

A live webcast of the Annual General Meeting will be available on www.hsbc.com. From shortly after the conclusion of the Annual General Meeting until 30 June 2011 a recording of the proceedings will be available on www.hsbc.com.

On behalf of the Board
D J Flint, *Group Chairman*
HSBC Holdings plc
Registered number 617987

28 February 2011

Directors' Remuneration Report

Report of the Remuneration Committee

Report of the Remuneration Committee	Page	220
Remuneration Committee – members and advisers		222
Overall principles		222
Executive Directors' remuneration		223
Executive Directors' 2010 emoluments and remuneration		224
Salary		225
Annual bonus		225
Performance Shares		226
Funding		228
Total shareholder return		228
Pensions		228
Share ownership guidelines		228
Service contracts		228
Other directorships		229
Non-executive Directors		229
Fees		230
Pensions		231
Share Plans		232

The principal purpose of HSBC's remuneration strategy is to support and drive sustainable performance over the long-term. Remuneration should reward success towards this end, but it must also not reward failure and it must be properly aligned with risk which remains on the balance sheet.

HSBC strives to achieve this through a variety of ways which are detailed under 'Overall principles' on page 222. These include taking a rounded view of financial and non-financial performance in determining reward levels, considering affordability (including cost and quantity of capital and liquidity considerations), market competitiveness, delivering awards with high levels of deferral and making all such deferred awards subject to clawback. Such clawback is applied at the sole discretion of the Remuneration Committee ('the Committee').

In our view these elements help to reinforce and reward the delivery of sustainable performance.

2010 performance

Key achievements

The annual financial objectives that we set for ourselves for 2010 were achieved, although in some areas they were lower than the established long-term targets. In the Group's 2010 performance, particular note was made of the following:

- good growth in profit before tax on both an underlying and a reported basis compared with 2009 and ahead of expectations at the start of 2010. This was primarily driven by lower loan

impairment charges and other credit risk provisions with all regions and customer groups contributing;

- strong growth was achieved in emerging markets with loans and advances to customers and revenue increasing in key markets;
- our capital ratios were above the target range, in part from the contribution of profit to capital but also from our ability to raise capital, as shown in the successful hybrid capital securities issue in the first half of the year;
- we maintained a highly liquid balance sheet, with a ratio of customer advances to customer accounts of 78.1%;
- we increased dividends for our shareholders, reflecting the profit-generating capability of the Group;
- return on average shareholders' equity of 9.5% was below our target range; and
- revenue declined and costs grew, resulting in an increase in the cost efficiency ratio from 52.0% to 55.2%. The Group is working on bringing the ratio back to target levels while meeting the need to invest for future growth.

Key non-financial achievements of the Group in 2010, which reflect the objectives set for senior management, are summarised below:

- process objectives focused on efficiency and qualitative measures which affect financial performance and mitigate risk. The target we set for operational losses as a percentage of revenue was met;
- progress in meeting customer recommendation and brand recognition targets was made in a challenging environment for retail and commercial banking. Brand health targets for PFS and Business Banking were met. Customer recommendation targets were met for the latter but not for PFS; and
- regarding the Group's employees, our 2010 employee engagement score was below target and was less than our 2009 score. However, the 2010 score exceeded the global average and the global financial sector norm for employee engagement in the year. The target for the ratio of revenue to staff costs was also met.

In determining remuneration levels for 2010, the Committee, applying HSBC's remuneration strategy and policy, remained mindful of the interests of the many stakeholders and the broader external context. This included taking into account the pay and

Directors' Remuneration Report (continued)

employment conditions of our employees compared to our Directors and senior executives.

Management of risk

The integration of risk management with reward commenced in 2008 when our Group Risk function became involved in the approval of relevant incentive plans. Subsequently, the concept of imputing the cost of capital in the determination of bonus funding was expanded across HSBC, starting with GB&M, and it now applies throughout the Group.

Since 2009, the Group Chief Risk Officer has provided advice to the Committee on the implications of the remuneration policy on risk and risk management. As outlined in 'Overall principles' on page 222, risk mitigation objectives are included in objectives.

From 2010, we have used a risk appetite framework which describes the quantum and types of risk that we are prepared to take in executing our strategy. It shapes our integrated approach to business, risk and capital management and supports us in achieving our return on equity objectives. The risk appetite framework is agreed by the HSBC Holdings Board and cascaded across businesses and geographies. It provides an important input into the Committee's deliberations with regard to remuneration. In addition, individual performance is also reviewed against key risk appetite targets for credit, market, operational and information and security risks to ensure that proposed individual remuneration is appropriate against these aspects.

In February 2010, the Group Risk Committee was established, which advises the Board on risk appetite and also on aligning reward structures with risk appetite. The Group Risk Committee receives information on risk related aspects of reward structures to be proposed by the Committee. The Group Chief Risk Officer regularly reports to, and attends meetings of, the Group Risk Committee.

Further information relating to our approach to risk management in general is set out on page 198.

Regulation

2010 has seen further significant change to the regulatory environment. Regrettably there is still a wide divergence in how regulations operate globally and this presents significant challenges to HSBC, which operates in 87 countries and territories worldwide. In order to deliver long-term sustainable performance, it is imperative we have market-competitive remuneration in order to attract,

motivate and retain talented and committed employees.

We work to ensure our remuneration policies are aligned with both new regulatory practices and the interests of shareholders and confirm that HSBC is fully compliant with the Financial Stability Board and the Financial Services Authority ('FSA') guidance and rules on remuneration.

Senior management changes

In September 2010, we announced that our Group Chairman, Lord Green, would retire from the Group on 3 December 2010 and that the Group Chief Executive and Chairman of The Hongkong and Shanghai Banking Corporation, M F Geoghegan, would step down as Group Chief Executive with effect from 31 December 2010 and provide advisory support to the Group until his retirement on 31 March 2011. M F Geoghegan will then act as an external consultant up to 30 June 2011. Succession to these positions affecting the executive Directors is set out below.

D J Flint was appointed Group Chairman with effect from 3 December 2010 and continues to be based in London.

S T Gulliver was appointed Group Chief Executive and Chairman of The Hongkong and Shanghai Banking Corporation with effect from 1 January 2011. In keeping with the policy established in September 2009, his principal office is located in Hong Kong.

A A Flockhart was appointed Chairman, Europe, Middle East, Africa, Latin America, Commercial Banking and Chairman of HSBC Bank plc with effect from 1 January 2011. He has relocated from Hong Kong to London to take up this remit.

I J Mackay was appointed an executive Director and the Group Finance Director with effect from 3 December 2010. He has relocated from Hong Kong to London to take up this remit.

2011 remuneration activities

As announced in 2010, the Committee is considering how HSBC can continue to improve the alignment between shareholders and senior management with regard to incentivising long-term sustainable performance. The Committee is currently in the process of consulting with major shareholders on this subject. Any material changes to our approach which result from this consultation will be explained to shareholders in the Chairman's letter accompanying the Notice of the Company's 2011 Annual General Meeting.

Directors' Remuneration Report (continued)

Remuneration Committee – members and advisers

The Committee meets regularly to consider human resource issues relating to terms and conditions of employment, remuneration and retirement benefits. Within the authority delegated by the Board, the Committee is responsible for approving remuneration policy and in doing so takes into account the pay and conditions across our Group. This includes the terms of bonus plans, share plans, other long-term incentive plans and the individual remuneration packages of executive Directors and other senior Group employees, including all in positions of significant influence and those having an impact on our risk profile. No Directors are involved in deciding their own remuneration.

The members of the Committee during 2010 were J D Coombe, W S H Laidlaw, G Morgan and J L Thornton. Sir Mark Moody-Stuart retired as a Director of HSBC Holdings and ceased to be a member and chairman of the Committee on 28 May 2010. J L Thornton was appointed chairman on 28 May 2010.

There were nine meetings of the Committee during 2010. The table on page 190 gives details of Directors' attendance at these meetings. Following

each meeting the Committee reports to the Board on its activities. The terms of reference of the Committee are available at www.hsbc.com/boardcommittees.

The Committee received independent advice on executive remuneration issues from Deloitte LLP and remuneration data from Towers Watson. Each of these firms also provided other consulting services to various parts of the Group. Other consultants are used from time to time to advise on specific issues. Going forward, the Committee has agreed to use advisers only as and when required and that these would be separate from the Company's advisers. During the year, the Group Chief Executive provided regular briefings to the Committee and the Committee received advice from the Group Managing Director, Human Resources, A Almeida, the Head of Group Performance and Reward, T Roberts and B Robertson, then the Group Chief Risk Officer.

Overall principles

Our global reward strategy provides a framework for the Committee to carry out its responsibilities during the year.

HSBC reward strategy	How achieved
A rounded approach to measuring performance	<ul style="list-style-type: none"> We assess performance with reference to clear and relevant objectives set within a holistic balanced scorecard framework. Under this framework, objectives are set under four categories – financial, process (including risk mitigation), customer and people. Significant importance is given to the achievement of efficiency and risk objectives as well as financial objectives. Objectives relating to customer development and the productivity of our human capital are key to sustained financial performance and the development of the Group over the short and medium term.
A focus on total remuneration with variable pay differentiated by performance	<ul style="list-style-type: none"> Reward is delivered through a combination of fixed and variable pay (salary, bonus, other long-term incentives). The variable pay element is differentiated by performance over both the short and long-term. The performance-related elements of pay comprise a material proportion of the total remuneration package for executive Directors, whilst maintaining an appropriate balance between fixed and variable elements. Remuneration is structured to provide an opportunity for market top quartile total remuneration for higher levels of market referenced performance.
Aligning individual rewards with Group performance and shareholders	<ul style="list-style-type: none"> A significant proportion of variable pay is deferred into, predominantly, awards of HSBC Holdings Restricted Shares to align recipients to the future performance of the Group and to retain key talent. For Code Staff (as defined under FSA rules) 50% of deferred variable pay is delivered in the form of deferred cash. Executive Directors and other senior executives are subject to share ownership guidelines.
Competitive and cost effective packages to attract and retain staff	<ul style="list-style-type: none"> A total remuneration package (salary, bonus, long-term incentives and other benefits) which is competitive in relation to comparable organisations in each of the markets in which we operate.
Effective management of risk	<ul style="list-style-type: none"> Discretion is used in order to assess the extent to which performance has been achieved, rather than applying a formulaic approach which, by its nature, may encourage inappropriate risk taking. Performance is assessed taking risk into account using a combination of quantitative and qualitative measures as informed by the risk appetite framework. Affordability is assessed (including the cost and quantity of capital and liquidity considerations). All Restricted Share awards made from 2010 onwards are, prior to vesting, subject to clawback as are deferred cash awards made from 2011 onwards.
Stakeholder interest	<ul style="list-style-type: none"> Consideration of shareholder interests together with consideration of the wider environment and societal aspects. Consideration of the pay and employment conditions of the Group's employees compared to its Directors and senior executives.

Directors' Remuneration Report (continued)

Executive Directors' remuneration

The table below sets out our policy relating to and the purpose of each element of the remuneration package for executive Directors.

Element	Delivery	Policy	Purpose	Timing
Fixed Base salary	<ul style="list-style-type: none"> Cash Monthly Pensionable 	<ul style="list-style-type: none"> Reviewed annually 	<ul style="list-style-type: none"> Reflects the market competitive rate for the role and relative responsibility 	<ul style="list-style-type: none"> Paid during the year
Variable Annual Bonus	<ul style="list-style-type: none"> Comprises a non-deferred and a deferred element. See below 	<ul style="list-style-type: none"> Total annual bonus award (including cash and deferred elements) of up to four times salary Fully discretionary 	<ul style="list-style-type: none"> Reflects the extent to which the individual and the Group's annual objectives have been met under the balanced scorecard approach, risk appetite framework, our absolute and relative performance to our peers and competitive market practice 	<ul style="list-style-type: none"> Awarded in the following financial year
Annual bonus (non-deferred)	<ul style="list-style-type: none"> Either cash or awards of Restricted Shares under the HSBC Share Plan Non pensionable 	<ul style="list-style-type: none"> At least 50% of non-deferred variable remuneration is awarded in Restricted Shares in line with FSA regulations Such share-based variable remuneration is subject to a 6-month retention period 	<ul style="list-style-type: none"> See above Also contributes to retention and encourages alignment with shareholders 	<ul style="list-style-type: none"> Awarded in the following financial year
Annual bonus (deferred)	<ul style="list-style-type: none"> Either deferred cash or awards of Restricted Shares under the HSBC Share Plan Non pensionable 	<ul style="list-style-type: none"> 40% – 60% of variable remuneration is deferred over a period of 3 years, in line with FSA regulations At least 50% of deferred variable remuneration is awarded in Restricted Shares in line with FSA regulations Such share-based variable remuneration is subject to a 6-month retention period 33% vest on each of the first and second anniversaries of an award, the balance (34%) vesting on third anniversary¹ 	<ul style="list-style-type: none"> See above Also contributes to retention and encourages alignment with shareholders 	<ul style="list-style-type: none"> Awarded in the following financial year
Performance Shares	<ul style="list-style-type: none"> Performance Shares awarded under the HSBC Share Plan Non pensionable 	<ul style="list-style-type: none"> Face value at grant of up to a maximum of seven times salary Vesting of awards based on three independent performance measures (relative total shareholder return ('TSR') 40%, economic profit 40% and growth in earnings per share ('EPS') 20%) and an over-riding 'sustained improvement' judgement by the Committee Performance conditions are measured over a three year period Performance targets are reviewed annually to ensure that they remain appropriate and challenging, and to consider whether they should be recalibrated for future awards 	<ul style="list-style-type: none"> To reflect our relative and absolute performance over the long-term. This takes account of an external measure of value creation, a measure of the extent to which the return on capital invested in HSBC is in excess of a benchmark return and a direct measure of the profits generated for shareholders Rewards the creation of sustained growth in shareholder value and encourages alignment with shareholders 	<ul style="list-style-type: none"> Normally awarded in the following financial year
Benefits Pension	<ul style="list-style-type: none"> Deferred cash or cash allowance 	<ul style="list-style-type: none"> Employer contributions based on percentage of salary 	<ul style="list-style-type: none"> Provides market competitive post-retirement benefits 	<ul style="list-style-type: none"> Paid or accrued during the year
Other benefits	<ul style="list-style-type: none"> Benefits in kind or cash allowance Non pensionable 	<ul style="list-style-type: none"> Benefits include provision of medical and other insurance, accountancy advice and travel assistance 	<ul style="list-style-type: none"> Provides market competitive benefits 	<ul style="list-style-type: none"> Received during the year

¹ By exception, V H C Cheng's 2010 award has a vesting date three years from the date of award.

Directors' Remuneration Report (continued)

In order to ensure that executive Directors' remuneration packages are competitive, having regard to the market in which we compete for executive talent, the Committee considers market data from a defined remuneration comparator group. This group comprises of nine global financial services companies, namely Banco Santander, Bank of America, Barclays, BNP Paribas, Citigroup, Deutsche Bank, JPMorgan Chase & Co, Standard Chartered and UBS. These companies were selected on the basis of their broadly similar business coverage, size and international scope, and are subject to annual review for continuing relevance.

The positioning of total remuneration (salary, bonus and the expected value of long-term incentives) for the executive Directors depends on the performance of the Group and individual performance assessed against a combination of financial and non-financial objectives within an annual balanced scorecard. The annual objectives in themselves are derived from medium term strategic plans.

The above approach applies to all executive Directors with the exception of the Group Chairman, D J Flint who from 2011 will no longer receive annual bonus payments and is not expected to be granted awards of Performance Shares, and S T Gulliver, whose variable compensation arrangements for 2010 take into account wholesale banking market practice. With effect from 2011, S T Gulliver will be subject to the same arrangements as other executive Directors.

Executive Directors' 2010 emoluments and remuneration

The emoluments of the Group Chairman and executive Directors of HSBC Holdings for 2010, disclosed pursuant to section 421 of the UK Companies Act 2006 and the Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008, were as follows:

	V H C Cheng		D J Flint		A A Flockhart		M F Geoghegan¹		Lord Green²		S T Gulliver		I J Mackay³	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
£000														
Salary	775	769	845	700	820	662	1,164	1,070	1,160	1,250	800	800	57	–
Allowances ⁴	193	191	434	394	–	–	421	548	31	8	154	8	36	–
Benefits in kind ⁵	311	663	8	8	629	437	430	57	3	4	17	18	27	–
Bonus ⁶	284	–	1,805	–	1,385	–	2,824	–	–	–	2,934	–	24	–
Total emoluments	1,563	1,623	3,092	1,102	2,834	1,099	4,839	1,675	1,194	1,262	3,905	826	144	–
US\$000														
Total emoluments	2,414	2,532	4,775	1,719	4,377	1,714	7,473	2,613	1,844	1,969	6,031	1,288	222	–

The total remuneration of the Group Chairman and executive Directors of HSBC Holdings for 2010, disclosed pursuant to the UK Listing Rules, was as follows:

	V H C Cheng		D J Flint		A A Flockhart		M F Geoghegan¹		Lord Green²		S T Gulliver		I J Mackay³	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
£000														
Salary, allowances and benefits in kind	1,279	1,623	1,287	1,102	1,449	1,099	2,015	1,675	1,194	1,262	971	826	120	–
Bonus ⁷	711	1,240	2,800	2,100	1,808	1,908	3,800	4,000	–	–	5,200	9,000	61	–
Total remuneration	1,990	2,863	4,087	3,202	3,257	3,007	5,815	5,675	1,194	1,262	6,171	9,826	181	–
US\$000														
Total remuneration	3,073	4,466	6,312	4,995	5,030	4,691	8,980	8,852	1,844	1,969	9,530	15,327	280	–

The variance in the above tables is caused by the different definitions of bonus under the UK Companies Act 2006 and the UK Listing Rules. Explanations of the constituent parts of the bonus calculated pursuant to the UK Companies Act 2006 and the UK Listing Rules are given in footnotes 6 and 7 respectively.

1 Stepped down as Group Chief Executive and a Director of HSBC Holdings on 31 December 2010. Retires from the Group on 31 March 2011.

2 Retired as Group Chairman and a Director of HSBC Holdings on 3 December 2010.

3 Appointed a Director of HSBC Holdings on 3 December 2010.

Directors' Remuneration Report (continued)

- 4 Allowances include an executive allowance paid to fund personal pension arrangements and a company car allowance.
- 5 Benefits in kind include provision of medical insurance, other insurance cover, accountancy advice and travel assistance. V H C Cheng, A A Flockhart and M F Geoghegan received housing and other benefits in kind that are normal within the location in which they are employed. I J Mackay relocated to London and he received temporary accommodation for him and his family together with other normal relocation benefits.
- 6 Where applicable, bonus comprises: (i) the estimated monetary value of 33% of the award of HSBC Holdings Restricted Shares that will vest on 1 March 2011 arising from the 2009 bonus awarded in March 2010 that was fully deferred into awards of HSBC Holdings Restricted Shares, as follows: D J Flint, £685,000, A A Flockhart, £662,000, M F Geoghegan £1,304,000 and S T Gulliver, £2,934,000; and (ii) 40% of the annual bonus in respect of the 2010 performance year that is non-deferred. The non-deferred bonus is payable half in cash and half in HSBC Holdings Restricted Shares which are subject to a six month retention period. Full details are set out below and on page 223.
- 7 The Bonus for 2010 comprises the deferred and non-deferred bonus, details of which are set out below and on page 223.

Retirement of M F Geoghegan in 2011

M F Geoghegan will continue to work under his existing compensation arrangements until his retirement on 31 March 2011; however he will not be eligible to receive any bonus in respect of 2011. M F Geoghegan will receive the sum of £1,027,500, and the Group will also make a pension contribution on his behalf equal to £401,250, in lieu of the remaining nine months notice period required to terminate the Service Agreement. Following his retirement, M F Geoghegan will provide consultancy to HSBC for a period of three months from 1 April 2011, at a consultancy fee of £200,000, which he intends to donate to charity. In accordance with our disclosure practices these sums will also be fully disclosed in the 2011 Directors' Remuneration Report.

Salary

To reflect the significantly increased responsibilities and maintain and reinforce a collegiate executive team, the salaries for two executive Directors were adjusted from 1 February 2010, equalising the salaries of D J Flint, S T Gulliver and A A Flockhart. In addition, with effect from 2010 the employer pension contribution or executive allowance, in lieu of pension, for D J Flint, A A Flockhart and S T Gulliver were equalised at 50% of basic salary.

On appointment as Group Chairman, the salary for D J Flint was increased to £1,500,000 with effect from 3 December 2010.

On appointment as Group Chief Executive, the salary for S T Gulliver was increased to £1,250,000, with effect from 1 January 2011.

On appointment as Chairman, Europe, Middle East, Africa, Latin America, Commercial Banking and Chairman of HSBC Bank plc, the salary for A A Flockhart was increased to £975,000, with effect from 1 January 2011.

I J Mackay was appointed an executive Director on 3 December 2010 with a base salary of £700,000, and will receive an executive allowance of 50% in lieu of pension.

No other salary increases are proposed for executive Directors.

Annual bonus

The awards made to executive Directors in respect of 2010 performance will be 60% deferred and 40% non-deferred (with the exception of S T Gulliver, whose arrangements are noted below). 50% of both the deferred and non-deferred components will be in the form of Restricted Shares issued under the HSBC Share Plan. The remaining 50% will be delivered as cash. The vesting policy as noted on page 223 under 'Executive Directors remuneration' will apply to the deferred awards.

S T Gulliver, at his request, will receive his 2010 annual bonus 100% fully deferred in the form of Restricted Shares. This award will be subject to the same vesting policy for other executive Directors' deferred awards.

The award made to the former Group Chief Executive, M F Geoghegan, and the Group Chairman, D J Flint, in respect of his previous role as Chief Financial Officer, Executive Director, Risk and Regulation, reflects the overall achievements of the Group under the balanced scorecard and risk appetite framework. The 2010 results show an improved profit after tax and return on equity, although below our target range, and a strong core tier 1 capital position. Loan impairment charges as a percentage of total operating income reduced and the firm's economic profit position improved, although it remained in an overall negative position. Operational losses for the Group were reduced from last year and notwithstanding the Group's employee engagement score reduced year on year, it still maintained its position ahead of the industry norm. From 2011 and onwards D J Flint will no longer receive an annual bonus payment.

The award made to the Group Chief Executive, S T Gulliver, reflects his overall strong achievements in his previous role as Chairman, Europe, Middle East and Global Businesses. Profit before tax for the businesses within his remit decreased slightly, however this was against challenging market

Directors' Remuneration Report (continued)

conditions. Operational losses for the year, however, also reduced substantially as well as there being a substantial decrease in loan impairment charges as a percentage of total operating income.

The award made to V H C Cheng, Chairman of HSBC Bank (China) Company Limited, reflects his performance in ensuring the continued strategic development in mainland China.

The award made to A A Flockhart reflects his overall achievements in his previous role

Bonus awards

	2010 performance ¹				2009 performance		2008 performance	
	Non-deferred		Deferred		Cash £000	Restricted Shares £000	Cash £000	Restricted Shares £000
	Cash £000	Restricted Shares £000	Cash £000	Restricted Shares £000				
V H C Cheng	142	142	213	213	–	1,240	–	1,639
D J Flint ²	560	560	840	840	–	2,100	–	–
A A Flockhart	362	362	542	542	–	1,908	–	1,655
M F Geoghegan ^{2,3}	760	760	1,140	1,140	–	4,000	–	–
Lord Green ⁴	–	–	–	–	–	–	–	–
S T Gulliver ^{2,5}	–	–	–	5,200	–	9,000	–	–
I J Mackay ⁶	12	12	18	18	–	–	–	–

1 The awards made in respect of 2010 performance will be delivered as described on page 225.

2 D J Flint, M F Geoghegan and S T Gulliver requested that they not be considered for a bonus in respect of 2008.

3 M F Geoghegan has stated that subject to the shares being released, he will make total donations up to the size of his bonus awarded for 2009 performance to charities by 2013.

4 At the former Group Chairman's request, he was not considered for an annual bonus award in 2010, 2009 and 2008.

5 S T Gulliver has requested that 100% of the award made to him in respect of 2010 performance be fully deferred in to Restricted Shares subject to the standard vesting and retention period.

6 Appointed a Director of HSBC Holdings on 3 December 2010.

Performance Shares

No awards of Performance Shares have been made since 2008. No awards are proposed to date. Awards may be considered later in 2011, subject to the conclusion of the current consultation with shareholders concerning a revised approach as referenced on page 221.

The average actual vesting of Performance Share awards made in 2004, 2005, 2006 and 2007 (which were tested in 2007, 2008, 2009 and 2010) has been 26.88% of their face value. The awards granted in 2007 did not satisfy the EPS condition but did satisfy the TSR condition and accordingly, 75.6% of the TSR element of the award (37.8% of the overall award) vested. The awards made in 2008 have not satisfied the EPS or economic profit measures. The extent to which the TSR part of the award will vest will be determined following the completion of the three year period on 25 March 2011.

Description of performance conditions

The performance measures for the long-term incentive awards of Performance Shares under the HSBC Share Plan remain as follows.

as Chairman, Personal and Commercial Banking and Insurance. Profit before tax increased and the return on equity increased in all areas from last year. Operational losses increased from last year, however, resulting in the cost efficiency across his remit to decrease.

The award for I J Mackay, reflects his overall achievements in his previous role as Chief Financial Officer, Asia-Pacific.

The vesting of awards is based on three independent performance measures and an overriding 'sustained improvement' judgement by the Committee. The three Group measures are relative TSR (40% of the award); economic profit (40%); and growth in EPS (20%).

These measures provide a basis on which to measure our relative and absolute performance over the long-term taking into account an external measure of value creation, a measure of the extent to which the return on capital invested in HSBC is in excess of a benchmark return and a direct measure of the profits generated for shareholders.

Awards will not vest unless the Committee is satisfied that our financial performance has shown a sustained improvement in the period since the award date. In determining whether we have achieved such sustained improvement the Committee will take account of all relevant factors, in particular, comparisons against the TSR comparator group in areas such as revenue growth and mix, cost efficiency, credit performance, cash return on cash invested, dividends and TSR.

The performance conditions are measured over a three year performance period and awards forfeited

Directors' Remuneration Report (continued)

to the extent that they have not been met. The performance measures and the targets described below apply to the last awards made in 2008.

Total shareholder return award

TSR is measured against a comparator group comprising the largest global banks in the world as well as other banks against which we compete for business at a regional and/or local level. These companies are:

TSR comparator group	
AGEAS	ICBC
Banco Bradesco	Itau Unibanco
Banco Santander	JPMorgan Chase
Bank of America	Lloyds Banking Group
Bank of China	National Australia Bank
Barclays	Royal Bank of Canada
BBVA	Royal Bank of Scotland
BNP Paribas	Société Générale
Citigroup	Standard Chartered
Credit Suisse Group	UBS
DBS Group	UniCredito Italiano
Deutsche Bank	Wells Fargo

During 2008, HBOS and Wachovia merged with other banks in the comparator group and in 2009 the remainder of the banking activities of Fortis were acquired by BNP Paribas, an existing member of the comparator group. For awards made in 2008, performance from the point of acquisition will track that of the acquirer. This approach retains the free float market capitalisation ('FFMC') weighting of the combined entities. The Committee determined that the comparator group remains large enough to be statistically valid and as such it was not necessary to introduce any replacement banks.

To reflect the fact that the range of market capitalisations within the comparator group is very wide, a FFMC weighted method is used to calculate TSR performance. Under this approach, our out-performance of the comparator group will be calculated by dividing the total FFMC of all of the companies that we have outperformed in terms of TSR by the total FFMC of all of the companies in the comparator group. The extent to which the TSR award vests is determined as follows:

If HSBC's TSR outperforms companies comprising	Proportion of TSR Award vesting ¹
75% of the total FFMC	100%
50% of the total FFMC	20%
< 50% of the total FFMC	nil

¹ Vesting will occur in a straight line between 20% and 100% where our performance falls between these incremental steps.

Economic profit award

Economic profit ('EP') is calculated as the average annual difference between return on invested capital and our benchmark cost of capital and is expressed as a percentage. EP is a key measure of shareholder value creation as it rewards management progressively to the extent that the return on the capital invested in HSBC by its shareholders is in excess of a threshold return, which itself exceeds our benchmark cost of capital.

For the awards made in 2008 the benchmark cost of capital was 10%. Return on invested capital is based on the profit attributable to shareholders. The extent to which the EP award vests is determined as follows:

Average annual EP over three years	Proportion of EP Award vesting ¹
8% or above	100%
< 3%	nil

¹ Vesting will occur in a straight line between 0% and 100% where our performance falls between these incremental steps.

Earnings per share award

Growth in EPS is measured on a point to point basis, by comparing EPS in the third financial year of the performance period with EPS in the financial year preceding that in which the award is made.

EPS growth in Year 3 over the base EPS	Proportion of EPS award vesting ¹
28% or above	100%
16%	20%
< 16%	nil

¹ Vesting will occur in a straight line between 20% and 100% where our performance falls between these incremental steps.

If events occur which cause the Committee to consider that a performance condition has become unfair or impractical in either direction, the right is reserved to the Committee, if it considers it appropriate, to amend, relax or waive the condition.

Awards will vest in full and immediately in cases of death. In the event of redundancy, retirement on grounds of injury or ill health and where a participant ceases to be employed by HSBC due to a company ceasing to be part of HSBC, awards will normally vest at the end of the vesting period on a time-apportioned basis to the extent that the performance conditions have been satisfied. In the event of a change of control, awards will normally vest immediately and on a time-apportioned basis to the extent that the performance

Directors' Remuneration Report (continued)

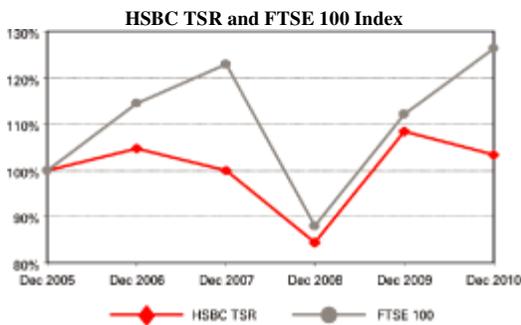
conditions have been satisfied. Awards will normally be forfeited if the participant is dismissed for cause or resigns from HSBC. In all circumstances the Committee retains discretion to ensure fair and reasonable treatment.

Funding

The dilution limits set out in the HSBC share plans comply with the Association of British Insurers' guidelines. To date, all vesting awards of Performance Shares and Restricted Shares under the HSBC Share Plan have been satisfied by the transfer of existing shares. To create additional core tier 1 capital and retain funds within HSBC, the Board has agreed that new shares may be issued to satisfy the vesting of awards of Restricted and Performance Shares that cannot be satisfied from shares already held by employee benefit trusts commencing in 2011.

Total shareholder return

Pursuant to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, the graph below shows the TSR performance against the FTSE 100 Index, for the five-year period ended 31 December 2010. The FTSE 100 Index has been chosen as this is a recognised broad equity market index of which HSBC Holdings is a member.



Source: IDC

Pensions

The normal retirement age for executive Directors is 65, with the exception of V H C Cheng, for whom no retirement age is specified in keeping with local legislation. The pension entitlements of the executive Directors for 2010 are set out on page 231.

Share ownership guidelines

To ensure appropriate alignment with our shareholders, we operate a formal share ownership policy, expressed as a number of shares, for executive Directors and the Group Managing Directors. The Committee considers that material share ownership by executives creates a community of interest between senior management and shareholders.

Under the existing guidelines, the shareholding is expected to be achieved within five years of the executive's appointment or three years from the date of approval of amendments to the HSBC Share Plan on 30 May 2008, whichever is the later. The executive Directors and Group Managing Directors are required to build and retain the following shareholdings:

		Number of shares ¹ held at 31 December 2010
	to be held	
V H C Cheng	200,000	1,383,564
D J Flint ²	400,000	494,933
A A Flockhart	200,000	1,066,450
S T Gulliver ³	600,000	4,279,244
I J Mackay ⁴	200,000	287,719
Group Managing Directors	125,000	— ⁵

- ¹ For the purposes of the guidelines, unvested awards of Restricted Shares are included. Unvested Performance Share awards are excluded.
- ² Appointed Group Chairman on 3 December 2010.
- ³ Appointed Group Chief Executive on 1 January 2011.
- ⁴ Appointed Group Finance Director on 3 December 2010.
- ⁵ All of the Group Managing Directors exceed the expected holdings.

The Committee monitors compliance with the share ownership guidelines annually. The Committee will have full discretion in determining any penalties in cases of non-compliance, which could include a reduction of future awards of long-term incentives and/or an increase in the proportion of the annual bonus that is deferred into shares.

Service contracts

Our policy is to employ executive Directors on one-year rolling contracts although longer initial terms may be approved by the Committee if considered appropriate. The Committee will, consistent with the best interests of the Group, seek to minimise termination payments.

Directors' Remuneration Report (continued)

Name	Contract date (rolling)	Notice period (Director & HSBC)	Compensation on termination by the company without notice or cause
V H C Cheng	15 March 2010	12 months	Payment in lieu of notice equal to base salary, pension entitlements and other benefits.
D J Flint	14 February 2011	12 months	Payment in lieu of notice equal to base salary, pension entitlements and other benefits.
A A Flockhart	14 February 2011	12 months	Payment in lieu of notice equal to base salary, pension entitlements and other benefits. Eligible to be considered for a bonus upon termination of employment other than where the Executive has resigned or the Company has terminated the Executive's employment with the contractual right to do so.
M F Geoghegan ¹	26 February 2010	12 months	Payment in lieu of notice equal to base salary, pension entitlements and other benefits. Eligible for a bonus calculated as not less than the average of the previous two years of bonus payments received, pro-rated for any part-year worked to termination.
Lord Green ²	28 February 2008	12 months	Payment in lieu of notice equal to base salary, pension entitlements and other benefits. Eligible for a bonus calculated as not less than the average of the previous two years of bonus payments received, pro-rated for any part-year worked to termination.
S T Gulliver ³	10 February 2011	12 months	Payment in lieu of notice equal to base salary, pension entitlements and other benefits. Eligible to be considered for a bonus upon termination of employment other than where the Executive has resigned or the Company has terminated the Executive's employment with the contractual right to do so.
I J Mackay ⁴	4 February 2011	12 months	Payment in lieu of notice equal to base salary, pension entitlements and other benefits. Eligible to be considered for a bonus upon termination of employment other than where the Executive has resigned or the Company has terminated the Executive's employment with the contractual right to do so.

¹ Stepped down as Group Chief Executive and a Director of HSBC Holdings on 31 December 2010.

² Retired as Group Chairman and a Director of HSBC Holdings on 3 December 2010.

³ The other benefits as part of the payment in lieu of notice do not include the accommodation and car provided in Hong Kong.

⁴ Appointed a Director of HSBC Holdings on 3 December 2010.

Other directorships

Executive Directors, if so authorised by either the Nomination Committee or the Board, may accept appointments as non-executive Directors of suitable companies which are not part of HSBC. Approval will not be given for executive Directors to accept a non-executive directorship of more than one FTSE 100 company nor the chairmanship of such a company. When considering a non-executive appointment, the Nomination Committee or Board will take into account the expected time commitment of such appointment. The time commitment for executive Directors' external appointments will be reviewed as part of the annual Board review. Any remuneration receivable in respect of an external appointment is normally paid to HSBC, unless otherwise approved by the Committee. D J Flint has elected to donate his fees as a non-executive Director of BP p.l.c. to charity. Lord Green donated his fees from the Supervisory Board of BASF SE to charity.

Non-executive Directors

Non-executive Directors are appointed for fixed terms not exceeding three years, subject to their re-election by shareholders at Annual General Meetings. Non-executive directors have no service contract and are not eligible to participate in our share plans. Current non-executive Directors' terms of appointment will expire as follows:

- in 2011, S A Catz, J D Coombe, J W J Hughes-Hallett, W S H Laidlaw and N R N Murthy;
- in 2012, M K T Cheung, J R Lomax, Sir Simon Robertson, J L Thornton and Sir Brian Williamson; and
- in 2013, R A Fairhead and G Morgan.

L M L Cha was appointed a non-executive Director with effect from 1 March 2011. Subject to her re-election by shareholders at the Annual General Meeting in 2011, her term will expire in 2014.

Directors' Remuneration Report (continued)**Fees**

Non-executive Directors' fees are regularly reviewed and compared with other large international companies of comparable complexity. The current fee, which was approved by shareholders in 2006, is £65,000 per annum. Having considered comprehensive data it is clear that the current non-executive Directors' fee is below the level paid

Board Committee annual fees¹

Group Audit Committee
Group Risk Committee
Remuneration Committee
Nomination Committee
Corporate Sustainability Committee

¹ The Board will consider increasing the fees for service on Board Committees during 2011.

The total of fees paid to each of the non-executive Directors of HSBC Holdings for 2010,

Fees paid to non-executive Directors
(Audited)

	2010 £000	2009 £000
S A Catz	65	65
M K T Cheung ¹	112	89
J D Coombe	130	105
J L Durán ²	27	65
R A Fairhead	152	135
W K L Fung ^{2,3}	54	132
J W J Hughes-Hallett	105	105
W S H Laidlaw	85	85
J R Lomax	102	82
Sir Mark Moody-Stuart ²	51	125
G Morgan	85	85
N R N Murthy	91	85
Sir Simon Robertson	115	115
J L Thornton ⁴	1,068	1,040
Sir Brian Williamson	87	95
Total	2,329	2,408
Total (US\$000)	3,597	3,756

¹ Includes fees as a non-executive Director and member of the Audit Committee of Hang Seng Bank Limited.

² Retired as a Director on 28 May 2010.

³ Includes fees as non-executive Deputy Chairman of The Hongkong and Shanghai Banking Corporation Limited.

⁴ Includes fees as non-executive Chairman of HSBC North America Holdings Inc.

in other major UK companies. The approval will therefore be sought at the Annual General Meeting in 2011 for the fee for non-executive Directors to be increased to £95,000 per annum with effect from 1 January 2011. A fee of £30,000 per annum is payable to the senior independent non-executive Director. In addition, non-executive Directors received the following fees for service on Board Committees:

Chairman £000	Member £000	Meetings held during 2010 (Number)
40	20	6
40	20	4
40	20	9
30	20	3
30	20	5

being emoluments for the purposes of the UK Companies Act 2006, is as follows:

Directors' Remuneration Report (continued)

Pensions

V H C Cheng is a member of the Hong Kong Special Administrative Region Mandatory Provident Fund ('MPF') and received an executive allowance of 25% of annual basic salary during 2010, less the mandatory contributions to the MPF by both the employer and employee, to fund personal pension arrangements (HK\$2,313,000). During 2010, the mandatory employer contribution to the MPF in respect of Mr Cheng was HK\$12,000.

D J Flint received an executive allowance of 55% of basic salary in lieu of personal pension arrangements in the month of January. From 1 February 2010, this allowance was reduced to 50% of basic salary. The executive allowance for the whole of 2010 amounted to £425,224.

A A Flockhart received employer contributions of 40% of basic salary into a personal pension plan in the month of January 2010. From 1 February 2010 Mr Flockhart received employer contributions of 50% of basic salary into a pension plan. The employer contributions for the whole of 2010 amounted to £404,319.

M F Geoghegan received an executive allowance of 50% of basic salary in lieu of pension between 1 January and 25 January 2010. From 26 January 2010, Mr Geoghegan received employer contributions of 50% of basic salary into a pension

plan. The employer contributions for the whole of 2010 amounted to £560,486.

Lord Green ceased membership of the HSBC Bank (UK) Pension Scheme on 5 April 2006. Since 6 April 2006, Lord Green has been entitled to receive benefits from an Employer Funded Retirement Benefits Scheme which together with entitlements from the HSBC Bank (UK) Pension Scheme provided benefits to Lord Green that were broadly comparable to an accrual rate of one-thirtieth of pensionable salary for each year of pensionable service. Lord Green retired on 3 December 2010 and began receiving his pension from 4 December 2010.

S T Gulliver received employer contributions of 30% of basic salary into a personal pension plan in the month of January 2010. From 1 February 2010 Mr Gulliver's pension arrangements were increased to 50% of basic salary. This was delivered as employer contributions of 30% of basic salary into a personal pension plan and an executive allowance of 20% of basic salary. The employer contributions and the executive allowance for the whole of 2010 amounted to £386,667.

I J Mackay received an executive allowance of 50% of basic salary in lieu of pension with effect from his appointment as executive Director on 3 December 2010 (£28,269 for the period to 31 December 2010) to fund personal pension arrangements.

Defined Benefit Pension arrangements

	Accrued annual pension at 31 December 2010 £000	Increase in accrued pension during 2010 £000	Increase in accrued pension during 2010, excluding any increase for inflation £000	Transfer value of accrued pension at 31 December 2009 ¹ £000	Transfer value of accrued pension at 31 December 2010 ¹ £000	Increase of transfer value of accrued pension (less personal contributions) in 2010 ¹ £000	Transfer value (less personal contributions) at 31 December 2010 relating to increase in accrued pensions during 2010, excluding any increase for inflation ¹ £000
A A Flockhart ²	283	13	13	4,863	4,974	111	201
Lord Green ³	–	38	5	19,119	–	381	–

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

2 A A Flockhart ceased accrual of pension in the International Staff Retirement Benefits Scheme ('ISRBS') on 30 November 2008 and he has deferred commencement of his pension. He received no increase for inflation to his accrued pension on 1 January 2010. The ISRBS retains a liability for a contingent spouse's pension of £129,900 per annum as at 31 December 2010.

3 Lord Green retired as a Director on 3 December 2010 and commenced receiving his pension from 4 December 2010.

The table overleaf shows unfunded pension payments, in respect of which provision has been made, during 2010 to six former Directors of HSBC Holdings.

The payments in respect of R Delbridge and Sir Brian Pearse were made by HSBC Bank plc as

former directors of that bank. The payment in respect of C F W de Croisset was made by HSBC France as a former director of that bank. There were no increases to sterling values of the pensions during 2010.

Directors' Remuneration Report (continued)

Unfunded pension payments

	2010 £	2009 £
B H Asher	101,858	101,858
C F W de Croisset	237,662	247,115
R Delbridge	146,507	146,507
Lord Green	2,992	–
Sir Brian Pearse	61,095	61,095
Sir William Purves	107,827	107,827
	657,941	664,402

Share Plans

At 31 December 2010, the undernamed Directors held options and awards of Performance Shares and Restricted Shares to acquire the number of HSBC Holdings ordinary shares set against their respective names.

HSBC Holdings savings-related share option plans

HSBC Holdings ordinary shares of US\$0.50

	Date of award	Exercise price (£)	Exercisable		At	At
			from ¹	until	1 Jan 2010	31 Dec 2010
D J Flint	25 Apr 2007	6.1760	1 Aug 2012	31 Jan 2013	2,650	2,650
A A Flockhart	29 Apr 2009	3.3116	1 Aug 2014	31 Jan 2015	4,529	4,529
		US\$				
I J Mackay	30 Apr 2008	11.8824	1 Aug 2011	31 Jan 2012	1,531 ²	1,531

The HSBC Holdings savings-related share option plans are all-employee share plans under which eligible HSBC employees may be granted options to acquire HSBC Holdings ordinary shares. Employees may make contributions of up to £250 (or equivalent) each month over a period of one, three or five years which may be used on the first, third or fifth anniversary of the commencement of the relevant savings contract, at the employee's election, to exercise the options. The plans help align the interests of employees with the creation of shareholder value and, as such, exercise of the options is not subject to any performance conditions. The options were awarded for nil consideration and are exercisable at a 20% discount to the average market value of the ordinary shares on the five business days immediately preceding the invitation date. No options lapsed during the year. There are no performance criteria conditional upon which the outstanding options are exercisable and there have been no variations to the terms and conditions since the awards were made. The market value per ordinary share at 31 December 2010 was £6.511. The highest and lowest market values per ordinary share during the year were £7.404 and £5.962. Market value is the mid-market price derived from the London Stock Exchange Daily Official List on the relevant date. Under the Securities and Futures Ordinance of Hong Kong, the options are categorised as unlisted physically settled equity derivatives.

- 1 May be advanced to an earlier date in certain circumstances, e.g. retirement.
- 2 Interest at 3 December 2010 – date of appointment.

Awards of Performance Shares

HSBC Share Plan

HSBC Holdings ordinary shares of US\$0.50

	Date of award	Year in which awards may vest	Awards held at	Awards vested during year ^{1,2}		Awards held at
			1 Jan 2010	Number	Monetary value £000	31 Dec 2010 ³
V H C Cheng	5 Mar 2007	2010	218,035	83,769	560	–
	3 Jun 2008	2011	157,852	–	–	163,188
D J Flint	5 Mar 2007	2010	326,626	125,489	838	–
	3 Jun 2008	2011	455,210	–	–	470,596
A A Flockhart	5 Mar 2007	2010	145,238	55,799	373	–
	3 Jun 2008	2011	155,227	–	–	160,474
M F Geoghegan	5 Mar 2007	2010	742,334	285,205	1,905	–
	3 Jun 2008	2011	1,069,746	–	–	1,105,902
Lord Green	5 Mar 2007	2010	556,750	213,903	1,429	–
	3 Jun 2008	2011	1,251,829	–	–	1,294,140 ⁴
S T Gulliver	5 Mar 2007	2010	161,319	61,979	414	–
	3 Jun 2008	2011	67,631	–	–	69,917

Vesting of these awards of Performance Shares is subject to the achievement of the corporate performance conditions set out on pages 226 to 228. Interests in awards of Performance Shares are categorised under the Securities and Futures Ordinance of Hong Kong as the interests of a beneficiary of a trust.

Directors' Remuneration Report (continued)

- The performance conditions of the total shareholder return element of the award were partially met and the following part of the awards vested on 31 March 2010, when the market value per share was £6.68: V H C Cheng, 82,957 shares; D J Flint, 124,273 shares; A A Flockhart, 55,259 shares; M F Geoghegan, 282,440 shares; Lord Green, 211,830 shares; and S T Gulliver, 61,378 shares. The following awards representing the fourth interim dividend for 2009 vested on 5 May 2010, when the market value per share was £6.53: V H C Cheng, 812 shares; D J Flint, 1,216 shares; A A Flockhart, 540 shares; M F Geoghegan, 2,765 shares; Lord Green, 2,073 shares; and S T Gulliver, 601 shares. The market value per share on the date of the award, 5 March 2007, was £8.96.
- The performance conditions for the earnings per share element and the remaining part of the total shareholder return element of the award were not met and, under the terms of the Plan, the following awards were forfeited on 31 March 2010: V H C Cheng, 136,506 shares; D J Flint, 204,493 shares; A A Flockhart, 90,931 shares; M F Geoghegan, 464,757 shares; Lord Green, 348,568 shares; and S T Gulliver, 100,998 shares. As a consequence, the fourth interim dividend for 2009 did not accrue on the forfeited shares.
- Includes additional shares arising from scrip dividends.
- Interest at 3 December 2010 – date of retirement.

Awards of Restricted Shares

HSBC Share Plan

HSBC Holdings ordinary shares of US\$0.50

	Date of award	Year in which awards may vest	Awards held on 1 Jan 2010	Awards made during year ¹		Awards vested during year ²		Awards held at 31 Dec 2010 ³
				Number	Monetary value £000	Number	Monetary value £000	
V H C Cheng	3 Mar 2008	2010 ⁴	103,936	–	–	104,616	713	–
	2 Mar 2009	2012	493,545	–	–	–	–	510,226
	1 Mar 2010	2013	–	193,534	1,320	–	–	198,773
D J Flint	1 Mar 2010	2011-2013 ⁵	–	307,917	2,100	–	–	316,252
A A Flockhart	31 Oct 2007	2010	64,621	–	–	66,806 ⁶	434	–
	3 Mar 2008	2011	15,064	–	–	–	–	15,572
	2 Mar 2009	2012	498,124	–	–	–	–	514,960
	1 Mar 2010	2011-2013 ⁵	–	297,746	2,031	–	–	305,806
M F Geoghegan	1 Mar 2010	2011-2013 ⁵	–	586,510	4,000	–	–	602,387
S T Gulliver	5 Mar 2007	2008-2010 ⁵	191,842	–	–	193,099	1,317	–
	3 Mar 2008	2009-2011 ⁵	388,157	–	–	202,986	1,384	192,796
	1 Mar 2010	2011-2013 ⁵	–	1,319,648	9,000	–	–	1,355,371
I J Mackay	31 Jul 2007	2009-2011 ⁷	47,679 ⁸	–	–	–	–	47,679
	31 Mar 2008	2011	46,252 ⁸	–	–	–	–	46,252
	2 Mar 2009	2012	100,309 ⁸	–	–	–	–	100,309
	1 Mar 2010	2011-2013 ⁵	59,262 ⁸	–	–	–	–	59,262

Vesting of Restricted Share awards is normally subject to the Director remaining an employee on the vesting date. The vesting date may be advanced to an earlier date in certain circumstances, e.g. death or retirement. Under the Securities and Futures Ordinance of Hong Kong, interests in Restricted Share awards granted in 2007 and 2008 are categorised as the interests of a beneficiary of a trust and interests in Restricted Share awards granted in 2009 and 2010 are categorised as the interests of a beneficial owner.

- At the date of the award, 1 March 2010, the market value per share was £6.82.
- At the date of vesting, 1 March 2010, the market value per share was £6.82. The market value per share on the dates of the awards, 5 March 2007 and 3 March 2008, was £8.96 and £7.90 respectively.
- Includes additional shares arising from scrip dividends.
- Vesting accelerated from 2011 to 2010.
- 33% of the award vests on each of the first and second anniversaries of the date of the award, with the balance vesting on the third anniversary of the date of the award.
- At the date of vesting, 29 October 2010, the market value per share was £6.49. The market value per share on the date of the award, 31 October 2007 was £9.51.
- 33% of the award vests on each of the second and third anniversaries of the date of the award with the balance vesting on the fourth anniversary of the date of the award.
- Interest at 3 December 2010 – date of appointment.

On behalf of the Board

J L Thornton

Chairman of Remuneration Committee

28 February 2011

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Report of Independent Registered Public Accounting Firm to the Board of Directors and Shareholders of HSBC Holdings plc

We have audited the accompanying consolidated financial statements of HSBC Holdings plc and its subsidiary undertakings (together 'HSBC') on pages 238 to 370 which comprise the consolidated balance sheets as of 31 December 2010 and 2009, and the related consolidated income statements, consolidated statements of cash flows, consolidated statements of comprehensive income and consolidated statements of changes in equity, for each of the years in the three-year period ended 31 December 2010, including the disclosures marked 'audited' within the critical accounting policies on pages 33 to 36, the 'Report of the Directors: Risk' section on pages 86 to 176 and the 'Report of the Directors: Capital' section on pages 177 to 182. We have also audited HSBC's internal control over financial reporting as of 31 December 2010, based on the framework for Directors' internal control evaluation contained within the Combined Code (The Revised Turnbull Guidance), and the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ('COSO'). HSBC's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying 'Management's Assessment of Internal Controls'. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the effectiveness of HSBC's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on assessed risk. Our audits also included performing other such procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorisations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Report of Independent Registered Public Accounting Firm to the Board of Directors and Shareholders of HSBC Holdings plc (continued)

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of HSBC as of 31 December 2010 and 2009, and the results of its operations and its cash flows for each of the years in the three-year period ended 31 December 2010, in conformity with International Financial Reporting Standards ('IFRSs') as adopted by the European Union ('EU') and IFRSs as issued by the International Accounting Standards Board ('IASB'). Also, in our opinion, HSBC maintained, in all material respects, effective internal control over financial reporting as of 31 December 2010, based on the framework for Directors' internal control evaluation contained within the Combined Code (The Revised Turnbull Guidance) and the criteria established in *Internal Control — Integrated Framework* issued by COSO.

As set out in the note 'Reclassification of financial assets' on page 320, for the year ended 31 December 2008, HSBC changed its method of accounting for certain financial assets following the adoption of 'Reclassification of Financial Assets ('Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures')'.

KPMG Audit Plc
London, England
28 February 2011

Financial statements

Financial statements

	Page		Page
Financial Statements		19 Financial assets designated at fair value	321
Consolidated income statement	238	20 Derivatives	322
Consolidated statement of comprehensive income	239	21 Financial investments	326
Consolidated balance sheet	240	22 Transfers of financial assets not qualifying for derecognition	329
Consolidated statement of cash flows	241	23 Interests in associates and joint ventures	330
Consolidated statement of changes in equity	242	24 Goodwill and intangible assets	332
HSBC Holdings balance sheet	245	25 Property, plant and equipment	336
HSBC Holdings statement of cash flows	246	26 Investments in subsidiaries	338
HSBC Holdings statement of changes in equity	247	27 Other assets	340
Notes on the Financial Statements		28 Trading liabilities	340
1 Basis of preparation	250	29 Financial liabilities designated at fair value	341
2 Summary of significant accounting policies	253	30 Debt securities in issue	341
3 Net income/(expense) from financial instruments designated at fair value	271	31 Other liabilities	342
4 Net earned insurance premiums	272	32 Liabilities under insurance contracts	343
5 Net insurance claims incurred and movement in liabilities to policyholders	272	33 Provisions	346
6 Net operating income	273	34 Subordinated liabilities	346
7 Employee compensation and benefits	274	35 Maturity analysis of assets and liabilities	350
8 Auditors' remuneration	285	36 Foreign exchange exposures	351
9 Share-based payments	286	37 Assets charged as security for liabilities and collateral accepted as security for assets	352
10 Tax expense	291	38 Non-controlling interests	352
11 Dividends	295	39 Called up share capital and other equity instruments	353
12 Earnings per share	296	40 Notes on the statement of cash flows	356
13 Segmental analysis	296	41 Contingent liabilities, contractual commitments and guarantees	358
14 Analysis of financial assets and liabilities by measurement basis	303	42 Lease commitments	359
15 Trading assets	307	43 Special purpose entities	361
16 Fair values of financial instruments carried at fair value	308	44 Legal proceedings, investigations and regulatory matters	365
17 Fair values of financial instruments not carried at fair value	318	45 Related party transactions	368
18 Reclassification of financial assets	320	46 Events after the balance sheet date	370
		Non-statutory accounts	370

Financial Statements (continued)**Consolidated income statement for the year ended 31 December 2010**

	Notes	2010 US\$m	2009 US\$m	2008 US\$m
Interest income		58,345	62,096	91,301
Interest expense		(18,904)	(21,366)	(48,738)
Net interest income		39,441	40,730	42,563
Fee income		21,117	21,403	24,764
Fee expense		(3,762)	(3,739)	(4,740)
Net fee income		17,355	17,664	20,024
Trading income excluding net interest income		4,680	6,236	847
Net interest income on trading activities		2,530	3,627	5,713
Net trading income		7,210	9,863	6,560
Changes in fair value of long-term debt issued and related derivatives		(258)	(6,247)	6,679
Net income/(expense) from other financial instruments designated at fair value		1,478	2,716	(2,827)
Net income/(expense) from financial instruments designated at fair value	3	1,220	(3,531)	3,852
Gains less losses from financial investments		968	520	197
Dividend income		112	126	272
Net earned insurance premiums	4	11,146	10,471	10,850
Gains on disposal of French regional banks		–	–	2,445
Other operating income		2,562	2,788	1,808
Total operating income		80,014	78,631	88,571
Net insurance claims incurred and movement in liabilities to policyholders	5	(11,767)	(12,450)	(6,889)
Net operating income before loan impairment charges and other credit risk provisions		68,247	66,181	81,682
Loan impairment charges and other credit risk provisions	6	(14,039)	(26,488)	(24,937)
Net operating income	6	54,208	39,693	56,745
Employee compensation and benefits	7	(19,836)	(18,468)	(20,792)
General and administrative expenses		(15,156)	(13,392)	(15,260)
Depreciation and impairment of property, plant and equipment	25	(1,713)	(1,725)	(1,750)
Goodwill impairment	24	–	–	(10,564)
Amortisation and impairment of intangible assets	24	(983)	(810)	(733)
Total operating expenses		(37,688)	(34,395)	(49,099)
Operating profit		16,520	5,298	7,646
Share of profit in associates and joint ventures	23	2,517	1,781	1,661
Profit before tax		19,037	7,079	9,307
Tax expense	10	(4,846)	(385)	(2,809)
Profit for the year		14,191	6,694	6,498
Profit attributable to shareholders of the parent company		13,159	5,834	5,728
Profit attributable to non-controlling interests		1,032	860	770
		US\$	US\$	US\$
Basic earnings per ordinary share	12	0.73	0.34	0.41
Diluted earnings per ordinary share	12	0.72	0.34	0.41

The accompanying notes on pages 250 to 370, 'Critical accounting policies' on pages 33 to 36, the audited sections of 'Risk' on pages 86 to 176 and the audited sections of 'Capital' on pages 177 to 182 form an integral part of these financial statements.

Financial Statements (continued)**Consolidated statement of comprehensive income for the year ended 31 December 2010**

	2010 US\$m	2009 US\$m	2008 US\$m
Profit for the year	14,191	6,694	6,498
Other comprehensive income/(expense)			
Available-for-sale investments	5,835	10,817	(21,904)
– fair value gains/(losses)	6,368	9,821	(23,722)
– fair value gains transferred to income statement on disposal	(1,174)	(648)	(1,316)
– amounts transferred to the income statement in respect of impairment losses	1,118	2,391	1,779
– income taxes	(477)	(747)	1,355
Cash flow hedges	(271)	772	124
– fair value gains/(losses)	(178)	481	(1,720)
– fair value (gains)/losses transferred to income statement	(164)	808	1,754
– income taxes	71	(517)	90
Actuarial losses on defined benefit plans	(61)	(2,608)	(1,175)
– before income taxes	(60)	(3,586)	(1,609)
– income taxes	(1)	978	434
Share of other comprehensive income/(expense) of associates and joint ventures	107	149	(559)
Exchange differences	(567)	4,975	(12,123)
Other comprehensive income/(expense) for the year, net of tax	5,043	14,105	(35,637)
Total comprehensive income/(expense) for the year	19,234	20,799	(29,139)
Total comprehensive income/(expense) for the year attributable to:			
– shareholders of the parent company	18,087	19,529	(29,143)
– non-controlling interests	1,147	1,270	4
	19,234	20,799	(29,139)

The accompanying notes on pages 250 to 370, 'Critical accounting policies' on pages 33 to 36, the audited sections of 'Risk' on pages 86 to 176 and the audited sections of 'Capital' on pages 177 to 182 form an integral part of these financial statements.

Financial Statements (continued)**Consolidated balance sheet at 31 December 2010**

	Notes	2010 US\$m	2009 US\$m
<i>Assets</i>			
Cash and balances at central banks		57,383	60,655
Items in the course of collection from other banks		6,072	6,395
Hong Kong Government certificates of indebtedness		19,057	17,463
Trading assets	15	385,052	421,381
Financial assets designated at fair value	19	37,011	37,181
Derivatives	20	260,757	250,886
Loans and advances to banks		208,271	179,781
Loans and advances to customers		958,366	896,231
Financial investments	21	400,755	369,158
Other assets	27	43,251	44,534
Current tax assets		1,096	2,937
Prepayments and accrued income		11,966	12,423
Interests in associates and joint ventures	23	17,198	13,011
Goodwill and intangible assets	24	29,922	29,994
Property, plant and equipment	25	11,521	13,802
Deferred tax assets	10	7,011	8,620
Total assets		2,454,689	2,364,452
<i>Liabilities and equity</i>			
Liabilities			
Hong Kong currency notes in circulation		19,057	17,463
Deposits by banks		110,584	124,872
Customer accounts		1,227,725	1,159,034
Items in the course of transmission to other banks		6,663	5,734
Trading liabilities	28	300,703	268,130
Financial liabilities designated at fair value	29	88,133	80,092
Derivatives	20	258,665	247,646
Debt securities in issue	30	145,401	146,896
Other liabilities	31	28,050	68,640
Current tax liabilities		1,804	2,140
Liabilities under insurance contracts	32	58,609	53,707
Accruals and deferred income		13,906	13,190
Provisions	33	2,138	1,965
Deferred tax liabilities	10	1,093	1,837
Retirement benefit liabilities	7	3,856	6,967
Subordinated liabilities	34	33,387	30,478
Total liabilities		2,299,774	2,228,791
Equity			
Called up share capital	39	8,843	8,705
Share premium account		8,454	8,413
Other equity instruments		5,851	2,133
Other reserves		27,169	22,236
Retained earnings		97,350	86,812
Total shareholders' equity		147,667	128,299
Non-controlling interests	38	7,248	7,362
Total equity		154,915	135,661
Total equity and liabilities		2,454,689	2,364,452

The accompanying notes on pages 250 to 370, 'Critical accounting policies' on pages 33 to 36, the audited sections of 'Risk' on pages 86 to 176 and the audited sections of 'Capital' on pages 177 to 182 form an integral part of these financial statements.



D J Flint, Group Chairman

Financial Statements (continued)**Consolidated statement of cash flows for the year ended 31 December 2010**

	Notes	2010 US\$m	2009 US\$m	2008 US\$m
Cash flows from operating activities				
Profit before tax		19,037	7,079	9,307
Adjustments for:				
– non-cash items included in profit before tax	40	18,887	31,384	41,305
– change in operating assets	40	(13,267)	(20,803)	18,123
– change in operating liabilities	40	42,272	14,645	(63,413)
– elimination of exchange differences ¹		(1,799)	(19,024)	36,132
– net gain from investing activities		(1,698)	(1,910)	(4,195)
– share of profits in associates and joint ventures		(2,517)	(1,781)	(1,661)
– dividends received from associates		441	414	655
– contributions paid to defined benefit plans		(3,321)	(974)	(719)
– tax paid		(2,293)	(2,132)	(5,114)
Net cash generated from operating activities		55,742	6,898	30,420
Cash flows from investing activities				
Purchase of financial investments		(341,202)	(304,629)	(277,023)
Proceeds from the sale and maturity of financial investments		321,846	241,341	223,138
Purchase of property, plant and equipment		(2,533)	(2,000)	(2,985)
Proceeds from the sale of property, plant and equipment		4,373	4,701	2,467
Proceeds from the sale of loan portfolios		4,243	4,852	9,941
Net purchase of intangible assets		(1,179)	(956)	(1,169)
Net cash inflow/(outflow) from acquisition of subsidiaries		(86)	(677)	1,313
Net cash inflow from disposal of subsidiaries		466	45	2,979
Net cash outflow from acquisition of or increase in stake of associates		(1,589)	(62)	(355)
Net cash inflow/(outflow) from the consolidation of funds		(19,566)	–	16,500
Proceeds from disposal of associates and joint ventures		254	308	101
Net cash used in investing activities		(34,973)	(57,077)	(25,093)
Cash flows from financing activities				
Issue of ordinary share capital		180	18,398	467
– rights issue		–	18,326	–
– other		180	72	467
Issue of other equity instruments		3,718	–	2,133
Net sales/(purchases) of own shares for market-making and investment purposes		163	(176)	(194)
Purchases of own shares to meet share awards and share option awards		11	(51)	(808)
On exercise of share options		2	12	27
Subordinated loan capital issued		4,481	2,959	7,094
Subordinated loan capital repaid		(2,475)	(4,637)	(350)
Net cash outflow from change in stake in subsidiaries		(229)	–	–
Dividends paid to shareholders of the parent company		(3,441)	(4,264)	(7,211)
Dividends paid to non-controlling interests		(595)	(702)	(714)
Dividends paid to holders of other equity instruments		(413)	(269)	(92)
Net cash generated from financing activities		1,402	11,270	352
Net increase/(decrease) in cash and cash equivalents		22,171	(38,909)	5,679
Cash and cash equivalents at 1 January		250,766	278,872	297,009
Exchange differences in respect of cash and cash equivalents		1,139	10,803	(23,816)
Cash and cash equivalents at 31 December	40	274,076	250,766	278,872

For footnote, see page 249.

The accompanying notes on pages 250 to 370, 'Critical accounting policies' on pages 33 to 36, the audited sections of 'Risk' on pages 86 to 176 and the audited sections of 'Capital' on pages 177 to 182 form an integral part of these financial statements.

Notes on the Financial Statements (continued)

Consolidated statement of changes in equity for the year ended 31 December 2010

	2010											
	Called up share capital US\$m	Share premium ² US\$m	Other equity instruments US\$m	Retained earnings ^{3,4} US\$m	Available-for-sale fair value reserve US\$m	Cash flow hedging reserve ⁵ US\$m	Foreign exchange reserve US\$m	Share-based payment reserve US\$m	Merger reserve ^{3,6} US\$m	Total shareholders' equity US\$m	Non-controlling interests US\$m	Total equity US\$m
At 1 January	8,705	8,413	2,133	86,812	(9,965)	(26)	2,994	1,925	27,308	128,299	7,362	135,661
Profit for the year	-	-	-	13,159	-	-	-	-	-	13,159	1,032	14,191
Other comprehensive income (net of tax)	-	-	-	49	5,671	(266)	(526)	-	-	4,928	115	5,043
Available-for-sale investments	-	-	-	-	5,671	-	-	-	-	5,671	164	5,835
Cash flow hedges	-	-	-	-	-	(266)	-	-	-	(266)	(5)	(271)
Actuarial losses on defined benefit plans	-	-	-	(58)	-	-	-	-	-	(58)	(3)	(61)
Share of other comprehensive income of associates and joint ventures	-	-	-	107	-	-	-	-	-	107	-	107
Exchange differences	-	-	-	-	-	-	(526)	-	-	(526)	(41)	(567)
Total comprehensive income for the year	-	-	-	13,208	5,671	(266)	(526)	-	-	18,087	1,147	19,234
Shares issued under employee share plans	12	168	-	-	-	-	-	-	-	180	-	180
Shares issued in lieu of dividends and amounts arising thereon ²	126	(127)	-	2,524	-	-	-	-	-	2,523	-	2,523
Capital securities issued ⁷	-	-	3,718	-	-	-	-	-	-	3,718	-	3,718
Dividends to shareholders	-	-	-	(6,350)	-	-	-	-	-	(6,350)	(725)	(7,075)
Tax credit on dividends	-	-	-	122	-	-	-	-	-	122	-	122
Own shares adjustment	-	-	-	174	-	-	-	-	-	174	-	174
Exercise and lapse of share options and vesting of share awards	-	-	-	809	-	-	-	(809)	-	-	-	-
Cost of share-based payment arrangements	-	-	-	-	-	-	-	812	-	812	-	812
Income taxes on share-based payments	-	-	-	(14)	-	-	-	-	-	(14)	-	(14)
Other movements	-	-	-	(58)	217	7	-	-	-	166	3	169
Transfers	-	-	-	173	-	-	-	(173)	-	-	-	-
Acquisition and disposal of subsidiaries	-	-	-	-	-	-	-	-	-	-	(436)	(436)
Changes in ownership interests in subsidiaries that did not result in loss of control	-	-	-	(50)	-	-	-	-	-	(50)	(103)	(153)
At 31 December	8,843	8,454	5,851	97,350	(4,077)	(285)	2,468	1,755	27,308	147,667	7,248	154,915

Notes on the Financial Statements (continued)

	2009											
	Called up share capital US\$m	Share premium ² US\$m	Other equity instruments US\$m	Retained earnings ^{3,4} US\$m	Available-for-sale fair value reserve US\$m	Cash flow hedging reserve ⁵ US\$m	Foreign exchange reserve US\$m	Share-based payment reserve US\$m	Merger reserve ^{3,6} US\$m	Total shareholders' equity US\$m	Non-controlling interests US\$m	Total equity US\$m
At 1 January	6,053	8,463	2,133	80,689	(20,550)	(806)	(1,843)	1,995	17,457	93,591	6,638	100,229
Profit for the year	–	–	–	5,834	–	–	–	–	–	5,834	860	6,694
Other comprehensive income (net of tax)	–	–	–	(2,536)	10,603	791	4,837	–	–	13,695	410	14,105
Available-for-sale investments	–	–	–	–	10,603	–	–	–	–	10,603	214	10,817
Cash flow hedges	–	–	–	–	–	791	–	–	–	791	(19)	772
Actuarial gains/(losses) on defined benefit plans	–	–	–	(2,685)	–	–	–	–	–	(2,685)	77	(2,608)
Share of other comprehensive income of associates and joint ventures	–	–	–	149	–	–	–	–	–	149	–	149
Exchange differences	–	–	–	–	–	–	4,837	–	–	4,837	138	4,975
Total comprehensive income for the year	–	–	–	3,298	10,603	791	4,837	–	–	19,529	1,270	20,799
Shares issued under employee share plans	4	69	–	–	–	–	–	–	–	73	–	73
Shares issued in lieu of dividends and amounts arising thereon ²	118	(119)	–	1,670	–	–	–	–	–	1,669	–	1,669
Shares issued in respect of rights issue ⁶	2,530	–	–	–	–	–	–	–	15,796	18,326	–	18,326
Dividends to shareholders	–	–	–	(5,639)	–	–	–	–	–	(5,639)	(832)	(6,471)
Tax credit on dividends	–	–	–	50	–	–	–	–	–	50	–	50
Own shares adjustment	–	–	–	(227)	–	–	–	–	–	(227)	–	(227)
Exercise and lapse of share options and vesting of share awards	–	–	–	807	–	–	–	(769)	–	38	–	38
Cost of share-based payment arrangements	–	–	–	–	–	–	–	683	–	683	–	683
Income taxes on share-based payments	–	–	–	9	–	–	–	–	–	9	–	9
Other movements	–	–	–	210	(18)	(11)	–	16	–	197	77	274
Transfers ⁶	–	–	–	5,945	–	–	–	–	(5,945)	–	–	–
Acquisition and disposal of subsidiaries	–	–	–	–	–	–	–	–	–	–	(38)	(38)
Change in ownership interests in subsidiaries that did not result in loss of control	–	–	–	–	–	–	–	–	–	–	247	247
At 31 December	8,705	8,413	2,133	86,812	(9,965)	(26)	2,994	1,925	27,308	128,299	7,362	135,661

Notes on the Financial Statements (continued)

Consolidated statement of changes in equity for the year ended 31 December 2010 (continued)

	2008											
	Called up share capital US\$m	Share premium ² US\$m	Other equity instruments US\$m	Retained earnings ^{3,4} US\$m	Available-for-sale fair value reserve US\$m	Cash flow hedging reserve ⁵ US\$m	Foreign exchange reserve US\$m	Share-based payment reserve US\$m	Merger reserve ^{3,6} US\$m	Total shareholders' equity US\$m	Non-controlling interests US\$m	Total equity US\$m
At 1 January	5,915	8,134	–	81,097	850	(917)	10,055	1,968	21,058	128,160	7,256	135,416
Profit for the year	–	–	–	5,728	–	–	–	–	–	5,728	770	6,498
Other comprehensive income (net of tax)	–	–	–	(1,605)	(21,474)	106	(11,898)	–	–	(34,871)	(766)	(35,637)
Available-for-sale investments	–	–	–	–	(21,474)	–	–	–	–	(21,474)	(430)	(21,904)
Cash flow hedges	–	–	–	–	–	106	–	–	–	106	18	124
Actuarial gains/(losses) on defined benefit plans	–	–	–	(1,046)	–	–	–	–	–	(1,046)	(129)	(1,175)
Share of other comprehensive income of associates and joint ventures	–	–	–	(559)	–	–	–	–	–	(559)	–	(559)
Exchange differences	–	–	–	–	–	–	(11,898)	–	–	(11,898)	(225)	(12,123)
Total comprehensive income for the year	–	–	–	4,123	(21,474)	106	(11,898)	–	–	(29,143)	4	(29,139)
Shares issued under employee share plans	20	450	–	–	–	–	–	–	–	470	–	470
Shares issued in lieu of dividends and amounts arising thereon ²	118	(121)	–	3,596	–	–	–	–	–	3,593	–	3,593
Capital securities issued ⁷	–	–	2,133	–	–	–	–	–	–	2,133	–	2,133
Dividends to shareholders	–	–	–	(11,301)	–	–	–	–	–	(11,301)	(813)	(12,114)
Own shares adjustment	–	–	–	(1,002)	–	–	–	–	–	(1,002)	–	(1,002)
Exercise and lapse of share options and vesting of share awards	–	–	–	827	–	–	–	(848)	–	(21)	–	(21)
Cost of share-based payment arrangements	–	–	–	–	–	–	–	819	–	819	–	819
Other movements	–	–	–	(252)	74	5	–	56	–	(117)	73	(44)
Transfers ⁶	–	–	–	3,601	–	–	–	–	(3,601)	–	–	–
Acquisition and disposal of subsidiaries	–	–	–	–	–	–	–	–	–	–	(33)	(33)
Change in ownership interests in subsidiaries that did not result in loss of control	–	–	–	–	–	–	–	–	–	–	151	151
At 31 December	6,053	8,463	2,133	80,689	(20,550)	(806)	(1,843)	1,995	17,457	93,591	6,638	100,229

Dividends per ordinary share at 31 December 2010 were US\$0.34 (2009: US\$0.34; 2008: US\$0.93).

For footnotes, see page 249.

The accompanying notes on pages 250 to 370, 'Critical accounting policies' on pages 33 to 36, the audited sections of 'Risk' on pages 86 to 176 and the audited sections of 'Capital' on pages 177 to 182 form an integral part of these financial statements.

Financial Statements (continued)**HSBC Holdings balance sheet at 31 December 2010**

	<i>Notes</i>	2010 US\$m	2009 US\$m
<i>Assets</i>			
Cash at bank and in hand:			
– balances with HSBC undertakings		459	224
Derivatives	20	2,327	2,981
Loans and advances to HSBC undertakings		21,238	23,212
Financial investments		2,025	2,455
Other assets		1	4
Current tax assets		224	562
Prepayments and accrued income		107	102
Investments in subsidiaries	26	92,899	86,247
Property, plant and equipment		4	6
Deferred tax assets	10	57	–
Total assets		119,341	115,793
<i>Liabilities and equity</i>			
Liabilities			
Amounts owed to HSBC undertakings		2,932	3,711
Financial liabilities designated at fair value	29	16,288	16,909
Derivatives	20	827	362
Debt securities in issue	30	2,668	2,839
Other liabilities	31	1,232	1,257
Accruals and deferred income		750	419
Deferred tax liabilities	10	–	14
Subordinated liabilities	34	13,313	14,406
Total liabilities		38,010	39,917
Equity			
Called up share capital	39	8,843	8,705
Share premium account		8,454	8,413
Other equity instruments		5,828	2,133
Merger reserve and other reserves		35,127	35,127
Other reserves		3,394	3,642
Retained earnings		19,685	17,856
Total equity		81,331	75,876
Total equity and liabilities		119,341	115,793

The accompanying notes on pages 250 to 370, 'Critical accounting policies' on pages 33 to 36, the audited sections of 'Risk' on pages 86 to 176 and the audited sections of 'Capital' on pages 177 to 182 form an integral part of these financial statements.


D J Flint, *Group Chairman*

Financial Statements (continued)**HSBC Holdings statement of cash flows for the year ended 31 December 2010**

	<i>Notes</i>	2010 US\$m	2009 US\$m
Cash flows from operating activities			
Profit/(loss) before tax		5,237	(2,058)
Adjustments for:			
– non-cash items included in profit before tax	40	185	5,974
– change in operating assets	40	3,091	(11,077)
– change in operating liabilities	40	(1,754)	2,040
– elimination of exchange differences ¹		–	1
– tax received		853	266
Net cash generated from/(used in) operating activities		7,612	(4,854)
Cash flows from investing activities			
Proceeds from sale of financial investments		–	275
Purchase of property, plant and equipment		–	(2)
Net cash outflow from acquisition of or increase in stake of subsidiaries		(6,649)	(10,344)
Net cash used in investing activities		(6,649)	(10,071)
Cash flows from financing activities			
Issue of ordinary share capital		180	18,333
– rights issue		–	18,261
– other		180	72
Issue of other equity instruments		3,695	–
On exercise of share options		2	12
Subordinated loan capital issued		1,349	2,456
Subordinated loan capital repaid		(2,100)	(4,380)
Debt securities issued		–	2,818
Dividends paid		(3,441)	(4,264)
Dividends paid to holders of other equity instruments		(413)	(269)
Net cash (used in)/generated from financing activities		(728)	14,706
Net increase/(decrease) in cash and cash equivalents		235	(219)
Cash and cash equivalents at 1 January		224	443
Cash and cash equivalents at 31 December	40	459	224

For footnote, see page 249.

The accompanying notes on pages 250 to 370, 'Critical accounting policies' on pages 33 to 36, the audited sections of 'Risk' on pages 86 to 176 and the audited sections of 'Capital' on pages 177 to 182 form an integral part of these financial statements.

Financial Statements (continued)

HSBC Holdings statement of changes in equity for the year ended 31 December 2010

	2010								
	Called up share capital US\$m	Share premium ² US\$m	Other equity instruments ⁷ US\$m	Retained earnings ⁸ US\$m	Available-for-sale fair value reserve US\$m	Other paid-in capital US\$m	Share-based payment reserve US\$m	Merger and other Reserves ⁶ US\$m	Total shareholders' equity US\$m
At 1 January	8,705	8,413	2,133	17,856	253	1,464	1,925	35,127	75,876
Profit for the year	-	-	-	5,658	-	-	-	-	5,658
Other comprehensive income (net of tax)	-	-	-	-	(197)	-	-	-	(197)
Available-for-sale investments	-	-	-	-	(275)	-	-	-	(275)
Income tax	-	-	-	-	78	-	-	-	78
Total comprehensive income for the year	-	-	-	5,658	(197)	-	-	-	5,461
Shares issued under employee share plans	12	168	-	-	-	-	-	-	180
Shares issued in lieu of dividends and amounts arising thereon ²	126	(127)	-	2,524	-	-	-	-	2,523
Capital securities issued ⁷	-	-	3,695	-	-	-	-	-	3,695
Dividends to shareholders	-	-	-	(6,350)	-	-	-	-	(6,350)
Own shares adjustment	-	-	-	(260)	-	-	-	-	(260)
Exercise and lapse of share options and vesting of share awards	-	-	-	-	-	119	(119)	-	-
Cost of share-based payment arrangements	-	-	-	-	-	-	28	-	28
Equity investments granted to employees of subsidiaries under employee share plans	-	-	-	-	-	-	76	-	76
Other movements	-	-	-	87	-	-	15	-	102
Transfers	-	-	-	170	-	-	(170)	-	-
At 31 December	8,843	8,454	5,828	19,685	56	1,583	1,755	35,127	81,331

Financial Statements (continued)

HSBC Holdings statement of changes in equity for the year ended 31 December 2010 (continued)

	2009								Total share-holders' equity US\$m
	Called up share capital US\$m	Share premium ² US\$m	Other equity instruments US\$m	Retained Earnings ⁸ US\$m	Available-for-sale fair value reserve US\$m	Other reserves			
						Other paid-in capital US\$m	Share-based payment reserve US\$m	Merger and other Reserves ⁶ US\$m	
At 1 January	6,053	8,463	2,133	17,094	190	1,318	1,995	25,341	62,587
Profit for the year	-	-	-	(1,096)	-	-	-	-	(1,096)
Other comprehensive income (net of tax)	-	-	-	-	63	-	-	-	63
Available-for-sale investments	-	-	-	-	103	-	-	-	103
Income tax	-	-	-	-	(40)	-	-	-	(40)
Total comprehensive income for the year	-	-	-	(1,096)	63	-	-	-	(1,033)
Shares issued under employee share plans	4	69	-	-	-	-	-	-	73
Shares issued in lieu of dividends and amounts arising thereon ²	118	(119)	-	1,670	-	-	-	-	1,669
Shares issued in respect of rights issue	2,530	-	-	-	-	-	-	15,731	18,261
Dividends to shareholders	-	-	-	(5,639)	-	-	-	-	(5,639)
Own shares adjustment	-	-	-	(188)	-	-	-	-	(188)
Exercise and lapse of share options and vesting of share awards	-	-	-	-	-	146	(146)	-	-
Cost of share-based payment arrangements	-	-	-	-	-	-	163	-	163
Income taxes on share-based payments	-	-	-	19	-	-	-	-	19
Equity investments granted to employees of subsidiaries under employee share plans	-	-	-	-	-	-	(99)	-	(99)
Other movements	-	-	-	51	-	-	12	-	63
Transfers ⁶	-	-	-	5,945	-	-	-	(5,945)	-
At 31 December	8,705	8,413	2,133	17,856	253	1,464	1,925	35,127	75,876

Dividends per ordinary share at 31 December 2010 were US\$0.34 (2009: US\$0.34; 2008: US\$0.93).

For footnotes, see page 249.

The accompanying notes on pages 250 to 370, 'Critical accounting policies' on pages 33 to 36, the audited sections of 'Risk' on pages 86 to 176 and the audited sections of 'Capital' on pages 177 to 182 form an integral part of these financial statements.

Financial Statements (continued)

Footnotes to Financial Statements

- 1 *Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on a line-by-line basis, as details cannot be determined without unreasonable expense.*
- 2 *Share premium includes the deduction of US\$1m in respect of issuance costs incurred during the year (2009: US\$1m; 2008: US\$3m).*
- 3 *Cumulative goodwill amounting to US\$5,138m has been charged against reserves in respect of acquisitions of subsidiaries prior to 1 January 1998, including US\$3,469m charged against the merger reserve arising on the acquisition of HSBC Bank plc. The balance of US\$1,669m has been charged against retained earnings.*
- 4 *Retained earnings include 123,331,979 (US\$1,799m) of own shares held within HSBC's insurance business, retirement funds for the benefit of policyholders or beneficiaries within employee trusts for the settlement of shares expected to be delivered under employee share schemes or bonus plans, and the market-making activities in Global Markets (2009: 179,964,968 (US\$2,572m); 2008: 194,751,829 (US\$3,094m)).*
- 5 *Amounts transferred to the income statement in respect of cash flow hedges include US\$605m (2009: US\$502m; 2008: US\$152m) taken to 'Net interest income' and US\$441m (2009: US\$306m; 2008: US\$1,602m) taken to 'Net trading income'.*
- 6 *Statutory share premium relief under Section 131 of the Companies Act 1985 (the 'Act') was taken in respect of the acquisition of HSBC Bank plc in 1992, HSBC France in 2000 and HSBC Finance Corporation in 2003 and the shares issued were recorded at their nominal value only. In HSBC's consolidated financial statements the fair value differences of US\$8,290m in respect of HSBC France and US\$12,768m in respect of HSBC Finance Corporation were recognised in the merger reserve. The merger reserve created on the acquisition of HSBC Finance Corporation subsequently became attached to HSBC Overseas Holdings (UK) Limited ('HOHU'), following a number of intra-group reorganisations. At 31 December 2009, US\$5,945m (2010: nil) was transferred from this reserve to retained earnings as a result of impairment in HSBC Holdings' investment in HOHU. During 2009, pursuant to section 131 of the Companies Act 1985, statutory share premium relief was taken in respect of the rights issue and US\$15,796m was recognised in the merger reserve. The merger reserve includes the deduction of US\$614m in respect of costs relating to the rights issue, of which US\$149m was subsequently transferred to the income statement. Of this US\$149m, US\$121m was a loss arising from accounting for the agreement with the underwriters as a contingent forward contract. The merger reserve excludes the loss of US\$344m on a forward foreign exchange contract associated with hedging the proceeds of the rights issue.*
- 7 *During June 2010, HSBC Holdings issued US\$3,800m of Perpetual Subordinated Capital Securities, Series 2 ('capital securities'), on which there were US\$82m of external issuance costs and US\$23m of intra-group issuance costs which are classified as equity under IFRSs. In April 2008, HSBC Holdings issued US\$2,200m of Perpetual Subordinated Capital Securities, including US\$67m of issuance costs, which are classified as equity under IFRSs.*
- 8 *Retained earnings include 39,814,107 (US\$562m) of own shares held to fund employee share plans (2009: 38,446,053 (US\$562m)).*

Notes on the Financial Statements

1 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the EU. EU-endorsed IFRSs may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2010, there were no unendorsed standards effective for the year ended 31 December 2010 affecting these consolidated and separate financial statements, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to HSBC. Accordingly, HSBC's financial statements for the year ended 31 December 2010 are prepared in accordance with IFRSs as issued by the IASB.

IFRSs comprise accounting standards issued by the IASB and its predecessor body as well as interpretations issued by the IFRS Interpretations Committee ('IFRIC') and its predecessor body.

During 2010, HSBC adopted the following major revisions and amendments to standards:

HSBC adopted the revised IFRS 3 'Business Combinations' ('IFRS 3') and amendments to IAS 27 'Consolidated and Separate Financial Statements' ('IAS 27'). The main changes under the standards are that:

- acquisition-related costs are recognised as an expense in the income statement in the period in which they are incurred;
- all consideration transferred, including contingent consideration, is recognised and measured at fair value at the acquisition date;
- equity interests held prior to control being obtained are remeasured to fair value at the date of obtaining control, and any gain or loss is recognised in the income statement;
- an option is available, on a transaction-by-transaction basis, to measure any non-controlling (previously referred to as minority) interests in the entity acquired either at fair value, or at the non-controlling interests' proportionate share of the net identifiable assets of the entity acquired; and
- changes in a parent's ownership interest in a subsidiary that do not result in a change of control are treated as transactions between equity holders and are reported in equity.

In terms of their application to HSBC, the revised IFRS 3 and the amendments to IAS 27 apply prospectively to acquisitions and transactions taking place on or after 1 January 2010, and have had no significant effect on the consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings.

During 2010, in addition to the above, HSBC adopted a number of interpretations and amendments to standards which had an insignificant effect on the consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings.

(b) Differences between IFRSs and Hong Kong Financial Reporting Standards

There are no significant differences between IFRSs and Hong Kong Financial Reporting Standards in terms of their application to HSBC and consequently there would be no significant differences had the financial statements been prepared in accordance with Hong Kong Financial Reporting Standards. The Notes on the Financial Statements, taken together with the Report of the Directors, include the aggregate of all disclosures necessary to satisfy IFRSs and Hong Kong reporting requirements.

(c) Presentation of information

Disclosures under IFRS 4 'Insurance Contracts' ('IFRS 4') and IFRS 7 'Financial Instruments: Disclosures' ('IFRS 7') concerning the nature and extent of risks relating to insurance contracts and financial instruments have been included in the audited sections of the 'Report of the Directors: Risk' on pages 86 to 176.

Capital disclosures under IAS 1 'Presentation of Financial Statements' ('IAS 1') have been included in the audited sections of 'Report of the Directors: Capital' on pages 177 to 182.

Notes on the Financial Statements (continued)

Disclosures relating to HSBC's securitisation activities and structured products have been included in the audited section of 'Report of the Directors: Risk' on pages 86 to 176.

In accordance with HSBC's policy to provide meaningful disclosures that help investors and other stakeholders understand the Group's performance, financial position and changes thereto, the information provided in the Notes on the Financial Statements and the Report of the Directors goes beyond the minimum levels required by accounting standards, statutory and regulatory requirements and listing rules. In particular, HSBC has adopted the British Bankers' Association Code for Financial Reporting Disclosure ('the BBA Code'). The BBA Code aims to increase the quality and comparability of banks' disclosures and sets out five disclosure principles together with supporting guidance. In line with the principles of the BBA Code, HSBC assesses good practice recommendations issued from time to time by relevant regulators and standard setters and will assess the applicability and relevance of such guidance, enhancing disclosures where appropriate.

In publishing the parent company financial statements here together with the Group financial statements, HSBC Holdings has taken advantage of the exemption in section 408(3) of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these financial statements.

HSBC's consolidated financial statements are presented in US dollars which is also HSBC Holdings' functional currency. HSBC Holdings' functional currency is the US dollar because the US dollar and currencies linked to it are the most significant currencies relevant to the underlying transactions, events and conditions of its subsidiaries, as well as representing a significant proportion of its funds generated from financing activities. HSBC uses the US dollar as its presentation currency in its consolidated financial statements because the US dollar and currencies linked to it form the major currency bloc in which HSBC transacts and funds its business.

(d) Comparative information

As required by US public company reporting requirements, these consolidated financial statements include two years of comparative information for the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of cash flows, consolidated statement of changes in equity and related Notes on the Financial Statements.

(e) Use of estimates and assumptions

The preparation of financial information requires the use of estimates and assumptions about future conditions. The use of available information and the application of judgement are inherent in the formation of estimates; actual results in the future may differ from estimates upon which financial information is prepared. Management believes that HSBC's critical accounting policies where judgement is necessarily applied are those which relate to impairment of loans and advances, goodwill impairment, the valuation of financial instruments, the impairment of available-for-sale financial assets and deferred tax assets (see 'Critical Accounting Policies' on pages 33 to 36, which form an integral part of these financial statements).

Further information about key assumptions concerning the future, and other key sources of estimation uncertainty, are set out in the Notes on the Financial Statements.

(f) Consolidation

The consolidated financial statements of HSBC comprise the financial statements of HSBC Holdings and its subsidiaries made up to 31 December, with the exception of the banking and insurance subsidiaries of HSBC Bank Argentina, whose financial statements are made up to 30 June annually to comply with local regulations. Accordingly, HSBC uses their audited interim financial statements, drawn up to 31 December annually.

Subsidiaries are consolidated from the date that HSBC gains control. The acquisition method of accounting is used when subsidiaries are acquired by HSBC. The cost of an acquisition is measured at the fair value of the consideration, including contingent consideration, given at the date of exchange. Acquisition-related costs are recognised as an expense in the income statement in the period in which they are incurred. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Goodwill is measured as the excess of the aggregate of the consideration transferred, the amount of non-controlling interest and the fair value of HSBC's previously held equity interest, if any, over the net of the amounts of the identifiable assets acquired and the liabilities assumed. The amount of non-controlling interest is measured either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable

Notes on the Financial Statements (continued)

net assets. In a business combination achieved in stages, the previously held equity interest is remeasured at the acquisition-date fair value with the resulting gain or loss recognised in the income statement. In the event that the amounts of net assets acquired is in excess of the aggregate of the consideration transferred, the amount of non-controlling interest and the fair value of HSBC's previously held equity interest, the difference is recognised immediately in the income statement.

Changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are treated as transactions between equity holders and are reported in equity.

Entities that are controlled by HSBC are consolidated until the date that control ceases.

In the context of Special Purpose Entities ('SPE's), the following circumstances may indicate a relationship in which, in substance, HSBC controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of HSBC according to its specific business needs so that HSBC obtains benefits from the SPE's operation;
- HSBC has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an 'autopilot' mechanism, HSBC has delegated these decision-making powers;
- HSBC has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incidental to the activities of the SPE; or
- HSBC retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

HSBC performs a re-assessment of consolidation whenever there is a change in the substance of the relationship between HSBC and an SPE.

All intra-HSBC transactions are eliminated on consolidation.

The consolidated financial statements of HSBC also include the attributable share of the results and reserves of joint ventures and associates. These are based on financial statements made up to 31 December, with the exception of the Bank of Communications, Ping An Insurance and Industrial Bank which are included on the basis of financial statements made up for the twelve months to 30 September. These are equity accounted three months in arrears in order to meet the requirements of the Group's reporting timetable. HSBC has taken into account the effect of significant transactions or events that occur between the period from 1 October to 31 December that would have a material effect on its results.

(g) Future accounting developments

At 31 December 2010, a number of standards and interpretations, and amendments thereto, had been issued by the IASB, which are not effective for HSBC's consolidated financial statements or the separate financial statements of HSBC Holdings as at 31 December 2010. Those which are expected to have a significant effect on HSBC's consolidated financial statements and the separate financial statements of HSBC Holdings are discussed below.

Standards and Interpretations issued by the IASB but not endorsed by the EU

In November 2009, the IASB issued IFRS 9 'Financial Instruments' ('IFRS 9') which introduced new requirements for the classification and measurement of financial assets. In October 2010, the IASB issued additions to IFRS 9 relating to financial liabilities. Together, these changes represent the first phase in the IASB's planned replacement of IAS 39 'Financial Instruments: Recognition and Measurement' ('IAS 39') with a less complex and improved standard for financial instruments.

The standard is effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IFRS 9 is required to be applied retrospectively. If the standard is adopted prior to 1 January 2012, an entity will be exempt from the requirement to restate prior period comparative information. IFRS 9 is subject to EU endorsement, the timing of which is uncertain. Accordingly, HSBC is unable to provide a date by which it plans to apply IFRS 9.

The main changes to the requirements of IAS 39 are summarised below.

Notes on the Financial Statements (continued)

- All financial assets that are currently in the scope of IAS 39 will be classified as either amortised cost or fair value. The available-for-sale, held-to-maturity and loans and receivables categories will no longer exist.
- Classification of financial assets is based on an entity's business model for managing the financial assets and their contractual cash flow characteristics. Reclassifications between the two categories are prohibited unless there is a change in the entity's business model.
- A financial asset is measured at amortised cost if two criteria are met: i) the objective of the business model is to hold the financial asset for the collection of the contractual cash flows; and ii) the contractual cash flows of the instrument are solely payments of principal and interest on the principal outstanding. All other financial assets are measured at fair value. Movements in the fair value of financial assets classified at fair value are recognised in profit or loss, except for equity investments where an entity takes the option to designate an equity instrument that is not held for trading at fair value through other comprehensive income. If this option is taken, all subsequent changes in fair value are recognised in other comprehensive income with no recycling of gains or losses to the income statement. Dividend income would continue to be recognised in the income statement.
- An entity is only permitted to designate a financial asset otherwise meeting the amortised cost criteria at fair value through profit or loss if doing so significantly reduces or eliminates an accounting mismatch. This designation is made on initial recognition and is irrevocable.
- Financial assets which contain embedded derivatives are to be classified in their entirety either at fair value or amortised cost depending on whether the contracts as a whole meet the relevant criteria under IFRS 9.
- Most of IAS 39's requirements for financial liabilities are retained, including amortised cost accounting for most financial liabilities. The guidance on separation of embedded derivatives will continue to apply to host contracts that are financial liabilities. However, fair value changes attributable to changes in own credit risk for financial liabilities designated under the fair value option other than loan commitments and financial guarantee contracts are to be presented in the statement of other comprehensive income unless the treatment would create or enlarge an accounting mismatch in profit or loss. These amounts are not subsequently reclassified to the income statement but may be transferred within equity.

The second and third phases in the IASB's project to replace IAS 39 will address the impairment of financial assets measured at amortised cost and hedge accounting. The IASB has indicated that it expects to finalise the replacement of IAS 39 by June 2011. In addition, the IASB is working with the US Financial Accounting Standards Board to reduce inconsistencies between US GAAP and IFRS in accounting for financial instruments. The impact of IFRS 9 may change as a consequence of further developments resulting from the IASB's project to replace IAS 39. As a result, it is impracticable to quantify the impact of IFRS 9 as at the date of publication of these financial statements.

2 Summary of significant accounting policies

(a) Interest income and expense

Interest income and expense for all financial instruments except for those classified as held for trading or designated at fair value (other than debt securities issued by HSBC and derivatives managed in conjunction with such debt securities issued) are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method. The effective interest method is a way of calculating the amortised cost of a financial asset or a financial liability (or groups of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, HSBC estimates cash flows considering all contractual terms of the financial instrument but excluding future credit losses. The calculation includes all amounts paid or received by HSBC that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

Interest on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Notes on the Financial Statements (continued)

(b) Non-interest income

Fee income is earned from a diverse range of services provided by HSBC to its customers. Fee income is accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third-party, such as an arrangement for the acquisition of shares or other securities);
- income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees); and
- income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and recorded in 'Interest income' (Note 2a).

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with the related interest income, expense and dividends.

Net income from financial instruments designated at fair value includes all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value through profit or loss. Interest income and expense and dividend income arising on these financial instruments are also included, except for interest arising from debt securities issued, and derivatives managed in conjunction with those debt securities, which is recognised in 'Interest expense' (Note 2a).

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders have approved the dividend for unlisted equity securities.

(c) Operating segments

HSBC's operating segments are organised into six geographical regions; Europe, Hong Kong, Rest of Asia-Pacific, Middle East, North America and Latin America. Due to the nature of the Group, HSBC's chief operating decision-maker regularly reviews operating activity on a number of bases, including by geographical region, customer group and global business, and retail businesses by geographical region. HSBC's operating segments were determined to be geographical regions because the chief operating decision-maker primarily uses information on geographical regions in order to make decisions about allocating resources and assessing performance.

Measurement of segmental assets, liabilities, income and expenses is in accordance with the Group's accounting policies. Segmental income and expenses include transfers between segments and these transfers are conducted on arm's length terms and conditions. Shared costs are included in segments on the basis of the actual recharges made.

(d) Valuation of financial instruments

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

Subsequent to initial recognition, the fair values of financial instruments measured at fair value are measured in accordance with HSBC's valuation methodologies, which are described in Note 16.

Notes on the Financial Statements (continued)

(e) Reclassification of financial assets

Non-derivative financial assets (other than those designated at fair value through profit or loss upon initial recognition) may be reclassified out of the fair value through profit or loss category in the following circumstances:

- financial assets that would have met the definition of loans and receivables at initial recognition (if the financial asset had not been required to be classified as held for trading) may be reclassified out of the fair value through profit or loss category if there is the intention and ability to hold the financial asset for the foreseeable future or until maturity; and
- financial assets (except financial assets that would have met the definition of loans and receivables at initial recognition) may be reclassified out of the fair value through profit or loss category and into another category in rare circumstances.

When a financial asset is reclassified as described in the above circumstances, the financial asset is reclassified at its fair value on the date of reclassification. Any gain or loss already recognised in the income statement is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

(f) Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated by HSBC which are not classified either as held for trading or designated at fair value. Loans and advances are recognised when cash is advanced to a borrower. They are derecognised when either the borrower repays its obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less any impairment losses. Where exposures are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment for the hedged risk only.

HSBC may commit to underwrite loans on fixed contractual terms for specified periods of time, where the drawdown of the loan is contingent upon certain future events outside the control of HSBC. Where the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative and measured at fair value through profit or loss. On drawdown, the loan is classified as held for trading and measured at fair value through profit or loss. Where it is not HSBC's intention to trade but hold the loan, a provision on the loan commitment is only recorded where it is probable that HSBC will incur a loss. This may occur, for example, where a loss of principal is probable or the interest rate charged on the loan is lower than the cost of funding. On inception of the loan, the loan to be held is recorded at its fair value and subsequently measured at amortised cost using the effective interest method. For certain transactions, such as leveraged finance and syndicated lending activities, the cash advanced is not necessarily the best evidence of the fair value of the loan. For these loans, where the initial fair value is lower than the cash amount advanced (for example, due to the rate of interest charged on the loan being below the market rate of interest), the write-down is charged to the income statement. The write-down will be recovered over the life of the loan, through the recognition of interest income using the effective interest method, unless the loan becomes impaired. The write-down is recorded as a reduction to other operating income.

Financial assets which have been reclassified into the loans and receivables category are initially recorded at the fair value at the date of reclassification and are subsequently measured at amortised cost, using the effective interest rate determined at the date of reclassification.

(g) Impairment of loans and advances

Losses for impaired loans are recognised promptly when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances are calculated on individual loans and on groups of loans assessed collectively. Impairment losses are recorded as charges to the income statement. The carrying amount of impaired loans on the balance sheet is reduced through the use of impairment allowance accounts. Losses expected from future events are not recognised.

Notes on the Financial Statements (continued)

Individually assessed loans and advances

For all loans that are considered individually significant, HSBC assesses on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired. The criteria used by HSBC to determine that there is such objective evidence include:

- known cash flow difficulties experienced by the borrower;
- past due contractual payments of either principal or interest;
- breach of loan covenants or conditions;
- the probability that the borrower will enter bankruptcy or other financial realisation; and
- a significant downgrading in credit rating by an external credit rating agency .

For those loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

- HSBC's aggregate exposure to the customer;
- the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors' commitments ranking ahead of, or *pari passu* with, HSBC and the likelihood of other creditors continuing to support the company;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding;
- the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and
- when available, the secondary market price of the debt.

Impairment losses are calculated by discounting the expected future cash flows of a loan at its original effective interest rate and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

Collectively assessed loans and advances

Impairment is assessed on a collective basis in two circumstances:

- to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment; and
- for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss. This reflects impairment losses that HSBC has incurred as a result of events occurring before the balance sheet date, which HSBC is not able to identify on an individual loan basis, and that can be reliably estimated. These losses will only be individually identified in the future. As soon as information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed on an individual basis for impairment.

Notes on the Financial Statements (continued)

The collective impairment allowance is determined after taking into account:

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

The period between a loss occurring and its identification is estimated by local management for each identified portfolio.

Homogeneous groups of loans and advances

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

- When appropriate empirical information is available, HSBC utilises roll rate methodology. This methodology employs statistical analyses of historical data and experience of delinquency and default to estimate the amount of loans that will eventually be written off as a result of the events occurring before the balance sheet date which HSBC is not able to identify on an individual loan basis, and that can be reliably estimated. Under this methodology, loans are grouped into ranges according to the number of days past due and statistical analysis is used to estimate the likelihood that loans in each range will progress through the various stages of delinquency, and ultimately prove irrecoverable. Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio, and the carrying amount of the portfolio. In certain highly developed markets, sophisticated models also take into account behavioural and account management trends as revealed in, for example, bankruptcy and rescheduling statistics.
- When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll rate methodology, HSBC adopts a basic formulaic approach based on historical loss rate experience.

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

These additional portfolio risk factors may include recent loan portfolio growth and product mix, unemployment rates, bankruptcy trends, geographic concentrations, loan product features (such as the ability of borrowers to repay adjustable-rate loans where reset interest rates give rise to increases in interest charges), economic conditions such as national and local trends in housing markets and interest rates, portfolio seasoning, account management policies and practices, current levels of write-offs, changes in laws and regulations and other items which can affect customer payment patterns on outstanding loans, such as natural disasters. These risk factors, where relevant, are taken into account when calculating the appropriate level of impairment allowances by adjusting the impairment allowances derived solely from historical loss experience.

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

Write-off of loans and advances

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds

Notes on the Financial Statements (continued)

from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write off may be earlier.

Reversals of impairment

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

Reclassified loans and advances

Where financial assets have been reclassified out of the fair value through profit or loss category to the loans and receivables category, the effective interest rate determined at the date of reclassification is used to calculate any impairment losses.

Following reclassification, where there is a subsequent increase in the estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the effective interest rate from the date of change in the estimate rather than as an adjustment to the carrying amount of the asset at the date of change in the estimate.

Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans as part of an orderly realisation are recorded as assets held for sale and reported in 'Other assets' if the carrying amounts of the assets are recovered principally through sale, the assets are available for sale in their present condition and their sale is highly probable. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan (net of impairment allowance) at the date of exchange. No depreciation is charged in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recognised in the income statement, in 'Other operating income'. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative write-down, is also recognised in 'Other operating income', together with any realised gains or losses on disposal.

Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as up to date loans for measurement purposes once the minimum number of payments required under the new arrangements have been received. These renegotiated loans are segregated from other parts of the loan portfolio for the purposes of collective impairment assessment, to reflect their risk profile. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or should be considered past due. The carrying amount of loans that have been classified as renegotiated retain this classification until maturity or derecognition. Interest is recorded on renegotiated loans taking into account the new contractual terms following renegotiation.

(h) Trading assets and trading liabilities

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

Notes on the Financial Statements (continued)

(i) Financial instruments designated at fair value

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated by management. HSBC may designate financial instruments at fair value when the designation:

- eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities, or recognising gains and losses on them, on different bases. Under this criterion, the main classes of financial instruments designated by HSBC are:

Long-term debt issues. The interest payable on certain fixed rate long-term debt securities issued has been matched with the interest on 'receive fixed/pay variable' interest rate swaps as part of a documented interest rate risk management strategy. An accounting mismatch would arise if the debt securities issued were accounted for at amortised cost, because the related derivatives are measured at fair value with changes in the fair value recognised in the income statement. By designating the long-term debt at fair value, the movement in the fair value of the long-term debt will also be recognised in the income statement.

Financial assets and financial liabilities under investment contracts. Liabilities to customers under linked contracts are determined based on the fair value of the assets held in the linked funds, with changes recognised in the income statement. If no designation was made for the assets relating to the customer liabilities they would be classified as available for sale and the changes in fair value would be recorded in other comprehensive income. These financial instruments are managed on a fair value basis and management information is also prepared on this basis. Designation at fair value of the financial assets and liabilities under investment contracts allows the changes in fair values to be recorded in the income statement and presented in the same line.

- applies to groups of financial assets, financial liabilities or combinations thereof that are managed, and their performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, and where information about the groups of financial instruments is reported to management on that basis. Under this criterion, certain financial assets held to meet liabilities under insurance contracts are the main class of financial instrument so designated. HSBC has documented risk management and investment strategies designed to manage such assets at fair value, taking into consideration the relationship of assets to liabilities in a way that mitigates market risks. Reports are provided to management on the fair value of the assets. Fair value measurement is also consistent with the regulatory reporting requirements under the appropriate regulations for these insurance operations.
- relates to financial instruments containing one or more embedded derivatives that significantly modify the cash flows resulting from those financial instruments, including certain debt issues and debt securities held.

The fair value designation, once made, is irrevocable. Designated financial assets and financial liabilities are recognised when HSBC enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and are normally derecognised when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently, the fair values are remeasured, and gains and losses from changes therein are recognised in the income statement in 'Net income from financial instruments designated at fair value'.

(j) Financial investments

Treasury bills, debt securities and equity securities intended to be held on a continuing basis, other than those designated at fair value, are classified as available for sale or held to maturity. Financial investments are recognised on trade date when HSBC enters into contractual arrangements with counterparties to purchase securities, and are normally derecognised when either the securities are sold or the borrowers repay their obligations.

- (i) Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income in 'Available-for-sale investments – fair value gains/(losses)' until the financial assets are either sold or become impaired. When available-for-sale financial assets are sold, cumulative gains or losses previously recognised in other comprehensive income are recognised in the income statement as 'Gains less losses from financial investments'.

Notes on the Financial Statements (continued)

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

At each balance sheet date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset. Impairment losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the income statement, is removed from other comprehensive income and recognised in the income statement.

Impairment losses for available-for-sale debt securities are recognised within 'Loan impairment charges and other credit risk provisions' in the income statement and impairment losses for available-for-sale equity securities are recognised within 'Gains less losses from financial investments' in the income statement. The impairment methodologies for available-for-sale financial assets are set out in more detail below.

- **Available-for-sale debt securities.** When assessing available-for-sale debt securities for objective evidence of impairment at the reporting date, HSBC considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. These events may include a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial reorganisation, or the disappearance of an active market for the debt security because of financial difficulties relating to the issuer.

These types of specific event and other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment of a debt security.

In addition, when assessing available-for-sale asset-backed securities ('ABS's) for objective evidence of impairment, HSBC considers the performance of underlying collateral and the extent and depth of market price declines. Changes in credit ratings are considered but a downgrade of a security's credit rating is not, of itself, evidence of impairment. The primary indicators of potential impairment are considered to be adverse fair value movements and the disappearance of an active market for a security. ABS impairment methodologies are described in more detail in 'Securitisation exposures and other structured products' on page 128.

- **Available-for-sale equity securities.** Objective evidence of impairment for available-for sale equity securities may include specific information about the issuer as detailed above, but may also include information about significant changes in technology, markets, economics or the law that provides evidence that the cost of the equity securities may not be recovered.

A significant or prolonged decline in the fair value of the asset below its cost is also objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the period in which the fair value of the asset has been below its original cost at initial recognition.

Once an impairment loss has been recognised on an available-for-sale financial asset, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the nature of the available-for-sale financial asset concerned:

- for an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in the income statement when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further

Notes on the Financial Statements (continued)

objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement to the extent of the increase in fair value;

- for an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised in other comprehensive income. Impairment losses recognised on the equity security are not reversed through the income statement. Subsequent decreases in the fair value of the available-for-sale equity security are recognised in the income statement, to the extent that further cumulative impairment losses have been incurred in relation to the acquisition cost of the equity security.

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

(k) Sale and repurchase agreements (including stock lending and borrowing)

When securities are sold subject to a commitment to repurchase them at a predetermined price ('repos'), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to sell ('reverse repos') 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' as appropriate. The difference between the sale and repurchase price is treated as interest and recognised over the life of the agreement.

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. The transfer of securities to counterparties under these agreements is not normally reflected on the balance sheet. Cash collateral advanced or received is recorded as an asset or a liability respectively.

Securities borrowed are not recognised on the balance sheet. If they are sold on to third parties, an obligation to return the securities is recorded as a trading liability and measured at fair value, and any gains or losses are included in 'Net trading income'.

(l) Derivatives and hedge accounting

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

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

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

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

Notes on the Financial Statements (continued)

is applied to derivatives designated as hedging instruments in a fair value, cash flow or net investment hedge provided certain criteria are met.

Hedge accounting

At the inception of a hedging relationship, HSBC documents the relationship between the hedging instruments and the hedged items, its risk management objective and its strategy for undertaking the hedge. HSBC also requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments, primarily derivatives, that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items. Interest on designated qualifying hedges is included in 'Net interest income'.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement, along with changes in the fair value of the hedged assets, liabilities or group thereof that are attributable to the hedged risk.

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

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income within 'Cash flow hedges – fair value gains/(losses)'. Any gain or loss in fair value relating to an ineffective portion is recognised immediately in the income statement.

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

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

Net investment hedge

Hedges of net investments in foreign operations are accounted for in a similar way to cash flow hedges. A gain or loss on the effective portion of the hedging instrument is recognised in other comprehensive income; a gain or loss on the ineffective portion is recognised immediately in the income statement. Gains and losses previously recognised in other comprehensive income are reclassified to the income statement on the disposal of the foreign operation.

Hedge effectiveness testing

To qualify for hedge accounting, HSBC requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness), and demonstrate actual effectiveness (retrospective effectiveness) on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method adopted by an entity to assess hedge effectiveness will depend on its risk management strategy.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is

Notes on the Financial Statements (continued)

designated. For actual effectiveness to be achieved, the changes in fair value or cash flows must offset each other in the range of 80% to 125%.

Hedge ineffectiveness is recognised in the income statement in 'Net trading income'.

Derivatives that do not qualify for hedge accounting

All gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in the income statement. These gains and losses are reported in 'Net trading income', except where derivatives are managed in conjunction with financial instruments designated at fair value (other than derivatives managed in conjunction with debt securities issued by the Group), in which case gains and losses are reported in 'Net income from financial instruments designated at fair value'. The interest on derivatives managed in conjunction with debt securities issued by the Group which are designated at fair value is recognised in 'Interest expense'. All other gains and losses on these derivatives are reported in 'Net income from financial instruments designated at fair value'.

(m) Derecognition of financial assets and liabilities

Financial assets are derecognised when the contractual right to receive cash flows from the assets has expired; or when HSBC has transferred its contractual right to receive the cash flows of the financial assets, and either:

- substantially all the risks and rewards of ownership have been transferred; or
- HSBC has neither retained nor transferred substantially all the risks and rewards, but has not retained control.

Financial liabilities are derecognised when they are extinguished, that is when the obligation is discharged, cancelled, or expires.

(n) Offsetting financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(o) Subsidiaries, associates and joint ventures

HSBC classifies investments in entities which it controls as subsidiaries. Where HSBC is a party to a contractual arrangement whereby, together with one or more parties, it undertakes an economic activity that is subject to joint control, HSBC classifies its interest in the venture as a joint venture. HSBC classifies investments in entities over which it has significant influence, and that are neither subsidiaries nor joint ventures, as associates. For the purpose of determining this classification, control is considered to be the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

HSBC Holdings' investments in subsidiaries are stated at cost less any impairment losses. An impairment loss recognised in prior periods shall be reversed through the income statement if, and only if, there has been a change in the estimates used to determine the recoverable amount of the investment in subsidiary since the last impairment loss was recognised.

Investments in associates and interests in joint ventures are recognised using the equity method. Under this method, such investments are initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in HSBC's share of net assets.

Profits on transactions between HSBC and its associates and joint ventures are eliminated to the extent of HSBC's interest in the respective associates or joint ventures. Losses are also eliminated to the extent of HSBC's interest in the associates or joint ventures unless the transaction provides evidence of an impairment of the asset transferred.

(p) Goodwill and intangible assets

- (i) Goodwill arises on the acquisition of subsidiaries, when the aggregate of the fair value of the consideration transferred, the amount of any non-controlling interest and the fair value of any previously held equity

Notes on the Financial Statements (continued)

interest in the acquiree exceed the amounts of the identifiable assets and liabilities acquired. If they do not exceed the amounts of the identifiable assets and liabilities of an acquired business, the difference is recognised immediately in the income statement. Goodwill arises on the acquisition of interests in joint ventures and associates when the cost of investment exceeds HSBC's share of the net fair value of the associate's or joint venture's identifiable assets and liabilities.

Intangible assets are recognised separately from goodwill when they are separable or arise from contractual or other legal rights, and their fair value can be measured reliably.

Goodwill is allocated to cash-generating units for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. Impairment testing is performed at least annually, and whenever there is an indication that the cash-generating unit may be impaired, by comparing the recoverable amount from a cash-generating unit with the carrying amount of its net assets, including attributable goodwill. The recoverable amount of an asset is the higher of its fair value less cost to sell, and its value in use. Value in use is the present value of the expected future cash flows from a cash-generating unit. If the recoverable amount is less than the carrying value, an impairment loss is charged to the income statement. Goodwill is stated at cost less accumulated impairment losses.

Goodwill on acquisitions of interests in joint ventures and associates is included in 'Interests in associates and joint ventures' and is not tested separately for impairment.

At the date of disposal of a business, attributable goodwill is included in HSBC's share of net assets in the calculation of the gain or loss on disposal.

- (ii) Intangible assets include the present value of in-force long-term insurance business, computer software, trade names, mortgage servicing rights, customer lists, core deposit relationships, credit card customer relationships and merchant or other loan relationships. Computer software includes both purchased and internally generated software. The cost of internally generated software comprises all directly attributable costs necessary to create, produce and prepare the software to be capable of operating in the manner intended by management. Costs incurred in the ongoing maintenance of software are expensed immediately as incurred.

Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable. Where:

- intangible assets have an indefinite useful life, or are not yet ready for use, they are tested for impairment annually. This impairment test may be performed at any time during the year, provided it is performed at the same time every year. An intangible asset recognised during the current period is tested before the end of the current year; and
- intangible assets have a finite useful life, except for the present value of in-force long-term insurance business, they are stated at cost less amortisation and accumulated impairment losses and are amortised over their estimated useful lives. Estimated useful life is the lower of legal duration and expected useful life. The amortisation of mortgage servicing rights is included within 'Net fee income'.

For the accounting policy governing the present value of in-force long-term insurance business (see Note 2y).

- (iii) Intangible assets with finite useful lives are amortised, generally on a straight-line basis, over their useful lives as follows:

Trade names	10 years
Mortgage servicing rights	generally between 5 and 12 years
Internally generated software	between 3 and 5 years
Purchased software	between 3 and 5 years
Customer/merchant relationships	between 3 and 10 years
Other	generally 10 years

Notes on the Financial Statements (continued)

(q) Property, plant and equipment

Land and buildings are stated at historical cost, or fair value at the date of transition to IFRSs ('deemed cost'), less any impairment losses and depreciation calculated to write-off the assets over their estimated useful lives as follows:

- freehold land is not depreciated;
- freehold buildings are depreciated at the greater of 2% per annum on a straight-line basis or over their remaining useful lives; and
- leasehold buildings are depreciated over the shorter of their unexpired terms of the leases or their remaining useful lives.

Equipment, fixtures and fittings (including equipment on operating leases where HSBC is the lessor) are stated at cost less any impairment losses and depreciation calculated on a straight-line basis to write-off the assets over their useful lives, which run to a maximum of 35 years but are generally between 5 years and 20 years.

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

HSBC holds certain properties as investments to earn rentals or for capital appreciation, or both. Investment properties are included in the balance sheet at fair value with changes therein recognised in the income statement in the period of change. Fair values are determined by independent professional valuers who apply recognised valuation techniques.

(r) Finance and operating leases

Agreements which transfer to counterparties substantially all the risks and rewards incidental to the ownership of assets, but not necessarily legal title, are classified as finance leases. When HSBC is a lessor under finance leases the amounts due under the leases, after deduction of unearned charges, are included in 'Loans and advances to banks' or 'Loans and advances to customers', as appropriate. The finance income receivable is recognised in 'Net interest income' over the periods of the leases so as to give a constant rate of return on the net investment in the leases.

When HSBC is a lessee under finance leases, the leased assets are capitalised and included in 'Property, plant and equipment' and the corresponding liability to the lessor is included in 'Other liabilities'. A finance lease and its corresponding liability are recognised initially at the fair value of the asset or, if lower, the present value of the minimum lease payments. Finance charges payable are recognised in 'Net interest income' over the period of the lease based on the interest rate implicit in the lease so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are classified as operating leases. When acting as lessor, HSBC includes the assets subject to operating leases in 'Property, plant and equipment' and accounts for them accordingly. Impairment losses are recognised to the extent that residual values are not fully recoverable and the carrying value of the assets is thereby impaired. When HSBC is the lessee, leased assets are not recognised on the balance sheet. Rentals payable and receivable under operating leases are accounted for on a straight-line basis over the periods of the leases and are included in 'General and administrative expenses' and 'Other operating income', respectively.

(s) Income tax

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

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

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

Notes on the Financial Statements (continued)

that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

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

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

(t) Pension and other post-employment benefits

HSBC operates a number of pension and other post-employment benefit plans throughout the world. These plans include both defined benefit and defined contribution plans and various other post-employment benefits such as post-employment healthcare.

Payments to defined contribution plans and state-managed retirement benefit plans, where HSBC's obligations under the plans are equivalent to a defined contribution plan, are charged as an expense as they fall due.

The defined benefit pension costs and the present value of defined benefit obligations are calculated at the reporting date by the schemes' actuaries using the Projected Unit Credit Method. The net charge to the income statement mainly comprises the current service cost, plus the unwinding of the discount rate on plan liabilities, less the expected return on plan assets, and is presented in operating expenses. Past service costs are charged immediately to the income statement to the extent that the benefits have vested, and are otherwise recognised on a straight-line basis over the average period until the benefits vest. Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred), as well as the effects of changes in actuarial assumptions. Actuarial gains and losses are recognised in other comprehensive income in the period in which they arise.

The defined benefit liability recognised in the balance sheet represents the present value of defined benefit obligations adjusted for unrecognised past service costs and reduced by the fair value of plan assets. Any net defined benefit surplus is limited to unrecognised past service costs plus the present value of available refunds and reductions in future contributions to the plan.

The cost of obligations arising from other post-employment defined benefit plans, such as defined benefit health-care plans, are accounted for on the same basis as defined benefit pension plans.

(u) Share-based payments

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

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

Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments

Notes on the Financial Statements (continued)

included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

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

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

Where HSBC Holdings enters into share-based payment arrangements involving employees of subsidiaries, the cost is recognised in 'Investment in subsidiaries' and credited to the 'Share-based payment reserve' over the vesting period. Where a subsidiary funds the share-based payment arrangement, 'Investment in subsidiaries' is reduced by the fair value of equity instruments.

(v) Foreign currencies

Items included in the financial statements of each of HSBC's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). HSBC's consolidated financial statements are presented in US dollars which is also HSBC Holdings' functional currency.

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the balance sheet date. Any resulting exchange differences are included in the income statement. Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Any exchange component of a gain or loss on a non-monetary item is recognised in other comprehensive income if the gain or loss on the non-monetary item is recognised in other comprehensive income. Any exchange component of a gain or loss on a non-monetary item is recognised in the income statement if the gain or loss on the non-monetary item is recognised in the income statement.

In the consolidated financial statements, the assets, including related goodwill where applicable, and liabilities of branches, subsidiaries, joint ventures and associates whose functional currency is not US dollars, are translated into the Group's presentation currency at the rate of exchange ruling at the balance sheet date. The results of branches, subsidiaries, joint ventures and associates whose functional currency is not US dollars are translated into US dollars at the average rates of exchange for the reporting period. Exchange differences arising from the retranslation of opening foreign currency net assets, and exchange differences arising from retranslation of the result for the reporting period from the average rate to the exchange rate prevailing at the period end, are recognised in other comprehensive income. Exchange differences on a monetary item that is part of a net investment in a foreign operation are recognised in the income statement of the separate financial statements. In consolidated financial statements these exchange differences are recognised in other comprehensive income. On disposal of a foreign operation, exchange differences relating thereto and previously recognised in other comprehensive income are recognised in the income statement.

(w) Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation, which has arisen as a result of past events, and for which a reliable estimate can be made of the amount of the obligation.

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of HSBC; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will

Notes on the Financial Statements (continued)

require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

(x) Financial guarantee contracts

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received or receivable. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations.

HSBC Holdings has issued financial guarantees and similar contracts to other Group entities. Where it has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, HSBC may elect to account for guarantees as an insurance contract. This election is made on a contract by contract basis, but the election for each contract is irrevocable. Where these guarantees have been classified as insurance contracts, they are measured and recognised as insurance liabilities.

(y) Insurance contracts

Through its insurance subsidiaries, HSBC issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which HSBC accepts significant insurance risk from another party by agreeing to compensate that party on the occurrence of a specified uncertain future event, is classified as an insurance contract. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant.

While investment contracts with discretionary participation features are financial instruments, they continue to be treated as insurance contracts as permitted by IFRS 4.

Insurance contracts are accounted for as follows:

Premiums

Gross insurance premiums for non-life insurance business are reported as income over the term of the insurance contracts based on the proportion of risks borne during the accounting period. The unearned premium (the proportion of the business underwritten in the accounting year relating to the period of risk after the balance sheet date) is calculated on a daily or monthly pro rata basis.

Premiums for life insurance contracts are accounted for when receivable, except in unit-linked insurance contracts where premiums are accounted for when liabilities are established.

Reinsurance premiums are accounted for in the same accounting period as the premiums for the direct insurance contracts to which they relate.

Claims and reinsurance recoveries

Gross insurance claims for non-life insurance contracts include paid claims and movements in outstanding claims liabilities.

Gross insurance claims for life insurance contracts reflect the total cost of claims arising during the year, including claim handling costs and any policyholder bonuses allocated in anticipation of a bonus declaration. Claims arising during the year include maturities, surrenders and death claims.

Maturity claims are recognised when due for payment. Surrenders are recognised when paid or at an earlier date on which, following notification, the policy ceases to be included within the calculation of the related insurance liabilities. Death claims are recognised when notified.

Reinsurance recoveries are accounted for in the same period as the related claim.

Liabilities under insurance contracts

Outstanding claims liabilities for non-life insurance contracts are based on the estimated ultimate cost of all claims incurred but not settled at the balance sheet date, whether reported or not, together with related claim-

Notes on the Financial Statements (continued)

handling costs and a reduction for the expected value of salvage and other recoveries. Liabilities for claims incurred but not reported are made on an estimated basis, using appropriate statistical techniques.

Liabilities under non-linked life insurance contracts are calculated by each life insurance operation based on local actuarial principles.

Liabilities under unit-linked life insurance contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

A liability adequacy test is carried out on insurance liabilities to ensure that the carrying amount of the liabilities is sufficient in the light of current estimates of future cash flows. When performing the liability adequacy test, all contractual cash flows are discounted and compared with the carrying value of the liability. When a shortfall is identified it is charged immediately to the income statement.

Present value of in-force long-term insurance business

The value placed on insurance contracts that are classified as long-term insurance business or long-term investment contracts with discretionary participating features ('DPF') and are in force at the balance sheet date is recognised as an asset. The asset represents the present value of the equity holders' interest in the profits expected to emerge from these contracts written at the balance sheet date.

The present value of in-force long-term insurance business and long-term investment contracts with DPF, referred to as 'PVIF', is determined by discounting the equity holders' interest in future profits expected to emerge from business currently in force using appropriate assumptions in assessing factors such as future mortality, lapse rates and levels of expenses and a risk discount rate that reflects the risk premium attributable to the respective contracts. The PVIF incorporates allowances for both non-market risk and the value of financial options and guarantees. The PVIF asset is presented gross of attributable tax in the balance sheet and movements in the PVIF asset are included in 'Other operating income' on a gross of tax basis.

Future profit participation

Where contracts provide discretionary profit participation benefits to policyholders, liabilities for these contracts include provisions for the future discretionary benefits to policyholders. These provisions reflect actual performance of the investment portfolio to date and management expectation on the future performance in connection with the assets backing the contracts, as well as other experience factors such as mortality, lapses and operational efficiency, where appropriate. This benefit may arise from the contractual terms, regulation, or past distribution policy.

In the case of net unrealised investment gains on contracts whose discretionary benefits principally reflect the actual performance of the investment portfolio, the corresponding increase in the liabilities is recognised in either the income statement or other comprehensive income, following the treatment of the unrealised gains on the relevant assets. In the case of net unrealised losses, a deferred participating asset is recognised only to the extent that its recoverability is highly probable. Movements in the liabilities arising from realised gains and losses on relevant assets are recognised in the income statement.

Investment contracts

Customer liabilities under linked and certain non-linked investment contracts and the corresponding financial assets are designated at fair value. Movements in fair value are recognised in 'Net income from financial investments designated at fair value'. Premiums receivable and amounts withdrawn are accounted for as increases or decreases in the liability recorded in respect of investment contracts.

Liabilities under linked investment contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

Investment management fees receivable are recognised in the income statement over the period of the provision of the investment management services, in 'Net fee income'.

The incremental costs directly related to the acquisition of new investment contracts or renewing existing investment contracts are deferred and amortised over the period during which the investment management services are provided.

Notes on the Financial Statements (continued)**(z) Debt securities issued and deposits by customers and banks**

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

(aa) Share capital

Shares are classified as equity when there is no contractual obligation to transfer cash or other financial assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

HSBC Holdings plc shares held by HSBC are recognised in equity as a deduction from retained earnings until they are cancelled. When such shares are subsequently sold, reissued or otherwise disposed of, any consideration received is included in equity, net of any directly attributable incremental transaction costs and related income tax effects.

(ab) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition, and include cash and balances at central banks, treasury bills and other eligible bills, loans and advances to banks, items in the course of collection from or in transmission to other banks, and certificates of deposit.

(ac) Rights issues

Rights issues to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights issues pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. On initial recognition, these rights are recognised in shareholders' equity and are not subsequently re-measured during the offer period.

Following the exercise of the rights and the allotment of new shares, the cash proceeds of the rights issue are recognised in shareholders' equity. Incremental costs directly attributable to the rights issue are shown as a deduction from the proceeds, net of tax.

Notes on the Financial Statements (continued)

3 Net income/(expense) from financial instruments designated at fair value

Net income/(expense) from financial instruments designated at fair value includes:

- all gains and losses from changes in the fair value of financial assets and liabilities designated at fair value, including liabilities under investment contracts;
- all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets and liabilities designated at fair value; and
- interest income, interest expense and dividend income in respect of:
 - financial assets and liabilities designated at fair value; and
 - derivatives managed in conjunction with the above,

except for interest arising from HSBC's issued debt securities and derivatives managed in conjunction with those debt securities, which is recognised in 'Interest expense'.

Net income/(expense) from financial instruments designated at fair value

HSBC

	2010 US\$m	2009 US\$m	2008 US\$m
Net income/(expense) arising on:			
– financial assets held to meet liabilities under insurance and investment contracts	2,349	3,793	(5,064)
– other financial assets designated at fair value	230	2	1,738
– derivatives managed in conjunction with other financial assets designated at fair value	(149)	(249)	77
	2,430	3,546	(3,249)
– liabilities to customers under investment contracts	(946)	(1,329)	1,751
– HSBC's long-term debt issued and related derivatives	(258)	(6,247)	6,679
– changes in own credit spread on long-term debt	(63)	(6,533)	6,570
– derivatives managed in conjunction with HSBC's issued debt securities	(275)	(1,726)	4,413
– other changes in fair value	80	2,012	(4,304)
– other financial liabilities designated at fair value	(18)	492	(1,368)
– derivatives managed in conjunction with other financial liabilities designated at fair value	12	7	39
	(1,210)	(7,077)	7,101
	1,220	(3,531)	3,852

HSBC Holdings

	2010 US\$m	2009 US\$m	2008 US\$m
Net income/(expense) arising on HSBC Holdings long-term debt issued and related derivatives			
– changes in own credit spread on long-term debt	248	(2,612)	2,262
– derivatives managed in conjunction with HSBC Holdings issued debt securities	(482)	(352)	688
– other changes in fair value	373	201	37
	139	(2,763)	2,987

Notes on the Financial Statements (continued)

4 Net earned insurance premiums

	Non-life insurance US\$m	Life insurance (non-linked) US\$m	Life insurance (linked) US\$m	Investment contracts with DPF ¹ US\$m	Total US\$m
2010					
Gross earned premiums	1,275	5,427	1,956	2,951	11,609
– gross written premiums	1,192	5,357	1,956	2,951	11,456
– movement in unearned premiums	83	70	–	–	153
Reinsurers' share of gross earned premiums	(160)	(289)	(14)	–	(463)
– gross written premiums ceded to reinsurers	(172)	(266)	(8)	–	(446)
– reinsurers' share of movement in unearned premiums	12	(23)	(6)	–	(17)
	1,115	5,138	1,942	2,951	11,146
2009					
Gross earned premiums	1,572	5,218	1,427	2,774	10,991
– gross written premiums	1,339	5,285	1,427	2,774	10,825
– movement in unearned premiums	233	(67)	–	–	166
Reinsurers' share of gross earned premiums	(225)	(278)	(17)	–	(520)
– gross written premiums ceded to reinsurers	(215)	(280)	(11)	–	(506)
– reinsurers' share of movement in unearned premiums	(10)	2	(6)	–	(14)
	1,347	4,940	1,410	2,774	10,471
2008					
Gross earned premiums	1,834	6,086	1,825	2,802	12,547
– gross written premiums	1,776	6,257	1,825	2,802	12,660
– movement in unearned premiums	58	(171)	–	–	(113)
Reinsurers' share of gross earned premiums	(263)	(851)	(583)	–	(1,697)
– gross written premiums ceded to reinsurers	(260)	(878)	(564)	–	(1,702)
– reinsurers' share of movement in unearned premiums	(3)	27	(19)	–	5
	1,571	5,235	1,242	2,802	10,850

¹ Discretionary participation features.

5 Net insurance claims incurred and movement in liabilities to policyholders

	Non-life insurance US\$m	Life insurance (non-linked) US\$m	Life insurance (linked) US\$m	Investment contracts with DPF ¹ US\$m	Total US\$m
2010					
Gross claims incurred and movement in liabilities	625	5,108	2,520	3,716	11,969
– claims, benefits and surrenders paid	815	1,355	507	2,023	4,700
– movement in liabilities	(190)	3,753	2,013	1,693	7,269
Reinsurers' share of claims incurred and movement in liabilities	(100)	(201)	99	–	(202)
– claims, benefits and surrenders paid	(114)	(143)	(45)	–	(302)
– movement in liabilities	14	(58)	144	–	100
	525	4,907	2,619	3,716	11,767

Notes on the Financial Statements (continued)

	Non-life insurance US\$m	Life insurance (non-linked) US\$m	Life insurance (linked) US\$m	Investment contracts with DPF ¹ US\$m	Total US\$m
2009					
Gross claims incurred and movement in liabilities	1,281	4,669	2,676	3,934	12,560
– claims, benefits and surrenders paid	987	2,098	325	1,818	5,228
– movement in liabilities	294	2,571	2,351	2,116	7,332
Reinsurers' share of claims incurred and movement in liabilities	(158)	(98)	146	–	(110)
– claims, benefits and surrenders paid	(156)	(159)	(21)	–	(336)
– movement in liabilities	(2)	61	167	–	226
	1,123	4,571	2,822	3,934	12,450
2008					
Gross claims incurred and movement in liabilities	1,044	5,480	939	1,743	9,206
– claims, benefits and surrenders paid	1,044	1,491	481	1,911	4,927
– movement in liabilities	–	3,989	458	(168)	4,279
Reinsurers' share of claims incurred and movement in liabilities	(83)	(792)	(1,442)	–	(2,317)
– claims, benefits and surrenders paid	(158)	(172)	(44)	–	(374)
– movement in liabilities	75	(620)	(1,398)	–	(1,943)
	961	4,688	(503)	1,743	6,889

1 Discretionary participation features.

6 Net operating income

Net operating income is stated after the following items of income, expense, gains and losses:

	2010 US\$m	2009 US\$m	2008 US\$m
Income			
Interest recognised on impaired financial assets	516	941	1,040
Fees earned on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	11,445	12,310	14,511
Fees earned on trust and other fiduciary activities where HSBC holds or invests assets on behalf of its customers	3,074	2,735	3,314
Income from listed investments	7,418	9,201	11,425
Income from unlisted investments	7,187	7,085	11,359
Losses from the fraud at Bernard L Madoff Investment Securities LLC (within net trading income)	–	(72)	(984)
Gain arising from dilution of interests in associates	188	–	–
Expense			
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated at fair value	(17,549)	(19,737)	(45,525)
Fees payable on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	(1,529)	(1,580)	(1,866)
Fees payable relating to trust and other fiduciary activities where HSBC holds or invests assets on behalf of its customers	(151)	(116)	(159)
Gains/(losses)			
Gain on disposal or settlement of loans and advances	121	244	94
Impairment of available-for-sale equity securities	(105)	(358)	(1,042)
Gains on disposal of property, plant and equipment, intangible assets and non-financial investments	639	457	465
Gain on sale/repurchase of properties	250	576	416
Loan impairment charges and other credit risk provisions	(14,039)	(26,488)	(24,937)
Net impairment charge on loans and advances	(13,548)	(24,942)	(24,131)
Impairment of available-for-sale debt securities	(472)	(1,474)	(737)
Impairment in respect of other credit risk provisions	(19)	(72)	(69)

Notes on the Financial Statements (continued)

7 Employee compensation and benefits

	2010 US\$m	2009 US\$m	2008 US\$m
Wages and salaries	17,193	16,268	18,169
Social security costs	1,567	1,512	1,625
Post-employment benefits	1,076	688	998
	19,836	18,468	20,792

Average number of persons employed by HSBC during the year

	2010	2009	2008
Europe	79,902	84,056	87,864
Hong Kong	29,105	28,894	30,030
Rest of Asia-Pacific	89,737	88,122	87,954
Middle East	8,983	8,468	8,201
North America	36,822	42,202	53,090
Latin America	57,778	57,774	64,319
Total	302,327	309,516	331,458

Post-employment benefit plans

Income statement charge

	2010 US\$m	2009 US\$m	2008 US\$m
Defined benefit pension plans	468	161	477
– HSBC Bank (UK) Pension Scheme	308	(179)	255
– Other plans	160	340	222
Defined contribution pension plans	545	492	498
Defined benefit healthcare plans	1,013	653	975
Defined contribution healthcare plans	58	31	13
	5	4	10
	1,076	688	998

Net assets/(liabilities) recognised on balance sheet in respect of defined benefit plans

	2010 US\$m	2009 US\$m
Defined benefit pension plans	(2,867)	(6,147)
HSBC Bank (UK) Pension Scheme	(622)	(3,822)
– fair value of plan assets	22,236	17,701
– present value of defined benefit obligations	(22,858)	(21,523)
Other plans	(2,245)	(2,325)
– fair value of plan assets	7,559	6,822
– present value of defined benefit obligations	(9,785)	(9,109)
– effect of limit on plan surpluses	(47)	(47)
– unrecognised past service cost	28	9
Defined benefit healthcare plans	(946)	(820)
– fair value of plan assets	165	142
– present value of defined benefit obligations	(1,087)	(937)
– unrecognised past service cost	(24)	(25)
Fair value of plan assets	29,960	24,665
Present value of defined benefit obligations	(33,730)	(31,569)
Effect of limit on plan surpluses	(47)	(47)
Unrecognised past service cost	4	(16)
	(3,813)	(6,967)
Retirement benefit liabilities	(3,856)	(6,967)
Retirement benefit assets	43	–

Notes on the Financial Statements (continued)

Cumulative actuarial gains/(losses) recognised in other comprehensive income

	2010 US\$m	2009 US\$m
At 1 January	(4,660)	(1,074)
HSBC Bank (UK) Pension Scheme	321	(3,692)
Other plans	(275)	179
Healthcare plans	(112)	(36)
Change in the effect of limit on plan surpluses ¹	6	(37)
Total actuarial losses recognised in other comprehensive income	(60)	(3,586)
At 31 December ²	(4,720)	(4,660)

1 Excludes exchange differences of US\$6m (2009: US\$1m).

2 Includes cumulative movements related to the limit on plan surpluses. This limit is US\$47m at 31 December 2010 (2009: US\$47m).

HSBC pension plans

	2010	2009	2008
Number of plans worldwide	218	211	205
	%	%	%
Percentage of HSBC employees:			
– enrolled in defined contribution plans	63	59	50
– enrolled in defined benefit plans	27	29	36
– covered by HSBC pension plans	90	88	86

HSBC has been progressively offering all new employees membership of defined contribution plans.

The majority of the Group's defined benefit plans are funded plans. The assets of most of the larger plans are held in trusts or similar funds separate from HSBC. The plans are reviewed at least annually or in accordance with local practice and regulations by qualified actuaries. The actuarial assumptions used to calculate the defined benefit obligations and related current service costs vary according to the economic conditions of the countries in which the plans are situated.

Pension plans in the UK

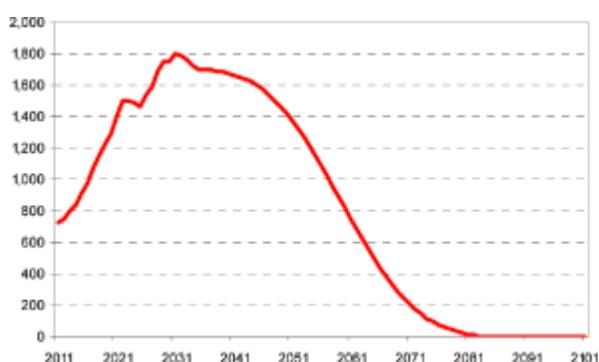
The largest plan exists in the UK, where the HSBC Bank (UK) Pension Scheme ('the Scheme') covers employees of HSBC Bank plc and certain other employees of HSBC. This comprises a funded defined benefit plan ('the principal plan'), which is closed to new entrants, and a defined contribution plan which was established in July 1996 for new employees.

The latest actuarial valuation of the principal plan was made as at 31 December 2008 by C G Singer, Fellow of the Institute of Actuaries, of Towers Watson Limited. At that date, the market value of the HSBC Bank (UK) Pension Scheme's assets was £10.6bn (US\$15.5bn) (including assets relating to the defined benefit plan, the defined contribution plan and additional voluntary contributions). The market value of the plan assets represented 77% of the amount expected to be required, on the basis of the assumptions adopted, to provide the benefits accrued to members after allowing for expected future increases in earnings, and the resulting deficit amounted to £3.2bn (US\$4.7bn). The method adopted for this investigation was the projected unit method.

The expected cash flows from the principal plan were projected by reference to the Retail Price Index ('RPI') swap break-even curve at 31 December 2008. Salary increases were assumed to be 0.5% per annum above RPI and inflationary pension increases, subject to a minimum of zero per cent and a maximum of 5% (maximum of 3% per annum in respect of service accrued since 1 July 2009), were assumed to be in line with RPI. The projected cash flows were discounted at the LIBOR swap curve at 31 December 2008 plus a margin for the expected return on the investment strategy of 190 basis points per annum. The mortality experience of the principal plan's pensioners over the three year period since the previous valuation was analysed and, on the basis of this analysis, the mortality assumptions were set based on the SAPS S1 series of tables which best fit the pensioner experience. Allowance was made for future improvements to mortality rates in line with the medium cohort projections with a minimum improvement rate set at 1.75% for males and 1.25% for females. The benefits payable from the defined benefit plan are expected to be as shown in the chart below.

Notes on the Financial Statements (continued)

Benefit payments (US\$m)



The expected cash flows of the principal plan were projected by reference to the RPI swap curve in calculating the liability recognised. The Occupational Pensions (Revaluation) Order 2010 confirmed the UK Government's intention to move to using the Consumer Prices Index ('CPI') rather than RPI as the inflation measure for determining the minimum pension increases to be applied to the statutory index-linked features of retirement benefits. Historical annual CPI increases have generally been lower than annual RPI increases. The rules of the principal plan prescribe that annual increases will be in line with RPI for pensions in payment and statutory index-linked prior to retirement for deferred pensions. In respect of deferred pensioners, consistent with communications to scheme members, HSBC continued to use RPI in calculating the liability recognised as at 31 December 2010. Using CPI to value the schemes liabilities in respect of deferred pensioners would result in a reduction in the principal plan's liabilities of approximately US\$400m based on the financial and demographic assumptions as at 31 December 2010.

As part of the 31 December 2008 valuation, calculations were also carried out as to the amount of assets that might be needed to meet the liabilities if the Scheme was discontinued and the members' benefits bought out with an insurance company (although in practice this may not be possible for a plan of this size) or the Trustee continued to run the plan without the support of HSBC. The amount required under this approach is estimated to be £19.8bn (US\$28.9bn) as at 31 December 2008. In arriving at this estimation, a more prudent assumption about future mortality was made than for the assessment of the ongoing position and it was assumed that the Trustee would alter the investment strategy to be an appropriately matched portfolio of UK government bonds. An explicit allowance for expenses was also included.

Information on the investment strategy of the principal plan can be found on page 172.

In February 2010, HSBC Bank plc agreed with the Trustee of the Scheme to reduce the deficit of the plan by meeting a schedule of future funding payments. On 17 June 2010, HSBC Bank plc agreed with the Trustee to accelerate the reduction of the deficit of the plan with a special contribution of £1,760m (US\$2,638m) in 2010 followed by a revised payment schedule in the following years, as shown below:

Additional future funding payments to the principal plan

	Original plan US\$m ¹	Original plan £m	Revised plan US\$m ¹	Revised plan £m
2011	–	–	–	–
2012	722	465	–	–
2013	722	465	–	–
2014	722	465	–	–
2015	978	630	–	–
2016	978	630	768	495
2017	978	630	978	630
2018	978	630	978	630

¹ The payment schedule was agreed with the Trustee in pounds sterling and the equivalent US dollar amounts are shown at the exchange rate effective as at 31 December 2010.

HSBC considers that the contributions set out above, together with investment returns at an expected level of 240 basis points above the LIBOR swap curve, would be sufficient to meet the deficit as at 31 December 2008 over the agreed period. At each subsequent actuarial valuation, HSBC has agreed with the Trustee that any shortfall in

Notes on the Financial Statements (continued)

investment returns relative to this expected level, subject to a maximum of 50 basis points per annum, will be eliminated by payment of equal cash instalments over the remaining years to the end of this recovery plan period.

HSBC Bank plc also agreed to make ongoing contributions to the principal plan in respect of the accrual of benefits of defined benefit section members at the rate of 34% of pensionable salaries (less member contributions) payable from 1 April 2010 until the completion of the next actuarial valuation, due as at 31 December 2011. During 2009, HSBC paid contributions at the rate of 38% of pensionable salaries (less member contributions) and continued contributions at this rate until 31 March 2010.

On 1 July 2009, changes to the design of the defined benefit section of the principal plan were made. This included the introduction of employee contributions, optionality concerning future benefit accrual and, with effect from 1 April 2010, an increased normal retirement age of 65 years. In addition, enhancements to the defined contribution section were also introduced.

Pension plans in Hong Kong

In Hong Kong, the HSBC Group Hong Kong Local Staff Retirement Benefit Scheme covers employees of The Hongkong and Shanghai Banking Corporation and certain other employees of HSBC. The scheme comprises a funded defined benefit scheme (which provides a lump sum on retirement but is now closed to new members) and a defined contribution scheme. The latter was established on 1 January 1999 for new employees. The latest actuarial valuation of the defined benefit scheme was made at 31 December 2009, and was performed by Estella Chiu, fellow of the Society of Actuaries of the United States of America, of HSBC Insurance (Asia) Limited, a subsidiary of HSBC Holdings. At that valuation date, the market value of the defined benefit scheme's assets was US\$1,088m. On an ongoing basis, the actuarial value of the scheme's assets represented 105% of the actuarial present value of the benefits accrued to members, after allowing for expected future increases in salaries, and the resulting surplus amounted to US\$71m. On a wind-up basis, the scheme's assets represented 107% of the members' vested benefits, based on current salaries, and the resulting surplus amounted to US\$89m. The attained age method has been adopted for the valuation and the major assumptions used in this valuation were a discount rate of 6% per annum and long-term salary increases of 5% per annum.

Pension plans in North America

The HSBC North America (US) Retirement Income Plan covers all employees of HSBC Bank USA, HSBC Finance and other HSBC entities in the US who have reached the age of 21 and met the one year of service participation requirement. The Retirement Income Plan is a funded defined benefit plan which provides final average pay benefits to legacy participants and cash balance benefits to all other participants. All new employees participate in the cash balance section of the plan. In November 2009, the Board of Directors of HSBC North America Holdings, Inc. ('HNAH') approved actions to cease all future benefit accruals for legacy participants under the final average pay formula components of the HSBC North America Retirement Income Plan with effect from 1 January 2011. Affected employees were informed of this decision in February 2010. As a result of these changes, HNAH recorded a one-time curtailment gain of US\$144m.

The most recent actuarial valuation of the plan to determine compliance with US statutory funding requirements was made at 1 January 2010 by Jennifer Jakubowski, Fellow of the Society of Actuaries, Enrolled Actuary, member of the American Academy of Actuaries, of Mercer. At that date, the market value of the plan's assets was US\$2,321m. The assets represented 85% of the benefits accrued to members as valued under the provisions of the Pension Protection Act of 2006 that was effective for the plan year beginning 1 January 2008. The resulting deficit amounted to US\$400m. The method employed for this valuation was the traditional unit credit method and the discount rate was determined using a segment rate method as selected by HSBC under the relevant regulations, which resulted in an effective interest rate of 6.64% per annum.

These determinations described above for actuarial funding valuation purposes are based on different methods and assumptions than those used for financial reporting purposes, and as a result should neither be compared nor related to other determinations included in these financial statements.

The HSBC Bank (UK) Pension Scheme, The HSBC Group Hong Kong Local Staff Retirement Benefit Scheme, and the HSBC North America (US) Retirement Income Plan cover 34% of HSBC's employees and represent 82% of the Group's present value of defined benefit obligations.

Notes on the Financial Statements (continued)

HSBC healthcare benefits plans

HSBC also provides post-employment healthcare benefits under plans in the UK, the US, Bermuda, Canada, Mexico and Brazil, the majority of which are unfunded. The majority of post-employment healthcare benefits plans are defined benefit plans and are accounted for in the same manner as defined benefit pension plans. The plans are reviewed at least annually or in accordance with local practice and regulations by qualified actuaries. The actuarial assumptions used to calculate the defined benefit obligation and related current service cost vary according to the economic conditions of the countries in which they are situated.

Defined benefit pension plans

Net liability under defined benefit pension plans

	HSBC Bank (UK) Pension Scheme		Other plans	
	2010 US\$m	2009 US\$m	2010 US\$m	2009 US\$m
Fair value of plan assets				
At 1 January	17,701	14,865	6,822	6,024
Expected return on plan assets	1,092	959	437	381
Contributions by HSBC	2,890	367	422	596
– normal	252	367	194	178
– special	2,638	–	228	418
Contributions by employees	23	5	17	17
Experience gains	1,772	871	394	65
Benefits paid	(744)	(884)	(440)	(522)
Transfers	136	–	(136)	–
Assets distributed on curtailments	–	–	(7)	(5)
Assets distributed on settlements	–	–	(10)	(6)
Exchange differences	(634)	1,518	60	272
At 31 December	22,236	17,701	7,559	6,822
Present value of defined benefit obligations				
At 1 January	(21,523)	(15,257)	(9,109)	(8,787)
Current service cost	(252)	(260)	(300)	(334)
Interest cost	(1,148)	(1,019)	(438)	(397)
Contributions by employees	(23)	(5)	(17)	(17)
Actuarial (losses)/gains	(1,451)	(4,563)	(669)	114
Benefits paid	744	884	518	608
Past service cost – vested immediately	–	–	(11)	(20)
Past service cost – unvested benefits	–	–	(20)	–
Business combinations	–	–	–	(4)
Transfers	(136)	–	136	–
Reduction in liabilities resulting from curtailments	–	–	158	41
Liabilities extinguished on settlements	–	499	12	1
Exchange differences	931	(1,802)	(45)	(314)
At 31 December	(22,858)	(21,523)	(9,785)	(9,109)
Funded	(22,858)	(21,523)	(9,241)	(8,588)
Unfunded	–	–	(544)	(521)
Effect of limit on plan surpluses	–	–	(47)	(47)
Unrecognised past service cost	–	–	28	9
Net liability	(622)	(3,822)	(2,245)	(2,325)
Retirement benefit liabilities recognised in the balance sheet	(622)	(3,822)	(2,288)	(2,325)
Retirement benefit assets recognised in the balance sheet (within ‘Other assets’)	–	–	43	–

Plan assets of the Group’s pension schemes included US\$57m (2009: US\$62m) of equities and US\$1m (2009: US\$2m) of bonds issued by HSBC and US\$1,592m (2009: US\$1,925m) of other assets placed or transacted with HSBC. The fair value of plan assets included derivatives entered into with HSBC Bank plc by the HSBC Bank (UK) Pension Scheme with a positive fair value of US\$2,173m at 31 December 2010 (2009: US\$1,049m positive fair value) and US\$77m positive fair value (2009: US\$27m positive fair value) in respect of the HSBC International Staff Retirement Benefits Scheme. Further details of these swap arrangements are included in Note 45.

Notes on the Financial Statements (continued)

On 17 June 2010, HSBC Bank plc made a £1,760m (US\$2,638m) special contribution to accelerate the reduction of the deficit of the HSBC Bank (UK) Pension Scheme. On the same day the Scheme used the contribution to acquire debt securities with a fair value of £1,760m (US\$2,638m) from HSBC in a transaction at an arm's length value determined by the Scheme's independent third-party advisors. The debt securities sold comprised supranational, agency and government-guaranteed securities, asset-backed securities, corporate subordinated debt and auction rate securities. The contribution together with net actuarial gains of US\$321m helped achieve a reduction in the net liability of the scheme from US\$3,822m at 31 December 2009 to US\$622m at 31 December 2010.

The special contributions of US\$228m to other plans include an additional contribution of US\$187m to the HSBC North America (US) Retirement Income Plan which was made to maintain a minimum funding level.

The actual return on plan assets for the year ended 31 December 2010 was a positive return of US\$3,695m (2009: positive US\$2,276m).

HSBC expects to make US\$880m of contributions to defined benefit pension plans during 2011. Benefits expected to be paid from the plans to retirees over each of the next five years, and in aggregate for the five years thereafter, are as follows:

Benefits expected to be paid from plans

	2011 US\$m	2012 US\$m	2013 US\$m	2014 US\$m	2015 US\$m	2016-2020 US\$m
HSBC Bank (UK) Pension Scheme	716	745	790	835	903	5,665
Other significant plans	502	506	528	568	579	3,639

Total (income)/expense recognised in the income statement in 'Employee compensation and benefits'

	HSBC Bank (UK) Pension Scheme			Other plans		
	2010 US\$m	2009 US\$m	2008 US\$m	2010 US\$m	2009 US\$m	2008 US\$m
Current service cost	252	260	387	300	334	357
Interest cost	1,148	1,019	1,227	438	397	466
Expected return on plan assets	(1,092)	(959)	(1,359)	(437)	(381)	(549)
Past service cost	-	-	-	12	21	9
Gains on curtailments	-	-	-	(151)	(36)	(20)
(Gains)/losses on settlements	-	(499)	-	(2)	5	(41)
Total (income)/expense	308	(179)	255	160	340	222

The US\$499m settlement gain in 2009 relates to an accounting benefit following a restructuring of the basis of delivery of death in service and ill health early retirement benefits to certain UK employees.

Summary

	HSBC Bank (UK) Pension Scheme				
	2010 US\$m	2009 US\$m	2008 US\$m	2007 US\$m	2006 US\$m
Defined benefit obligation	(22,858)	(21,523)	(15,257)	(23,512)	(24,332)
Fair value of plan assets	22,236	17,701	14,865	22,704	20,587
Net deficit	(622)	(3,822)	(392)	(808)	(3,745)
Experience gains/(losses) on plan liabilities	(327)	(234)	(49)	(64)	540
Experience gains/(losses) on plan assets	1,772	871	(2,861)	29	-
Gains/(losses) from changes in actuarial assumptions	(1,124)	(4,329)	3,081	2,459	(570)
Total net actuarial gains/(losses)	321	(3,692)	171	2,424	(30)

Notes on the Financial Statements (continued)

Summary (continued)

	2010 US\$m	2009 US\$m	Other plans		
			2008 US\$m	2007 US\$m	2006 US\$m
Defined benefit obligation	(9,785)	(9,109)	(8,787)	(8,873)	(7,916)
Fair value of plan assets	7,559	6,822	6,024	7,768	7,116
Net deficit	(2,226)	(2,287)	(2,763)	(1,105)	(800)
Experience gains/(losses) on plan liabilities	(73)	20	(52)	(354)	(167)
Experience gains/(losses) on plan assets	394	65	(1,452)	157	203
Gains/(losses) from changes in actuarial assumptions	(596)	94	(306)	(121)	(44)
Total net actuarial gains/(losses)	(275)	179	(1,810)	(318)	(8)

Defined benefit healthcare plans

Net liability under defined benefit healthcare plans

	2010 US\$m	2009 US\$m
Fair value of plan assets		
At 1 January	142	128
Expected return on plan assets	13	11
Contributions by HSBC	9	11
Experience gains	6	8
Benefits paid	(12)	(4)
Assets distributed on settlements	(2)	(4)
Exchange differences	9	(8)
At 31 December	165	142
Present value of defined benefit obligations		
At 1 January	(937)	(839)
Current service cost	(12)	(11)
Interest cost	(60)	(55)
Contributions by employees	(1)	(2)
Actuarial losses	(118)	(44)
Benefits paid	52	43
Reduction in liabilities resulting from curtailments	-	22
Liabilities extinguished on settlements	2	4
Exchange differences	(13)	(55)
At 31 December	(1,087)	(937)
Funded	(197)	(148)
Unfunded	(890)	(789)
Unrecognised past service cost	(24)	(25)
At 31 December	(946)	(820)

The actual return on plan assets for the year ended 31 December 2010 was a positive return of US\$19m (2009: positive US\$19m).

HSBC expects to make US\$61m of contributions to post-employment healthcare benefit plans during 2011. Benefits expected to be paid from the plans to retirees over each of the next five years, and in aggregate for the five years thereafter, are as follows:

Benefits expected to be paid from plans

	2011 US\$m	2012 US\$m	2013 US\$m	2014 US\$m	2015 US\$m	2016-2020 US\$m
Significant plans	57	58	60	62	64	334

Notes on the Financial Statements (continued)

Total expense recognised in the income statement in 'Employee compensation and benefits'

	2010 US\$m	2009 US\$m	2008 US\$m
Current service cost	12	11	19
Interest cost	60	55	65
Expected return on plan assets	(13)	(11)	(12)
Past service cost	(1)	(2)	(2)
Gains on curtailments	–	(22)	(31)
Gains on settlements	–	–	(26)
Total expense	58	31	13

Summary

	2010 US\$m	2009 US\$m	2008 US\$m	2007 US\$m	2006 US\$m
Defined benefit obligation	(1,087)	(937)	(839)	(1,038)	(1,106)
Fair value of plan assets	165	142	128	146	133
Net deficit	(922)	(795)	(711)	(892)	(973)
Experience gains/(losses) on plan liabilities	(27)	13	(34)	15	(12)
Experience gains/(losses) on plan assets	6	8	(14)	(6)	(1)
Gains/(losses) from changes in actuarial assumptions	(91)	(57)	32	94	(25)
Total net actuarial gains/(losses)	(112)	(36)	(16)	103	(38)

Post-employment defined benefit plans' principal actuarial financial assumptions

The principal actuarial financial assumptions used to calculate the Group's obligations under its defined benefit pension and post-employment healthcare plans at 31 December for each period, and used as the basis for measuring periodic costs under the plans in the following periods, were as follows.

Principal actuarial assumptions

	Discount rate %	Inflation rate %	Rate of increase for pensions ¹ %	Rate of pay increase %	Healthcare cost trend		Year of ultimate rate
					Initial rate %	Ultimate rate %	
At 31 December 2010							
UK ²	5.40	3.70	3.50	4.20	7.70	7.70	n/a
Hong Kong	2.85	n/a	n/a	5.00	n/a	n/a	n/a
US	5.41	2.50	n/a	2.75	7.20	4.50	2027
Jersey	5.40	3.70	3.70	5.45	n/a	n/a	n/a
Mexico	7.50	3.50	3.50	4.50	6.75	6.75	n/a
Brazil	10.51	4.50	4.50	5.50	10.00	5.50	2020
France	4.75	2.00	2.00	3.00	n/a	n/a	n/a
Canada	5.45	2.50	n/a	3.72	8.00	5.00	2015
Switzerland	2.60	1.50	n/a	2.50	n/a	n/a	n/a
Germany	5.00	2.00	2.00	3.00	n/a	n/a	n/a
At 31 December 2009							
UK ²	5.70	3.70	3.50	4.20	7.70	7.70	n/a
Hong Kong	2.58	n/a	n/a	5.00	n/a	n/a	n/a
US	5.92	2.50	n/a	3.50	7.40	4.50	2027
Jersey	5.70	3.70	3.70	5.45	n/a	n/a	n/a
Mexico	8.50	3.50	3.50	4.50	6.75	6.75	n/a
Brazil	11.25	4.50	4.50	5.50	10.00	5.50	2019
France	5.50	2.00	2.00	3.00	n/a	n/a	n/a
Canada	6.25	2.50	n/a	3.72	8.00	5.00	2015
Switzerland	3.25	1.50	n/a	2.50	n/a	n/a	n/a
Germany	5.50	2.00	2.00	3.00	n/a	n/a	n/a

Notes on the Financial Statements (continued)

Principal actuarial assumptions (continued)

	Discount rate %	Inflation rate %	Rate of increase for pensions ¹ %	Rate of pay increase %	Healthcare cost trend		Year of ultimate rate
					Initial rate %	Ultimate rate %	
At 31 December 2008							
UK ²	6.50	2.90	3.00	3.40	6.90	6.90	n/a
Hong Kong	1.19	n/a	n/a	5.00	n/a	n/a	n/a
US	6.05	2.50	n/a	3.50	8.90	5.00	2018
Jersey	6.50	2.90	2.90	4.65	n/a	n/a	n/a
Mexico	8.10	3.50	2.00	4.50	6.75	6.75	n/a
Brazil	10.75	4.50	4.50	5.50	10.00	5.50	2018
France	5.75	2.00	2.00	3.00	n/a	n/a	n/a
Canada	7.19	2.50	n/a	3.85	8.20	4.90	2012
Switzerland	2.60	1.50	n/a	2.39	n/a	n/a	n/a
Germany	5.75	2.00	2.00	3.00	n/a	n/a	n/a

1 Rate of increase for pensions in payment and deferred pensions (except for the UK).

2 Rate of increase for pensions in the UK is for pensions in payment only, capped at 5%. Deferred pensions are projected to increase in line with the assumed inflation rate.

HSBC determines the discount rates to be applied to its obligations in consultation with the plans' local actuaries, on the basis of current average yields of high quality (AA rated or equivalent) debt instruments, with maturities consistent with those of the defined benefit obligations. In countries where there is not a deep market in corporate bonds, government bond yields have been used. The yield curve has been extrapolated where the term of the liabilities is longer than the duration of available bonds and the discount rate used then takes into account the term of the liabilities and the shape of the yield curve. When determining the discount rate with reference to a bond index, an appropriate index for the specific region has been used.

Mortality tables and average life expectancy at age 65

	Mortality table	Life expectancy at age 65 for a male member currently:		Life expectancy at age 65 for a female member currently:	
		Aged 65	Aged 45	Aged 65	Aged 45
At 31 December 2010					
UK	SAPS MC ¹	22.4	24.3	23.4	25.3
Hong Kong ⁴	n/a	n/a	n/a	n/a	n/a
US	RP 2000 fully generational	19.3	20.8	21.2	22.1
Jersey	80% of PNA00 ²	24.2	26.2	26.6	28.5
Mexico	EMSSA-97 AA generational scale from RP 2000 series	18.6	20.1	21.1	22.0
Brazil	RP 2000 fully generational	19.3	20.8	21.2	22.1
France	TG 05	23.4	26.1	26.8	29.7
Canada	UP94 generational	19.5	21.1	22.0	22.8
Switzerland	BVG 2005 ³	17.9	17.9	21.0	21.0
Germany	Heubeck 2005 G	18.4	21.1	22.5	25.1
At 31 December 2009					
UK	SAPS MC ¹	22.3	24.2	23.3	25.2
Hong Kong ⁴	n/a	n/a	n/a	n/a	n/a
US	RP 2000 fully generational	19.2	20.7	21.2	22.1
Jersey	80% of PNA00 ²	24.1	26.1	26.5	28.4
Mexico	EMSSA-97 AA generational scale from RP 2000 series	18.5	20.1	21.1	22.0
Brazil	RP 2000 fully generational	19.2	20.7	21.2	22.1
France	TG 05	23.2	26.0	26.7	29.6
Canada	UP94 generational	19.5	21.1	22.0	22.8
Switzerland	BVG 2005 ³	17.9	17.9	21.0	21.0
Germany	Heubeck 2005 G	18.3	21.0	22.4	25.0

1 SAPS MC projections with 1% minimum improvement beyond 2002. Light table with 1.08 rating for male and standard table with 1.06 rating for female.

2 PNA00 year of birth and medium cohort with 1% minimum improvement thereafter.

3 Additional 8.5% liability loading for future mortality improvements.

4 The significant plans in Hong Kong are lump sum plans which do not use a post-retirement mortality table.

Notes on the Financial Statements (continued)

Expected rates of return

	2010		2009	
	Expected rates of return ¹ %	Value US\$m	Expected rates of return ¹ %	Value US\$m
HSBC Bank (UK) Pension Scheme				
Fair value of plan assets		22,236		17,701
Equities	8.4	3,415	8.4	2,770
Bonds	5.3	15,638	5.3	12,597
Property	7.6	1,438	7.7	1,502
Other	4.0	1,745	5.3	832
Other plans				
Fair value of plan assets		7,559		6,822
Equities	8.2	2,617	8.2	2,302
Bonds	5.0	4,073	5.0	3,809
Property	6.1	98	6.4	55
Other	6.2	771	3.5	656
Healthcare plans				
Fair value of plan assets		165		142
Equities	12.0	49	12.2	43
Bonds	8.4	81	8.7	72
Other	7.6	35	4.6	27

¹ The expected rates of return are used to measure the net defined benefit pension costs in each subsequent year, and weighted on the basis of the fair value of the plan assets.

The expected return on plan assets represents the best estimate of long-term future asset returns, which takes into account historical market returns plus additional factors such as the current rate of inflation and interest rates.

Actuarial assumption sensitivities

The discount rate is sensitive to changes in market conditions arising during the reporting period. The mortality rates used are sensitive to experience from the plan member profile. The following table shows the effect of changes in these and the other key assumptions on the principal defined benefit pension plan:

The effect of changes in key assumptions on the principal plan

	HSBC Bank (UK) Pension Scheme	
	2010 US\$m	2009 US\$m
Discount rate		
Change in pension obligation at year end from a 25bps increase	(941)	(879)
Change in pension obligation at year end from a 25bps decrease	1,003	946
Change in 2011 pension cost from a 25bps increase	(9)	(13)
Change in 2011 pension cost from a 25bps decrease	9	13
Rate of inflation		
Change in pension obligation at year end from a 25bps increase	1,029	964
Change in pension obligation at year end from a 25bps decrease	(978)	(907)
Change in 2011 pension cost from a 25bps increase	67	65
Change in 2011 pension cost from a 25bps decrease	(64)	(63)
Rate of increase for pensions in payment and deferred pensions		
Change in pension obligation at year end from a 25bps increase	813	800
Change in pension obligation at year end from a 25bps decrease	(775)	(766)
Change in 2011 pension cost from a 25bps increase	48	50
Change in 2011 pension cost from a 25bps decrease	(45)	(49)
Rate of pay increase		
Change in pension obligation at year end from a 25bps increase	216	195
Change in pension obligation at year end from a 25bps decrease	(203)	(174)
Change in 2011 pension cost from a 25bps increase	20	18
Change in 2011 pension cost from a 25bps decrease	(17)	(16)
Investment return		
Change in 2011 pension cost from a 25bps increase	(54)	(44)
Change in 2011 pension cost from a 25bps decrease	54	44
Mortality		
Change in pension obligation from each additional year of longevity assumed	497	487

Notes on the Financial Statements (continued)

The effect of changes in the discount rate and in mortality rates on plans other than the principal plan

	Other plans	
	2010 US\$m	2009 US\$m
Change in defined benefit obligation at year end from a 25bps increase in discount rate	(290)	(269)
Change in 2011 pension cost from a 25bps increase in discount rate	(1)	(3)
Increase in defined benefit obligation from each additional year of longevity assumed	131	120

Effect of one percentage point change in assumed healthcare cost trend rates

	2010		2009	
	1% increase US\$m	1% decrease US\$m	1% increase US\$m	1% decrease US\$m
Increase/(decrease) of the aggregate of the current service cost and interest cost	8	(7)	8	(7)
Increase/(decrease) of defined benefit obligation	106	(86)	86	(75)

HSBC Holdings

Employee compensation and benefit expense in respect of HSBC Holdings' employees in 2010 amounted to US\$244m (2009: US\$217m). The average number of persons employed by HSBC Holdings during 2010 was 1,015 (2009: 876).

Employees of HSBC Holdings who are members of defined benefit pension plans are principally members of either the HSBC Bank (UK) Pension Scheme or the HSBC International Staff Retirement Benefits Scheme.

Directors' emoluments

The aggregate emoluments of the Directors of HSBC Holdings, computed in accordance with the Companies Act 2006 and the Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008 were:

	2010 US\$000	2009 US\$000	2008 US\$000
Fees	3,597	3,756	2,529
Salaries and other emoluments	12,841	11,835	11,584
Bonuses	14,294	–	–
	30,732	15,591	14,113
Gains on the exercise of share options	–	–	23
Vesting of Long-Term Incentive awards	8,523	1,579	7,147

In addition, there were payments under retirement benefit agreements with former Directors of US\$1,016,089 (2009: US\$1,036,385). The provision at 31 December 2010 in respect of unfunded pension obligations to former Directors amounted to US\$17,628,508 (2009: US\$16,296,028).

During the year, aggregate contributions to pension schemes in respect of Directors were US\$1,055,582 (2009: US\$788,734). Discretionary bonuses for Directors are based on a combination of individual and corporate performance and are determined by the Remuneration Committee. Details of Directors' remuneration, share options and conditional awards under the Restricted Share Plan 2000 and the HSBC Share Plan are included in the 'Directors' Remuneration Report' on pages 232 and 233.

Notes on the Financial Statements (continued)

8 Auditors' remuneration

Auditors' remuneration in relation to the statutory audit amounted to US\$51.4m (2009: US\$50.7m; 2008: US\$54.9m). The following fees were payable by HSBC to the Group's principal auditor, KPMG Audit Plc and its associates (together 'KPMG'):

Fees payable by HSBC to KPMG

	2010 US\$m	2009 US\$m	2008 US\$m
Audit fees for HSBC Holdings' statutory audit ¹	2.4	2.3	2.1
– fees relating to current year	2.4	2.1	2.5
– fees relating to prior year	–	0.2	(0.4)
Fees payable to KPMG for other services provided to HSBC	75.9	77.1	88.3
Audit-related services:			
– audit of HSBC's subsidiaries, pursuant to legislation ²	46.7	45.9	48.6
– other services pursuant to legislation ³	20.8	24.2	26.5
Tax services ⁴	2.4	2.6	3.1
Other services:			
– services relating to information technology ⁵	0.1	0.3	0.6
– services related to corporate finance transactions ⁶	–	0.1	1.4
– all other services ⁷	5.9	4.0	8.1
Total fees payable	78.3	79.4	90.4

- ¹ Fees payable to KPMG Audit Plc for the statutory audit of the consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings. They exclude amounts payable for the statutory audit of HSBC Holdings' subsidiaries which have been included in 'Fees payable to KPMG for other services provided to HSBC'.
- ² Including fees payable to KPMG for the statutory audit of HSBC's subsidiaries.
- ³ Including services for assurance and other services that relate to statutory and regulatory filings, including comfort letters and interim reviews.
- ⁴ Including tax compliance services and tax advisory services.
- ⁵ Including advice on IT security and business continuity and performing agreed-upon IT testing procedures.
- ⁶ Including fees payable to KPMG for transaction-related work, including US debt issuances.
- ⁷ Including other assurance and advisory services such as translation services, ad-hoc accounting advice and review of financial models.

No fees were payable by HSBC to KPMG for the following types of services: internal audit services, valuation and actuarial services, services related to litigation and services related to recruitment and remuneration.

Fees payable by HSBC's associated pension schemes to KPMG

	2010 US\$000	2009 US\$000	2008 US\$000
Audit fees	384	670	720
Tax services	–	–	73
All other services	–	260	–
Total fees payable	384	930	793

No fees were payable by HSBC's associated pension schemes to KPMG for the following types of services: other services pursuant to legislation, services relating to information technology, internal audit services, valuation and actuarial services, services related to litigation, services related to recruitment and remuneration, and services related to corporate finance transactions.

In addition to the above, KPMG estimate they have been paid fees of US\$14.9m (2009: US\$8.1m; 2008: US\$4.8m) by parties other than HSBC but where HSBC is connected with the contracting party and therefore may be involved in appointing KPMG. These fees arise from services such as auditing mutual funds managed by HSBC and reviewing the financial position of corporate concerns which borrow from HSBC.

Fees payable to KPMG for non-audit services for HSBC Holdings are not disclosed separately because such fees are disclosed on a consolidated basis for HSBC Group.

Notes on the Financial Statements (continued)

9 Share-based payments

During 2010, US\$813m was charged to the income statement in respect of share-based payment transactions settled in equity (2009: US\$683m; 2008: US\$819m). This expense, which was computed from the fair values of the share-based payment transactions when contracted, arose under employee share awards made in accordance with HSBC's reward structures.

Calculation of fair values

Fair values of share options/awards, measured at the date of grant of the option/award, are calculated using a Black-Scholes model. When modelling options/awards with vesting dependent on HSBC's Total Shareholder Return ('TSR') over a period, the TSR performance targets are incorporated into the model using Monte Carlo simulation. The expected life of options depends on the behaviour of option holders, which is incorporated into the option model on the basis of historical observable data. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used.

Significant weighted average assumptions used to estimate the fair value of options granted

	Savings-related share option plans		
	1-year plan	3-year plans	5-year plans
2010			
Risk-free interest rate ¹ (%)	0.7	1.9	2.9
Expected life ² (years)	1	3	5
Expected volatility ³ (%)	30	30	30
Share price at grant date (£)	6.82	6.82	6.82
2009			
Risk-free interest rate ¹ (%)	0.7	2.1	2.4
Expected life ² (years)	1	3	5
Expected volatility ³ (%)	50	35	30
Share price at grant date (£)	4.65	4.65	4.65
2008			
Risk-free interest rate ¹ (%)	4.5	4.5	4.5
Expected life ² (years)	1	3	5
Expected volatility ³ (%)	25	25	25
Share price at grant date (£)	8.80	8.80	8.80

1 The risk-free rate was determined from the UK gilts yield curve for the UK Savings-Related Share Option Plans. A similar yield curve was used for the International Savings-Related Share Option Plans.

2 Expected life is not a single input parameter but a function of various behavioural assumptions.

3 Expected volatility is estimated by considering both historic average share price volatility and implied volatility derived from traded options over HSBC shares of similar maturity to those of the employee options.

The expected US dollar denominated dividend yield was determined to be 4.5% per annum in line with consensus analyst forecasts (2009: 4.5%). Prior to 2009, HSBC adopted a dividend growth model and incorporated expected dividends into the valuation model for share options and awards. In 2008, the expected dividend growth was determined to be 7% for the first year and 8% thereafter.

The HSBC Share Plan

The HSBC Share Plan was approved at the 2005 Annual General Meeting and amendments were approved at the 2008 Annual General Meeting. Under this plan, Performance Share awards, Restricted Share awards and share option awards may be made. The aim of the HSBC Share Plan is to align the interests of executives with the creation of shareholder value and recognise individual performance and potential. Awards are also made under this plan for recruitment and retention purposes.

Performance Share awards

Awards of Performance Shares are made to executive Directors and other senior executives after taking into account individual performance in the previous year. For awards made prior to 2008, each award is divided into two equal parts for testing attainment against pre-determined benchmarks. One half of the award is subject to a TSR measure, based on HSBC's ranking against a comparator group of 28 major banks; the other half is subject to an earnings per share ('EPS') target. For each element of the award, shares are released to the employee on a sliding scale from 30%

Notes on the Financial Statements (continued)

to 100% of the award, depending on the scale of achievement against the benchmarks, providing that the minimum criteria for each performance measure have been met.

For awards made during 2008 and prospectively, each award is divided into three parts for testing attainment against pre-determined benchmarks. 40% of the award is subject to a TSR measure, based on a free-float market capitalisation ranking method; 40% is subject to an economic profit measure, calculated as the average annual difference between return on invested capital and HSBC's benchmark cost of capital; and 20% is subject to an EPS target. For the TSR and EPS elements of the awards, shares are released to the employee on a sliding scale from 20% to 100% of the award, depending on the scale of achievement against the benchmarks. For the economic profit element of the awards, shares are released to the employee on a sliding scale from zero to 100%, depending on the scale of achievement against the benchmark. In all cases, shares are only released when the minimum criteria for each performance measure has been met. The performance conditions are measured over a three year performance period and awards forfeited to the extent they have not been met.

In addition to the performance conditions mentioned above, before an award can vest, the Remuneration Committee needs to be satisfied that the Group has shown a sustained improvement in the period since the award was made. In determining this, the Remuneration Committee will take account of all relevant factors, in particular, comparisons against the TSR comparator group in areas such as revenue growth and mix, cost efficiency, credit performance as measured by risk-adjusted revenues, cash return on cash invested, dividend performance and TSR.

Movement in Performance Share awards under the HSBC Share Plan

	2010	2009
	Number	Number
	(000s)	(000s)
Outstanding at 1 January	7,360	11,619
Additions during the year ¹	351	333
Adjustment for rights issue	–	1,712
Released in the year	(1,181)	(1,076)
Forfeited in the year	(2,105)	(5,228)
Outstanding at 31 December	4,425	7,360

¹ Additions during the year comprised reinvested dividend equivalents.

No Performance Shares were awarded by HSBC in 2010 and 2009.

Restricted Share awards

Awards of Restricted Shares are made to employees on the basis of their performance, potential and retention requirements, to aid recruitment or as a part-deferral of annual bonuses. Shares are awarded without corporate performance conditions and generally vest between one and three years from the date of award, providing the employees have remained continually employed by HSBC for this period.

Movement in Restricted Share awards under the HSBC Share Plan

	2010	2009
	Number	Number
	(000s)	(000s)
Outstanding at 1 January	184,318	122,206
Additions during the year	110,711	108,439
Adjustment for rights issue	–	26,119
Released in the year	(55,419)	(49,718)
Forfeited in the year	(10,518)	(22,728)
Outstanding at 31 December	229,092	184,318

The weighted average fair value of Restricted Share awards in 2010 was US\$10.50 (2009: US\$6.31).

Share options

A small number of discretionary share options were granted in 2005 exclusively to individuals employed by HSBC France under the HSBC Share Plan rules, after the expiry of the Group Share Option Plan rules.

Notes on the Financial Statements (continued)

Nil-cost share options were granted to senior executives on the basis of their performance in the previous year. The share options were subject to the achievement of the same corporate performance conditions as the 2005 Performance Share awards. The options vested after three years in the same proportion as the 2005 Performance Shares but were only exercisable up to the fourth anniversary of the date of grant. These options have now lapsed and there are currently no options with outstanding performance conditions.

Share options were also awarded to a number of employees under the HSBC Share Plan rules. These options may vest after three years and are exercisable up to the tenth anniversary of the date of the grant, after which they lapse.

Movement in share options under the HSBC Share Plan

	2010		2009	
	Number (000s)	Weighted average exercise price £	Number (000s)	Weighted average exercise price £
Outstanding at 1 January	86	7.99	300	8.89
Adjustment for rights issue	-	-	44	7.75
Forfeited and expired in the year	-	-	(258)	7.66
Outstanding and exercisable at 31 December	86	7.99	86	7.99

No share options were granted in 2010 and 2009. The weighted average remaining contractual life of options outstanding at the balance sheet date was 4.8 years (2009: 5.8 years). The exercise price of options outstanding at the balance sheet date was £7.99 (2009: £7.99).

Savings-related share option plans

Savings-related share option plans invite eligible employees to enter into savings contracts to save up to £250 per month (or its equivalent in US dollars, Hong Kong dollars or euros), with the option to use the savings to acquire shares. The aim of the plans is to align the interests of all employees with the creation of shareholder value. The options are exercisable within three months following the first anniversary of the commencement of a one-year savings contract or within six months following either the third or the fifth anniversaries of the commencement of three-year or five-year savings contracts, respectively. The exercise price is set at a 20% (2009: 20%) discount to the market value immediately preceding the date of invitation (except for the one-year options granted under the US sub-plan where a 15% discount is applied).

Movement in savings-related share options

	2010		2009	
	Number (000s)	Weighted average exercise price £	Number (000s)	Weighted average exercise price £
Outstanding at 1 January	172,526	3.69	74,401	6.97
Granted in the year	22,017	5.39	152,796	3.32
Adjustment for rights issue	-	-	7,970	6.08
Exercised in the year	(16,830)	4.18	(5,011)	5.72
Forfeited, cancelled and expired in the year	(19,858)	4.44	(57,630)	5.96
Outstanding at 31 December	157,855	3.87	172,526	3.69

Notes on the Financial Statements (continued)

The weighted average fair value of options granted during the year was US\$2.41 (2009: US\$2.03). The weighted average share price at the date the share options were exercised was US\$10.08 (2009: US\$10.23). The exercise price range and weighted average remaining contractual life for options outstanding at the balance sheet date were as follows:

	2010	2009
Exercise price range (£)	3.31 – 6.69	3.31 – 6.69
Weighted average remaining contractual life (years)	2.76	3.47
Of which exercisable:		
Number (000s)	1,883	5,145
Weighted average exercise price (£)	6.23	6.26

HSBC Holdings Restricted Share Plan 2000

Restricted Share awards made under the Restricted Share Plan

Awards of Restricted Shares were made under the Restricted Share Plan to eligible employees from 2000 to 2005, after taking into account the employees' performance in the previous year, their potential and retention requirements. Restricted shares were also awarded as part-deferral of annual bonuses or for recruitment purposes. Shares were awarded without corporate performance conditions and in most cases fully vest within three years from the date of award, providing the employees have remained continuously employed by HSBC for the period.

Movement on Restricted Share awards under the HSBC Holdings Restricted Share Plan

	2010 Number (000s)	2009 Number (000s)
Outstanding at 1 January	173	2,717
Additions during the year ¹	–	30
Adjustment for rights issue	–	376
Released in the year	–	(2,916)
Forfeited in the year	(173)	(34)
Outstanding at 31 December	–	173

¹ Additions in 2009 principally comprised reinvested dividend equivalents.

At 31 December 2009 the weighted average remaining vesting period was 0.3 years.

HSBC Holdings Group Share Option Plan

The HSBC Holdings Group Share Option Plan was a long-term incentive plan under which certain HSBC employees between 2000 and 2005 were awarded share options. The aim of the plan was to align the interests of those higher performing employees with the creation of shareholder value. In most jurisdictions, this was achieved by setting certain TSR targets which would normally have to be attained in order for the awards to vest. Options were granted at market value and are normally exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions. Options granted after May 2005 are made under the HSBC Share Plan.

Movement on the HSBC Holdings Group Share Option Plan awards

	2010		2009	
	Number (000s)	Weighted average exercise price £	Number (000s)	Weighted average exercise price £
Outstanding and exercisable at 1 January	157,719	7.12	142,593	8.16
Adjustment for rights issue	–	–	21,333	7.12
Exercised in the year	(1,015)	6.08	(1,548)	6.28
Forfeited and expired in the year	(3,946)	7.36	(4,659)	7.15
Outstanding and exercisable at 31 December	152,758	7.12	157,719	7.12

Notes on the Financial Statements (continued)

The weighted average share price at the date the share options were exercised was US\$10.26 (2009: US\$9.14). The number of options, weighted average exercise price and weighted average remaining contractual life of options outstanding at the balance sheet date, analysed by exercise price range, were as follows:

	2010		2009	
	6.00 – 7.00	7.01 – 8.50	6.00 – 7.00	7.01 – 8.50
Exercise price range (£)				
Number (000s)	26,927	125,831	28,406	129,313
Weighted average exercise price (£)	6.03	7.36	6.03	7.36
Weighted average remaining contractual life (years)	2.33	2.34	3.33	3.34
Of which exercisable:				
Number (000s)	26,927	125,831	28,406	129,313
Weighted average exercise price (£)	6.03	7.36	6.03	7.36

HSBC Holdings Executive Share Option Scheme

The HSBC Holdings Executive Share Option Scheme was a long-term incentive plan under which certain senior HSBC employees were awarded share options before the adoption of the HSBC Holdings Group Share Option Plan in 2000. The aim of the plan was to align the interests of those higher performing senior employees with the creation of shareholder value. This was achieved by setting certain TSR targets to be attained in order for the awards to vest. Options were granted at market value and were exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions. No awards have been made under this plan since 2000 and all options have now expired or been exercised.

Movement on the HSBC Holdings Executive Share Option Scheme awards

	2010		2009	
	Number (000s)	Weighted average exercise price £	Number (000s)	Weighted average exercise price £
Outstanding and exercisable at 1 January	6,707	6.50	13,964	6.92
Adjustment for rights issue	–	–	2,046	6.04
Exercised in the year	(4,229)	6.50	(920)	6.39
Expired in the year	(2,478)	6.50	(8,383)	5.61
Outstanding and exercisable at 31 December	–	–	6,707	6.50

The weighted average share price at the date the share options were exercised was US\$10.26 (2009: US\$9.14).

At 31 December 2009, the exercise price range for options outstanding was £5.50–£7.00 and the weighted average remaining contractual life of options outstanding was 0.26 years.

HSBC France and subsidiary company plans

Before its acquisition by HSBC in 2000, HSBC France and certain of its subsidiaries operated employee share option plans. Options over HSBC France shares granted between 1994 and 1999 vested upon announcement of HSBC's agreement to acquire HSBC France and were therefore included in the valuation of HSBC France.

HSBC France granted 909,000 options in 2000 after the public announcement of the acquisition. The options vested on 1 January 2002. The HSBC France shares obtained on exercise of the options were exchangeable for HSBC Holdings ordinary shares of US\$0.50. Options were granted at market value and are exercisable within ten years of the date of grant. Movements in options granted after the public announcement are shown below.

Movement on HSBC France share options

	2010		2009	
	Number (000s)	Exercise price €	Number (000s)	Exercise price €
Outstanding and exercisable at 1 January	604	142.5	604	142.5
Forfeited in the year	(604)	142.5	–	–
Outstanding and exercisable at 31 December	–	–	604	142.5

Notes on the Financial Statements (continued)

At 31 December 2009, the remaining contractual life for options outstanding was 0.3 years.

At the date of its acquisition, certain of HSBC France's subsidiary companies also operated employee share option plans. On exercise of certain of these options, the subsidiary shares are exchanged for HSBC ordinary shares. The total number of HSBC ordinary shares exchanged under such arrangements in 2010 was 9,281 (2009: 70,257).

HSBC Finance

Upon acquisition, HSBC Finance share options previously granted were converted to share options over HSBC ordinary shares of US\$0.50 each at a rate of 2.675 HSBC share options (the same ratio as the Exchange Offer for HSBC Finance) for each HSBC Finance share option. Options granted under HSBC Finance's own share option schemes prior to the announcement of the acquisition by HSBC in November 2002 vested as options over HSBC shares upon acquisition by HSBC. Options granted after the announcement of the acquisition but prior to its completion on 28 March 2003 generally vest equally over four years and expire ten years from the date of grant. Options granted after the announcement are shown in the table below.

Movement on HSBC Finance share options

	2010		2009	
	Number (000s)	Exercise price US\$	Number (000s)	Exercise price US\$
Outstanding at 1 January	2,736	9.29	2,402	10.66
Adjustment for rights issue	–	–	354	9.29
Exercised in the year	(307)	9.29	(20)	9.29
Expired in the year	–	–	–	9.29
Outstanding and exercisable at 31 December	2,429	9.29	2,736	9.29

The weighted average share price at the date the share options were exercised was US\$10.26 (2009: US\$9.14). The remaining contractual life for options outstanding at the balance sheet date was 1.9 years (2009: 2.9 years).

10 Tax expense

	2010 US\$m	2009 US\$m	2008 US\$m
Current tax			
UK Corporation tax	383	206	1,671
– on current year profit	404	280	1,738
– adjustments in respect of prior years	(21)	(74)	(67)
Overseas tax	3,328	1,847	1,703
– on current year profit	3,235	1,826	1,732
– adjustments in respect of prior years	93	21	(29)
	3,711	2,053	3,374
Deferred tax			
Origination and reversal of temporary differences	1,176	(1,672)	(504)
Effect of changes in tax rates	31	(10)	(89)
Adjustments in respect of prior years	(72)	14	28
	1,135	(1,668)	(565)
Tax expense	4,846	385	2,809

The UK corporation tax rate applying to HSBC Holdings and its subsidiaries was 28% (2009: 28%; 2008: 30% to 31 March 2008 and 28% thereafter). Overseas tax included Hong Kong profits tax of US\$962m (2009: US\$783m; 2008: US\$846m). The Hong Kong tax rate applying to the profits of subsidiaries assessable in Hong Kong was 16.5% (2009: 16.5%; 2008: 16.5%). Other overseas subsidiaries and overseas branches provided for taxation at the appropriate rates in the countries in which they operate.

Notes on the Financial Statements (continued)

The following table reconciles the tax expense which would apply if all profits had been taxed at the UK corporation tax rate:

Analysis of tax expense

	2010		2009		2008	
	US\$m	%	US\$m	%	US\$m	%
Taxation at UK corporation tax rate of 28% (2009: 28%; 2008: 28.5%) ¹	5,330	28.0	1,982	28.0	2,652	28.5
Goodwill impairment	–	–	–	–	3,010	32.3
Non-deductible loss on foreign exchange swaps on rights issue proceeds ²	–	–	96	1.4	–	–
Effect of taxing overseas profits in principal locations at different rates	(744)	(3.9)	(1,345)	(19.0)	(1,339)	(14.4)
Gains not subject to tax	(275)	(1.4)	(238)	(3.4)	(1,016)	(10.9)
Adjustments in respect of prior period liabilities	–	–	(39)	(0.6)	(67)	(0.7)
Low income housing tax credits ³	(86)	(0.5)	(98)	(1.4)	(103)	(1.1)
Effect of profit in associates and joint ventures	(705)	(3.7)	(499)	(7.1)	(473)	(5.1)
Tax impact of intra-group transfer of subsidiary ⁴	1,216	6.4	–	–	–	–
Impact of gains arising from dilution of interests in associates	(53)	(0.3)	–	–	–	–
Deferred tax temporary differences not provided/(previously not recognised) ⁵	(6)	–	360	5.1	157	1.7
Non taxable income	(374)	(2.0)	(365)	(5.2)	(519)	(5.6)
Permanent disallowables	276	1.5	223	3.2	217	2.3
Additional provision for tax on overseas dividends	–	–	341	4.8	294	3.2
Effect of bank payroll tax	79	0.4	–	–	–	–
Change in tax rates	31	0.2	(10)	(0.1)	(89)	(0.9)
Local taxes and overseas withholding tax	61	0.3	12	0.1	122	1.3
Other items	96	0.5	(35)	(0.4)	(37)	(0.4)
Tax expense ¹	4,846	25.5	385	5.4	2,809	30.2

1 The change in the UK corporation tax rate from 30% to 28% with effect from 1 April 2008 gave rise to a blended tax rate for 2008 of 28.5%.

2 In August 2009, the UK Government enacted legislation that gains or losses on transactions designated to hedge foreign exchange exposures connected to rights issues should be disregarded for tax purposes.

3 Low income housing tax credits arise in the US and are designed to encourage the provision of rental housing for low income households.

4 This relates to the transfer of HSBC Bank Canada, which was part of the sub-group headed by HSBC North America Holdings Inc, to HSBC Overseas Holdings (UK) Limited. A taxable gain arises on this disposal but the crystallisation of deferred tax assets and utilisation of current year foreign tax credits meant that no tax was paid on this transfer.

5 2009 and 2008 include the effect of previously unrecognised temporary differences principally related to the recognition of foreign tax credits and trading losses, respectively.

On 22 June 2010, the UK Government announced its intention to reduce the main rate of corporation tax from 28% to 24%. It is proposed that the reduction will be phased in over a period of four years with a 1% decrease in the main corporation tax rate for each year starting on 1 April 2011. As at 31 December 2010, only the initial phase to reduce the main rate of UK corporation tax from 28% to 27% has been substantively enacted and therefore only this change has been reflected in the amounts recognised as at that date. However, it is not expected that the future proposed rate changes will have a significant effect on the net UK deferred tax asset recognised at 31 December 2010 of US\$383m.

Deferred taxation

The following table shows the deferred tax assets and liabilities before offsetting balances within countries and the related movements recognised in the income statement, other comprehensive income and directly in equity.

Notes on the Financial Statements (continued)

Movement of deferred tax assets and liabilities before offsetting balances within countries

	Retirement benefits US\$m	Loan impairment allowances US\$m	Unused tax losses US\$m	Accelerated capital allowances US\$m	Available-for-sale investments US\$m	Cash flow hedges US\$m	Share-based payments US\$m	Assets leased to customers US\$m	Revaluation of property US\$m	Fee income US\$m	Relief for unused tax credits US\$m	Other US\$m	Total US\$m
2010													
Assets	1,772	6,363	164	215	68	229	196	-	-	-	243	1,535	10,785
Liabilities	-	-	-	(129)	(340)	(91)	-	(1,121)	(399)	(1,080)	-	(842)	(4,002)
At 1 January 2010	1,772	6,363	164	86	(272)	138	196	(1,121)	(399)	(1,080)	243	693	6,783
Acquisitions and disposals	-	8	-	-	12	(2)	-	-	-	-	-	(16)	2
Income statement	(468)	(1,702)	2	14	(16)	3	50	250	75	386	(72)	343	(1,135)
Other comprehensive income:													
– available-for-sale investment	-	-	-	-	(73)	-	-	-	-	-	-	-	(73)
– cash flow hedges	-	-	-	-	-	70	-	-	-	-	-	-	70
– actuarial losses	(1)	-	-	-	-	-	-	-	-	-	-	-	(1)
Equity:													
– share-based payments	-	-	-	-	-	-	(14)	-	-	-	-	-	(14)
Foreign exchange and other adjustments	235	130	15	(117)	225	55	9	164	99	(62)	(4)	(463)	286
At 31 December 2010	1,538	4,799	181	(17)	(124)	264	241	(707)	(225)	(756)	167	557	5,918
Assets	1,538	4,799	181	109	11	352	241	-	-	-	170	957	8,358
Liabilities	-	-	-	(126)	(135)	(88)	-	(707)	(225)	(756)	(3)	(400)	(2,440)
2009													
Assets	927	5,891	282	99	518	1,145	245	-	-	-	94	363	9,564
Liabilities	-	-	-	(167)	(121)	(280)	-	(916)	(374)	(930)	-	(1,620)	(4,408)
At 1 January 2009	927	5,891	282	(68)	397	865	245	(916)	(374)	(930)	94	(1,257)	5,156
Acquisitions and disposals	-	-	-	-	-	-	-	-	-	-	-	-	-
Income statement	(193)	19	(141)	132	(33)	(4)	(82)	136	29	3	414	1,388	1,668
Other comprehensive income:													
– available-for-sale investment	-	-	-	-	(587)	-	-	-	-	-	-	-	(587)
– cash flow hedges	-	-	-	-	-	(517)	-	-	-	-	-	-	(517)
– actuarial losses	978	-	-	-	-	-	-	-	-	-	-	-	978
Equity:													
– share-based payments	-	-	-	-	-	-	9	-	-	-	-	-	9
Foreign exchange and other adjustments	60	453	23	22	(49)	(206)	24	(341)	(54)	(153)	(265)	562	76
At 31 December 2009	1,772	6,363	164	86	(272)	138	196	(1,121)	(399)	(1,080)	243	693	6,783
Assets	1,772	6,363	164	215	68	229	196	-	-	-	243	1,535	10,785
Liabilities	-	-	-	(129)	(340)	(91)	-	(1,121)	(399)	(1,080)	-	(842)	(4,002)

Notes on the Financial Statements (continued)

Presentation of deferred tax balances

Deferred tax balances are presented in the consolidated balance sheet after offsetting asset and liability balances where HSBC has the legal right to set off and intends to settle on a net basis, as follows:

	2010 US\$m	2009 US\$m
Deferred tax assets	7,011	8,620
Deferred tax liabilities	<u>(1,093)</u>	<u>(1,837)</u>
	5,918	6,783

Analysis of deferred tax assets by country

	2010 US\$m	2009 US\$m
US	4,043	5,110
Brazil	883	1,289
Mexico	665	620
UK	383	395
Other	<u>1,037</u>	<u>1,206</u>
	7,011	8,620

The amount of temporary differences, unused tax losses and unused tax credits excluding the US, for which no deferred tax asset is recognised in the balance sheet is US\$2,473m (2009: US\$1,723m). Of this amount, US\$2,366m (2009: US\$1,608m) has no expiry date, US\$107m (2009: US\$115m) is scheduled to expire within 10 years (2009: 10 years) and the remaining will expire after 10 years. The deferred tax asset unrecognised in respect of these items is US\$601m (2009: US\$491m), of which US\$564m (2009: US\$450m) has no expiry date, US\$37m (2009: US\$40m) is scheduled to expire within 10 years (2009: 10 years) and the remaining will expire after 10 years.

In the US, the deferred tax asset unrecognised in respect of temporary differences, unused tax losses and unused tax credits was US\$1,715m (2009: US\$1,577m), of which US\$70m (2009: US\$52m) has no expiry date, US\$908m (2009: US\$932m) is scheduled to expire within 10 years (2009: 10 years) and the remaining will expire within 20 years.

The US deferred tax assets not recognised of US\$1,715m (2009: US\$1,577m) comprise unused state losses of US\$694m (2009: US\$854m), unused federal losses of US\$43m (2009: nil), unused tax credits of US\$908m (2009: US\$716m) and other differences of US\$70m (2009: US\$7m). The gross temporary difference in respect of the unused state losses is US\$12,486m (2009: US\$15,517m), the unused federal losses are US\$122m (2009: nil), the other differences are US\$200m (2009: US\$20m), while no gross equivalent is applied to the unused tax credits.

Deferred tax of US\$89m (2009: US\$94m) has been provided in respect of distributable reserves of associates that, on distribution, would attract withholding tax.

Deferred tax is not recognised in respect of the Group's investments in subsidiaries and branches where remittance is not contemplated, and for those associates and interests in joint ventures where it has been determined that no additional tax will arise. The aggregate amount of temporary differences associated with investments where no deferred tax liability is recognised is nil (2009: nil; 2008: US\$38,443m). Following the change in the UK tax treatment of dividends on 1 July 2009, no UK tax is expected to arise on distributions from group entities and no temporary difference exists except where withholding tax or other foreign tax could arise on the investments. No amount is disclosed for the unrecognised deferred tax or the 2010 and 2009 temporary differences associated with such investments, as it is impracticable to determine the amount of income taxes that would be payable when any temporary differences reverse.

Of the total net deferred tax assets of US\$7.0bn at 31 December 2010 (2009: US\$8.6bn), US\$4.0bn (2009: US\$5.1bn) arose in respect of HSBC's US operations where there has been a recent history of losses. Management's analysis of the recognition of these deferred tax assets significantly discounts any future expected profits from the US operations and relies to a greater extent on capital support to the US operations from HSBC Holdings plc, including tax planning strategies implemented in relation to such support. Further to the implementation of this strategy, the transfer of HSBC Bank Canada, which was part of the sub-group headed by HSBC North America Holdings Inc., to HSBC Overseas Holdings (UK) Limited in an internal reorganisation on 31 January 2010, provided substantial support for the recoverability of the US deferred tax assets. The associated taxable gain arising in the US operations

Notes on the Financial Statements (continued)

reduced the deferred tax assets by US\$1.2bn. US legislation enacted on 6 November 2009 allowed for an extended carryback period for certain federal tax net operating losses. This had the effect of crystallising deferred tax assets related to such losses at 31 December 2009 by approximately US\$1.6bn. Currently, it has been determined that the US operations primary tax planning strategy, in combination with other tax planning strategies, provides support for the realisation of the net deferred tax assets recorded for the US operations. Such determination is based on HSBC's business forecasts and assessments as to the most efficient and effective deployment of HSBC capital, most importantly including the length of time such capital will need to be maintained in the US for purposes of the tax planning strategy.

The deferred tax assets relating to HSBC's Brazil operation is US\$0.9bn (2009: US\$1.3bn) and the Mexican operation is US\$0.7bn (2009: US\$0.6bn). On the evidence available, including management projections of income and the state of the Brazilian and Mexican economies, there will be sufficient taxable income generated by the businesses to support these assets.

HSBC Holdings

	Deferred tax assets/(liabilities)	
	2010 US\$m	2009 US\$m
Temporary differences:		
– short-term timing differences	1	1
– available-for-sale investments	(21)	(99)
– fair valued assets and liabilities	61	76
– share-based payments	16	8
	57	(14)

11 Dividends

Dividends to shareholders of the parent company

	2010			2009			2008		
	Per share US\$	Total US\$m	Settled in scrip US\$m	Per share US\$	Total US\$m	Settled in scrip US\$m	Per share US\$	Total US\$m	Settled in scrip US\$m
Dividends declared on ordinary shares									
In respect of previous year:									
– fourth interim dividend	0.10	1,733	838	0.10	1,210	624	0.39	4,620	2,233
In respect of current year:									
– first interim dividend	0.08	1,394	746	0.08	1,384	190	0.18	2,158	256
– second interim dividend	0.08	1,402	735	0.08	1,385	696	0.18	2,166	727
– third interim dividend	0.08	1,408	205	0.08	1,391	160	0.18	2,175	380
	0.34	5,937	2,524	0.34	5,370	1,670	0.93	11,119	3,596
Quarterly dividends on preference shares classified as equity									
March dividend	15.50	22		15.50	22		15.50	22	
June dividend	15.50	23		15.50	23		15.50	23	
September dividend	15.50	22		15.50	22		15.50	22	
December dividend	15.50	23		15.50	23		15.50	23	
	62.00	90		62.00	90		62.00	90	
Quarterly coupons on capital securities classified as equity¹									
January coupon	0.508	44		0.508	44		–	–	
April coupon	0.508	45		0.508	45		–	–	
July coupon	0.508	45		0.508	45		0.541	47	
September coupon	0.450	68		–	–		–	–	
October coupon	0.508	45		0.508	45		0.508	45	
December coupon	0.500	76		–	–		–	–	
	2.982	323		2.032	179		1.049	92	

¹ HSBC Holdings issued Perpetual Subordinated Capital Securities of US\$3,800m in June 2010 and US\$2,200m in April 2008, which are classified as equity under IFRSs.

Notes on the Financial Statements (continued)

The Directors declared after the end of the year a fourth interim dividend in respect of the financial year ended 31 December 2010 of US\$0.12 per ordinary share, a distribution of approximately US\$2,125m. The fourth interim dividend will be payable on 5 May 2011 to holders of record on 17 March 2011 on the Hong Kong Overseas Branch Register and 18 March 2011 on the Principal Register in the UK or the Bermuda Overseas Branch Register. No liability is recorded in the financial statements in respect of the fourth interim dividend for 2010.

On 18 January 2011, HSBC paid a further coupon on the capital securities of US\$0.508 per security, a distribution of US\$44m. No liability is recorded in the balance sheet at 31 December 2010 in respect of this coupon payment.

12 Earnings per share

Basic earnings per ordinary share was calculated by dividing the profit attributable to ordinary shareholders of the parent company by the weighted average number of ordinary shares outstanding, excluding own shares held. Diluted earnings per ordinary share was calculated by dividing the basic earnings, which require no adjustment for the effects of dilutive potential ordinary shares, by the weighted average number of ordinary shares outstanding, excluding own shares held, plus the weighted average number of ordinary shares that would be issued on conversion of dilutive potential ordinary shares.

Profit attributable to the ordinary shareholders of the parent company

	2010 US\$m	2009 US\$m	2008 US\$m
Profit attributable to shareholders of the parent company	13,159	5,834	5,728
Dividend payable on preference shares classified as equity	(90)	(90)	(90)
Coupon payable on capital securities classified as equity	(323)	(179)	(92)
Profit attributable to the ordinary shareholders of the parent company	12,746	5,565	5,546

Basic and diluted earnings per share

	2010			2009			2008		
	Profit US\$m	Number of shares (millions)	Per share US\$	Profit US\$m	Number of shares (millions)	Per share US\$	Profit US\$m	Number of shares (millions)	Per share US\$
Basic ¹	12,746	17,404	0.73	5,565	16,277	0.34	5,546	13,555	0.41
Effect of dilutive potential ordinary shares		229			143			118	
– Savings-related Share Option Plan		55			26			13	
– Executive Share Option Scheme		–			–			3	
– Group Share Option Plan		–			–			5	
– Restricted and performance share awards		174			117			95	
– HSBC France share options		–			–			1	
– HSBC Finance share options		–			–			1	
Diluted ²	12,746	17,633	0.72	5,565	16,420	0.34	5,546	13,673	0.41

1 Weighted average number of ordinary shares outstanding.

2 Weighted average number of ordinary shares outstanding assuming dilution.

The weighted average number of dilutive potential ordinary shares excludes 150m employee share options that were anti-dilutive (2009: 214m; 2008: 166m).

13 Segmental analysis

HSBC's operating segments are organised into six geographical regions, Europe, Hong Kong, Rest of Asia-Pacific, Middle East, North America and Latin America. Due to the nature of the Group, HSBC's chief operating decision-maker regularly reviews operating activity on a number of bases, including by geographical region, customer group and global business and retail businesses by geographical region. The segmental analysis is presented on a geographical basis because, although information is reviewed on a number of bases, capital resources are allocated and performance is assessed primarily by geographical region. Also, the economic conditions of each geographical region are highly influential in determining the performance of the different businesses carried out in each region. As a result, provision of segmental information on a geographical basis provides the most meaningful basis from which

Notes on the Financial Statements (continued)

to assess performance. HSBC's chief operating decision-maker is the Group Management Board which operates as a general management committee under the direct authority of the Board.

Geographical information is classified by the location of the principal operations of the subsidiary or, for The Hongkong and Shanghai Banking Corporation, HSBC Bank, HSBC Bank Middle East and HSBC Bank USA, by the location of the branch responsible for reporting the results or advancing the funds.

Information provided to HSBC's chief operating decision-maker to make decisions about allocating resources to, and assessing the performance of, operating segments is measured in accordance with IFRSs. The financial information shown below includes the effects of intra-HSBC transactions between operating segments which are conducted on an arm's length basis and eliminated in a separate column. Shared costs are included in operating segments on the basis of the actual recharges made.

Products and services

HSBC provides a comprehensive range of banking and related financial services to its customers in its six geographical regions. The products and services offered to customers are organised by customer group and global business.

- Personal Financial Services offers a broad range of products and services to meet the personal banking, consumer finance and wealth management needs of individual customers. Personal banking products typically include current and savings accounts, mortgages and personal loans, credit cards, debit cards, insurance, wealth management and local and international payment services.
- Commercial Banking product offerings include the provision of financing services, payments and cash management, international trade finance, treasury and capital markets, commercial cards, insurance, and online and direct banking offerings.
- Global Banking and Markets provides tailored financial solutions to major government, corporate and institutional clients and private investors worldwide. The client-focused business lines deliver a full range of banking capabilities including financing, advisory and transaction services; a markets business that provides services in credit, rates, foreign exchange, money markets and securities services; global asset management services and principal investment activities.
- Global Private Banking provides a range of services to meet the banking, investment and wealth advisory needs of high net worth individuals.

Financial information

In the following segmental analysis, the benefit of shareholders' funds impacts the analysis only to the extent that these funds are actually allocated to businesses in the segment by way of intra-HSBC capital and funding structures.

Notes on the Financial Statements (continued)

Profit/(loss) for the year

	2010							Total US\$m
	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Intra- HSBC items US\$m	
Interest income	17,550	5,102	6,432	2,003	16,781	11,590	(1,113)	58,345
Interest expense	(6,300)	(856)	(2,604)	(636)	(4,342)	(5,279)	1,113	(18,904)
Net interest income	11,250	4,246	3,828	1,367	12,439	6,311	-	39,441
Fee income	8,334	3,460	2,399	737	4,524	2,366	(703)	21,117
Fee expense	(1,963)	(498)	(467)	(60)	(860)	(617)	703	(3,762)
Net fee income	6,371	2,962	1,932	677	3,664	1,749	-	17,355
Trading income excluding net interest income	1,461	1,107	1,207	343	109	453	-	4,680
Net interest income on trading activities	1,402	205	411	27	205	280	-	2,530
Net trading income	2,863	1,312	1,618	370	314	733	-	7,210
Changes in fair value of long- term debt issued and related derivatives	(365)	(2)	(2)	-	111	-	-	(258)
Net income from other financial instruments designated at fair value	647	380	26	-	-	425	-	1,478
Net income from financial instruments designated at fair value	282	378	24	-	111	425	-	1,220
Gains less losses from financial investments	486	98	146	(3)	143	98	-	968
Dividend income	20	30	1	7	42	12	-	112
Net earned insurance premiums	4,067	4,332	448	-	245	2,054	-	11,146
Other operating income/(expense)	2,117	1,606	1,598	(8)	233	141	(3,125)	2,562
Total operating income	27,456	14,964	9,595	2,410	17,191	11,523	(3,125)	80,014
Net insurance claims incurred and movement in liabilities to policyholders	(4,706)	(4,762)	(363)	-	(144)	(1,792)	-	(11,767)
Net operating income before loan impairment charges and other credit risk provisions	22,750	10,202	9,232	2,410	17,047	9,731	(3,125)	68,247
Loan impairment charges and other credit risk provisions	(3,020)	(114)	(439)	(627)	(8,295)	(1,544)	-	(14,039)
Net operating income	19,730	10,088	8,793	1,783	8,752	8,187	(3,125)	54,208
Employee compensation and benefits	(7,875)	(2,341)	(2,719)	(579)	(3,672)	(2,650)	-	(19,836)
General and administrative expenses	(6,499)	(1,686)	(2,181)	(450)	(4,179)	(3,286)	3,125	(15,156)
Depreciation and impairment of property, plant and equipment	(719)	(237)	(189)	(42)	(288)	(238)	-	(1,713)
Amortisation and impairment of intangible assets	(352)	(167)	(54)	(7)	(183)	(220)	-	(983)
Total operating expenses	(15,445)	(4,431)	(5,143)	(1,078)	(8,322)	(6,394)	3,125	(37,688)
Operating profit	4,285	5,657	3,650	705	430	1,793	-	16,520
Share of profit in associates and joint ventures	17	35	2,252	187	24	2	-	2,517
Profit before tax	4,302	5,692	5,902	892	454	1,795	-	19,037
Tax expense	(1,006)	(987)	(962)	(138)	(1,180)	(573)	-	(4,846)
Profit/(loss) for the year	3,296	4,705	4,940	754	(726)	1,222	-	14,191

Notes on the Financial Statements (continued)

	2009							
	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Intra- HSBC items US\$m	Total US\$m
Interest income	20,283	5,327	5,877	2,260	19,526	10,091	(1,268)	62,096
Interest expense	(8,015)	(1,132)	(2,338)	(775)	(5,856)	(4,518)	1,268	(21,366)
Net interest income	12,268	4,195	3,539	1,485	13,670	5,573	–	40,730
Fee income	8,576	3,099	1,972	682	5,496	2,230	(652)	21,403
Fee expense	(2,309)	(430)	(415)	(57)	(679)	(501)	652	(3,739)
Net fee income	6,267	2,669	1,557	625	4,817	1,729	–	17,664
Trading income excluding net interest income	2,861	1,068	1,264	369	35	639	–	6,236
Net interest income on trading activities	2,598	157	342	25	296	209	–	3,627
Net trading income	5,459	1,225	1,606	394	331	848	–	9,863
Changes in fair value of long-term debt issued and related derivatives	(2,746)	(3)	(1)	–	(3,497)	–	–	(6,247)
Net income from other financial instruments designated at fair value	1,321	788	111	–	1	495	–	2,716
Net income/(expense) from financial instruments designated at fair value	(1,425)	785	110	–	(3,496)	495	–	(3,531)
Gains less losses from financial investments	50	9	(19)	16	296	168	–	520
Dividend income	29	28	2	3	53	11	–	126
Net earned insurance premiums	4,223	3,674	365	–	309	1,900	–	10,471
Other operating income	2,262	1,274	1,238	71	566	133	(2,756)	2,788
Total operating income	29,133	13,859	8,398	2,594	16,546	10,857	(2,756)	78,631
Net insurance claims incurred and movement in liabilities to policyholders	(5,589)	(4,392)	(395)	–	(241)	(1,833)	–	(12,450)
Net operating income before loan impairment charges and other credit risk provisions	23,544	9,467	8,003	2,594	16,305	9,024	(2,756)	66,181
Loan impairment charges and other credit risk provisions	(5,568)	(500)	(896)	(1,334)	(15,664)	(2,526)	–	(26,488)
Net operating income	17,976	8,967	7,107	1,260	641	6,498	(2,756)	39,693
Employee compensation and benefits	(7,174)	(2,102)	(2,363)	(545)	(4,085)	(2,199)	–	(18,468)
General and administrative expenses	(5,775)	(1,502)	(1,872)	(419)	(3,794)	(2,786)	2,756	(13,392)
Depreciation and impairment of property, plant and equipment	(762)	(224)	(172)	(31)	(329)	(207)	–	(1,725)
Amortisation and impairment of intangible assets	(277)	(118)	(43)	(6)	(183)	(183)	–	(810)
Total operating expenses	(13,988)	(3,946)	(4,450)	(1,001)	(8,391)	(5,375)	2,756	(34,395)
Operating profit/(loss)	3,988	5,021	2,657	259	(7,750)	1,123	–	5,298
Share of profit in associates and joint ventures	21	8	1,543	196	12	1	–	1,781
Profit/(loss) before tax	4,009	5,029	4,200	455	(7,738)	1,124	–	7,079
Tax income/(expense)	(776)	(869)	(753)	(94)	2,285	(178)	–	(385)
Profit/(loss) for the year	3,233	4,160	3,447	361	(5,453)	946	–	6,694

Notes on the Financial Statements (continued)

Profit/(loss) for the year (continued)

	2008							
	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Intra- HSBC items US\$m	Total US\$m
Interest income	35,117	9,530	9,066	2,451	25,897	11,632	(2,392)	91,301
Interest expense	(25,421)	(3,832)	(5,129)	(895)	(10,679)	(5,174)	2,392	(48,738)
Net interest income	9,696	5,698	3,937	1,556	15,218	6,458	–	42,563
Fee income	10,225	3,062	2,414	740	6,292	2,716	(685)	24,764
Fee expense	(2,733)	(482)	(547)	(49)	(1,065)	(549)	685	(4,740)
Net fee income	7,492	2,580	1,867	691	5,227	2,167	–	20,024
Trading income/(expense) excluding net interest income	1,691	856	1,443	380	(3,879)	356	–	847
Net interest income on trading activities	3,666	337	599	22	744	345	–	5,713
Net trading income/(expense)	5,357	1,193	2,042	402	(3,135)	701	–	6,560
Changes in fair value of long-term debt issued and related derivatives	2,939	3	1	–	3,736	–	–	6,679
Net income/(expense) from other financial instruments designated at fair value	(1,826)	(1,194)	(172)	–	1	364	–	(2,827)
Net income/(expense) from financial instruments designated at fair value	1,113	(1,191)	(171)	–	3,737	364	–	3,852
Gains less losses from financial investments	418	(309)	24	8	(120)	176	–	197
Dividend income	130	41	2	2	77	20	–	272
Net earned insurance premiums	5,299	3,247	197	–	390	1,717	–	10,850
Gains on disposal of French regional banks	2,445	–	–	–	–	–	–	2,445
Other operating income	2,096	817	1,055	9	23	300	(2,492)	1,808
Total operating income	34,046	12,076	8,953	2,668	21,417	11,903	(2,492)	88,571
Net insurance claims incurred and movement in liabilities to policyholders	(3,367)	(1,922)	28	–	(238)	(1,390)	–	(6,889)
Net operating income before loan impairment charges and other credit risk provisions	30,679	10,154	8,981	2,668	21,179	10,513	(2,492)	81,682
Loan impairment charges and other credit risk provisions	(3,754)	(765)	(852)	(279)	(16,795)	(2,492)	–	(24,937)
Net operating income	26,925	9,389	8,129	2,389	4,384	8,021	(2,492)	56,745
Employee compensation and benefits	(8,551)	(2,069)	(2,475)	(544)	(4,609)	(2,544)	–	(20,792)
General and administrative expenses	(6,428)	(1,562)	(2,037)	(384)	(4,282)	(3,059)	2,492	(15,260)
Depreciation and impairment of property, plant and equipment	(865)	(209)	(163)	(25)	(265)	(223)	–	(1,750)
Amortisation and impairment of intangible assets	(228)	(103)	(29)	(6)	(203)	(164)	–	(733)
Goodwill impairment	–	–	–	–	(10,564)	–	–	(10,564)
Total operating expenses	(16,072)	(3,943)	(4,704)	(959)	(19,923)	(5,990)	2,492	(49,099)
Operating profit/(loss)	10,853	5,446	3,425	1,430	(15,539)	2,031	–	7,646
Share of profit in associates and joint ventures	16	15	1,297	316	11	6	–	1,661
Profit/(loss) before tax	10,869	5,461	4,722	1,746	(15,528)	2,037	–	9,307
Tax income/(expense)	(2,199)	(899)	(928)	(245)	1,715	(253)	–	(2,809)
Profit/(loss) for the year	8,670	4,562	3,794	1,501	(13,813)	1,784	–	6,498

Notes on the Financial Statements (continued)

Other information about the profit/(loss) for the year

	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Intra- HSBC items US\$m	Total US\$m
2010								
Net operating income	19,730	10,088	8,793	1,783	8,752	8,187	(3,125)	54,208
External	18,881	9,170	7,728	1,774	8,504	8,151	-	54,208
Inter-segment	849	918	1,065	9	248	36	(3,125)	-
Profit/(loss) for the year includes the following significant non-cash items:								
Depreciation, amortisation and impairment	1,071	404	243	49	471	458	-	2,696
Loan impairment losses gross of recoveries and other credit risk provisions	3,303	169	615	684	8,476	1,812	-	15,059
Impairment of financial investments	35	41	4	5	21	1	-	107
2009								
Net operating income	17,976	8,967	7,107	1,260	641	6,498	(2,756)	39,693
External	16,734	8,352	6,056	1,283	767	6,501	-	39,693
Inter-segment	1,242	615	1,051	(23)	(126)	(3)	(2,756)	-
Profit/(loss) for the year includes the following significant non-cash items:								
Depreciation, amortisation and impairment	1,039	342	215	37	515	390	-	2,538
Loan impairment losses gross of recoveries and other credit risk provisions	5,833	534	1,028	1,361	15,757	2,865	-	27,378
Impairment of financial investments	137	129	50	4	38	-	-	358
2008								
Net operating income	26,925	9,389	8,129	2,389	4,384	8,021	(2,492)	56,745
External	25,887	8,205	7,010	2,386	5,236	8,021	-	56,745
Inter-segment	1,038	1,184	1,119	3	(852)	-	(2,492)	-
Profit/(loss) for the year includes the following significant non-cash items:								
Depreciation, amortisation and impairment	1,093	312	192	31	11,352	387	-	13,367
Loan impairment losses gross of recoveries and other credit risk provisions	4,050	803	960	309	16,892	2,757	-	25,771
Impairment of financial investments	278	535	-	-	229	-	-	1,042

Notes on the Financial Statements (continued)

Performance ratios

	Europe %	Hong Kong %	Rest of Asia- Pacific %	Middle East %	North America %	Latin America %	Total %
2010							
Share of HSBC's profit before tax	22.6	29.9	31.0	4.7	2.4	9.4	100.0
Cost efficiency ratio	67.9	43.4	55.7	44.7	48.8	65.7	55.2
2009							
Share of HSBC's profit/(loss) before tax	56.7	71.0	59.3	6.4	(109.3)	15.9	100.0
Cost efficiency ratio	59.4	41.7	55.6	38.6	51.5	59.6	52.0
2008							
Share of HSBC's profit/(loss) before tax	116.7	58.7	50.7	18.8	(166.8)	21.9	100.0
Cost efficiency ratio	52.4	38.8	52.4	35.9	94.1	57.0	60.1

Balance sheet information

	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Intra- HSBC items US\$m	Total US\$m
At 31 December 2010								
Loans and advances to customers (net)	435,799	140,691	108,731	24,626	190,532	57,987	–	958,366
Interests in associates and joint ventures	186	207	15,035	1,661	104	5	–	17,198
Total assets	1,249,527	429,565	278,062	52,757	492,487	139,938	(187,647)	2,454,689
Customer accounts	491,563	297,484	158,155	33,511	158,486	88,526	–	1,227,725
Total liabilities	1,189,996	422,101	246,989	45,379	459,301	123,655	(187,647)	2,299,774
Capital expenditure incurred ¹	865	836	168	46	774	788	–	3,477
At 31 December 2009								
Loans and advances to customers (net)	439,481	99,381	80,043	22,844	206,853	47,629	–	896,231
Interests in associates and joint ventures	147	157	11,083	1,573	42	9	–	13,011
Total assets	1,268,600	399,243	222,139	48,107	475,014	115,967	(164,618)	2,364,452
Customer accounts	495,019	275,441	133,999	32,529	149,157	72,889	–	1,159,034
Total liabilities	1,213,907	384,912	203,243	42,325	447,530	101,492	(164,618)	2,228,791
Capital expenditure incurred ¹	983	290	159	102	658	540	–	2,732
At 31 December 2008								
Loans and advances to customers (net)	426,191	100,220	80,661	27,295	256,214	42,287	–	932,868
Interests in associates and joint ventures	137	153	9,728	1,383	128	8	–	11,537
Total assets	1,392,049	414,484	225,573	50,952	596,302	102,946	(254,841)	2,527,465
Customer accounts	502,476	250,517	124,194	35,165	143,532	59,443	–	1,115,327
Total liabilities	1,361,960	400,637	210,478	45,416	571,657	91,929	(254,841)	2,427,236
Capital expenditure incurred ¹	2,078	440	426	85	726	617	–	4,372

¹ Expenditure incurred on property, plant and equipment and other intangible assets. Excludes assets acquired as part of business combinations and goodwill.

Notes on the Financial Statements (continued)

Other financial information

Net operating income by customer group and global business

	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Global Private Banking US\$m	Other ¹ US\$m	Intra- HSBC items US\$m	Total US\$m
2010							
Net operating income	21,317	12,029	18,957	3,105	4,663	(5,863)	54,208
External	19,529	11,419	22,090	2,194	(1,024)	–	54,208
Internal	1,788	610	(3,133)	911	5,687	(5,863)	–
2009							
Net operating income	15,513	9,571	18,652	2,984	(2,031)	(4,996)	39,693
External	13,804	9,285	21,383	2,275	(7,054)	–	39,693
Internal	1,709	286	(2,731)	709	5,023	(4,996)	–
2008							
Net operating income	20,269	13,144	12,047	3,563	12,290	(4,568)	56,745
External	15,023	13,080	17,739	2,231	8,672	–	56,745
Internal	5,246	64	(5,692)	1,332	3,618	(4,568)	–

1 The main items reported in the 'Other' category are certain property activities, unallocated investment activities, centrally held investment companies, movements in fair value of own debt and HSBC's holding company and financing operations. The 'Other' category also includes gains and losses on the disposal of certain significant subsidiaries or business units.

Information by country

	2010		2009		2008	
	External net operating income ¹ US\$m	Non- current assets ² US\$m	External net operating income ¹ US\$m	Non- current assets ² US\$m	External net operating income ¹ US\$m	Non- current assets ² US\$m
UK	11,467	19,661	9,958	19,704	15,789	12,491
Hong Kong	9,170	4,630	8,352	3,374	8,205	3,527
USA	6,098	6,669	(1,042)	5,499	2,862	4,660
France	3,185	10,914	3,322	11,782	6,457	11,862
Brazil	4,506	2,025	3,368	1,868	3,886	1,421
Other countries	19,782	29,747	15,735	25,557	19,546	23,020
	54,208	73,646	39,693	67,784	56,745	56,981

1 External net operating income is attributed to countries on the basis of the location of the branch responsible for reporting the results or advancing the funds.

2 Non-current assets consist of property, plant and equipment, goodwill, other intangible assets, interests in associates and joint ventures and certain other assets expected to be recovered more than twelve months after the reporting period.

14 Analysis of financial assets and liabilities by measurement basis

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting policies in Note 2 describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of the financial assets and liabilities by category as defined in IAS 39 and by balance sheet heading.

Notes on the Financial Statements (continued)

HSBC

	At 31 December 2010							
	Held for trading US\$m	Designated at fair value US\$m	Held-to-maturity securities US\$m	Available-for-sale securities US\$m	Financial assets and liabilities at amortised cost US\$m	Derivatives designated as fair value hedging instruments US\$m	Derivatives designated as cash flow hedging instruments US\$m	Total US\$m
Financial assets								
Cash and balances at central banks	–	–	–	–	57,383	–	–	57,383
Items in the course of collection from other banks	–	–	–	–	6,072	–	–	6,072
Hong Kong Government certificates of indebtedness	–	–	–	–	19,057	–	–	19,057
Trading assets	385,052	–	–	–	–	–	–	385,052
Financial assets designated at fair value	–	37,011	–	–	–	–	–	37,011
Derivatives	256,689	–	–	–	–	596	3,472	260,757
Loans and advances to banks	–	–	–	–	208,271	–	–	208,271
Loans and advances to customers	–	–	–	–	958,366	–	–	958,366
Financial investments	–	–	19,499	381,256	–	–	–	400,755
Other assets	–	–	–	–	20,097	–	–	20,097
Accrued income	–	–	–	–	10,274	–	–	10,274
Total financial assets	641,741	37,011	19,499	381,256	1,279,520	596	3,472	2,363,095
Financial liabilities								
Hong Kong currency notes in circulation	–	–	–	–	19,057	–	–	19,057
Deposits by banks	–	–	–	–	110,584	–	–	110,584
Customer accounts	–	–	–	–	1,227,725	–	–	1,227,725
Items in the course of transmission to other banks	–	–	–	–	6,663	–	–	6,663
Trading liabilities	300,703	–	–	–	–	–	–	300,703
Financial liabilities designated at fair value	–	88,133	–	–	–	–	–	88,133
Derivatives	254,416	–	–	–	–	2,226	2,023	258,665
Debt securities in issue	–	–	–	–	145,401	–	–	145,401
Other liabilities	–	–	–	–	25,533	–	–	25,533
Accruals	–	–	–	–	12,545	–	–	12,545
Subordinated liabilities	–	–	–	–	33,387	–	–	33,387
Total financial liabilities	555,119	88,133	–	–	1,580,895	2,226	2,023	2,228,396

Notes on the Financial Statements (continued)

At 31 December 2009

	Held for trading US\$m	Designated at fair value US\$m	Held-to- maturity securities US\$m	Available- for-sale securities US\$m	Financial assets and liabilities at amortised cost US\$m	Derivatives designated as fair value hedging instruments US\$m	Derivatives designated as cash flow hedging instruments US\$m	Total US\$m
Financial assets								
Cash and balances at central banks	–	–	–	–	60,655	–	–	60,655
Items in the course of collection from other banks	–	–	–	–	6,395	–	–	6,395
Hong Kong Government certificates of indebtedness	–	–	–	–	17,463	–	–	17,463
Trading assets	421,381	–	–	–	–	–	–	421,381
Financial assets designated at fair value	–	37,181	–	–	–	–	–	37,181
Derivatives	245,685	–	–	–	–	584	4,617	250,886
Loans and advances to banks	–	–	–	–	179,781	–	–	179,781
Loans and advances to customers	–	–	–	–	896,231	–	–	896,231
Financial investments	–	–	17,626	351,532	–	–	–	369,158
Other assets	–	–	–	3	26,114	–	–	26,117
Accrued income	–	–	–	–	10,256	–	–	10,256
Total financial assets	667,066	37,181	17,626	351,535	1,196,895	584	4,617	2,275,504
Financial liabilities								
Hong Kong currency notes in circulation	–	–	–	–	17,463	–	–	17,463
Deposits by banks	–	–	–	–	124,872	–	–	124,872
Customer accounts	–	–	–	–	1,159,034	–	–	1,159,034
Items in the course of transmission to other banks	–	–	–	–	5,734	–	–	5,734
Trading liabilities	268,130	–	–	–	–	–	–	268,130
Financial liabilities designated at fair value	–	80,092	–	–	–	–	–	80,092
Derivatives	244,072	–	–	–	–	1,085	2,489	247,646
Debt securities in issue	–	–	–	–	146,896	–	–	146,896
Other liabilities	–	–	–	–	66,169	–	–	66,169
Accruals	–	–	–	–	11,644	–	–	11,644
Subordinated liabilities	–	–	–	–	30,478	–	–	30,478
Total financial liabilities	512,202	80,092	–	–	1,562,290	1,085	2,489	2,158,158

Notes on the Financial Statements (continued)

HSBC Holdings

	At 31 December 2010					
	Held for trading US\$m	Designated at fair value US\$m	Loans and receivables US\$m	Available-for-sale securities US\$m	Financial assets and liabilities at amortised cost US\$m	Total US\$m
Financial assets						
Cash at bank and in hand	–	–	–	–	459	459
Derivatives	2,327	–	–	–	–	2,327
Loans and advances to HSBC undertakings	–	–	21,238	–	–	21,238
Financial investments	–	–	–	2,025	–	2,025
Other assets	–	–	–	–	1	1
Total financial assets	2,327	–	21,238	2,025	460	26,050
Financial liabilities						
Amounts owed to HSBC undertakings	–	–	–	–	2,932	2,932
Financial liabilities designated at fair value	–	16,288	–	–	–	16,288
Derivatives	827	–	–	–	–	827
Debt securities in issue	–	–	–	–	2,668	2,668
Other liabilities	–	–	–	–	1,216	1,216
Accruals	–	–	–	–	566	566
Subordinated liabilities	–	–	–	–	13,313	13,313
Total financial liabilities	827	16,288	–	–	20,695	37,810
	At 31 December 2009					
	Held for trading US\$m	Designated at fair value US\$m	Loans and receivables US\$m	Available-for-sale securities US\$m	Financial assets and liabilities at amortised cost US\$m	Total US\$m
Financial assets						
Cash at bank and in hand	–	–	–	–	224	224
Derivatives	2,981	–	–	–	–	2,981
Loans and advances to HSBC undertakings	–	–	23,212	–	–	23,212
Financial investments	–	–	–	2,455	–	2,455
Other assets	–	–	–	–	4	4
Total financial assets	2,981	–	23,212	2,455	228	28,876
Financial liabilities						
Amounts owed to HSBC undertakings	–	–	–	–	3,711	3,711
Financial liabilities designated at fair value	–	16,909	–	–	–	16,909
Derivatives	362	–	–	–	–	362
Debt securities in issue	–	–	–	–	2,839	2,839
Other liabilities	–	–	–	–	8	8
Accruals	–	–	–	–	419	419
Subordinated liabilities	–	–	–	–	14,406	14,406
Total financial liabilities	362	16,909	–	–	21,383	38,654

Notes on the Financial Statements (continued)

15 Trading assets

	2010 US\$m	2009 US\$m
Trading assets:		
– not subject to repledge or resale by counterparties	284,940	320,155
– which may be repledged or resold by counterparties	100,112	101,226
	385,052	421,381
Treasury and other eligible bills	25,620	22,346
Debt securities	168,268	201,598
Equity securities	41,086	35,311
	234,974	259,255
Trading securities at fair value	234,974	259,255
Loans and advances to banks	70,456	78,126
Loans and advances to customers	79,622	84,000
	385,052	421,381

Trading securities valued at fair value

	Fair value ¹	
	2010 US\$m	2009 US\$m
US Treasury and US Government agencies ²	20,239	17,620
UK Government	17,036	12,113
Hong Kong Government	11,053	10,649
Other government	92,826	94,264
Asset-backed securities ³	3,998	5,308
Corporate debt and other securities	48,736	83,990
Equity securities	41,086	35,311
	234,974	259,255

1 Included within these figures are debt securities issued by banks and other financial institutions of US\$37,170m (2009: US\$41,466m), of which US\$8,330m (2009: US\$7,280m) are guaranteed by various governments.

2 Includes securities that are supported by an explicit guarantee issued by the US Government.

3 Excludes asset-backed securities included under US Treasury and US Government agencies.

Trading securities listed on a recognised exchange and unlisted

	Treasury and other eligible bills US\$m	Debt securities US\$m	Equity securities US\$m	Total US\$m
Fair value at 31 December 2010				
Listed on a recognised exchange ¹	698	113,878	40,098	154,674
Unlisted	24,922	54,390	988	80,300
	25,620	168,268	41,086	234,974
Fair value at 31 December 2009				
Listed on a recognised exchange ¹	3,107	159,030	33,428	195,565
Unlisted	19,239	42,568	1,883	63,690
	22,346	201,598	35,311	259,255

1 Included within listed investments are US\$3,254m (2009: US\$3,229m) of investments listed in Hong Kong.

Loans and advances to banks held for trading

	2010 US\$m	2009 US\$m
Reverse repos	45,771	50,357
Settlement accounts	5,226	10,128
Stock borrowing	6,346	4,711
Other	13,113	12,930
	70,456	78,126

Notes on the Financial Statements (continued)*Loans and advances to customers held for trading*

	2010	2009
	US\$m	US\$m
Reverse repos	46,366	42,172
Settlement accounts	7,516	12,134
Stock borrowing	11,161	18,042
Other	14,579	11,652
	79,622	84,000

16 Fair values of financial instruments carried at fair value

The classification of financial instruments is determined in accordance with the accounting policies set out in Note 2. The use of assumptions and estimation in valuing financial instruments is described on page 34.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The following table sets out the financial instruments carried at fair value.

Financial instruments carried at fair value and bases of valuation

	Valuation techniques			Total
	Quoted market price Level 1 US\$m	Using observable inputs Level 2 US\$m	With significant unobservable inputs Level 3 US\$m	
31 December 2010				
Assets				
Trading assets	224,613	154,750	5,689	385,052
Financial assets designated at fair value	23,641	12,783	587	37,011
Derivatives	2,078	254,718	3,961	260,757
Financial investments: available for sale	214,276	158,743	8,237	381,256
Liabilities				
Trading liabilities	124,874	164,436	11,393	300,703
Financial liabilities designated at fair value	22,193	65,370	570	88,133
Derivatives	1,808	253,051	3,806	258,665
31 December 2009				
Assets				
Trading assets	272,509	142,452	6,420	421,381
Financial assets designated at fair value	24,184	11,773	1,224	37,181
Derivatives	1,961	244,472	4,453	250,886
Financial investments: available for sale	163,149	178,168	10,214	351,531
Liabilities				
Trading liabilities	119,544	139,812	8,774	268,130
Financial liabilities designated at fair value	27,553	52,032	507	80,092
Derivatives	1,843	240,611	5,192	247,646

The reduction of Level 1 trading assets reflects the deconsolidation of CNAV funds which is discussed further on page 363. The increase in Level 1 available-for-sale instruments reflects increased investment in government and US agency securities. The rise in the size of Level 2 trading assets and liabilities reflects an increase in repo and reverse repo activity.

There were no material transfers between Level 1 and Level 2 in the period.

Control framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk-taker.

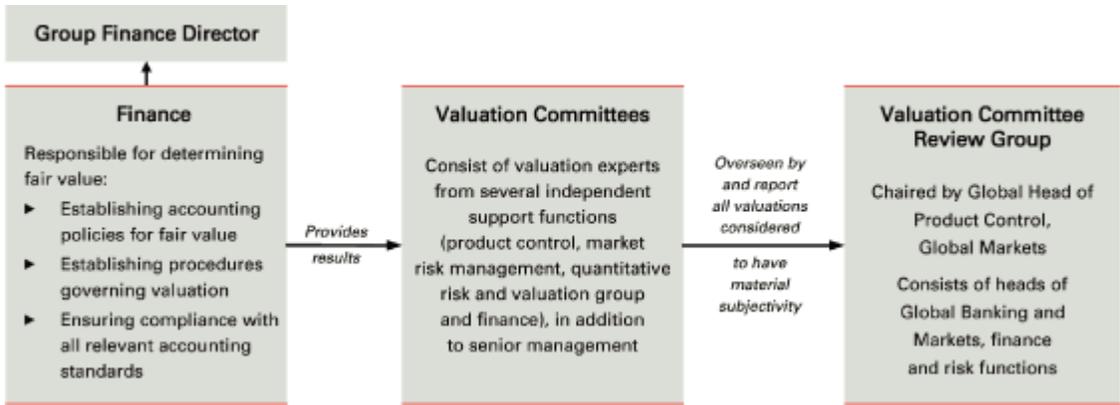
Notes on the Financial Statements (continued)

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, HSBC will source alternative market information to validate the financial instrument’s fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors that are considered in this regard are, *inter alia*:

- the extent to which prices may be expected to represent genuine traded or tradeable prices;
- the degree of similarity between financial instruments;
- the degree of consistency between different sources;
- the process followed by the pricing provider to derive the data;
- the elapsed time between the date to which the market data relates and the balance sheet date; and
- the manner in which the data was sourced.

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

The fair value governance structure is as follows:



Determination of fair value

Fair values are determined according to the following hierarchy:

- *Level 1 – quoted market price:* financial instruments with quoted prices for identical instruments in active markets.
- *Level 2 – valuation technique using observable inputs:* financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
- *Level 3 – valuation technique with significant unobservable inputs:* financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

The best evidence of fair value is a quoted price in an actively traded market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. Where a financial instrument has a quoted price in an active market and it is part of a portfolio, the fair value of the portfolio is calculated as the product of the number of units and quoted price and no block discounts are applied. In the event that the market for a financial instrument is not active, a valuation technique is used.

The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. In inactive markets, obtaining assurance that the transaction price provides evidence of fair value or determining the adjustments to transaction prices that are necessary to measure the fair value of the instrument requires additional work during the valuation process.

Notes on the Financial Statements (continued)

Valuation techniques incorporate assumptions about factors that other market participants would use in their valuations, including interest rate yield curves, exchange rates, volatilities, and prepayment and default rates. During the year, as a result of evolving market practice in the pricing of certain interest rate derivatives, HSBC has, for single currency swaps with collateralised counterparties and in significant major currencies, adopted a discounting curve that reflects the overnight interest rate ('OIS discounting'). Previously, in line with market practice, discount curves did not reflect this overnight interest rate component but were based on a term LIBOR rate. The financial effect of this change was not significant.

The majority of valuation techniques employ only observable market data. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them, the derivation of fair value is more judgemental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's carrying amount and/or inception profit ('day 1 gain or loss') is driven by unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

In certain circumstances, primarily where debt is hedged with interest rate derivatives, HSBC records its own debt in issue at fair value, based on quoted prices in an active market for the specific instrument concerned, if available. When quoted market prices are unavailable, the own debt in issue is valued using valuation techniques, the inputs for which are either based upon quoted prices in an inactive market for the instrument, or are estimated by comparison with quoted prices in an active market for similar instruments. In both cases, the fair value includes the effect of applying the credit spread which is appropriate to HSBC's liabilities. The change in fair value of issued debt securities attributable to the Group's own credit spread is computed as follows: for each security at each reporting date, an externally verifiable price is obtained or a price is derived using credit spreads for similar securities for the same issuer. Then, using discounted cash flow, each security is valued using a LIBOR-based discount curve. The difference in the valuations is attributable to the Group's own credit spread. This methodology is applied consistently across all securities.

Structured notes issued and certain other hybrid instrument liabilities are included within trading liabilities and are measured at fair value. The credit spread applied to these instruments is derived from the spreads at which HSBC issues structured notes. These market spreads are smaller than credit spreads observed for plain vanilla debt or in the credit default swap markets.

Gains and losses arising from changes in the credit spread of liabilities issued by HSBC reverse over the contractual life of the debt, provided that the debt is not repaid at a premium or a discount.

Fair value adjustments

Fair value adjustments are adopted when HSBC considers that there are additional factors that would be considered by a market participant that are not incorporated within the valuation model. The magnitude of fair value adjustments depends upon many entity-specific factors, and therefore fair value adjustments may not be comparable across the banking industry.

HSBC classifies fair value adjustments as either 'risk-related' or 'model-related'. The majority of these adjustments relate to Global Banking and Markets.

Movements in the level of fair value adjustments do not necessarily result in the recognition of profits or losses within the income statement. For example, as models are enhanced, fair value adjustments may no longer be required. Similarly, fair value adjustments will decrease when the related positions are unwound, but this may not result in profit or loss.

Notes on the Financial Statements (continued)*Global Banking and Markets fair value adjustments*

	At 31 December	
	2010 US\$m	2009 US\$m
Type of adjustment		
Risk-related	2,171	2,955
Bid-offer	620	528
Uncertainty	136	223
Credit risk adjustment	1,355	2,172
Other	60	32
Model-related	389	457
Model limitation	383	391
Other	6	66
Inception profit (Day 1 P&L reserves) (Note 20)	250	260
	2,810	3,672

The most significant fair value adjustment movement related to the release of US\$490m of credit risk adjustments held for monoline insurers of which US\$336m resulted from commutations. The commutations did not result in a material gain or loss. The remainder of the decrease in the credit risk adjustment derived primarily from commutations or restructures with non-monoline counterparties and internal credit rating upgrades of certain counterparties.

Risk-related adjustments*Bid-offer*

IAS 39 requires that portfolios are marked at bid or offer, as appropriate. Valuation models will typically generate mid market values. The bid-offer adjustment reflects the cost that would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the actual position.

Uncertainty

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

Credit risk adjustment

The credit risk adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the counterparty may default and HSBC may not receive the full market value of the transactions.

Model-related adjustments*Model limitation*

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

Inception profit (Day 1 P&L reserves)

Inception profit adjustments are adopted where the fair value estimated by a valuation model is based on one or more significant unobservable inputs. The accounting for inception profit adjustments is discussed on page 254. An analysis of the movement in the deferred Day 1 P&L reserve is provided on page 324.

Notes on the Financial Statements (continued)

Credit risk adjustment methodology

HSBC calculates a separate credit risk adjustment for each HSBC legal entity, and within each entity for each counterparty to which the entity has exposure. The calculation of the monoline credit risk adjustment and sensitivity to different assumptions is described on page 137. Of the total credit risk adjustment at 31 December 2010 of US\$1,355m (2009: US\$2,172m), US\$836m (2009: US\$1,163m) relates to the credit risk adjustment taken against non-monoline counterparties. The methodology for calculating the credit risk adjustment for non-monoline counterparties is described below.

HSBC calculates the credit risk adjustment by applying the probability of default of the counterparty to the expected positive exposure to the counterparty, and multiplying the result by the loss expected in the event of default. The calculation is performed over the life of the potential exposure.

The probability of default is based on HSBC's internal credit rating for the counterparty, taking into account how credit ratings may deteriorate over the duration of the exposure through the use of historical rating transition matrices. For most products, to calculate the expected positive exposure to a counterparty, HSBC uses a simulation methodology to incorporate the range of potential exposures across the portfolio of transactions with the counterparty over the life of an instrument. The simulation methodology includes credit mitigants such as counterparty netting agreements and collateral agreements with the counterparty. A standard loss given default assumption of 60% is generally adopted. HSBC does not adjust derivative liabilities for HSBC's own credit risk, such an adjustment is often referred to as a 'debit valuation adjustment'.

For certain types of exotic derivatives where the products are not currently supported by the simulation, or for derivative exposures in smaller trading locations where the simulation tool is not yet available, HSBC adopts alternative methodologies. These may involve mapping to the results for similar products from the simulation tool or where such a mapping approach is not appropriate, a simplified methodology is used, generally following the same principles as the simulation methodology. The calculation is applied at a trade level, with more limited recognition of credit mitigants such as netting or collateral agreements than used in the simulation methodology described previously.

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

HSBC includes all third party counterparties in the credit risk adjustment calculation and does not net credit risk adjustments across HSBC Group entities. During 2010, there were no material changes made by HSBC to the methodologies used to calculate the credit risk adjustment.

Fair value valuation bases

Financial instruments measured at fair value using a valuation technique with significant unobservable inputs – Level 3

	Assets				Liabilities		
	Available for sale US\$m	Held for trading US\$m	Designated at fair value through profit or loss US\$m	Derivatives US\$m	Held for trading US\$m	Designated at fair value through profit or loss US\$m	Derivatives US\$m
At 31 December 2010							
Private equity including strategic investments	4,057	278	120	–	–	–	–
Asset-backed securities	1,949	566	–	–	–	–	–
Leveraged finance	–	–	–	–	–	–	11
Loans held for securitisation	–	1,043	–	–	–	–	–
Structured notes	–	–	–	–	10,667	–	–
Derivatives with monolines	–	–	–	1,005	–	–	–
Other derivatives	–	–	–	2,956	–	–	3,787
Other portfolios	2,231	3,802	467	–	726	570	8
	8,237	5,689	587	3,961	11,393	570	3,806

Notes on the Financial Statements (continued)

	Assets				Liabilities		
	Available for sale US\$m	Held for trading US\$m	Designated at fair value through profit or loss US\$m	Derivatives US\$m	Held for trading US\$m	Designated at fair value through profit or loss US\$m	Derivatives US\$m
At 31 December 2009							
Private equity and strategic investments	2,949	197	345	–	–	–	–
Asset-backed securities	4,270	944	–	–	–	–	–
Leveraged finance	–	73	–	–	–	–	25
Loans held for securitisation	–	1,395	–	–	–	–	–
Structured notes	–	196	–	–	5,055	–	–
Derivatives with monolines	–	–	–	1,305	–	–	–
Other derivatives	–	–	–	3,148	–	–	5,167
Other portfolios	2,995	3,615	879	–	3,719	507	–
	10,214	6,420	1,224	4,453	8,774	507	5,192

Private equity and strategic investments

HSBC's private equity and strategic investments are generally classified as available for sale and are not traded in active markets. In the absence of an active market, an investment's fair value is estimated on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors, as well as by reference to market valuations for similar entities quoted in an active market, or the price at which similar companies have changed ownership.

Asset-backed securities

Illiquidity and a lack of transparency in the market for ABSs have resulted in less observable data being available. While quoted market prices are generally used to determine the fair value of these securities, valuation models are used to substantiate the reliability of the limited market data available and to identify whether any adjustments to quoted market prices are required. For ABSs including residential MBSs, the valuation uses an industry standard model and the assumptions relating to prepayment speeds, default rates and loss severity based on collateral type, and performance, as appropriate. The valuations output is benchmarked for consistency against observable data for securities of a similar nature.

Loans, including leveraged finance and loans held for securitisation

Loans held at fair value are valued from broker quotes and/or market data consensus providers when available. In the absence of an observable market, the fair value is determined using valuation techniques. These techniques include discounted cash flow models, which incorporate assumptions regarding an appropriate credit spread for the loan, derived from other market instruments issued by the same or comparable entities.

Structured notes

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

Derivatives

OTC (i.e. non-exchange traded) derivatives are valued using valuation models. Valuation models calculate the present value of expected future cash flows, based upon 'no-arbitrage' principles. For many vanilla derivative products, such as interest rate swaps and European options, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some differences in market practice. Inputs to valuation models are determined from observable market data wherever possible, including prices available from exchanges, dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices via model calibration procedures or estimated from historical data or other sources. Examples of inputs that may be unobservable include volatility surfaces, in whole or in part, for less commonly traded option products, and correlations between market factors such as foreign exchange rates, interest rates and equity prices. The valuation of derivatives with monolines is discussed on page 137.

Notes on the Financial Statements (continued)

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

The following table provides a reconciliation of the movement between opening and closing balances of Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs:

Movement in Level 3 financial instruments

	Assets				Liabilities		
	Available for sale US\$m	Held for trading US\$m	Designated at fair value through profit or loss US\$m	Derivatives US\$m	Held for trading US\$m	Designated at fair value through profit or loss US\$m	Derivatives US\$m
2010							
At 1 January	10,214	6,420	1,224	4,453	8,774	507	5,192
Total gains/(losses) recognised in profit or loss	345	158	63	(675)	166	(11)	(240)
Total gains/(losses) recognised in other comprehensive income ¹	618	(101)	(36)	(110)	(157)	74	93
Purchases	3,708	858	81	–	(356)	–	–
New issuances	–	–	–	–	4,025	–	–
Sales	(2,461)	(1,543)	(8)	–	–	–	–
Settlements	(1,032)	1	(22)	64	(948)	–	(820)
Transfers out	(7,065)	(629)	(894)	(669)	(1,750)	–	(1,003)
Transfers in	3,910	525	179	898	1,639	–	584
At 31 December	8,237	5,689	587	3,961	11,393	570	3,806
Total gains/(losses) recognised in profit or loss relating to assets and liabilities held on 31 December:	113	116	17	268	180	(14)	361
– net interest income	89	–	–	–	–	–	–
– trading income excluding net interest income	–	98	–	268	198	–	361
– net interest income on trading activities	–	18	–	–	(18)	–	–
– net income/(expense) from other financial instruments designated at fair value	–	–	17	–	–	(14)	–
– dividend income	24	–	–	–	–	–	–
2009							
At 1 January	9,116	7,561	460	9,883	6,509	–	3,805
Total gains/(losses) recognised in profit or loss	(260)	(730)	97	(5,275)	(107)	(3)	(1,372)
Total gains recognised in other comprehensive income ¹	617	85	–	119	301	10	94
Purchases	1,785	1,598	260	–	22	–	–
New issuances	–	–	–	–	2,522	500	–
Sales	(806)	(2,166)	(13)	–	–	–	–
Settlements	(1,059)	(295)	(6)	(104)	(1,266)	–	(206)
Transfers out	(3,043)	(1,077)	–	(1,057)	(537)	–	(620)
Transfers in	3,864	1,444	426	887	1,330	–	3,491
At 31 December	10,214	6,420	1,224	4,453	8,774	507	5,192
Total gains/(losses) recognised in profit or loss relating to assets and liabilities held on 31 December:	(371)	(596)	98	(3,753)	(136)	(3)	(135)
– net interest income	(364)	–	–	–	–	–	–
– trading income excluding net interest income	–	(640)	98	(3,753)	(135)	–	(135)
– net interest income on trading activities	–	44	–	–	(1)	–	–
– gains less losses from financial investments	(9)	–	–	–	–	–	–
– net income/(expense) from other financial instruments designated at fair value	–	–	–	–	–	(3)	–
– dividend income	2	–	–	–	–	–	–

¹ Included in 'Available-for-sale investments: Fair value gains/(losses)' and 'Exchange differences' in the consolidated statement of comprehensive income.

Notes on the Financial Statements (continued)

Available-for-sale securities: Greater pricing certainty of valuations in ABS markets (particularly MBS) has resulted in the transfer of assets out of Level 3 during 2010. Transfers into Level 3 were primarily related to strategic investments in Asia.

Trading assets: Greater pricing certainty of valuations in ABS markets (particularly MBS) and certain corporate bonds has resulted in the transfer of assets out of Level 3 during 2010. Transfers into Level 3 were driven by certain other corporate bonds for which pricing certainty decreased. Sales relate to disposals of whole loans, municipal bonds and various ABSs.

Derivative assets: Transfers out of Level 3 were driven by increased observability of longer-dated equity index volatility, particularly in Asian markets. Transfers in relate primarily to quanto structured credit transactions. Commutations of monoline derivatives and the narrowing of credit spreads have led to an overall reduction in the value of Level 3 assets.

Trading liabilities: Transfers out of and in to Level 3 relate primarily to increased / decreased observability of structured notes with embedded equity derivatives. New issuances relate to structured notes particularly those with embedded equity derivatives issued in the US.

Derivative liabilities: The increased observability in certain OTC equity derivative markets primarily in Asia led to transfers out of Level 3. Transfers in were driven by structured credit transactions.

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

As discussed above, the fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data. The following table shows the sensitivity of these fair values to reasonably possible alternative assumptions:

Sensitivity of fair values to reasonably possible alternative assumptions

	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes US\$m	Unfavourable changes US\$m	Favourable changes US\$m	Unfavourable changes US\$m
At 31 December 2010				
Derivatives, trading assets and trading liabilities ¹	554	(444)	–	–
Financial assets and liabilities designated at fair value	77	(75)	–	–
Financial investments: available for sale	–	–	763	(744)
	631	(519)	763	(744)
At 31 December 2009				
Derivatives, trading assets and trading liabilities ¹	984	(577)	–	–
Financial assets and liabilities designated at fair value	102	(98)	–	–
Financial investments: available for sale	–	–	1,161	(1,157)
	1,086	(675)	1,161	(1,157)

¹ Derivatives, trading assets and trading liabilities are presented as one category to reflect the manner in which these financial instruments are risk-managed.

The decrease in the effect of changes in significant unobservable inputs in relation to derivatives, trading assets and trading liabilities during the year primarily reflected the decreased sensitivity to monoline credit risk adjustment assumptions as exposures have reduced. The decrease in the effect of changes in significant unobservable inputs for available-for-sale assets arose from increased pricing certainty in respect of ABSs.

Notes on the Financial Statements (continued)*Sensitivity of fair values to reasonably possible alternative assumptions by Level 3 instrument type*

	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes US\$m	Unfavourable changes US\$m	Favourable changes US\$m	Unfavourable changes US\$m
At 31 December 2010				
Private equity investments	112	(71)	383	(383)
Asset-backed securities	8	(8)	179	(181)
Loans held for securitisation	8	(8)	–	–
Structured notes	18	(16)	–	–
Derivatives with monolines	94	(8)	–	–
Other derivatives	256	(258)	–	–
Other portfolios	135	(150)	201	(180)
	631	(519)	763	(744)
At 31 December 2009				
Private equity investments	54	(54)	302	(299)
Asset-backed securities	41	(41)	734	(735)
Leveraged finance	1	(1)	–	–
Loans held for securitisation	16	(16)	–	–
Structured notes	3	(3)	–	–
Derivatives with monolines	333	(25)	–	–
Other derivatives	309	(332)	–	–
Other portfolios	329	(203)	125	(123)
	1,086	(675)	1,161	(1,157)

Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable parameters using statistical techniques. When parameters are not amenable to statistical analysis, quantification of uncertainty is judgemental.

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

In respect of private equity investments, in many of the methodologies, the principal assumption is the valuation multiple to be applied to the main financial indicators. This may be determined with reference to multiples for comparable listed companies and includes discounts for marketability.

For ABSs, the principal assumptions in the models are based on benchmark information about prepayment speeds, default rates, loss severities and the historical performance of the underlying assets.

For leveraged finance, loans held for securitisation and derivatives with monolines the principal assumption concerns the appropriate value to be attributed to the counterparty credit risk. This requires estimation of exposure at default, probability of default and recovery in the event of default. For loan transactions, assessment of exposure at default is straightforward. For derivative transactions, a future exposure profile is generated on the basis of current market data. Probabilities of default and recovery levels are estimated using available evidence, which may include financial information, historical experience, CDS spreads and consensus recovery levels.

For structured notes and other derivatives, principal assumptions concern the value to be attributed to future volatility of asset values and the future correlation between asset values. These principal assumptions include credit volatilities and correlations used in the valuation of structured credit derivatives (including leveraged credit derivatives). For such unobservable assumptions, estimates are based on available market data, which may include the use of a proxy method to derive a volatility or a correlation from comparable assets for which market data is more readily available, and/or an examination of historical levels.

Notes on the Financial Statements (continued)

HSBC Holdings

The following table provides an analysis of the basis for valuing financial assets and financial liabilities measured at fair value in the financial statements:

Bases of valuing HSBC Holdings' financial assets and liabilities measured at fair value

	Valuation techniques			Total US\$m
	Quoted market price Level 1 US\$m	Using observable inputs Level 2 US\$m	With significant unobservable inputs Level 3 US\$m	
At 31 December 2010				
Assets				
Derivatives	–	2,327	–	2,327
Financial investments: available for sale	–	–	2,025	2,025
Liabilities				
Financial liabilities designated at fair value	12,029	4,259	–	16,288
Derivatives	–	827	–	827
At 31 December 2009				
Assets				
Derivatives	–	2,981	–	2,981
Financial investments: available for sale	–	–	2,455	2,455
Liabilities				
Financial liabilities designated at fair value	12,549	4,360	–	16,909
Derivatives	–	362	–	362

Financial instruments measured at fair value – Level 3

Financial investments measured using a valuation technique with significant unobservable inputs (Level 3) comprise fixed-rate preferred securities and senior notes purchased from HSBC undertakings. The unobservable elements of the valuation technique include the use of implied credit spreads and simplified bond pricing assumptions.

Movement in Level 3 financial instruments available for sale

	2010 US\$m	2009 US\$m
At 1 January	2,455	2,629
Total gains or losses:		
– recognised in profit or loss	(155)	(2)
– recognised in other comprehensive income	(275)	103
Settlements	–	(275)
At 31 December	2,025	2,455
Total gains or losses recognised in profit or loss relating to those assets and liabilities held on 31 December	(1)	(2)

In certain circumstances, the fair value of financial instruments are measured using valuation models that incorporate assumptions that are not supported by prices from observable current market transactions in the same instrument and are not based on observable market data. The following table shows the sensitivity of non-derivative financial instruments to reasonably possible alternative assumptions:

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

	Reflected in equity	
	Favourable changes US\$m	Unfavourable changes US\$m
Financial investments: available for sale		
At 31 December 2010	34	(33)
At 31 December 2009	115	(107)

Notes on the Financial Statements (continued)**17 Fair values of financial instruments not carried at fair value**

The classification of financial instruments is determined in accordance with the accounting policies set out in Note 2.

Fair values of financial instruments which are not carried at fair value on the balance sheet

	At 31 December 2010		At 31 December 2009	
	Carrying amount US\$m	Fair value US\$m	Carrying amount US\$m	Fair value US\$m
Assets				
Loans and advances to banks	208,271	208,311	179,781	179,658
Loans and advances to customers	958,366	934,444	896,231	855,780
Financial investments: debt securities	19,386	20,374	17,526	18,097
Financial investments: treasury and other eligible bills	113	113	101	101
Liabilities				
Deposits by banks	110,584	110,563	124,872	124,856
Customer accounts	1,227,725	1,227,428	1,159,034	1,160,036
Debt securities in issue	145,401	145,417	146,896	145,888
Subordinated liabilities	33,387	33,161	30,478	30,307

Fair values of financial instruments held for sale which are not carried at fair value on the balance sheet

	At 31 December 2010		At 31 December 2009	
	Carrying amount US\$m	Fair value US\$m	Carrying amount US\$m	Fair value US\$m
Assets classified as held for sale				
Loans and advances to banks and customers	116	116	1,356	1,316

The following is a list of financial instruments whose carrying amount is a reasonable approximation of fair value because, for example, they are short-term in nature or reprice to current market rates frequently:

Assets

Cash and balances at central banks
 Items in the course of collection from other banks
 Hong Kong Government certificates of indebtedness
 Endorsements and acceptances
 Short-term receivables within 'Other assets'
 Accrued income

Liabilities

Hong Kong currency notes in circulation
 Items in the course of transmission to other banks
 Investment contracts with discretionary participation features within 'Liabilities under insurance contracts'
 Endorsements and acceptances
 Short-term payables within 'Other liabilities'
 Accruals

Analysis of loans and advances to customers by geographical segment

	At 31 December 2010		At 31 December 2009	
	Carrying amount US\$m	Fair value US\$m	Carrying amount US\$m	Fair value US\$m
Loans and advances to customers				
Europe	435,799	430,333	439,481	431,158
Hong Kong	140,691	140,699	99,381	99,694
Rest of Asia-Pacific	108,731	108,582	80,043	79,972
Middle East	24,626	24,539	22,844	22,538
North America	190,532	172,522	206,853	174,957
Latin America	57,987	57,769	47,629	47,461
	958,366	934,444	896,231	855,780

Notes on the Financial Statements (continued)

Valuation

The calculation of fair value incorporates HSBC's estimate of the amount at which financial assets could be exchanged, or financial liabilities settled, between knowledgeable, willing parties in an arm's length transaction. It does not reflect the economic benefits and costs that HSBC expects to flow from the instruments' cash flows over their expected future lives. Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available, so comparisons of fair values between entities may not be meaningful and users are advised to exercise caution when using this data.

Loans and advances to banks and customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using discounted cash flow models.

Performing loans are grouped, as far as possible, into homogeneous pools segregated by maturity and interest rates and the contractual cash flows are generally discounted using HSBC's estimate of the discount rate that a market participant would use in valuing instruments with similar maturity, re-pricing and credit risk characteristics.

The fair value of a loan portfolio reflects both loan impairments at the balance sheet date and estimates of market participants' expectations of credit losses over the life of the loans. For impaired loans, fair value is estimated by discounting the future cash flows over the time period they are expected to be recovered.

Financial investments

The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that take into consideration the prices and future earnings streams of equivalent quoted securities.

Deposits by banks and customer accounts

For the purpose of estimating fair value, deposits by banks and customer accounts are grouped by remaining contractual maturity. Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is assumed to be the amount payable on demand at the balance sheet date.

Debt securities in issue and subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments.

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. In many cases, it would not be possible to realise immediately the estimated fair values given the size of the portfolios measured. Accordingly, these fair values do not represent the value of these financial instruments to HSBC as a going concern.

HSBC Holdings

The methods used by HSBC Holdings to determine fair values of financial instruments for the purpose of measurement and disclosure are described above.

The following table provides an analysis of the fair value of financial instruments not carried at fair value on the balance sheet:

Notes on the Financial Statements (continued)*Fair values of HSBC Holdings' financial instruments not carried at fair value on the balance sheet*

	At 31 December 2010		At 31 December 2009	
	Carrying amount US\$m	Fair value US\$m	Carrying amount US\$m	Fair value US\$m
Assets				
Loans and advances to HSBC undertakings	21,238	21,798	23,212	23,871
Liabilities				
Amounts owed to HSBC undertakings	2,932	2,963	3,711	3,827
Debt securities in issue	2,668	2,960	2,839	3,141
Subordinated liabilities	13,313	14,428	14,406	15,666

18 Reclassification of financial assets

During the second half of 2008, HSBC reclassified US\$15.3bn and US\$2.6bn of financial assets from the held-for-trading category to the loans and receivables and available-for-sale classifications, respectively, as permitted by the relevant amendment to IAS 39 and explained in Note 2(e) on the Financial Statements. No further reclassifications were undertaken by HSBC in 2010 and 2009.

Reclassification of HSBC's financial assets

	At 31 December 2010		At 31 December 2009	
	Carrying amount US\$m	Fair value US\$m	Carrying amount US\$m	Fair value US\$m
Reclassification to loans and receivables				
ABSs	5,892	4,977	7,827	6,177
Trading loans – commercial mortgage loans	522	493	553	506
Leveraged finance and syndicated loans	4,533	4,166	5,824	5,434
	10,947	9,636	14,204	12,117
Reclassification to available for sale				
Corporate debt and other securities	91	91	1,408	1,408
	11,038	9,727	15,612	13,525

The following table shows the fair value gains and losses, income and expense recognised in the income statement in respect of reclassified assets and the gains and losses that would have been recognised if no reclassification had taken place.

Effect of reclassifying and not reclassifying financial assets

	Financial assets reclassified to:					Total US\$m
	loans and receivables			available for sale		
	Trading loans – commercial mortgage loans	Leveraged finance and syndicated loans	Total	Corporate debt and other securities	Total	
	US\$m	US\$m	US\$m	US\$m	US\$m	
2010						
Recorded in the income statement ¹	235	29	346	56	666	
Assuming no reclassification ²	908	45	307	59	1,319	
Net effect of reclassification	(673)	(16)	39	(3)	(653)	
Attributable to:						
Europe	(527)	(16)	(23)	(2)	(568)	
North America	(146)	–	49	(1)	(98)	
Middle East	–	–	13	–	13	

Notes on the Financial Statements (continued)

	Financial assets reclassified to:					
	loans and receivables				available for sale	
	ABSs US\$m	Trading loans – commercial mortgage loans US\$m	Leveraged finance and syndicated loans US\$m	Total US\$m	Corporate debt and other securities US\$m	Total US\$m
2009						
Recorded in the income statement ¹	511	32	434	977	101	1,078
Assuming no reclassification ²	767	15	1,494	2,276	301	2,577
2008						
Net effect of reclassification	(256)	17	(1,060)	(1,299)	(200)	(1,499)
Attributable to:						
Europe	(212)	17	(566)	(761)	(170)	(931)
North America	(44)	–	(543)	(587)	(30)	(617)
Middle East	–	–	49	49	–	49
2008						
Recorded in the income statement ¹	303	17	192	512	22	534
Assuming no reclassification ²	(1,549)	(13)	(1,239)	(2,801)	(202)	(3,003)
2008						
Net effect of reclassification	1,852	30	1,431	3,313	224	3,537
Attributable to:						
Europe	1,537	30	803	2,370	193	2,563
North America	315	–	601	916	31	947
Middle East	–	–	27	27	–	27

1 'Income and expense' recorded in the income statement represents the accrual of the effective interest rate and, for 2010, includes US\$6m in respect of impairment (2009: US\$163m; 2008: US\$26m). The effect on the income statement for 2008 shows the income and expense post-reclassification. In 2008 pre-reclassification, the assets were held at fair value and a loss of US\$1,371m was recorded in the period up to reclassification.

2 Effect on the income statement during the year had the reclassification not occurred.

19 Financial assets designated at fair value

	2010 US\$m	2009 US\$m
Financial assets designated at fair value:		
– not subject to repledge or resale by counterparties	36,990	37,166
– which may be repledged or resold by counterparties	21	15
	37,011	37,181
Treasury and other eligible bills	159	223
Debt securities	18,248	20,718
Equity securities	17,418	14,983
Securities designated at fair value	35,825	35,924
Loans and advances to banks	315	354
Loans and advances to customers	871	903
	37,011	37,181

Securities designated at fair value

	Fair value ¹	
	2010 US\$m	2009 US\$m
US Treasury and US Government agencies ²	78	78
UK Government	1,304	4,799
Hong Kong Government	151	177
Other government	4,130	3,491
Asset-backed securities ³	6,128	6,463
Corporate debt and other securities	6,616	5,933
Equities	17,418	14,983
	35,825	35,924

1 Included within these figures are debt securities issued by banks and other financial institutions of US\$10,185m (2009: US\$13,745m), of which US\$48m (2009: US\$49m) are guaranteed by various governments.

2 Includes securities that are supported by an explicit guarantee issued by the US Government.

3 Excludes asset-backed securities included under US Treasury and US Government agencies.

Notes on the Financial Statements (continued)*Securities listed on a recognised exchange and unlisted*

	Treasury and other eligible bills US\$m	Debt securities US\$m	Equity securities US\$m	Total US\$m
Fair value at 31 December 2010				
Listed on a recognised exchange ¹	21	4,168	12,548	16,737
Unlisted	138	14,080	4,870	19,088
	159	18,248	17,418	35,825
Fair value at 31 December 2009				
Listed on a recognised exchange ¹	78	7,168	10,549	17,795
Unlisted	145	13,550	4,434	18,129
	223	20,718	14,983	35,924

¹ Included within listed investments are US\$756m of investments listed in Hong Kong (2009: US\$506m).

20 Derivatives*Fair values of derivatives by product contract type held by HSBC*

	Assets			Liabilities		
	Trading US\$m	Hedging US\$m	Total US\$m	Trading US\$m	Hedging US\$m	Total US\$m
At 31 December 2010						
Foreign exchange	65,905	1,304	67,209	67,564	340	67,904
Interest rate	278,364	2,764	281,128	273,222	3,909	277,131
Equity	13,983	–	13,983	14,716	–	14,716
Credit	20,907	–	20,907	20,027	–	20,027
Commodity and other	1,261	–	1,261	2,618	–	2,618
Gross total fair values	380,420	4,068	384,488	378,147	4,249	382,396
Netting			(123,731)			(123,731)
Total			260,757			258,665
At 31 December 2009						
Foreign exchange	55,036	1,695	56,731	54,502	300	54,802
Interest rate	212,102	3,506	215,608	209,351	3,274	212,625
Equity	15,729	–	15,729	19,013	–	19,013
Credit	28,479	–	28,479	27,042	–	27,042
Commodity and other	1,135	–	1,135	960	–	960
Gross total fair values	312,481	5,201	317,682	310,868	3,574	314,442
Netting			(66,796)			(66,796)
Total			250,886			247,646

The 4% increase in the fair value of derivative assets during 2010 was driven both by this increased volume of open trades and by small net declines in yield curves of major currencies over the year. The netting adjustment increased as increasing volumes of transactions, particularly interest rate derivatives and credit derivatives, were executed through clearing houses, where the settlement arrangements satisfied the IFRS netting criteria.

Fair values of derivatives by product contract type held by HSBC Holdings with subsidiaries

	At 31 December 2010		At 31 December 2009	
	Trading assets US\$m	Trading liabilities US\$m	Trading assets US\$m	Trading liabilities US\$m
Foreign exchange	1,407	827	2,250	362
Interest rate	920	–	731	–
	2,327	827	2,981	362

Notes on the Financial Statements (continued)

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, bonds, interest rates, foreign exchange, credit spreads, commodities and equity or other indices. Derivatives enable users to increase, reduce or alter exposure to credit or market risks. HSBC makes markets in derivatives for its customers and uses derivatives to manage its exposure to credit and market risks.

Derivatives are carried at fair value and shown in the balance sheet as separate totals of assets and liabilities. A description of how the fair value of derivatives is derived is set out on page 313. Derivative assets and liabilities on different transactions are only set off if the transactions are with the same counterparty, a legal right of set-off exists and the cash flows are intended to be settled on a net basis.

Use of derivatives

HSBC transacts derivatives for three primary purposes: to create risk management solutions for clients, to manage the portfolio risks arising from client business and to manage and hedge HSBC's own risks. Derivatives (except for derivatives which are designated as effective hedging instruments as defined in IAS 39) are held for trading. The held for trading classification includes two types of derivatives: those used in sales and trading activities, and those used for risk management purposes but which for various reasons do not meet the qualifying criteria for hedge accounting. The second category includes derivatives managed in conjunction with financial instruments designated at fair value. These activities are described more fully below.

HSBC's derivative activities give rise to significant open positions in portfolios of derivatives. These positions are managed constantly to ensure that they remain within acceptable risk levels, with matching deals being utilised to achieve this where necessary. When entering into derivative transactions, HSBC employs the same credit risk management procedures to assess and approve potential credit exposures that are used for traditional lending.

Trading derivatives

Most of HSBC's derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities in derivatives are entered into principally for the purpose of generating profits from short-term fluctuations in price or margin. Positions may be traded actively or be held over a period of time to benefit from expected changes in exchange rates, interest rates, equity prices or other market parameters. Trading includes market-making, positioning and arbitrage activities. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume; positioning means managing market risk positions in the expectation of benefiting from favourable movements in prices, rates or indices; arbitrage involves identifying and profiting from price differentials between markets and products.

As mentioned above, other derivatives classified as held for trading include non-qualifying hedging derivatives, ineffective hedging derivatives and the components of hedging derivatives that are excluded from assessing hedge effectiveness. Non-qualifying hedging derivatives are entered into for risk management purposes but do not meet the criteria for hedge accounting. These include derivatives managed in conjunction with financial instruments designated at fair value.

Gains and losses from changes in the fair value of derivatives, including the contractual interest, that do not qualify for hedge accounting are reported in 'Net trading income', except for derivatives managed in conjunction with financial instruments designated at fair value, where gains and losses are reported in 'Net income from financial instruments designated at fair value', together with the gains and losses on the economically hedged items. Where the derivatives are managed with debt securities in issue, the contractual interest is shown in 'interest expense' together with the interest payable on the issued debt. Substantially all of HSBC Holdings' derivatives entered into with HSBC undertakings are managed in conjunction with financial liabilities designated at fair value.

The notional contract amounts of derivatives held for trading purposes indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk. The 27% increase in the notional amounts of HSBC's derivative assets during 2010 was primarily driven by an increase in the number of open interest rate contracts, reflecting increased trading volumes in the period.

Notes on the Financial Statements (continued)

Notional contract amounts of derivatives held for trading purposes by product type

	HSBC		HSBC Holdings	
	At 31 December 2010 US\$m	At 31 December 2009 US\$m	At 31 December 2010 US\$m	At 31 December 2009 US\$m
Foreign exchange	3,692,798	2,883,201	17,287	17,150
Interest rate	18,104,141	13,874,355	6,804	6,804
Equity	294,587	217,828	–	–
Credit	1,065,218	1,237,055	–	–
Commodity and other	82,856	53,720	–	–
	23,239,600	18,266,159	24,091	23,954

Credit derivatives

HSBC trades credit derivatives through its principal dealing operations and acts as a principal counterparty to a broad range of users, structuring deals to produce risk management products for its customers, or making markets in certain products. Risk is typically controlled through entering into offsetting credit derivative contracts with other counterparties.

HSBC manages the credit risk arising on buying and selling credit derivative protection by including the related credit exposures within its overall credit limit structure for the relevant counterparty. Trading of credit derivatives is restricted to a small number of offices within the major centres which have the control infrastructure and market skills to manage effectively the credit risk inherent in the products.

Credit derivatives are also deployed to a limited extent for the risk management of the Group's loan portfolios.

The notional contract amount of credit derivatives of US\$1,065,218m (2009: US\$1,237,055m) consisted of protection bought of US\$530,235m (2009: US\$614,690m) and protection sold of US\$534,983m (2009: US\$622,365m).

The credit derivative business operates within the market risk management framework described on pages 145 to 154.

Derivatives valued using models with unobservable inputs

The difference between the fair value at initial recognition (the transaction price) and the value that would have been derived had valuation techniques used for subsequent measurement been applied at initial recognition, less subsequent releases, is as follows:

Unamortised balance of derivatives valued using models with significant unobservable inputs

	2010 US\$m	2009 US\$m
Unamortised balance at 1 January	260	204
Deferral on new transactions	331	192
Recognised in the income statement during the period:		
– amortisation	(106)	(86)
– subsequent to unobservable inputs becoming observable	(17)	(19)
– maturity, termination or offsetting derivative	(163)	(42)
Exchange differences	(15)	11
Risk hedged	(40)	–
Unamortised balance at 31 December ¹	250	260

¹ This amount is yet to be recognised in the consolidated income statement.

Hedging instruments

HSBC uses derivatives (principally interest rate swaps) for hedging purposes in the management of its own asset and liability portfolios and structural positions. This enables HSBC to optimise the overall cost to the Group of accessing debt capital markets, and to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities.

Notes on the Financial Statements (continued)

The accounting treatment of hedge transactions varies according to the nature of the instrument hedged and the type of hedge transactions. Derivatives may qualify as hedges for accounting purposes if they are fair value hedges, cash flow hedges, or hedges in net investment of foreign operations. These are described under the relevant headings below.

The notional contract amounts of derivatives held for hedging purposes indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Notional contract amounts of derivatives held for hedging purposes by product type

	At 31 December 2010		At 31 December 2009	
	Cash flow hedge US\$m	Fair value hedge US\$m	Cash flow hedge US\$m	Fair value hedge US\$m
Foreign exchange	10,599	1,392	12,359	2,469
Interest rate	282,412	62,757	236,388	42,224
	293,011	64,149	248,747	44,693

Fair value hedges

HSBC's fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates. For qualifying fair value hedges, all changes in the fair value of the derivative and in the fair value of the item in relation to the risk being hedged are recognised in the income statement. If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortised to the income statement as a yield adjustment over the remainder of the hedging period.

Fair value of derivatives designated as fair value hedges

	At 31 December 2010		At 31 December 2009	
	Assets US\$m	Liabilities US\$m	Assets US\$m	Liabilities US\$m
Foreign exchange	153	–	342	–
Interest rate	443	2,226	242	1,085
	596	2,226	584	1,085

Gains or losses arising from fair value hedges

	2010 US\$m	2009 US\$m	2008 US\$m
Gains/(losses):			
– on hedging instruments	(830)	114	(296)
– on the hedged items attributable to the hedged risk	868	(159)	301
	38	(45)	5

The gains and losses on ineffective portions of fair value hedges are recognised immediately in 'Net trading income'.

Cash flow hedges

HSBC's cash flow hedges consist principally of interest rate and cross-currency swaps that are used to protect against exposures to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio of financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedges of forecast transactions. Gains and losses are initially recognised in other comprehensive income, and accumulated in the cash flow hedging reserve, and are transferred to the income statement when the forecast cash flows affect the income statement.

Notes on the Financial Statements (continued)*Fair value of derivatives designated as cash flow hedges*

	At 31 December 2010		At 31 December 2009	
	Assets US\$m	Liabilities US\$m	Assets US\$m	Liabilities US\$m
Foreign exchange	1,151	340	1,353	300
Interest rate	2,321	1,683	3,264	2,189
	3,472	2,023	4,617	2,489

Forecast principal balances on which interest cash flows are expected to arise

	3 months or less US\$m	More than 3 months but less than 1 year US\$m	5 years or less more than 1 year US\$m	More than 5 years US\$m
	At 31 December 2010			
Assets	163,006	97,174	58,975	1,358
Liabilities	(89,112)	(58,811)	(42,259)	(6,065)
Net cash inflows/(outflows) exposure	73,894	38,363	16,716	(4,707)
At 31 December 2009				
Assets	120,915	111,456	53,184	476
Liabilities	(71,143)	(78,841)	(39,377)	(6,559)
Net cash inflows/(outflows) exposure	49,772	32,615	13,807	(6,083)

This table reflects the interest rate repricing profile of the underlying hedged items.

The gains and losses on ineffective portions of such derivatives are recognised immediately in 'Net trading income'. During the year to 31 December 2010 a loss of US\$9m (2009: gain of US\$90m; 2008: loss of US\$40m) was recognised due to hedge ineffectiveness.

Hedges of net investments in foreign operations

The Group applies hedge accounting in respect of certain consolidated net investments. Hedging is undertaken using forward foreign exchange contracts or by financing with currency borrowings.

At 31 December 2010, the fair values of outstanding financial instruments designated as hedges of net investments in foreign operations were liabilities of US\$34m (2009: US\$28m) and notional contract values of US\$644m (2009: US\$566m).

The ineffectiveness recognised in 'Net trading income' in the year ended 31 December 2010 that arose from hedges in foreign operations was nil (2009 and 2008: nil).

21 Financial investments

	2010 US\$m	2009 US\$m
Financial investments:		
– not subject to repledge or resale by counterparties	369,597	356,864
– which may be repledged or resold by counterparties	31,158	12,294
	400,755	369,158

Notes on the Financial Statements (continued)

Carrying amount and fair value of financial investments

	2010		2009	
	Carrying amount US\$m	Fair value US\$m	Carrying amount US\$m	Fair value US\$m
Treasury and other eligible bills	57,129	57,129	58,434	58,434
– available for sale	57,016	57,016	58,333	58,333
– held to maturity	113	113	101	101
Debt securities	335,643	336,632	301,600	302,171
– available for sale	316,257	316,257	284,074	284,074
– held to maturity	19,386	20,375	17,526	18,097
Equity securities	7,983	7,983	9,124	9,124
– available for sale	7,983	7,983	9,124	9,124
Total financial investments	400,755	401,744	369,158	369,729

Financial investments at amortised cost and fair value

	Amortised cost US\$m	Fair value ¹ US\$m
At 31 December 2010		
US Treasury	37,380	37,255
US Government agencies ²	20,895	21,339
US Government sponsored entities ²	5,029	5,267
UK Government	31,069	31,815
Hong Kong Government	29,770	29,793
Other government	108,947	109,806
Asset-backed securities ³	39,845	33,175
Corporate debt and other securities	124,704	125,311
Equities	5,605	7,983
	403,244	401,744
At 31 December 2009		
US Treasury	17,650	17,635
US Government agencies ²	12,539	12,804
US Government sponsored entities ²	4,885	4,924
UK Government	9,653	9,782
Hong Kong Government	37,747	37,763
Other government	87,122	87,881
Asset-backed securities ³	48,500	34,914
Corporate debt and other securities	153,639	154,902
Equities	7,051	9,124
	378,786	369,729
At 31 December 2008		
US Treasury	11,528	11,755
US Government agencies ²	8,131	8,307
US Government sponsored entities ²	15,109	15,240
UK Government	16,077	16,217
Hong Kong Government	966	989
Other government	60,755	61,528
Asset-backed securities ³	55,685	36,052
Corporate debt and other securities	145,269	143,940
Equities	5,901	7,251
	319,421	301,279

1 Included within the above figures are debt securities issued by banks and other financial institutions of US\$99,733m (2009: US\$133,256m; 2008: US\$140,878m), of which US\$38,862m (2009: US\$55,324m; 2008: US\$39,213m) are guaranteed by various governments. The fair value of the debt securities issued by banks and other financial institutions was US\$100,070m (2009: US\$133,461m; 2008: US\$141,526m).

2 Includes securities that are supported by an explicit guarantee issued by the US Government.

3 Excludes asset-backed securities included under US Government agencies and sponsored entities.

Notes on the Financial Statements (continued)

Financial investments listed on a recognised exchange and unlisted

	Treasury and other eligible bills available for sale US\$m	Treasury and other eligible bills held to maturity US\$m	Debt securities available for sale US\$m	Debt securities held to maturity US\$m	Equity securities available for sale US\$m	Total US\$m
Carrying amount at 31 December 2010						
Listed on a recognised exchange ¹	1,400	–	138,374	4,182	851	144,807
Unlisted ²	55,616	113	177,883	15,204	7,132	255,948
	57,016	113	316,257	19,386	7,983	400,755
Carrying amount at 31 December 2009						
Listed on a recognised exchange ¹	2,334	–	135,653	2,743	911	141,641
Unlisted ²	55,999	101	148,421	14,783	8,213	227,517
	58,333	101	284,074	17,526	9,124	369,158

1 The fair value of listed held-to-maturity debt securities as at 31 December 2010 was US\$4,332m (2009: US\$2,769m). Included within listed investments were US\$1,902m (2009: US\$1,670m) of investments listed in Hong Kong.

2 Unlisted treasury and other eligible bills available for sale primarily comprise treasury bills not listed on a recognised exchange but for which there is a liquid market.

Maturities of investments in debt securities at their carrying amount

	At 31 December	
	2010 US\$m	2009 US\$m
Remaining contractual maturity of total debt securities:		
1 year or less	92,961	75,782
5 years or less but over 1 year	124,596	141,683
10 years or less but over 5 years	56,926	31,934
Over 10 years	61,160	52,201
	335,643	301,600
Remaining contractual maturity of debt securities available for sale:		
1 year or less	91,939	75,160
5 years or less but over 1 year	117,931	135,187
10 years or less but over 5 years	50,113	26,105
Over 10 years	56,274	47,622
	316,257	284,074
Remaining contractual maturity of debt securities held to maturity:		
1 year or less	1,022	622
5 years or less but over 1 year	6,665	6,496
10 years or less but over 5 years	6,813	5,829
Over 10 years	4,886	4,579
	19,386	17,526

Contractual maturities and weighted average yields of investment debt securities at 31 December 2010

	Within one year		After one year but within five years		After five years but within ten years		After ten years	
	Amount US\$m	Yield %	Amount US\$m	Yield %	Amount US\$m	Yield %	Amount US\$m	Yield %
Available-for-sale								
US Treasury	8,761	0.95	13,513	1.19	9,225	2.61	4,648	4.32
US Government agencies	–	–	7	2.95	230	4.78	20,236	3.71
US Government-sponsored agencies	859	0.70	114	1.75	1,993	3.81	445	3.60
UK Government	3,994	2.90	11,407	2.22	13,987	2.97	1,248	2.80
Hong Kong Government	362	0.55	407	2.95	–	–	–	–
Other governments	28,779	2.25	44,920	4.00	6,945	4.65	2,073	4.58
Asset-backed securities	392	0.77	2,311	1.73	7,773	0.66	29,178	0.64
Corporate debt and other securities	49,014	2.26	44,009	2.54	10,342	3.44	4,065	4.72
Total amortised cost	92,161		116,688		50,495		61,893	
Total carrying value	91,939		117,931		50,113		56,274	

Notes on the Financial Statements (continued)

	Within one year		After one year but within five years		After five years but within ten years		After ten years	
	Amount US\$m	Yield %	Amount US\$m	Yield %	Amount US\$m	Yield %	Amount US\$m	Yield %
Held-to-maturity								
US Treasury	–	–	32	3.13	60	6.67	62	9.68
US Government agencies	–	–	–	–	6	7.65	416	6.49
US Government-sponsored agencies	19	5.26	28	7.14	2	6.92	1,560	6.15
Hong Kong Government	2	3.02	–	–	8	5.05	–	–
Other governments	53	5.66	424	3.30	252	4.37	595	7.23
Asset-backed securities	–	–	–	–	–	–	191	6.28
Corporate debt and other securities	948	4.01	6,181	4.29	6,485	4.52	2,062	5.92
Total amortised cost	1,022		6,665		6,813		4,886	
Total carrying value	1,022		6,665		6,813		4,886	

The maturity distributions of asset-backed securities are presented in the above table on the basis of contractual maturity dates. The weighted average yield for each range of maturities is calculated by dividing the annualised interest income for the year ended 31 December 2010 by the book amount of available-for-sale debt securities at that date. The yields do not include the effect of related derivatives.

22 Transfers of financial assets not qualifying for derecognition

HSBC enters into transactions in the normal course of business by which it transfers recognised financial assets directly to third parties or to SPEs. These transfers may give rise to the full or partial derecognition of the financial assets concerned.

- Full derecognition occurs when HSBC transfers its contractual right to receive cash flows from the financial assets, or retains the right but assumes an obligation to pass on the cash flows from the asset, and transfers substantially all the risks and rewards of ownership. The risks include credit, interest rate, currency, prepayment and other price risks.
- Partial derecognition occurs when HSBC sells or otherwise transfers financial assets in such a way that some but not substantially all of the risks and rewards of ownership are transferred but control is retained. These financial assets are recognised on the balance sheet to the extent of HSBC's continuing involvement.

The majority of financial assets that do not qualify for derecognition are (i) debt securities held by counterparties as collateral under repurchase agreements or (ii) equity securities lent under securities lending agreements. The following table analyses the carrying amount of financial assets that did not qualify for derecognition and their associated financial liabilities:

Financial assets and associated financial liabilities not qualifying for derecognition

Nature of transaction	2010		2009	
	Carrying amount of transferred assets US\$m	Carrying amount of associated liabilities US\$m	Carrying amount of transferred assets US\$m	Carrying amount of associated liabilities US\$m
Repurchase agreements	124,625	122,455	108,518	107,525
Securities lending agreements	7,277	7,202	7,363	7,264
	131,902	129,657	115,881	114,789

A small proportion of financial assets that do not qualify for derecognition relate to loans, credit cards, debt securities and trade receivables that have been securitised under arrangements by which HSBC retains a continuing involvement in such transferred assets. Continuing involvement may entail retaining the rights to future cash flows arising from the assets after investors have received their contractual terms (for example, interest rate strips); providing subordinated interest; liquidity support; continuing to service the underlying asset; or entering into derivative transactions with the securitisation vehicles. As such, HSBC continues to be exposed to risks associated with these transactions.

Notes on the Financial Statements (continued)

The rights and obligations that HSBC retains from its continuing involvement in securitisations are initially recorded as an allocation of the fair value of the financial asset between the part that is derecognised and the part that continues to be recognised on the date of transfer. The following analyses the carrying amount of financial assets to the extent of HSBC's continuing involvement that qualified for partial derecognition during the year, and their associated liabilities:

HSBC's continuing involvement in financial assets qualifying for partial derecognition

	Securitisations at 31 December	
	2010 US\$m	2009 US\$m
Carrying amount of assets (original)	17,427	17,427
Carrying amount of assets (currently recognised)	42	139
Carrying amount of associated liabilities (currently recognised)	21	69

23 Interests in associates and joint ventures

Associates

Principal associates of HSBC

	At 31 December 2010		At 31 December 2009	
	Carrying amount US\$m	Fair value US\$m	Carrying amount US\$m	Fair value US\$m
Listed				
Bank of Communications Co., Limited	6,944	10,773	5,110	10,820
Industrial Bank Co., Limited	1,769	2,799	1,084	3,774
Ping An Insurance (Group) Company of China, Limited	5,596	13,735	4,391	10,803
SABB Takaful Company	28	49	29	99
The Saudi British Bank	1,580	3,224	1,376	3,472
	15,917	30,580	11,990	28,968

Listed

Bank of Communications Co., Limited
Industrial Bank Co., Limited
Ping An Insurance (Group) Company of China, Limited
SABB Takaful Company
The Saudi British Bank

Unlisted

Barrowgate Limited³
Vietnam Technological and Commercial Joint Stock Bank
Yantai Bank Co., Limited²

¹ People's Republic of China.

² Yantai Bank Co., Limited was previously known as Yantai City Commercial Bank. The investment is held through Hang Seng Bank Limited, a 62.14% owned subsidiary of HSBC.

³ Issued equity capital is less than HK\$1m.

All the above investments in associates are owned by subsidiaries of HSBC Holdings.

During 2010, HSBC disposed of its 48.92% interest in the equity capital of British Arab Commercial Bank Public Limited Company, which was previously reported as an unlisted principal associate.

Details of all HSBC associates and joint ventures, as required under Section 409 Companies Act 2006, will be annexed to the next Annual Return of HSBC Holdings filed with the UK Registrar of Companies.

HSBC had US\$12,540m (2009: US\$9,501m) of investments in associates and joint ventures listed in Hong Kong.

For the year ended 31 December 2010, HSBC's share of associates and joint ventures' tax on profit was US\$774m (2009: US\$491m), which is included within share of profit in associates and joint ventures in the income statement.

At 31 December 2010		
Country of incorporation	HSBC's interest in equity capital	Issued equity capital
PRC ¹	19.03%	RMB56,260m
PRC ¹	12.80%	RMB5,992m
PRC ¹	16.13%	RMB7,345m
Saudi Arabia	32.50%	SR340m
Saudi Arabia	40.00%	SR7,500m
Hong Kong	24.64%	–
Vietnam	19.79%	VND6,932,184m
PRC ¹	20.00%	RMB2,000m

Notes on the Financial Statements (continued)

Summarised aggregate financial information on associates

	2010 US\$m	2009 US\$m
HSBC's share of:		
– assets	191,286	158,890
– liabilities	175,812	147,501
– revenues	9,274	7,514
– profit after tax	2,479	1,735

HSBC's investment in Bank of Communications Co., Limited was equity accounted with effect from August 2004. HSBC's significant influence in Bank of Communications Co., Limited was established as a result of representation on the Board of Directors, and in accordance with the Technical Support and Assistance Agreements, HSBC is assisting in the development of financial and operating policies and a number of staff have been seconded to assist in this process.

HSBC's investment in Industrial Bank Co., Limited was equity accounted with effect from May 2004, reflecting HSBC's significant influence over this associate. HSBC's significant influence was established as a result of representation on the Board of Directors, and in accordance with the Technical Support and Assistance Agreements, HSBC is assisting in the development of financial and operating policies.

HSBC's investment in Ping An Insurance (Group) Company of China, Limited was equity accounted with effect from 31 August 2005, reflecting HSBC's significant influence over this associate. HSBC's significant influence was established as a result of representation on the Board of Directors. In May 2010, following the issue of shares by the associate to a third party, HSBC's holding was diluted to 16.13% and a dilution gain of US\$188m was recognised in 'Other operating income'.

The statutory accounting reference date of Bank of Communications Co., Limited, Ping An Insurance (Group) Company of China, Limited and Industrial Bank Co., Limited is 31 December. For the year ended 31 December 2010, these companies were included on the basis of financial statements made up for the twelve months to 30 September 2010, taking into account changes in the subsequent period from 1 October 2010 to 31 December 2010 that would have materially affected their results.

HSBC acquired 15% of Vietnam Technological & Commercial Joint Stock Bank in October 2007. This investment was equity accounted from that date due to HSBC's representation on the Board of Directors and involvement in the Technical Support and Assistance Agreement. In December 2007, as a result of a rights issue in which HSBC did not participate, HSBC's equity interest was diluted to 14.44%. In September 2008, HSBC increased its equity interest to 20%. HSBC's equity interest has been subsequently diluted to below 20% due to the issue of shares by the associate to its own employees.

Joint ventures

Principal interests in joint ventures

	At 31 December 2010		
Country of incorporation	Principal activity	HSBC's interest in equity capital	Issued equity capital
HSBC Saudi Arabia Limited	Investment banking	60.00%	SR50m
Vaultex UK Limited	Cash management	50.00%	£10m
Hana HSBC Life Insurance Co., Ltd	Insurance manufacturing	49.99%	KRW60,201m
Canara HSBC Oriental Bank of Commerce Life Insurance Company Limited	Insurance manufacturing	26.00%	INR5,000m

Notes on the Financial Statements (continued)

Summarised aggregate financial information on joint ventures

	2010 US\$m	2009 US\$m
HSBC's share of:		
– current assets	1,481	700
– non-current assets	97	513
– current liabilities	706	621
– non-current liabilities	666	416
– income	366	370
– expenses	328	324

Goodwill included in carrying amount of associates and joint ventures

	2010 US\$m	2009 US\$m
Gross amount		
At 1 January	1,446	1,453
Additions	60	5
Exchange differences	40	(12)
Other changes	(28)	–
At 31 December ¹	1,518	1,446

¹ Includes the carrying amount of goodwill arising from joint ventures of US\$32m (2009: US\$32m).

24 Goodwill and intangible assets

	2010 US\$m	2009 US\$m
Goodwill	22,406	23,241
Present value of in-force long-term insurance business ('PVIF') ¹	3,440	2,780
Other intangible assets	4,076	3,973
	29,922	29,994

¹ Disclosures on PVIF are provided on page 170.

Goodwill

Reconciliation of goodwill

	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Total US\$m
Gross amount							
At 1 January 2010	15,915	123	1,053	69	12,483	4,162	33,805
Additions	–	–	16	–	–	–	16
Disposals	(3)	–	–	–	(17)	–	(20)
Exchange differences	(1,004)	1	52	(4)	(1)	154	(802)
Other changes	(23)	–	(6)	–	–	–	(29)
At 31 December 2010	14,885	124	1,115	65	12,465	4,316	32,970
Accumulated impairment losses							
At 1 January and 31 December 2010	–	–	–	–	(10,564)	–	(10,564)
Net carrying amount at 31 December 2010	14,885	124	1,115	65	1,901	4,316	22,406

Notes on the Financial Statements (continued)

	Europe US\$m	Hong Kong US\$m	Rest of Asia- Pacific US\$m	Middle East US\$m	North America US\$m	Latin America US\$m	Total US\$m
Gross amount							
At 1 January 2009	15,511	122	364	69	12,487	3,866	32,419
Additions	–	–	570	–	–	10	580
Disposals	(3)	–	–	–	–	–	(3)
Exchange differences	460	1	119	–	–	294	874
Other changes	(53)	–	–	–	(4)	(8)	(65)
At 31 December 2009	15,915	123	1,053	69	12,483	4,162	33,805
Accumulated impairment losses							
At 1 January and 31 December 2009	–	–	–	–	(10,564)	–	(10,564)
Net carrying amount at 31 December 2009	15,915	123	1,053	69	1,919	4,162	23,241

During 2010, there was no impairment of goodwill (2009: nil; 2008: US\$10.6bn).

Impairment testing

Timing of impairment testing

HSBC's impairment test in respect of goodwill allocated to each cash-generating unit ('CGU') is performed as at 1 July each year. In line with the accounting policy set out in Note 2p, goodwill is also retested for impairment whenever there is an indication that goodwill may be impaired.

There was no indication of impairment in the period to 31 December 2010 and therefore goodwill has not been retested since 1 July 2010. For the purpose of impairment testing, the Group's CGUs are based on customer groups and global business separated by geographical region. The CGUs represent the lowest level at which goodwill is monitored for internal management purposes.

Basis of the recoverable amount – value in use or fair value less costs to sell

The recoverable amount of all CGUs to which goodwill has been allocated was equal to its value in use ('VIU') at each respective testing date for 2009 and 2010.

For each significant CGU, the VIU is calculated by discounting management's cash flow projections for the CGU. The discount rate used is based on the cost of capital HSBC allocates to investments in the countries within which the CGU operates. The long-term growth rate is used to extrapolate the cash flows in perpetuity because of the long-term perspective within the Group of the business units making up the CGUs. In 2010, for most CGUs, management's cash flow projections until the end of 2011 were used. However, due to the current economic conditions in Personal Financial Services – Latin America, a 10-year cash flow projection was used to more accurately estimate the cash flows for the period.

Key assumptions in VIU calculation and management's approach to determining the values assigned to each key assumption

Cash-generating unit	2010			2009		
	Goodwill at 1 July 2010 US\$m	Discount rate %	Nominal growth rate beyond initial cash flow projections %	Goodwill at 1 July 2009 US\$m	Discount rate %	Nominal growth rate beyond initial cash flow projections %
Personal Financial Services – Europe	4,017	11.0	3.0	4,507	11.0	3.1
Commercial Banking – Europe	3,015	11.0	3.0	3,480	11.0	3.1
Global Private Banking – Europe	4,055	11.0	3.0	4,483	11.0	3.1
Global Banking and Markets – Europe	2,983	12.0	3.0	3,489	11.0	3.1
Personal Financial Services – Latin America	2,385	14.3	8.6	2,350	15.0	8.0
Total goodwill in the CGUs listed above	16,455			18,309		

Notes on the Financial Statements (continued)

At 1 July 2010, aggregate goodwill of US\$4,674m (1 July 2009: US\$4,475m) had been allocated to CGUs that were not considered individually significant. These CGUs do not carry on their balance sheets any significant intangible assets with indefinite useful lives, other than goodwill.

Nominal long-term growth rate: external data that reflects the market's assessment of GDP and inflation for the countries within which the CGU operates. The rates used for 2009 and 2010 are taken as an average of the last 10 years.

Discount rate: the discount rate used to discount the cash flows is based on the cost of capital assigned to each CGU, which is derived using a Capital Asset Pricing Model ('CAPM'). The CAPM depends on inputs reflecting a number of financial and economic variables including the risk-free rate in the country concerned and a premium to reflect the inherent risk of the business being evaluated. These variables are based on the market's assessment of the economic variables and management's judgement. In addition, for the purposes of testing goodwill for impairment, management supplements this process by comparing the discount rates derived using the internally generated CAPM with cost of capital rates produced by external sources. HSBC uses externally-sourced cost of capital rates where, in management's judgement, those rates reflect more accurately the current market and economic conditions. For 2010 and 2009, internal costs of capital rates were consistent with externally-sourced rates.

Management's judgement in estimating the cash flows of a CGU: the cash flow projections for each CGU are based on plans approved by the Group Management Board. The key assumptions in addition to the discount rate and nominal long-term growth rate for each significant CGU are discussed below.

Personal Financial Services – Europe and Commercial Banking – Europe: the assumptions included in the cash flow projections for Personal Financial Services – Europe and Commercial Banking – Europe reflect the economic environment and financial outlook of the European countries within these two segments. Key assumptions include the level of interest rates and the level and change in unemployment rates. While current economic conditions in Europe continue to be challenging, management's cash flow projections are based primarily on these prevailing conditions. Risks include a double-dip recession in the UK and the continuation of base rates at their current low levels. Based on the conditions at the balance sheet date, management determined that a reasonably possible change in any of the key assumptions described above would not cause an impairment to be recognised in respect of Personal Financial Services – Europe or Commercial Banking – Europe.

Global Private Banking – Europe: the revenues in Global Private Banking – Europe are predominately generated through HSBC's client relationships. The cash flow forecast reflects current economic conditions and key assumptions include the level of interest rates and client risk appetite. Further economic deterioration could result in a decrease in assets under management and a reduction in fee and trading income through increased client risk aversion. Based on the conditions at the balance sheet date, management determined that a reasonably possible change in any of the key assumptions described above would not cause an impairment to be recognised in respect of Global Private Banking – Europe.

Global Banking and Markets – Europe: the cash flows generated by Global Banking and Markets – Europe are diversified and there is no one key assumption that drives the cash flow projection of this CGU. In line with other CGUs, Global Banking and Markets – Europe is sensitive to changes in the interest rate environment and the strength of economic recovery in Europe. One of the key factors which may impact the carrying value of this CGU is the level of impairment charges which may emerge in the future, particularly in respect of holdings of available-for-sale sub-prime and Alt-A Residential MBSs. Based on management's current assessment of the credit quality of these securities, which includes stressed scenarios for collateral defaults and house prices, and the level of credit support available, management determined that a reasonably possible change in key assumptions would not cause an impairment to be recognised in respect of Global Banking and Markets – Europe.

Personal Financial Services – Latin America: the assumptions included in the cash flow projections for Personal Financial Services – Latin America reflect the economic environment and financial outlook of the countries within this segment, with Brazil and Mexico being two of the largest countries included within this segment. Key assumptions include the growth in lending and deposit volumes and the credit quality of the loan portfolios. Mexico and Central America in particular are sensitive to economic conditions in the US which could constrain demand. Based on the conditions at the balance sheet date, management determined that a reasonably possible change in any of the key assumptions described above would not cause an impairment to be recognised in respect of Personal Financial Services – Latin America.

Notes on the Financial Statements (continued)

Other intangible assets

Movement of intangible assets excluding goodwill and the PVIF

	Trade names US\$m	Mortgage servicing rights US\$m	Internally generated software US\$m	Purchased software US\$m	Customer/merchant relationships US\$m	Other US\$m	Total US\$m
Cost							
At 1 January 2010	68	689	4,400	954	1,988	502	8,601
Additions ¹	–	52	960	140	48	4	1,204
Disposals	–	(105)	(40)	(15)	(79)	–	(239)
Amount written off	–	–	(70)	(2)	–	–	(72)
Exchange differences	–	–	(68)	(4)	30	27	(15)
Other changes	–	–	20	(8)	–	(30)	(18)
At 31 December 2010	68	636	5,202	1,065	1,987	503	9,461
Accumulated amortisation							
At 1 January 2010	(50)	(240)	(2,511)	(747)	(955)	(125)	(4,628)
Charge for the year ²	(5)	(105)	(596)	(97)	(243)	(30)	(1,076)
Impairment	–	–	(12)	–	–	–	(12)
Disposals	–	105	33	8	68	(1)	213
Amount written off	–	–	70	2	–	–	72
Exchange differences	1	–	48	1	(13)	(1)	36
Other changes	2	–	10	(15)	–	13	10
At 31 December 2010	(52)	(240)	(2,958)	(848)	(1,143)	(144)	(5,385)
Net carrying amount at 31 December 2010	16	396	2,244	217	844	359	4,076
Cost							
At 1 January 2009	67	1,360	3,429	867	1,749	421	7,893
Additions ¹	–	116	763	65	20	10	974
Acquisition of subsidiaries	–	–	–	–	58	–	58
Disposals	–	(29)	(14)	(18)	(25)	–	(86)
Amount written off	–	(757)	(45)	(1)	(15)	–	(818)
Exchange differences	1	–	247	53	201	9	511
Other changes	–	(1)	20	(12)	–	62	69
At 31 December 2009	68	689	4,400	954	1,988	502	8,601
Accumulated amortisation							
At 1 January 2009	(45)	(1,023)	(1,992)	(631)	(681)	(52)	(4,424)
Charge for the year ²	(4)	(3)	(433)	(98)	(228)	(30)	(796)
Impairment	–	–	(6)	(5)	(6)	–	(17)
Disposals	–	29	6	18	15	–	68
Amount written off	–	757	45	1	15	–	818
Exchange differences	(1)	–	(131)	(32)	(72)	(1)	(237)
Other changes	–	–	–	–	2	(42)	(40)
At 31 December 2009	(50)	(240)	(2,511)	(747)	(955)	(125)	(4,628)
Net carrying amount at 31 December 2009	18	449	1,889	207	1,033	377	3,973

1 At 31 December 2010, HSBC had US\$0.2m (2009: US\$0.2m) of contractual commitments to acquire intangible assets.

2 The amortisation charge for the year is recognised within the income statement under 'Amortisation and impairment of intangible assets', with the exception of the amortisation of mortgage servicing rights which is recognised in net fee income.

Notes on the Financial Statements (continued)

25 Property, plant and equipment

	Freehold land and buildings US\$m	Long Leasehold land and buildings US\$m	Short leasehold land and buildings ¹ US\$m	Equipment, fixtures and fittings ² US\$m	Equipment on operating leases US\$m	Total ³ US\$m
Cost or fair value						
At 1 January 2010	3,915	1,327	3,135	11,552	5,236	25,165
Additions at cost ⁴	349	76	632	1,456	65	2,578
Fair value adjustments	31	24	38	–	–	93
Disposals ⁵	(307)	(8)	(82)	(355)	(5,113)	(5,865)
Reclassified to held for sale	(73)	(16)	(3)	(35)	–	(127)
Transfers	(47)	(147)	199	(5)	–	–
Exchange differences	(47)	(5)	(17)	(62)	(135)	(266)
Other changes	131	422	102	(22)	–	633
At 31 December 2010	3,952	1,673	4,004	12,529	53	22,211
Accumulated depreciation and impairment						
At 1 January 2010	(450)	(229)	(1,065)	(7,743)	(1,876)	(11,363)
Depreciation charge for the year	(91)	(46)	(203)	(1,178)	(150)	(1,668)
Disposals ⁵	31	–	68	344	1,956	2,399
Reclassified (from)/to held for sale	24	–	1	26	–	51
Transfers	23	20	(43)	–	–	–
Impairment losses recognised	(22)	–	1	(24)	–	(45)
Exchange differences	5	2	5	54	45	111
Other changes	(106)	(54)	(32)	15	2	(175)
At 31 December 2010	(586)	(307)	(1,268)	(8,506)	(23)	(10,690)
Net carrying amount at 31 December 2010	3,366	1,366	2,736	4,023	30	11,521
Cost or fair value						
At 1 January 2009	4,126	1,736	2,924	10,320	4,547	23,653
Additions at cost ⁴	344	35	179	1,253	299	2,110
Acquisition of subsidiaries	–	–	15	7	–	22
Fair value adjustments	(58)	16	18	–	–	(24)
Disposals	(201)	(510)	(98)	(640)	(117)	(1,566)
Reclassified to held for sale	(697)	–	(20)	(63)	–	(780)
Transfers	–	(2)	2	–	–	–
Exchange differences	342	62	90	737	507	1,738
Other changes	59	(10)	25	(62)	–	12
At 31 December 2009	3,915	1,327	3,135	11,552	5,236	25,165
Accumulated depreciation and impairment						
At 1 January 2009	(368)	(228)	(886)	(6,614)	(1,532)	(9,628)
Depreciation charge for the year	(82)	(44)	(193)	(1,160)	(169)	(1,648)
Disposals	39	46	90	495	(4)	666
Reclassified to held for sale	46	–	3	30	–	79
Impairment losses recognised	(30)	(1)	(26)	(20)	–	(77)
Exchange differences	(25)	(7)	(42)	(496)	(173)	(743)
Other changes	(30)	5	(11)	22	2	(12)
At 31 December 2009	(450)	(229)	(1,065)	(7,743)	(1,876)	(11,363)
Net carrying amount at 31 December 2009	3,465	1,098	2,070	3,809	3,360	13,802

1 Including assets held on finance leases with a net book value of US\$11m (2009: US\$18m).

2 Including assets held on finance leases with a net book value of US\$204m (2009: US\$513m).

3 Including assets with a net book value of US\$31m (2009: US\$36m) pledged as security for liabilities.

4 At 31 December 2010, HSBC had US\$593m (2009: US\$878m) of contractual commitments to acquire property, plant and equipment.

5 The disposals included under 'Equipment on operating leases' relate to the sale of a subsidiary, Eversholt Rail Group, during the year.

Leasehold land and buildings

Leasehold land and buildings are considered to be held under finance lease contracts where the value of the land cannot reliably be separated from the value of the lease and the respective contracts do not meet the criteria for classification as operating leases. Included within 'Short leasehold land and buildings' are the following amounts in respect of assets classed as improvements to buildings, which are carried at depreciated historical cost:

Notes on the Financial Statements (continued)*Leasehold land and buildings*

	2010		2009	
	Cost US\$m	Accumulated depreciation US\$m	Cost US\$m	Accumulated depreciation US\$m
At 1 January	1,824	(831)	1,621	(675)
Additions	181	–	175	–
Disposals	(81)	54	(89)	71
Depreciation charge for the year	–	(133)	–	(133)
Impairment loss recognised	–	–	–	(24)
Exchange differences	(16)	–	86	(40)
Other changes	36	(23)	31	(30)
At 31 December	1,944	(933)	1,824	(831)
Net carrying amount at 31 December	1,011		993	

Investment properties*Movement on the fair value of investment properties*

	Freehold land and buildings US\$m	Long leasehold land and buildings US\$m	Short leasehold land and buildings US\$m	Total US\$m
Fair value				
At 1 January 2010	640	184	237	1,061
Additions at cost	240	–	–	240
Fair value adjustments	31	24	38	93
Disposals	(216)	(2)	–	(218)
Transfers	–	(42)	42	–
Exchange differences	(34)	(1)	(1)	(36)
Other changes	6	(7)	(6)	(7)
At 31 December 2010	667	156	310	1,133
Fair value				
At 1 January 2009	566	188	217	971
Additions at cost	36	–	–	36
Fair value adjustments	(58)	16	18	(24)
Disposals	–	(25)	–	(25)
Exchange differences	57	5	–	62
Other changes	39	–	2	41
At 31 December 2009	640	184	237	1,061

Investment properties are valued on an open market value basis as at 31 December each year by independent professional valuers who have recent experience in the location and type of properties. Investment properties in Hong Kong, the Macau Special Administrative Region and mainland China, which represent more than 35% by value of HSBC's investment properties subject to revaluation, were valued by an independent valuer who is a member of the Hong Kong Institute of Surveyors and who has recent experience in the locations and categories of the investment properties.

Included within 'Other operating income' was rental income of US\$26m (2009: US\$81m; 2008: US\$23m) earned by HSBC on its investment properties. Direct operating expenses of US\$3m (2009: US\$2m; 2008: US\$2m) incurred in respect of the investment properties during the year were recognised in 'General and administrative expenses'. Direct operating expenses arising in respect of investment properties that did not generate rental income during 2010 amounted to nil (2009 and 2008: nil).

At 31 December 2010, HSBC had no contractual obligations to purchase, construct, develop, maintain or enhance investment properties (2009: nil).

HSBC Holdings had no investment properties at 31 December 2010 or 2009.

Notes on the Financial Statements (continued)

HSBC properties leased to customers

HSBC properties leased to customers included US\$441m at 31 December 2010 (2009: US\$434m) let under operating leases, net of accumulated depreciation of US\$19m (2009: US\$18m). None was held by HSBC Holdings.

26 Investments in subsidiaries

Principal subsidiaries of HSBC Holdings

	At 31 December 2010			
	Country of incorporation or registration	HSBC's interest in equity capital %	Issued equity capital	Share class
Europe				
HSBC Asset Finance (UK) Limited	England	100	£265m	Ordinary £1
HSBC Bank A.S.	Turkey	100	TRL652m	A-Common TRL1 B-Common TRL1
HSBC Bank Malta p.l.c.	Malta	70.03	€88m	Ordinary €0.30
HSBC Bank plc	England	100	£797m	Ordinary £1 Preferred Ordinary £1 Series 2 Third Dollar Preference US\$0.01 Third Dollar Preference US\$0.01 Shares €5.00
HSBC France	France	99.99	€337m	Shares €5.00
HSBC Bank International Limited	Jersey	100	£1m	Ordinary £1
HSBC Life (UK) Limited	England	100	£94m	Ordinary £1
HSBC Private Banking Holdings (Suisse) S.A.	Switzerland	100	CHF1,363m	Ordinary CHF1,000
HSBC Trinkaus & Burkhardt AG	Germany	80.40	€28m	Shares of no par value
Marks and Spencer Retail Financial Services Holdings Limited	England	100	£67m	Ordinary £1
Hong Kong				
Hang Seng Bank Limited ⁷	Hong Kong	62.14	HK\$9,559m	Ordinary HK\$5.00
HSBC Insurance (Asia) Limited	Hong Kong	100	HK\$318m	Ordinary HK\$1,000
HSBC Life (International) Limited	Bermuda	100	HK\$421m	Ordinary HK\$1.00
The Hongkong and Shanghai Banking Corporation Limited	Hong Kong	100	HK\$22,494m	Ordinary HK\$2.50 CIP ¹ US\$1.00 CRP ² US\$1.00 NIP ³ US\$1.00
Rest of Asia-Pacific				
HSBC Bank Australia Limited	Australia	100	A\$751m	Shares of no par value
HSBC Bank (China) Company Limited	PRC ⁴	100	RMB8,000m	Ordinary CNY1.00
HSBC Bank Malaysia Berhad	Malaysia	100	RM115m	Ordinary RM0.50
Middle East				
HSBC Bank Middle East Limited	Jersey	100	US\$931m	CRP ² US\$1.00 Ordinary US\$1.00
HSBC Bank Egypt S.A.E.	Egypt	94.53	EGP1,511m	Ordinary EGP84.00
North America				
HSBC Bank Bermuda Limited	Bermuda	100	US\$30m	Common BMD1.00
HSBC Bank Canada	Canada	100	C\$1,225m	Class 1 Pref of NPV ⁵ Class 2 Pref of NPV ⁵ Common of NPV
HSBC Bank USA, N.A.	United States	100	US\$2m	Common US\$100
HSBC Finance Corporation	United States	100	- ⁶	Common US\$0.01
HSBC Securities (USA) Inc.	United States	100	- ⁶	Common US\$0.05
Latin America				
HSBC Bank Argentina S.A.	Argentina	99.99	ARS1,244m	Ordinary-A ARS1.00 Ordinary-B ARS1.00
HSBC Bank Brasil S.A. – Banco Múltiplo	Brazil	100	BRL5,178m	Shares of no par value
HSBC Mexico, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC.	Mexico	99.99	MXN5,087m	Ordinary MXN2.00
HSBC Bank (Panama) S.A.	Panama	100	US\$10m	Ordinary PAB 1.00

1 Cumulative Irredeemable Preference shares.

2 Cumulative Redeemable Preference shares

3 Non-cumulative Irredeemable Preference shares.

4 People's Republic of China

5 Preference shares of nil par value.

6 Issued equity capital is less than US\$1m.

7 Listed in Hong Kong.

Details of the debt, subordinated debt and preference shares issued by the principal subsidiaries to parties external to the Group are included in the Notes 30 'Debt securities in issue', 34 'Subordinated liabilities' and 38 'Non-controlling interests', respectively.

Notes on the Financial Statements (continued)

All the above subsidiaries are included in the HSBC consolidated financial statements.

Details of all HSBC subsidiaries will be annexed to the next Annual Return of HSBC Holdings filed with the UK Registrar of Companies.

All the above make their financial statements up to 31 December except for HSBC Bank Argentina S.A., whose financial statements are made up to 30 June annually.

The principal countries of operation are the same as the countries of incorporation except for HSBC Bank Middle East Limited which operates mainly in the Middle East and HSBC Life (International) Limited which operates mainly in Hong Kong.

Subsidiaries which experience significant restrictions on their ability to transfer funds to HSBC in the form of cash dividends or to repay loans and advances

During 2010 and 2009, none of the Group's subsidiaries experienced significant restrictions on paying dividends or repaying loans and advances.

Subsidiaries excluding SPEs where HSBC owns less than 50% of the voting rights

At 31 December 2009, HSBC consolidated HSBC Private Equity Fund 3 ('HPEF3') but only had a 38.8% interest in its equity capital. HSBC had control under IAS 27 because it was the investment adviser/manager of the fund and had a significant equity interest.

On 30 November 2010, the Group completed the sale of an 80.1% interest in HSBC Private Equity (Asia) Limited ('HPEA') to HPEA's management. As a result, the Group no longer controls HPEF3. The Group previously consolidated HPEF 3 by virtue of its control over HPEA, which in turn controlled HPEF3. Upon deconsolidation, the group retains its 38.8% interest in HPEF3 as an available for sale investment. HPEF3 has been renamed The Headland Private Equity Fund 3 Limited.

SPEs consolidated by HSBC where HSBC owns less than 50% of the voting rights

	Carrying value of total consolidated assets		Nature of SPE
	2010 US\$bn	2009 US\$bn	
Barion Funding Limited	4.5	4.4	Structured investment conduit
Bryant Park Funding LLC	3.0	3.8	Conduit
HSBC Affinity Corporation I	4.2	4.9	Securitisation
HSBC Auto Receivables Corporation	-	1.3	Securitisation
HSBC Corporate Money Fund (Euro)	-	0.8	Money market fund
HSBC Funding Inc V	5.4	5.3	Securitisation
HSBC Home Equity Loan Corporation I	2.8	3.1	Securitisation
HSBC Home Equity Loan Corporation II	2.8	3.3	Securitisation
HSBC Investor Prime Money Market Fund	-	10.7	Money market fund
HSBC Receivables Funding, Inc I	3.7	5.4	Securitisation
HSBC Receivables Inc Funding II	2.0	1.8	Securitisation
HSBC Sterling Liquidity Fund	-	7.5	Money market fund
HSBC US Dollar Liquidity Fund	-	23.4	Money market fund
Malachite Funding Limited	3.9	4.3	Structured investment conduit
Mazarin Funding Limited	10.3	11.3	Structured investment conduit
Metrix Funding Ltd	1.4	3.7	Securitisation
Metrix Securities plc	1.0	4.2	Securitisation
Regency Assets Limited	6.3	6.8	Conduit
Solitaire Funding Ltd	13.5	12.8	Conduit
Turquoise Receivable Trustee Ltd	-	0.5	Securitisation

In addition to the above, HSBC consolidates a number of individually insignificant SPEs with total assets of US\$10.6bn. For further details, see 'Special purpose entities' on page 361.

In each of the above cases, HSBC has less than 50% of the voting rights, but consolidates because it has the majority of risks and rewards of ownership of the SPE, or the substance of the relationship with the SPE is such that its activities are conducted on behalf of HSBC according to its specific business needs so that HSBC obtains benefit from the SPE's operation. The consolidation of SPEs sponsored by HSBC is discussed on page 251.

Notes on the Financial Statements (continued)**Acquisitions**

There were minor acquisitions and increases in investment in subsidiaries which increased goodwill by US\$16m.

27 Other assets

	2010 US\$m	2009 US\$m
Bullion	18,446	13,757
Assets held for sale	1,991	3,118
Reinsurers' share of liabilities under insurance contracts (Note 32)	1,865	2,069
Endorsements and acceptances	10,116	9,311
Other accounts	10,833	16,279
	43,251	44,534

At 31 December 2010, 'Assets held for sale' included US\$520m related to the sale of a majority interest in the UK-based global real estate and infrastructure private equity fund management business to the unit's senior management team. The transaction is expected to complete in the first half of 2011. Associated liabilities of US\$86m are included in 'Other Liabilities'.

Non-current assets held for sale

	2010 US\$m	2009 US\$m
Interests in associates	–	105
Property, plant and equipment	1,333	1,639
Investment properties	9	1
Financial assets	116	1,359
Other	3	14
	1,461	3,118

The property, plant and equipment classified as held for sale is the result of repossession of property that had been pledged as collateral by customers. Substantially all of these assets are disposed of within 12 months of acquisition. The majority arose within the geographical segment of North America. At 31 December 2009, property, plant and equipment held for sale also included US\$257m in relation to the proposed sale of 452 Fifth Avenue and 1 W. 39th Street in New York and US\$370m in relation to the proposed sale of 103 Champs Elysées and 15 Rue Vernet in Paris. On completion of these transactions in 2010 gains of US\$56m and US\$194m respectively were recognised within 'Other operating income'.

At 31 December 2009, financial assets classified as held for sale included US\$972m of vehicle finance loans and US\$366m of credit card portfolios, presented in the geographical segment of North America.

Neither a gain nor loss was recognised on reclassifying assets as held for sale during the year.

28 Trading liabilities

	2010 US\$m	2009 US\$m
Deposits by banks	38,678	41,165
Customer accounts	125,684	99,306
Other debt securities in issue (Note 30)	33,726	37,592
Other liabilities – net short positions in securities	102,615	90,067
	300,703	268,130

At 31 December 2010, the cumulative amount of change in fair value attributable to changes in HSBC credit risk was a gain of US\$142m (2009: gain of US\$119m).

Notes on the Financial Statements (continued)**29 Financial liabilities designated at fair value**

HSBC		2010	2009
		US\$m	US\$m
Deposits by banks and customer accounts		6,527	6,586
Liabilities to customers under investment contracts		11,700	10,865
Debt securities in issue (Note 30)		46,091	38,208
Subordinated liabilities (Note 34)		19,395	20,180
Preferred securities (Note 34)		4,420	4,253
		88,133	80,092

The carrying amount at 31 December 2010 of financial liabilities designated at fair value was US\$1,631m more than the contractual amount at maturity (2009: US\$1,346m more). The cumulative amount of the change in fair value attributable to changes in credit risk was a gain of US\$1,279m (2009: gain of US\$1,510m).

HSBC Holdings

HSBC Holdings		2010	2009
		US\$m	US\$m
Subordinated liabilities (Note 34):			
– owed to third parties		12,029	12,549
– owed to HSBC undertakings		4,259	4,360
		16,288	16,909

The carrying amount at 31 December 2010 of financial liabilities designated at fair value was US\$855m more than the contractual amount at maturity (2009: US\$769m more). The cumulative amount of the change in fair value attributable to changes in credit risk was a gain of US\$439m (2009: gain of US\$191m).

30 Debt securities in issue

		2010	2009
		US\$m	US\$m
Bonds and medium-term notes		162,948	160,295
Other debt securities in issue		62,270	62,401
		225,218	222,696
Of which debt securities in issue reported as:			
– trading liabilities (Note 28)		(33,726)	(37,592)
– financial liabilities designated at fair value (Note 29)		(46,091)	(38,208)
		145,401	146,896

Certain debt securities in issue are managed on a fair value basis as part of HSBC's interest rate risk management policies. The hedged portion of these debt securities is presented within the balance sheet caption 'Financial liabilities designated at fair value', with the remaining portion included within 'Trading liabilities'. The following table analyses the carrying amount of bonds and medium-term notes in issue at 31 December with original maturities greater than one year:

Notes on the Financial Statements (continued)

Bonds and medium-term notes

HSBC

	2010 US\$m	2009 US\$m
Fixed rate		
Secured financing:		
0.01% to 3.99%: until 2068	6,666	5,929
4.00% to 4.99%: until 2013	1,956	1,948
5.00% to 5.99%: until 2022	387	1,315
7.00% to 7.99%: until 2019	209	9
8.00% to 9.99%: until 2028	394	417
10.00% or higher: until 2011	–	43
Other fixed rate senior debt:		
0.01% to 3.99%: until 2057	39,596	22,554
4.00% to 4.99%: until 2046	12,854	15,754
5.00% to 5.99%: until 2021	19,011	25,619
6.00% to 6.99%: until 2033	11,008	11,066
7.00% to 7.99%: until 2032	3,124	3,900
8.00% to 9.99%: until 2036	254	1,737
10.00% or higher: until 2021	337	280
	95,796	90,571
Variable interest rate		
Secured financings – 0.01% to 13.99%: until 2068	8,448	13,971
FHLB advances – 0.01% to 0.99%: until 2036	1,000	1,000
Other variable interest rate senior debt – 0.01% to 12.99%: until 2068	53,301	50,258
	62,749	65,229
Structured notes		
Interest rate linked	4	5
Equity, equity index or credit-linked	4,399	4,490
	4,403	4,495
	162,948	160,295
HSBC Holdings		
	2010 US\$m	2009 US\$m
Fixed rate senior debt, unsecured:		
4.00% to 4.99%: until 2014	1,664	1,791
6.00% to 6.99%: until 2024	1,004	1,048
	2,668	2,839

31 Other liabilities

	HSBC		HSBC Holdings	
	2010 US\$m	2009 US\$m	2010 US\$m	2009 US\$m
Amounts due to investors in funds consolidated by HSBC	840	48,193	–	–
Obligations under finance leases (Note 42)	454	644	–	–
Dividend declared and payable by HSBC Holdings (Note 11)	1,203	1,231	1,203	1,231
Endorsements and acceptances	10,123	9,313	–	–
Other liabilities	15,430	9,259	29	26
	28,050	68,640	1,232	1,257

Notes on the Financial Statements (continued)**32 Liabilities under insurance contracts**

	Gross US\$m	Reinsurers' share US\$m	Net US\$m
At 31 December 2010			
Non-life insurance liabilities			
Unearned premium provision	727	(129)	598
Notified claims	879	(230)	649
Claims incurred but not reported	745	(75)	670
Other	105	2	107
	2,456	(432)	2,024
Life insurance liabilities to policyholders			
Life (non-linked)	23,583	(673)	22,910
Investment contracts with discretionary participation features ¹	22,074	–	22,074
Life (linked)	10,496	(760)	9,736
	56,153	(1,433)	54,720
	58,609	(1,865)	56,744
At 31 December 2009			
Non-life insurance liabilities			
Unearned premium provision	833	(135)	698
Notified claims	1,032	(245)	787
Claims incurred but not reported	685	(82)	603
Other	178	(5)	173
	2,728	(467)	2,261
Life insurance liabilities to policyholders			
Life (non-linked)	20,979	(771)	20,208
Investment contracts with discretionary participation features ¹	21,014	–	21,014
Life (linked)	8,986	(831)	8,155
	50,979	(1,602)	49,377
	53,707	(2,069)	51,638

¹ Though investment contracts with discretionary participation features are financial instruments, HSBC continues to treat them as insurance contracts as permitted by IFRS 4.

Notes on the Financial Statements (continued)

Movement on non-life insurance liabilities

	Gross US\$m	Reinsurers' share US\$m	Net US\$m
2010			
Unearned premium reserve ('UPR')			
At 1 January	833	(135)	698
Changes in UPR recognised as (income)/expense	(83)	(12)	(95)
Gross written premiums	1,192	(172)	1,020
Gross earned premiums	(1,275)	160	(1,115)
Exchange differences and other movements	(23)	18	(5)
At 31 December	727	(129)	598
Notified and incurred but not reported claims			
At 1 January	1,717	(327)	1,390
Notified claims	1,032	(245)	787
Claims incurred but not reported	685	(82)	603
Claims paid in current year	(815)	114	(701)
Claims incurred in respect of current year	519	(111)	408
Claims incurred in respect of prior years	106	11	117
Exchange differences and other movements	97	8	105
At 31 December	1,624	(305)	1,319
Notified claims	879	(230)	649
Claims incurred but not reported	745	(75)	670
Other	105	2	107
Total non-life insurance liabilities	2,456	(432)	2,024
2009			
Unearned premium reserve ('UPR')			
At 1 January	1,136	(159)	977
Changes in UPR recognised as (income)/expense	(233)	10	(223)
Gross written premiums	1,339	(215)	1,124
Gross earned premiums	(1,572)	225	(1,347)
Exchange differences and other movements	(70)	14	(56)
At 31 December	833	(135)	698
Notified and incurred but not reported claims			
At 1 January	1,276	(271)	1,005
Notified claims	908	(230)	678
Claims incurred but not reported	368	(41)	327
Claims paid in current year	(987)	156	(831)
Claims incurred in respect of current year	939	(156)	783
Claims incurred in respect of prior years	342	(2)	340
Exchange differences and other movements	147	(54)	93
At 31 December	1,717	(327)	1,390
Notified claims	1,032	(245)	787
Claims incurred but not reported	685	(82)	603
Other	178	(5)	173
Total non-life insurance liabilities	2,728	(467)	2,261

Notes on the Financial Statements (continued)

Life insurance liabilities to policyholders

	Gross US\$m	Reinsurers' share US\$m	Net US\$m
2010			
Life (non-linked)			
At 1 January	20,979	(771)	20,208
Benefits paid	(1,355)	143	(1,212)
Increase in liabilities to policyholders	5,108	(201)	4,907
Exchange differences and other movements	(1,149)	156	(993)
At 31 December	23,583	(673)	22,910
Investment contracts with discretionary participation features			
At 1 January	21,014	–	21,014
Benefits paid	(2,023)	–	(2,023)
Increase in liabilities to policyholders	3,716	–	3,716
Exchange differences and other movements ¹	(633)	–	(633)
At 31 December	22,074	–	22,074
Life (linked)			
At 1 January	8,986	(831)	8,155
Benefits paid	(507)	45	(462)
Increase in liabilities to policyholders	2,520	99	2,619
Exchange differences and other movements ²	(503)	(73)	(576)
At 31 December	10,496	(760)	9,736
Total liabilities to policyholders	56,153	(1,433)	54,720
2009			
Life (non-linked)			
At 1 January	17,370	(637)	16,733
Benefits paid	(2,098)	159	(1,939)
Increase in liabilities to policyholders	4,669	(98)	4,571
Exchange differences and other movements	1,038	(195)	843
At 31 December	20,979	(771)	20,208
Investment contracts with discretionary participation features			
At 1 January	17,766	–	17,766
Benefits paid	(1,818)	–	(1,818)
Increase in liabilities to policyholders	3,934	–	3,934
Exchange differences and other movements ¹	1,132	–	1,132
At 31 December	21,014	–	21,014
Life (linked)			
At 1 January	6,067	(956)	5,111
Benefits paid	(325)	21	(304)
Increase in liabilities to policyholders	2,676	146	2,822
Exchange differences and other movements ²	568	(42)	526
At 31 December	8,986	(831)	8,155
Total liabilities to policyholders	50,979	(1,602)	49,377

1 Includes movement in liabilities relating to discretionary profit participation benefits due to policyholders arising from net unrealised investment gains recognised in other comprehensive income.

2 Includes amounts arising under reinsurance agreements.

The increase in liabilities to policyholders represents the aggregate of all events giving rise to additional liabilities to policyholders in the year. The key factors contributing to the movement in liabilities to policyholders include death claims, surrenders, lapses, liabilities to policyholders created at the initial inception of the policies, the declaration of bonuses and other amounts attributable to policyholders.

Notes on the Financial Statements (continued)**33 Provisions**

	2010	2009
	US\$m	US\$m
At 1 January	1,965	1,730
Additional provisions/increase in provisions	812	894
Provisions utilised	(564)	(684)
Amounts reversed	(132)	(225)
Exchange differences and other movements	57	250
At 31 December	2,138	1,965

Provisions include US\$1,257m (2009: US\$1,025m) relating to legal proceedings, investigations and regulatory matters, US\$405m (2009: US\$449m) relating to costs arising from contingent liabilities and contractual commitments; and US\$118m (2009: US\$158m) relating to provisions for onerous property contracts.

34 Subordinated liabilities

HSBC		
	2010	2009
	US\$m	US\$m
Subordinated liabilities		
At amortised cost		
– subordinated liabilities	33,387	30,478
– preferred securities	28,309	23,893
	5,078	6,585
Designated at fair value (Note 29)		
– subordinated liabilities	23,815	24,433
– preferred securities	19,395	20,180
	4,420	4,253
	57,202	54,911
Subordinated liabilities		
HSBC Holdings	22,878	23,048
Other HSBC	34,324	31,863
	57,202	54,911

Notes on the Financial Statements (continued)

HSBC's subordinated liabilities

		2010	2009
		US\$m	US\$m
		22,878	23,048
Amounts owed to third parties by HSBC Holdings (see page 349)			
Other HSBC subordinated liabilities			
US\$2,939m	6.676% senior subordinated notes 2021 ¹	2,174	–
€1,400m	5.3687% non-cumulative step-up perpetual preferred securities ²	1,843	1,804
US\$1,250m	4.875% subordinated notes 2020	1,252	–
US\$1,250m	4.61% non-cumulative step-up perpetual preferred securities ²	1,185	1,077
£700m	5.844% non-cumulative step-up perpetual preferred securities ³	1,087	1,136
€800m	Callable subordinated floating rate notes 2016 ⁴	1,070	1,152
US\$1,000m	4.625% subordinated notes 2014	1,009	1,002
US\$1,000m	5.911% trust preferred securities 2035 ⁵	994	993
US\$1,000m	5.875% subordinated notes 2034	971	950
€750m	5.13% non-cumulative step-up perpetual preferred securities ²	958	960
£600m	4.75% subordinated notes 2046	919	961
US\$900m	10.176% non-cumulative step-up perpetual preferred securities, series 2 ²	891	890
€600m	4.25% callable subordinated notes 2016 ⁴	823	904
€600m	8.03% non-cumulative step-up perpetual preferred securities ²	801	862
£500m	4.75% callable subordinated notes 2020 ⁶	774	785
£500m	8.208% non-cumulative step-up perpetual preferred securities ²	772	806
US\$750m	Undated floating rate primary capital notes	750	750
US\$750m	5.00% subordinated notes 2020	747	–
£500m	5.375% subordinated notes 2033	729	776
US\$750m	5.625% subordinated notes 2035	728	712
US\$700m	7.00% subordinated notes 2039	694	688
€500m	Callable subordinated floating rate notes 2020 ⁷	592	639
£350m	Callable subordinated variable coupon notes 2017 ⁸	562	608
£350m	5.00% callable subordinated notes 2023 ⁹	547	550
US\$500m	6.00% subordinated notes 2017	526	521
£350m	5.375% callable subordinated step-up notes 2030 ¹⁰	510	531
US\$500m	Undated floating rate primary capital notes	500	500
£300m	6.5% subordinated notes 2023	462	483
US\$450m	Callable subordinated floating rate notes 2016 ¹¹	450	449
£300m	5.862% non-cumulative step-up perpetual preferred securities ³	434	412
CAD400m	4.80% subordinated notes 2022	417	382
US\$400m	Primary capital undated floating rate notes	407	407
US\$400m	Primary capital undated floating rate notes (second series)	403	404
US\$400m	Primary capital undated floating rate notes (third series)	400	400
£225m	6.25% subordinated notes 2041	347	363
US\$300m	7.65% subordinated notes 2025	342	312
US\$300m	6.95% subordinated notes 2011	310	321
BRL500m	Subordinated certificates of deposit 2016	301	287
US\$300m	Undated floating rate primary capital notes, series 3	300	300
US\$300m	Callable subordinated floating rate notes 2017 ¹²	300	299
US\$250m	Non-convertible subordinated obligations 2019	248	247
BRL383m	Subordinated certificates of deposit 2015	231	220
US\$250m	7.20% subordinated debentures 2097	213	213
AUD200m	Callable subordinated floating rate notes 2016 ¹³	204	180
AUD200m	Callable subordinated floating rate notes 2020	204	–
US\$200m	7.808% capital securities 2026	200	200
US\$200m	8.38% capital securities 2027	200	200
CAD200m	4.94% subordinated debentures 2021	200	190
US\$1,350m	9.547% non-cumulative step-up perpetual preferred securities, series 1 ¹⁴	–	1,349
	Other subordinated liabilities each less than US\$200m	3,343	3,688
		34,324	31,863
		57,202	54,911

Subordinated loan capital is repayable at par on maturity, but some is repayable prior to maturity at the option of the borrower, generally subject to prior notification to the Financial Services Authority and, where relevant, the consent of the local banking regulator, and in certain cases at a premium over par. Interest rates on the floating rate loan capital are related to interbank offered rates. On the remaining subordinated loan capital, interest is payable at fixed rates of up to 10.176%.

Notes on the Financial Statements (continued)

- 1 Approximately 25% of the 6.676% senior subordinated notes 2021 is held by HSBC Holdings.
- 2 See 'Step-up perpetual preferred securities' below, note (a) 'Guaranteed by HSBC Holdings'.
- 3 See 'Step-up perpetual preferred securities' below, note (b) 'Guaranteed by HSBC Bank'.
- 4 On 15 February 2011, HSBC gave notice to holders of its €800m callable subordinated floating rate notes 2016 and its €600m 4.25% callable subordinated notes 2016 that it will call and redeem the notes at par on 29 March 2011 and 18 March 2011, respectively.
- 5 The distributions on the trust preferred securities change in November 2015 to three-month dollar LIBOR plus 1.926%.
- 6 The interest rate on the 4.75% callable subordinated notes 2020 changes in September 2015 to three-month sterling LIBOR plus 0.82%.
- 7 The interest margin on the callable subordinated floating rate notes 2020 increases by 0.5% from September 2015.
- 8 The interest rate on the callable subordinated variable coupon notes 2017 is fixed at 5.75% until June 2012. Thereafter, the rate per annum is the sum of the gross redemption yield of the then prevailing five-year UK gilt plus 1.70%.
- 9 The interest rate on the 5.00% callable subordinated notes 2023 changes in March 2018 to become the rate per annum which is the sum of the gross redemption yield of the then prevailing five-year UK gilt plus 1.80%.
- 10 The interest rate on the 5.375% callable subordinated step-up notes 2030 changes in November 2025 to three-month sterling LIBOR plus 1.50%.
- 11 The interest margin on the US\$450m callable subordinated floating rate notes 2016 increases by 0.5% from July 2011.
- 12 The interest margin on the callable subordinated floating rate notes 2017 increases by 0.5% from July 2012.
- 13 The interest margin on the callable subordinated floating rate notes 2016 increases by 0.5% from May 2011.
- 14 In June 2010, HSBC redeemed its 9.547% non-cumulative step-up preferred securities, series 1 at par.

Footnotes 4 to 13 relate to notes that are repayable at the option of the borrower on the date of the change of the interest rate, and at subsequent interest rate reset dates and interest payment dates in some cases, subject to prior notification to the Financial Services Authority and, where relevant, the consent of the local banking regulator.

Step-up perpetual preferred securities

(a) Guaranteed by HSBC Holdings

The six issues of non-cumulative step-up perpetual preferred securities (footnote 2) were made by Jersey limited partnerships and are guaranteed, on a subordinated basis, by HSBC Holdings. The proceeds of the issues were on-lent to HSBC Holdings by the limited partnerships by issue of subordinated notes. The preferred securities qualify as tier 1 hybrid capital for HSBC. The preferred securities, together with the guarantee, are intended to provide investors with rights to income and capital distributions and distributions upon liquidation of HSBC Holdings that are equivalent to the rights that they would have had if they had purchased non-cumulative perpetual preference shares of HSBC Holdings.

The preferred securities are perpetual, but redeemable in 2014, 2013, 2016, 2030, 2012 and 2015, respectively, at the option of the general partner of the limited partnerships. If not redeemed, the distributions payable step-up and become floating rate or, for the sterling issue, for each successive five-year period the sum of the then five-year benchmark UK gilt plus a margin. There are limitations on the payment of distributions if prohibited under UK banking regulations or other requirements, if a payment would cause a breach of HSBC's capital adequacy requirements, or if HSBC Holdings has insufficient distributable reserves (as defined).

HSBC Holdings has covenanted that if it is 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) HSBC's total capital ratio falls below the regulatory minimum ratio required, or (ii) the Directors expect that, in view of the deteriorating financial condition of HSBC Holdings, the former will occur in the near term, then the preferred securities will be substituted by preference shares of HSBC Holdings having economic terms which are in all material respects equivalent to those of the preferred securities and the guarantee taken together.

(b) Guaranteed by HSBC Bank

The two issues of non-cumulative step-up perpetual preferred securities (footnote 3) were made by Jersey limited partnerships and are guaranteed, on a subordinated basis, by HSBC Bank. The proceeds of the issues were on-lent to HSBC Bank by the limited partnerships by issue of subordinated notes. The preferred securities qualify as tier 1 hybrid capital for HSBC and for HSBC Bank on a solo and consolidated basis and, together with the guarantee, are intended to provide investors with rights to income and capital distributions and distributions upon liquidation of HSBC Bank that are equivalent to the rights they would have had if they had purchased non-cumulative perpetual preference shares of HSBC Bank.

The two issues of preferred securities are perpetual, but redeemable in 2031 and 2020, respectively, at the option of the general partner of the limited partnerships. If not redeemed, the distributions payable step-up and become floating rate. The same limitations on the payment of distributions apply to HSBC Bank as to HSBC Holdings,

Notes on the Financial Statements (continued)

as described above. HSBC Bank has provided a similar covenant to that provided by HSBC Holdings, also as described above.

If (i) any of the two issues of preferred securities are outstanding in November 2048 or April 2049, respectively, or (ii) the total capital ratio of HSBC Bank on a solo and consolidated basis falls below the regulatory minimum ratio required, or (iii) in view of the deteriorating financial condition of HSBC Bank, the Directors expect (ii) to occur in the near term, then the preferred securities will be substituted by preference shares of HSBC Bank having economic terms which are in all material respects equivalent to those of the preferred securities and the guarantee taken together.

HSBC Holdings

	2010 US\$m	2009 US\$m
Subordinated liabilities:		
– at amortised cost	13,313	14,406
– designated at fair value (Note 29)	16,288	16,909
	29,601	31,315

HSBC Holdings' subordinated liabilities

	2010 US\$m	2009 US\$m
Amounts owed to third parties		
US\$2,500m 6.5% subordinated notes 2037	2,695	2,659
€1,750m 6.0% subordinated notes 2019	2,578	2,835
€1,600m 6.25% subordinated notes 2018	2,142	2,306
US\$2,000m 6.5% subordinated notes 2036	2,050	2,052
€900m 6.375% callable subordinated notes 2022 ¹	1,493	1,517
US\$1,400m 5.25% subordinated notes 2012	1,492	1,488
US\$1,500m 6.8% subordinated notes 2038	1,485	1,484
€1,000m 5.375% subordinated notes 2012	1,405	1,549
€900m 6.0% subordinated notes 2040	1,372	–
£750m 7.0% subordinated notes 2038	1,210	1,267
£650m 6.75% subordinated notes 2028	1,000	1,043
£650m 5.75% subordinated notes 2027	971	1,000
€700m 3.625% callable subordinated notes 2020 ²	928	1,005
US\$750m Callable subordinated floating rate notes 2016 ³	750	750
US\$488m 7.625% subordinated notes 2032	582	587
£250m 9.875% subordinated bonds 2018 ⁴	467	496
US\$222m 7.35% subordinated notes 2032	258	260
US\$750m Callable subordinated floating rate notes 2015 ⁵	–	750
	22,878	23,048
Amounts owed to HSBC undertakings		
€1,400m 5.3687% fixed/floating subordinated notes 2043 – HSBC Capital Funding (Euro 2) LP	1,957	2,042
US\$1,250m 4.61% fixed/floating subordinated notes 2043 – HSBC Capital Funding (Dollar 2) LP	1,274	1,223
€750m 5.13% fixed/floating subordinated notes 2044 – HSBC Capital Funding (Euro 3) LP	1,028	1,095
US\$900m 10.176% subordinated step-up cumulative notes 2040 – HSBC Capital Funding (Dollar 1) LP	891	890
€600m 8.03% subordinated step-up cumulative notes 2040 – HSBC Capital Funding (Euro 1) LP	801	862
£500m 8.208% subordinated step-up cumulative notes 2040 – HSBC Capital Funding (Sterling 1) LP	772	806
US\$1,350m 9.547% subordinated step-up cumulative notes 2040 – HSBC Capital Funding (Dollar 1) LP ⁶	–	1,349
	6,723	8,267
	29,601	31,315

1 The interest rate on the 6.375% callable subordinated notes 2022 changes in October 2017 to become three-month sterling LIBOR plus 1.3%. The notes may be redeemed at par from October 2017 at the option of the borrower, subject to the prior notification to the FSA.

Notes on the Financial Statements (continued)

- 2 The interest rate on the 3.625% callable subordinated notes 2020 changes in June 2015 to become three-month EURIBOR plus 0.93%. The notes may be redeemed at par from June 2015 at the option of the borrower, subject to the prior notification to the FSA.
- 3 The interest margin on the callable subordinated floating rate notes 2016 increases by 0.5% from October 2011. The notes are repayable from their step up date at the option of the borrower, subject to the prior notification to the FSA.
- 4 The interest rate on the 9.875% subordinated bonds 2018 changes in April 2013 to become the higher of (i) 9.875% or (ii) the sum of the yield on the relevant benchmark treasury stock plus 2.5%. The bonds may be redeemed in April 2013 at par and redemption has also been allowed from April 1998, subject to the prior notification to the FSA, for an amount based on the redemption yields of the relevant benchmark treasury stocks.
- 5 In March 2010, HSBC Holdings redeemed its US\$750m callable subordinated floating rate notes due 2015 at par.
- 6 In June 2010, HSBC Holdings redeemed its 9.547% subordinated step-up cumulative notes 2040 – HSBC Capital Funding (Dollar 1) LP at par.

35 Maturity analysis of assets and liabilities

The following is an analysis, by remaining contractual maturities at the balance sheet date, of asset and liability line items that represent amounts expected to be recovered or settled within one year, and after more than one year.

Trading assets and liabilities are excluded because they are not held for collection or settlement over the period of contractual maturity.

Maturity analysis of assets and liabilities

HSBC

	At 31 December 2010			At 31 December 2009		
	Due within one year US\$m	Due after more than one year US\$m	Total US\$m	Due within one year US\$m	Due after more than one year US\$m	Total US\$m
Assets						
Financial assets designated at fair value	3,030	33,981	37,011	3,786	33,395	37,181
Loans and advances to banks	200,098	8,173	208,271	172,916	6,865	179,781
Loans and advances to customers	424,713	533,653	958,366	381,967	514,264	896,231
Financial investments	149,954	250,801	400,755	134,824	234,334	369,158
Other financial assets	19,417	5,519	24,936	26,189	7,383	33,572
	797,212	832,127	1,629,339	719,682	796,241	1,515,923
Liabilities						
Deposits by banks	105,462	5,122	110,584	118,308	6,564	124,872
Customer accounts	1,181,095	46,630	1,227,725	1,114,149	44,885	1,159,034
Financial liabilities designated at fair value	10,141	77,992	88,133	4,666	75,426	80,092
Debt securities in issue	86,096	59,305	145,401	83,590	63,306	146,896
Other financial liabilities	24,865	4,792	29,657	67,061	3,606	70,667
Subordinated liabilities	791	32,596	33,387	369	30,109	30,478
	1,408,450	226,437	1,634,887	1,388,143	223,896	1,612,039

HSBC Holdings

	At 31 December 2010			At 31 December 2009		
	Due within one year US\$m	Due after more than one year US\$m	Total US\$m	Due within one year US\$m	Due after more than one year US\$m	Total US\$m
Assets						
Loans and advances to HSBC undertakings	13,691	7,547	21,238	18,067	5,145	23,212
Financial investments	–	2,025	2,025	–	2,455	2,455
Other financial assets	1	–	1	4	–	4
	13,692	9,572	23,264	18,071	7,600	25,671
Liabilities						
Amounts owed to HSBC undertakings	1,480	1,452	2,932	277	3,434	3,711
Financial liabilities designated at fair value	–	16,288	16,288	–	16,909	16,909
Debt securities in issue	–	2,668	2,668	–	2,839	2,839
Other financial liabilities	1,782	–	1,782	1,240	17	1,257
Subordinated liabilities	–	13,313	13,313	–	14,406	14,406
	3,262	33,721	36,983	1,517	37,605	39,122

Notes on the Financial Statements (continued)**36 Foreign exchange exposures****Structural foreign exchange exposures**

HSBC's structural foreign exchange exposures are represented by the net asset value of its foreign exchange equity and subordinated debt investments in subsidiaries, branches, joint ventures and associates with non-US dollar functional currencies. Gains or losses on structural foreign exchange exposures are recognised in other comprehensive income. HSBC's management of its structural foreign exchange exposures is discussed in the 'Report of the Directors: Risk' on page 149.

In its separate financial statements, HSBC Holdings recognises its foreign exchange gains and losses on structural foreign exchange exposures in the income statement.

Net structural foreign exchange exposures

	2010 US\$m	2009 US\$m
Currency of structural exposure		
Pound sterling	23,247	21,369
Euro	23,222	25,284
Chinese renminbi	17,454	13,398
Brazilian reais	6,004	5,234
Mexican pesos	5,991	5,393
Indian rupees	4,754	3,836
Canadian dollars	4,012	3,620
Swiss francs	3,357	2,910
Hong Kong dollars	2,659	3,842
UAE dirhams	2,469	2,209
Turkish lira	1,854	1,741
Malaysian ringgit	1,619	1,300
Korean won	1,456	1,412
Taiwanese dollars	1,429	547
Australian dollars	1,381	1,017
Indonesian rupiah	1,190	1,057
Saudi riyals	907	657
Argentine pesos	881	675
Egyptian pounds	642	561
Philippine pesos	635	473
Vietnamese dong	621	505
Singapore dollars	596	556
Qatari rial	510	384
Thai baht	424	357
Costa Rican colon	416	375
Honduran lempira	291	282
Japanese yen	267	228
Colombian pesos	266	220
Russian rouble	257	295
Chilean pesos	249	230
South African rand	238	201
Omani rial	234	210
Brunei dollars	227	132
Jordanian dinar	181	159
New Zealand dollars	172	161
Algerian dinar	155	146
Sri Lankan rupee	136	141
Bahraini dinar	133	85
Kazakh tenge	109	64
Others, each less than US\$100m	658	523
Total	111,303	101,789

Shareholders' equity would decrease by US\$2,213m (2009: US\$2,222m) if euro and sterling foreign currency exchange rates weakened by 5% relative to the US dollar.

Notes on the Financial Statements (continued)

37 Assets charged as security for liabilities and collateral accepted as security for assets

Financial assets pledged to secure liabilities

	Assets pledged at 31 December	
	2010 US\$m	2009 US\$m
Treasury bills and other eligible securities	5,859	3,970
Loans and advances to banks	11,773	6,767
Loans and advances to customers	60,500	77,699
Debt securities	214,126	203,766
Equity shares	7,216	7,305
Other	931	646
	300,405	300,153

These transactions are conducted under terms that are usual and customary to collateralised transactions, including, where relevant, standard securities lending and repurchase agreements.

Collateral accepted as security for assets

The fair value of assets accepted as collateral that HSBC is permitted to sell or repledge in the absence of default is US\$333,921m (2009: US\$362,560m). The fair value of any such collateral that has been sold or repledged was US\$205,470m (2009: US\$215,940m). HSBC is obliged to return equivalent securities.

These transactions are conducted under terms that are usual and customary to standard securities borrowing and reverse repurchase agreements.

38 Non-controlling interests

	2010 US\$m	2009 US\$m
Non-controlling interests attributable to holders of ordinary shares in subsidiaries	4,522	4,665
Preference shares issued by subsidiaries	2,726	2,697
	7,248	7,362

Preference shares issued by subsidiaries

	2010 US\$m	2009 US\$m
US\$575m 6.36% non-cumulative preferred stock, Series B ¹	559	559
US\$518m Floating rate non-cumulative preferred stock, Series F ²	518	518
US\$374m Floating rate non-cumulative preferred stock, Series G ³	374	374
US\$374m 6.50% non-cumulative preferred stock, Series H ³	374	374
CAD250m Non-cumulative 5 year rate reset class 1 preferred shares, Series E ⁴	251	238
CAD175m Non-cumulative redeemable class 1 preferred shares, Series C ⁵	175	167
CAD175m Non-cumulative class 1 preferred shares, Series D ⁵	175	167
US\$150m Depositary shares each representing 25% interest in a share of adjustable-rate cumulative preferred stock, Series D ⁶	150	150
US\$150m Cumulative preferred stock ⁷	150	150
	2,726	2,697

1 The Series B preferred stock has been redeemable at the option of HSBC Finance Corporation, in whole or in part, from 24 June 2010 at par.

2 The Series F preferred stock has been redeemable at par at the option of HSBC USA, Inc., in whole or in part, on any dividend payment date from 7 April 2010.

3 The Series G and Series H preferred stock are redeemable at par at the option of HSBC USA, Inc., in whole or in part, at any time from 1 January 2011 and 1 July 2011, respectively.

4 The Series E preferred shares are redeemable at par at the option of HSBC Bank Canada, in whole or in part commencing 30 June 2014 and on 30 June every five years thereafter.

5 The Series C and Series D preferred shares have been redeemable at a declining premium above par at the option of HSBC Bank Canada, in whole or in part, from 30 June 2010 and 31 December 2010, respectively.

6 The preferred stock has been redeemable at the option of HSBC USA, Inc., in whole or in part, from 1 July 1999 at par.

7 The preferred stock has been redeemable at the option of HSBC USA, Inc., in whole or in part, from 1 October 2007 at par.

Notes on the Financial Statements (continued)

All redemptions are subject to prior notification to the Financial Services Authority and, where relevant, the local banking regulator.

39 Called up share capital and other equity instruments

Issued and fully paid

	2010 US\$m	2009 US\$m
HSBC Holdings ordinary shares ¹	8,843	8,705
	Number	US\$m
HSBC Holdings ordinary shares of US\$0.50 each		
At 1 January 2010	17,408,206,768	8,705
Shares issued under HSBC employee share plans	25,001,734	12
Shares issued in lieu of dividends	252,947,400	126
At 31 December 2010	17,686,155,902	8,843
At 1 January 2009	12,105,265,082	6,053
Shares issued under HSBC employee share plans	7,476,952	4
Shares issued in lieu of dividends	235,225,669	118
Shares issued in respect of rights issue	5,060,239,065	2,530
At 31 December 2009	17,408,206,768	8,705

¹ All ordinary shares in issue confer identical rights in respect of capital, dividends, voting and otherwise.

	Number	US\$m
HSBC Holdings non-cumulative preference shares of US\$0.01 each		
At 1 January 2010 and 31 December 2010	1,450,000	–
At 1 January 2009 and 31 December 2009	1,450,000	–

Dividends on the HSBC Holdings non-cumulative dollar preference shares ('Dollar Preference Shares') in issue are paid quarterly at the sole and absolute discretion of the Board of Directors. The Board of Directors will not declare a dividend on the Dollar Preference Shares in issue if payment of the dividend would cause HSBC Holdings not to meet the applicable capital adequacy requirements of the FSA or the profit of HSBC Holdings available for distribution as dividends is not sufficient to enable HSBC Holdings to pay in full both dividends on the Dollar Preference Shares in issue and dividends on any other shares that are scheduled to be paid on the same date and that have an equal right to dividends. HSBC Holdings may not declare or pay dividends on any class of its shares ranking lower in the right to dividends than the Dollar Preference Shares in issue nor redeem nor purchase in any manner any of its other shares ranking equal with or lower than the Dollar Preference Shares in issue unless it has paid in full, or set aside an amount to provide for payment in full, the dividends on the Dollar Preference Shares in issue for the then-current dividend period. The Dollar Preference Shares in issue carry no rights to conversion into ordinary shares of HSBC Holdings. Holders of the Dollar Preference Shares in issue will only be entitled to attend and vote at general meetings of shareholders of HSBC Holdings if the dividend payable on the Dollar Preference Shares in issue has not been paid in full for four consecutive dividend payment dates. In such circumstances, holders of the Dollar Preference Shares in issue will be entitled to vote on all matters put to general meetings until such time as HSBC Holdings has paid a full dividend on the Dollar Preference Shares in issue. HSBC Holdings may redeem the Dollar Preference Shares in issue in whole at any time on or after 16 December 2010, subject to prior notification to the FSA.

HSBC Holdings non-cumulative preference shares of £0.01 each

On 29 December 2010 HSBC Holdings issued one non-cumulative sterling preference share of £0.01 ('Sterling Preference Share') to facilitate the cancellation of the non-voting deferred shares and comply with the provisions of the Companies (Authorised Minimum) Regulations 2009. Dividends on the Sterling Preference Share in issue are paid quarterly at the sole and absolute discretion of the Board. The Sterling Preference Share in issue carries no rights to conversion into ordinary shares of HSBC Holdings and no rights to attend and vote at general meetings of shareholders of HSBC Holdings. HSBC Holdings may redeem the Sterling Preference Share in issue in whole at any time at the option of the Company.

Notes on the Financial Statements (continued)

HSBC Holdings non-voting deferred shares

301,500 non-voting deferred shares of £1 each were in issue throughout 2009 and up to 29 December 2010 and were held by a subsidiary of HSBC Holdings. As part of a technical internal capital reorganisation necessitated by the amended EU Capital Requirements Directive 2, which applied to HSBC Holdings from 31 December 2010, all of the non-voting deferred shares of £1 each were cancelled.

Other equity instruments

On 9 April 2008, HSBC Holdings issued, in bearer form, 88m 8.125% Perpetual Subordinated Capital Securities ('Capital Securities'), each with a par value of US\$25 and with an aggregate nominal value of US\$2,200m. The Capital Securities were issued at par value, raising US\$2,133m, net of issuance costs. The Capital Securities were issued to support the development of and to strengthen further HSBC's capital base. Coupon payments on the Capital Securities are paid quarterly in arrears from 15 July 2008 and may be deferred at the discretion of HSBC Holdings. The Capital Securities have no fixed maturity and are redeemable at HSBC's option on or after 15 April 2013 at their principal amounts together with any accrued, unpaid and deferred coupon payments. While any coupon payments are unpaid or deferred, HSBC Holdings will not declare, pay dividends or make distributions or similar periodic payments in respect of, or repurchase, redeem or otherwise acquire any securities of lower or equal rank. At the Company's discretion, and subject to certain conditions being satisfied, the Capital Securities may be exchanged on any coupon payment date for non-cumulative preference shares to be issued by HSBC Holdings and which would rank *pari passu* with the dollar and sterling preference shares in issue. The preference shares will be issued at a nominal value of US\$0.01 per share and a premium of US\$24.99 per share, with both such amounts being subscribed and fully paid.

During June 2010, HSBC Holdings issued, in bearer form, 152m 8.00% of Perpetual Subordinated Capital Securities, Series 2 ('Capital Securities, Series 2'), each with a par value of US\$25 and with an aggregate nominal value of US\$3,800m. The Capital Securities, Series 2 were issued at par value, raising US\$3,718m, net of issuance costs. These securities were issued on substantially the same terms as the Capital Securities issued in 2008. Coupon payments on the Capital Securities, Series 2 are paid quarterly in arrears from 15 September 2010 and may be deferred at the discretion of HSBC Holdings. The Capital Securities, Series 2 have no fixed maturity and are redeemable at HSBC's option on or after 15 December 2015 at their principal amounts together with any accrued, unpaid and deferred coupon payments. At the Company's discretion, and subject to certain conditions being satisfied, the Capital Securities, Series 2 may be exchanged on any coupon payment date for non-cumulative preference shares to be issued by HSBC Holdings and which would rank *pari passu* with the dollar and sterling preference shares in issue. The preference shares will be issued at a nominal value of US\$0.01 per share and a premium of US\$24.99 per share, with both such amounts being subscribed and fully paid.

Shares under option

Details of the options outstanding to subscribe for HSBC Holdings ordinary shares under the HSBC Holdings Group Share Option Plan, HSBC Holdings Executive Share Option Scheme, the HSBC Share Plan and HSBC Holdings savings-related share option plans are given in Note 9.

Aggregate options outstanding under these plans

	Number of HSBC Holdings ordinary shares	Period of exercise	Exercise price
31 December 2010	249,242,968	2011 to 2016	£3,3116 – 8.4024
	47,428,892	2011 to 2016	HK\$37.8797 – 94.5057
	3,128,508	2011 to 2016	€3.6361 – 9.5912
	10,899,415	2011 to 2016	US\$4.8876 – 12.0958
31 December 2009 ¹	270,742,989	2010 to 2015	£3,3116 – 8.4024
	50,938,242	2010 to 2015	HK\$37.8797 – 94.5057
	3,283,710	2010 to 2015	€3.6361 – 9.5912
	12,073,216	2010 to 2015	US\$4.8876 – 12.0958
31 December 2008	211,226,573	2009 to 2015	£5.3496 – 9.642
	11,344,167	2009 to 2014	HK\$103.4401 – 108.4483
	1,304,119	2009 to 2014	€8.6720 – 11.0062
	7,382,145	2009 to 2014	US\$13.3290 – 14.7478

¹ During 2009, the number and prices of unexercised share options were adjusted for the rights issue.

Notes on the Financial Statements (continued)

HSBC France and subsidiary company plans

Following the acquisition of HSBC France in 2000, outstanding employee share options over HSBC France shares vested. On exercise of the options, the HSBC France shares were exchangeable for HSBC Holdings ordinary shares at the ratio of 14.917916 HSBC Holdings ordinary shares for each HSBC France.

During 2010, no employee share options (2009: nil) were exercised and no HSBC France shares were issued and exchanged for HSBC Holdings ordinary shares (2009: nil). During 2010, 604,250 options over HSBC France shares lapsed (2009: 183,627). At 31 December 2010, there are no employee share options outstanding and the HSBC Holdings Employee Benefit Trust 2001 (No. 1) held no (2009: 9,963,718) HSBC Holdings ordinary shares to exchange for HSBC France shares arising from the exercise of options.

HSBC France options effectively outstanding over HSBC Holdings ordinary shares

	Number of HSBC France shares exchangeable for HSBC Holdings ordinary shares	Period of exercise	Exercise price
31 December 2010	–	–	–
31 December 2009	604,250	2010	€142.50
31 December 2008	787,877	2009 to 2010	€81.71 – 142.50

HSBC Private Bank France plan

There are also outstanding options over the shares of HSBC Private Bank France, a subsidiary of HSBC France.

On exercise of the options, the HSBC Private Bank France shares are exchangeable for HSBC Holdings ordinary shares at the ratio of 2.099984 HSBC Holdings ordinary shares for each HSBC Private Bank France share. During 2010, 4,420 (2009: 33,456) HSBC Private Bank France shares were issued following the exercise of employee share options and exchanged for 9,281 (2009: 70,248) HSBC Holdings ordinary shares, such shares being delivered from The CCF Employee Benefit Trust 2001 (Private Banking France). During 2010, no options over HSBC Private Bank France shares lapsed (2009: 9,000). At 31 December 2010, The CCF Employee Benefit Trust 2001 (Private Banking France) held 989,502 (2009: 998,783) HSBC Holdings ordinary shares which may be exchanged for HSBC Private Bank France shares arising from the exercise of options.

HSBC Private Bank France options effectively outstanding over HSBC Holdings ordinary shares

	Number of HSBC Private Bank France shares exchangeable for HSBC Holdings ordinary shares	Period of exercise	Exercise price
31 December 2010	287,100	2011 to 2012	€20.80 – 22.22
31 December 2009	291,520	2010 to 2012	€12.44 – 22.22
31 December 2008	333,976	2009 to 2012	€10.84 – 22.22

HSBC Finance plan

Following the acquisition of HSBC Finance in 2003, all outstanding options and equity-based awards over HSBC Finance common shares were converted into rights to receive HSBC Holdings ordinary shares in the same ratio as the share exchange offer for HSBC Finance (2.675 HSBC Holdings ordinary shares for each HSBC Finance common share) and the exercise prices per share adjusted accordingly. During 2010, 306,964 options (2009: 20,000) over HSBC Holdings ordinary shares were exercised and 306,964 (2009: 20,000) HSBC Holdings ordinary shares delivered from The HSBC (Household) Employee Benefit Trust 2003 to satisfy the exercise of these options. During 2010, options over 6,681,169 (2009: 5,606,714) HSBC Holdings ordinary shares lapsed. At 31 December 2010, the Trust held a total of 2,335,315 (2009: 2,642,279) HSBC Holdings ordinary shares and 1,455 (2009: 1,455) ADSs, which may be used to satisfy the exercise of these options and equity-based awards under the HSBC Finance share plans. Each ADS represents five HSBC Holdings ordinary shares.

Notes on the Financial Statements (continued)

Options outstanding over HSBC Holdings ordinary shares under the HSBC Finance share plan

	Number of HSBC Holdings ordinary shares	Period of exercise	Exercise price
31 December 2010	11,117,826	2011 to 2012	US\$9.29 – 18.62
31 December 2009 ¹	18,105,959	2010 to 2012	US\$9.29 – 18.62
31 December 2008	20,681,582	2009 to 2012	US\$10.66 – 21.37

¹ During 2009, the number and prices of unexercised share options were adjusted for the rights issue.

HSBC Bank Bermuda plans

Following the acquisition of HSBC Bank Bermuda in 2004, all outstanding employee share options over HSBC Bank Bermuda shares were converted into rights to receive HSBC Holdings ordinary shares based on the consideration of US\$40 for each HSBC Bank Bermuda share and the average closing price of HSBC Holdings ordinary shares, derived from the London Stock Exchange Daily Official List, for the five business days preceding the closing date of the acquisition. During 2010, options over 4,781 HSBC Holdings ordinary shares were exercised (2009: 18,153) and satisfied by delivery from the HSBC (Bank of Bermuda) Employee Benefit Trust 2004. During 2010, options over 137,888 (2009: 24,673) HSBC Holdings ordinary shares lapsed. At 31 December 2010, the HSBC (Bank of Bermuda) Employee Benefit Trust 2004 held 2,108,830 (2009: 2,113,611) HSBC Holdings ordinary shares which may be used to satisfy the exercise of options.

Options outstanding over HSBC Holdings ordinary shares under the HSBC Bank Bermuda share plan

	Number of HSBC Holdings ordinary shares	Period of exercise	Exercise price
31 December 2010	2,339,033	2011 to 2013	US\$9.32 – 15.99
31 December 2009 ¹	2,481,702	2010 to 2013	US\$6.13 – 15.99
31 December 2008	2,205,321	2009 to 2013	US\$7.04 – 18.35

¹ During 2009, the number and prices of unexercised share options were adjusted for the rights issue.

Maximum obligation to deliver HSBC Holdings ordinary shares

At 31 December 2010, the maximum obligation to deliver HSBC Holdings ordinary shares under all of the above option arrangements, together with awards of Performance Shares and Restricted Shares under the HSBC Share Plan, was 558,187,326 (2009: 559,960,290). The total number of shares at 31 December 2010 held by employee benefit trusts that may be used to satisfy such obligations to deliver HSBC Holdings ordinary shares was 79,541,700 (2009: 134,903,061).

40 Notes on the statement of cash flows

Non-cash items included in profit before tax

	HSBC			HSBC Holdings	
	2010 US\$m	2009 US\$m	2008 US\$m	2010 US\$m	2009 US\$m
Depreciation, amortisation and impairment	2,801	2,538	13,367	2	5,947
Gains arising from dilution of interests in associates	(188)	–	–	–	–
Revaluations on investment property	(93)	24	92	–	–
Share-based payment expense	812	683	819	28	21
Loan impairment losses gross of recoveries and other credit risk provisions	15,059	27,378	25,771	–	–
Provisions	680	669	591	–	–
Impairment of financial investments	105	358	1,042	113	–
Charge for defined benefit plans	526	192	490	–	–
Accretion of discounts and amortisation of premiums	(815)	(458)	(867)	42	6
	18,887	31,384	41,305	185	5,974

Notes on the Financial Statements (continued)

Change in operating assets

	HSBC			HSBC Holdings	
	2010 US\$m	2009 US\$m	2008 US\$m	2010 US\$m	2009 US\$m
Change in loans to HSBC undertakings	–	–	–	1,974	(11,408)
Change in prepayments and accrued income	457	3,198	4,178	(5)	(44)
Change in net trading securities and net derivatives	60,337	15,388	(23,293)	1,119	354
Change in loans and advances to banks	5,213	(30,354)	22,596	–	–
Change in loans and advances to customers	(79,283)	6,149	7,279	–	–
Change in financial assets designated at fair value	154	(8,911)	12,757	–	–
Change in other assets	(145)	(6,273)	(5,394)	3	21
	(13,267)	(20,803)	18,123	3,091	(11,077)

Change in operating liabilities

	HSBC			HSBC Holdings	
	2010 US\$m	2009 US\$m	2008 US\$m	2010 US\$m	2009 US\$m
Change in accruals and deferred income	716	(2,258)	(6,169)	147	131
Change in deposits by banks	(14,288)	(5,216)	(3,038)	–	–
Change in customer accounts	68,691	41,983	32,372	–	–
Change in debt securities in issue	(1,495)	(32,797)	(67,152)	(171)	21
Change in financial liabilities designated at fair value	5,659	7,430	(15,352)	(621)	2,411
Change in other liabilities	(17,011)	5,503	(4,074)	(1,109)	(523)
	42,272	14,645	(63,413)	(1,754)	2,040

Cash and cash equivalents

	HSBC			HSBC Holdings	
	2010 US\$m	2009 US\$m	2008 US\$m	2010 US\$m	2009 US\$m
Cash at bank with HSBC undertakings	–	–	–	459	224
Cash and balances at central banks	57,383	60,655	52,396	–	–
Items in the course of collection from other banks	6,072	6,395	6,003	–	–
Loans and advances to banks of one month or less	189,197	160,673	165,066	–	–
Treasury bills, other bills and certificates of deposit less than three months	28,087	28,777	62,639	–	–
Less: items in the course of transmission to other banks	(6,663)	(5,734)	(7,232)	–	–
	274,076	250,766	278,872	459	224

Interest and dividends

	HSBC			HSBC Holdings	
	2010 US\$m	2009 US\$m	2008 US\$m	2010 US\$m	2009 US\$m
Interest paid	(21,405)	(29,030)	(60,342)	(2,363)	(2,513)
Interest received	63,696	74,062	107,019	1,405	1,560
Dividends received	563	1,023	1,876	7,008	7,488

The amount of cash and cash equivalents not available for use by HSBC at 31 December 2010 was US\$37,413m (2009: US\$19,119m), of which US\$28,780m (2009: US\$11,595m) related to mandatory deposits at central banks.

Notes on the Financial Statements (continued)

41 Contingent liabilities, contractual commitments and guarantees

	HSBC		HSBC Holdings	
	2010 US\$m	2009 US\$m	2010 US\$m	2009 US\$m
Guarantees and contingent liabilities				
Guarantees and irrevocable letters of credit pledged as collateral security	71,157	73,385	46,988	35,073
Other contingent liabilities	166	174	–	–
	71,323	73,559	46,988	35,073
Commitments				
Documentary credits and short-term trade-related transactions	12,051	9,066	–	–
Forward asset purchases and forward deposits placed	30	192	–	–
Undrawn formal standby facilities, credit lines and other commitments to lend	590,432	548,792	2,720	3,240
	602,513	558,050	2,720	3,240

The above table discloses the nominal principal amounts of commitments excluding capital commitments, which are separately disclosed below, guarantees and other contingent liabilities; mainly credit-related instruments including both financial and non-financial guarantees and commitments to extend credit. Contingent liabilities arising from legal proceedings and regulatory matters against the Group are disclosed in Note 44. Nominal principal amounts represent the amounts at risk should contracts be fully drawn upon and clients default. The amount of the loan commitments shown above reflects, where relevant, the expected level of take-up of pre-approved loan offers made by mailshots to personal customers. As a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not representative of future liquidity requirements.

Guarantees

HSBC provides guarantees and similar undertakings on behalf of both third-party customers and other entities within the HSBC Group. These guarantees are generally provided in the normal course of HSBC's banking business. The principal types of guarantees provided, and the maximum potential amount of future payments which HSBC could be required to make at 31 December 2010, were as follows:

Guarantee type	At 31 December 2010		At 31 December 2009	
	Guarantees in favour of third parties US\$m	Guarantees by HSBC Holdings in favour of other HSBC Group entities US\$m	Guarantees in favour of third parties US\$m	Guarantees by HSBC Holdings in favour of other HSBC Group entities US\$m
Guarantees of indebtedness including financial guarantees ¹ and guarantees of a capital nature	21,175	46,988	23,558	35,073
Standby letters of credit that are financial guarantees	8,033	–	10,712	–
Other direct credit substitutes ²	6,555	–	4,676	–
Performance bonds ³	15,367	–	14,468	–
Bid bonds ³	927	–	728	–
Standby letters of credit related to particular transactions ³	6,263	–	4,944	–
Other transaction-related guarantees ³	12,746	–	13,577	–
Other items	91	–	722	–
	71,157	46,988	73,385	35,073

¹ Financial guarantees are contracts that require the issuer to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

² Other direct credit substitutes include re-insurance letters of credit and trade-related letters of credit issued without provision for the issuing entity to retain title to the underlying shipment.

³ Performance bonds, bid bonds, standby letters of credit and other transaction-related guarantees are undertakings by which the obligation on HSBC to make payment depends on the outcome of a future event.

Notes on the Financial Statements (continued)

The amounts disclosed in the above table are nominal principal amounts and reflect HSBC's maximum exposure under a large number of individual guarantee undertakings. The risks and exposures arising from guarantees are captured and managed in accordance with HSBC's overall credit risk management policies and procedures. Approximately half of the above guarantees have a term of less than one year. Guarantees with terms of more than one year are subject to HSBC's annual credit review process.

Financial Services Compensation Scheme

The Financial Services Compensation Scheme ('FSCS') has provided compensation to consumers following the collapse of a number of deposit takers. The compensation paid out to consumers is currently funded through loans from the Bank of England and HM Treasury. The bank could be liable to pay a proportion of the outstanding borrowings that the FSCS has borrowed from HM Treasury which at 31 March 2010 stood at approximately £20bn (US\$30bn). Currently, the levy paid by the bank represents its share of the interest on these borrowings. The accrual at 31 December 2010 was US\$144m in respect of the 2010/11 and 2011/12 levy years (2009: US\$182m in respect of the 2009/10 and 2010/11 levy years).

The ultimate FSCS levy to the industry as a result of the collapses cannot currently be estimated reliably as it is dependent on various uncertain factors including the potential recoveries of assets by the FSCS and changes in the interest rate, the level of protected deposits and the population of FSCS members at the time.

Commitments

In addition to the commitments disclosed on page 358, at 31 December 2010, HSBC had US\$1,071m (2009: US\$1,359m) of capital commitments contracted but not provided for and US\$287m (2009: US\$227m) of capital commitments authorised but not contracted for.

Associates

HSBC's share of associates' contingent liabilities amounted to US\$25,640m at 31 December 2010 (2009: US\$19,770m). No matters arose where HSBC was severally liable.

42 Lease commitments

Finance lease commitments

HSBC leases land and buildings (including branches) and equipment from third parties under finance lease arrangements to support its operations.

	At 31 December 2010			At 31 December 2009		
	Total future minimum payments US\$m	Future interest charges US\$m	Present value of finance lease commitments US\$m	Total future minimum payments US\$m	Future interest charges US\$m	Present value of finance lease commitments US\$m
Lease commitments:						
– no later than one year	107	(20)	87	103	(29)	74
– later than one year and no later than five years	187	(92)	95	249	(116)	133
– later than five years	390	(118)	272	619	(182)	437
	684	(230)	454	971	(327)	644

At 31 December 2010, future minimum sublease payments of US\$436m (2009: US\$512m) are expected to be received under non-cancellable subleases at the balance sheet date.

Notes on the Financial Statements (continued)

Operating lease commitments

At 31 December 2010, HSBC was obligated under a number of non-cancellable operating leases for properties, plant and equipment on which the future minimum lease payments extend over a number of years.

	At 31 December 2010		At 31 December 2009	
	Land and buildings US\$m	Equipment US\$m	Land and buildings US\$m	Equipment US\$m
Future minimum lease payments under non-cancellable operating leases:				
– no later than one year	920	23	846	11
– later than one year and no later than five years	2,663	37	2,253	11
– later than five years	2,614	–	2,534	–
	6,197	60	5,633	22

At 31 December 2010, future minimum sublease payments of US\$21m (2009: US\$21m) are expected to be received under non-cancellable subleases at the balance sheet date.

In 2010, US\$888m (2009: US\$1,100m; 2008: US\$861m) was charged to 'General and administrative expenses' in respect of lease and sublease agreements, of which US\$869m (2009: US\$833m; 2008: US\$635m) related to minimum lease payments, US\$18m (2009: US\$16m; 2008: US\$22m) to contingent rents, and US\$1m (2009: US\$251m; 2008: US\$204m) to sublease payments.

The contingent rent represents escalation payments made to landlords for operating, tax and other escalation expenses.

Finance lease receivables

HSBC leases a variety of assets to third parties under finance leases, including transport assets (such as aircraft), property and general plant and machinery. At the end of lease terms, assets may be sold to third parties or leased for further terms. Lessees may participate in any sales proceeds achieved. Lease rentals arising during the lease terms will either be fixed in quantum or be varied to reflect changes in, for example, tax or interest rates. Rentals are calculated to recover the cost of assets less their residual value, and earn finance income.

	At 31 December 2010			At 31 December 2009		
	Total future minimum payments US\$m	Unearned finance income US\$m	Present value US\$m	Total future minimum payments US\$m	Unearned finance income US\$m	Present value US\$m
Lease receivables:						
– no later than one year	3,002	(344)	2,658	2,874	(328)	2,546
– later than one year and no later than five years	8,940	(813)	8,127	9,525	(1,061)	8,464
– later than five years	6,629	(1,462)	5,167	6,902	(1,737)	5,165
	18,571	(2,619)	15,952	19,301	(3,126)	16,175

At 31 December 2010, unguaranteed residual values of US\$243m (2009: US\$230m) had been accrued, and the accumulated allowance for uncollectible minimum lease payments receivable amounted to US\$11m (2009: US\$21m). During the year, no contingent rents were received (2009: nil) and recognised in the income statement.

Notes on the Financial Statements (continued)

Operating lease receivables

HSBC leases a variety of different assets to third parties under operating lease arrangements, including transport assets, property and general plant and machinery.

	At 31 December 2010		At 31 December 2009	
	Land and buildings US\$m	Equipment US\$m	Land and buildings US\$m	Equipment US\$m
Future minimum lease payments under non-cancellable operating leases:				
– no later than one year	18	17	37	857
– later than one year and no later than five years	21	22	21	917
– later than five years	14	2	23	447
	53	41	81	2,221

43 Special purpose entities

HSBC enters into certain transactions with customers in the ordinary course of business which involve the establishment of special purpose entities ('SPE's) to facilitate or secure customer transactions. HSBC structures that utilise SPEs are authorised centrally when they are established to ensure appropriate purpose and governance. The activities of SPEs administered by HSBC are closely monitored by senior management.

SPEs are assessed for consolidation in accordance with the accounting policy set out in Note 1f.

Total consolidated assets held by SPEs by balance sheet classification

	Conduits US\$bn	Secur- isations US\$bn	Money market funds US\$bn	Non-money market investment funds US\$bn	Total US\$bn
At 31 December 2010					
Cash	1.0	0.7	–	0.3	2.0
Trading assets	0.1	0.6	0.4	0.5	1.6
Financial assets designated at fair value	0.1	–	–	6.4	6.5
Derivatives	–	0.3	–	–	0.3
Loans and advances to banks	–	1.4	–	–	1.4
Loans and advances to customers	8.4	22.2	–	–	30.6
Financial investments	30.5	0.1	–	–	30.6
Other assets	1.6	0.4	–	0.4	2.4
	41.7	25.7	0.4	7.6	75.4
At 31 December 2009					
Cash	–	–	–	0.2	0.2
Trading assets	–	0.9	42.8	0.2	43.9
Financial assets designated at fair value	0.1	–	–	5.3	5.4
Derivatives	–	1.2	–	–	1.2
Loans and advances to banks	0.3	–	–	–	0.3
Loans and advances to customers	10.3	35.4	–	–	45.7
Financial investments	31.4	–	–	–	31.4
Other assets	1.6	1.4	0.3	–	3.3
	43.7	38.9	43.1	5.7	131.4

HSBC's maximum exposure to SPEs

The following table shows the total assets of the various types of SPEs and the amount of funding provided by HSBC to these SPEs. The table also shows HSBC's maximum exposure to the SPEs and, within that exposure, the liquidity and credit enhancements provided by HSBC. The maximum exposures to SPEs represent HSBC's maximum possible risk exposure that could occur as a result of the Group's arrangements and commitments to SPEs. The maximum amounts are contingent in nature, and may arise as a result of drawdowns under liquidity facilities, where these have been provided, and any other funding commitments, or as a result of any loss protection provided by HSBC to the SPEs. The conditions under which such exposure might arise differ depending on the nature of each SPE and HSBC's involvement with it.

Notes on the Financial Statements (continued)

Total assets of consolidated and unconsolidated SPEs and HSBC's funding and maximum exposure

	Consolidated SPEs				Unconsolidated SPEs		
	Total assets US\$bn	Funding provided by HSBC US\$bn	Liquidity and credit enhance- ments US\$bn	HSBC's maximum exposure US\$bn	Total assets US\$bn	Funding provided by HSBC US\$bn	HSBC's maximum exposure US\$bn
At 31 December 2010							
Conduits	41.7	28.6	38.3	50.5	–	–	–
Securities investment conduits	32.2	28.6	25.6	37.8	–	–	–
Multi-seller conduits	9.5	0.0	12.7	12.7	–	–	–
Securitisations	25.7	1.9	0.1	4.7	9.9	–	–
Money market funds	0.4	0.4	–	0.4	95.8	0.7	0.7
Constant net asset value funds	–	–	–	–	74.9	0.5	0.5
Other	0.4	0.4	–	0.4	20.9	0.2	0.2
Non-money market investment funds	7.6	6.9	–	6.9	274.7	1.7	1.7
	75.4	37.8	38.4	62.5	380.4	2.4	2.4
At 31 December 2009							
Conduits	43.7	32.8	43.5	56.9	–	–	–
Securities investment conduits	32.8	32.4	29.1	42.5	–	–	–
Multi-seller conduits	10.9	0.4	14.4	14.4	–	–	–
Securitisations	38.9	2.9	0.1	7.9	11.1	0.1	0.1
Money market funds	43.1	1.5	–	1.5	55.9	0.3	0.3
Constant net asset value funds	42.4	0.9	–	0.9	31.2	0.1	0.1
Other	0.7	0.6	–	0.6	24.7	0.2	0.2
Non-money market investment funds	5.7	5.4	–	5.4	249.7	1.4	1.4
Other	–	–	–	–	20.6	8.8	3.2
	131.4	42.6	43.6	71.7	337.3	10.6	5.0

Conduits

HSBC sponsors and manages two types of conduits: securities investment conduits ('SIC's) and multi-seller conduits.

Securities investment conduits

Solitaire, HSBC's principal SIC, purchases highly rated asset-backed securities ('ABS's) to facilitate tailored investment opportunities. At 31 December 2010, Solitaire held US\$11.7bn of ABSs (2009: US\$11.7bn). These are included within the disclosures of ABS 'held through consolidated SPEs' on page 133. HSBC's other SICs, Mazarin, Barion and Malachite, evolved from the restructuring of HSBC's sponsored structured investment vehicles ('SIV's) in 2008.

Solitaire

Commercial Paper ('CP') issued by Solitaire benefits from a 100% liquidity facility provided by HSBC. At 31 December 2010, US\$7.6bn of Solitaire's assets were funded by the draw-down of the liquidity facility (2009: US\$7.6bn). HSBC is exposed to credit losses on the drawn amounts.

HSBC's maximum exposure represents the risk that HSBC may be required to fund the vehicle in the event the CP is redeemed without reinvestment from third parties. At 31 December 2010 this amounted to US\$16.8bn (31 December 2009: US\$18.4bn).

Mazarin

HSBC is exposed to the par value of Mazarin's assets through the provision of a liquidity facility equal to the lesser of the amortised cost of issued senior debt and the amortised cost of non-defaulted assets. At 31 December 2010 this amounted to US\$11.6bn (2009: US\$13.6bn). First loss protection is provided through the capital notes issued by Mazarin, which are substantially all held by third parties.

Notes on the Financial Statements (continued)

At 31 December 2010, HSBC held 1.3% of Mazarin's capital notes (2009: 1.3%) which have a par value of US\$17m (2009: US\$17m) and a carrying amount of US\$0.6m (2009: US\$0.6m).

Barion and Malachite

HSBC's primary exposure to these SICs is represented by the amortised cost of the debt required to support the non-cash assets of the vehicles. At 31 December 2010 this amounted to US\$9.4bn (2009: US\$10.5bn). First loss protection is provided through the capital notes issued by these vehicles, which are substantially all held by third parties.

At 31 December 2010, HSBC held 3.7% of the capital notes issued by these vehicles (2009: 3.8%) which have a par value of US\$35m (2009: US\$37m) and a carrying amount of US\$2m (2009: US\$2m).

Multi-seller conduits

These vehicles were established for the purpose of providing access to flexible market-based sources of finance for HSBC's clients.

HSBC's maximum exposure is equal to the transaction-specific liquidity facilities offered to the multi-seller conduits. First loss protection is provided by the originator of the assets, and not by HSBC, through transaction-specific credit enhancements. A layer of secondary loss protection is provided by HSBC in the form of programme-wide enhancement facilities.

The following table sets out the weighted average life of the asset portfolios for the above mentioned conduits.

Weighted average life of portfolios

Weighted average life (years)	Solitaire	Other SICs	Total SICs	Total multi-seller conduits
At 31 December 2010	5.1	4.0	4.4	1.8
At 31 December 2009	6.3	4.1	4.9	2.4

Securitisations

HSBC uses SPEs to securitise customer loans and advances that it has originated in order to diversify its sources of funding for asset origination and for capital efficiency purposes. The loans and advances are transferred by HSBC to the SPEs for cash, and the SPEs issue debt securities to investors to fund the cash purchases.

HSBC's maximum exposure is the aggregate of any holdings of notes issued by these vehicles and the reserve account positions intended to provide credit support under certain pre-defined circumstances to senior note holders.

In addition, HSBC uses SPEs to mitigate the capital absorbed by some of the customer loans and advances it has originated. Credit derivatives are used to transfer the credit risk associated with these customer loans and advances to an SPE, using securitisations commonly known as synthetic securitisations by which the SPE writes credit default swap protection to HSBC. The SPE is funded by the issuance of notes with the cash held as collateral against the credit default protection. From a UK regulatory perspective, the credit protection issued by the SPE in respect of the customer loans allows the risk weight of the loans to be replaced by the risk weight of the collateral in the SPE and as a result mitigates the capital absorbed by the customer loans. Any notes issued by the SPE and held by HSBC attract the appropriate risk weight under the relevant regulatory regime. These SPEs are consolidated when HSBC is exposed to the majority of risks and rewards of ownership.

Money market funds

HSBC has established and manages a number of money market funds which provide customers with tailored investment opportunities within narrow and well-defined objectives.

The majority of these money market funds are Constant Net Asset Value funds ('CNAV'), which invest in shorter-dated and highly-rated money market securities with the objective of providing investors with a highly liquid and secure investment. In September 2008 during the financial crisis, HSBC consolidated certain of its CNAV funds as a result of a number of actions taken to maintain their AAA rating and mitigate the risks of forced sales of liquid assets to meet potential redemptions. Since consolidation of the CNAV funds, HSBC has not provided any additional support to the funds and

Notes on the Financial Statements (continued)

letters of indemnity provided in 2008 have all expired. At all times the funds continued to be governed by their prospectuses.

In December 2010, management determined that it would not provide similar support in the future in the light of changes in the application of banking regulations. As a result, any presumption of ongoing support caused by past actions is no longer valid and it is not appropriate to continue to consolidate the CNAV funds.

The effect of deconsolidating the CNAV funds on HSBC's balance sheet was to derecognise US\$44.4bn of assets and US\$43.9bn of liabilities. The deconsolidation of the CNAV funds did not have a material impact on HSBC's consolidated income statement for the year ended 31 December 2010.

HSBC's maximum exposure to the CNAV funds is represented by HSBC's investment in the units of the funds which at 31 December 2010 amounted to US\$0.5bn (2009: US\$1.0bn). Investments in units of the funds are included within 'Trading assets'. Prior to deconsolidation, the interest income from the CNAV funds and the expense payable to third-party holders of units in the funds were presented within 'Net interest income on trading activities'.

HSBC's maximum exposure to money market funds is represented by HSBC's investment in the units of each fund, which at 31 December 2010 amounted to US\$1.1bn (2009: US\$1.8bn).

Non-money market investment funds

HSBC has established a large number of non-money market investment funds to enable customers to invest in a range of assets, typically equities and debt securities.

HSBC's maximum exposure to non-money market investment funds is represented by its investment in the units of each fund which at 31 December 2010 amounted to US\$8.6bn (2009: US\$6.8bn).

Other

HSBC also establishes SPEs in the normal course of business for a number of purposes, for example, structured credit transactions for customers, to provide finance to public and private sector infrastructure projects, and for asset and structured finance transactions.

In certain transactions HSBC is exposed to risk often referred to as gap risk. Gap risk typically arises in transactions where the aggregate potential claims against the SPE by HSBC pursuant to one or more derivatives could be greater than the value of the collateral held by the SPE and securing such derivatives. HSBC often mitigates such gap risk by incorporating in the SPE transaction features which allow for deleveraging, a managed liquidation of the portfolio, or other mechanisms including trade restructuring or unwinding the trade. Following the inclusion of such risk reduction mechanisms, HSBC has, in certain circumstances, retained all or a portion of the underlying exposure in the transaction. In these circumstances, HSBC assesses whether the exposure retained causes a requirement under IFRSs to consolidate the SPE. When this retained exposure represents ABSs, it has been included in 'Nature of HSBC's exposures' on page 129.

Third-party sponsored SPEs

Through standby liquidity facility commitments, HSBC has exposure to third-party sponsored SIVs, conduits and securitisations under normal banking arrangements on standard market terms. These exposures are not considered significant to HSBC's operations.

Additional off-balance sheet arrangements and commitments

Additional off-balance sheet commitments such as financial guarantees, letters of credit and commitments to lend are disclosed in Note 41.

Leveraged finance transactions

Loan commitments in respect of leveraged finance transactions are accounted for as derivatives where it is HSBC's intention to sell the loan after origination. Further information is provided on pages 138 and 139.

Notes on the Financial Statements (continued)

44 Legal proceedings, investigations and regulatory matters

HSBC is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions including the UK, Hong Kong and the US arising out of its normal business operations. Apart from the matters described below, HSBC considers that none of these matters is material, either individually or in the aggregate. HSBC recognises a provision for a liability in relation to these matters when it is probable that an outflow of economic benefits will be required to settle an obligation which has arisen as a result of past events, and for which a reliable estimate can be made of the amount of the obligation. While the outcome of these matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of legal proceedings, investigations and regulatory matters as at 31 December 2010 (see note 33, Provisions).

Securities litigation

As a result of an August 2002 restatement of previously reported consolidated financial statements and other corporate events, including the 2002 settlement with 46 State Attorneys General relating to real estate lending practices, Household International (now HSBC Finance) and certain former officers were named as defendants in a class action law suit, *Jaffe v Household International Inc, et al* No 2. C 5893 (N.D.Ill, filed 19 August 2002). The complaint asserted claims under the US Securities Exchange Act of 1934, on behalf of all persons who acquired and disposed of Household International common stock between 30 July 1999 and 11 October 2002. The claims alleged that the defendants knowingly or recklessly made false and misleading statements of material fact relating to Household's Consumer Lending operations, including collections, sales and lending practices, some of which ultimately led to the 2002 State settlement agreement, and facts relating to accounting practices evidenced by the restatement. Following a jury trial concluded in April 2009, which was decided partly in favour of the plaintiffs, the Court issued a ruling on 22 November 2010, within the second phase of the case to determine actual damages, that claim forms should be mailed to class members, and also set out a method for calculating damages for class members who filed claims. At subsequent hearings the Court has allowed HSBC Finance to take limited discovery on the issue of whether investors relied on the 'misleading statements' at the time they made their investments and also reserved on the issue of whether HSBC Finance would ultimately be entitled to a jury trial on the issue of reliance.

Despite the jury verdict and the 22 November 2010 ruling, HSBC continues to believe that it has meritorious defences, and intends to seek an appeal of the Court's rulings. Lead Plaintiffs, in Court filings, have estimated that damages could range 'somewhere between US\$2.4bn to US\$3.2bn to class members', before pre-judgement interest. The timing and outcome of the resolution of this matter is uncertain. Given the complexity and uncertainties associated with the actual determination of damages, including but not limited to the number of class members that may file valid claims, the number of claims that can be substantiated by class members providing adequate documentation, the reduction of trading losses by any trading gains made over the relevant period, the determination of reliance by class members on the financial statements, and whether any given class member was the beneficial owner of the shares, HSBC is unable at this time to estimate reliably the amount of any damages, or range of possible damages, that could arise, but they could be significant.

Bernard L. Madoff Investment Securities LLC

In December 2008, Bernard L. Madoff ('Madoff') was arrested for running a Ponzi scheme and a trustee was appointed for the liquidation of his firm, Bernard L. Madoff Investment Securities LLC ('Madoff Securities'), an SEC-registered broker-dealer and investment adviser. Since his appointment, the trustee has been recovering assets and processing claims of Madoff Securities customers. Madoff subsequently pleaded guilty to various charges and is serving a 150-year prison sentence. He has acknowledged, in essence, that while purporting to invest his customers' money in securities and, upon request, return their profits and principal, he in fact never invested in securities and used other customers' money to fulfil requests for the return of profits and principal. The relevant US authorities are continuing their investigations into his fraud, and have brought charges against others.

Various non-US HSBC companies provided custodial, administration and similar services to a number of funds incorporated outside the US whose assets were invested with Madoff Securities.

Based on information provided by Madoff Securities, as at 30 November 2008, the purported aggregate value of these funds was US\$8.4bn, an amount that includes fictitious profits reported by Madoff. Based on information available to HSBC to date, we estimate that the funds' actual transfers to Madoff Securities minus their actual withdrawals from Madoff Securities during the time that HSBC serviced the funds totalled approximately US\$4.3bn.

Notes on the Financial Statements (continued)

Plaintiffs (including funds, fund investors, and the Madoff Securities trustee) have commenced Madoff-related proceedings against numerous defendants in a multitude of jurisdictions. Various HSBC companies have been named as defendants in suits in the US, Ireland, Luxembourg, and other jurisdictions. The suits (which include US class actions) allege that the HSBC defendants knew or should have known of Madoff's fraud and breached various duties to the funds and fund investors. In December 2010, the Madoff Securities trustee commenced suits against various HSBC companies in the US bankruptcy court and in the English High Court. The US action (which also names certain funds, investment managers, and other entities and individuals) seeks US\$9bn in damages and additional recoveries from HSBC and the various co-defendants. It seeks damages against HSBC for allegedly aiding and abetting Madoff's fraud and breach of fiduciary duty. It also seeks, pursuant to US bankruptcy law, recovery of unspecified amounts received by HSBC from funds invested with Madoff, including amounts that HSBC received when it redeemed units HSBC held in the various funds. HSBC acquired those fund units in connection with financing transactions HSBC had entered into with various clients. The trustee's US bankruptcy law claims also seek recovery of fees earned by HSBC for providing custodial, administration and similar services to the funds. The trustee's English action seeks recovery of unspecified transfers of money from Madoff Securities to or through HSBC, on the ground that the HSBC defendants actually or constructively knew of Madoff's fraud.

Between October 2009 and July 2010, Fairfield Sentry Limited and Fairfield Sigma Limited ('Fairfield'), funds whose assets were directly or indirectly invested with Madoff Securities, commenced multiple suits in the British Virgin Islands and the US against numerous fund shareholders, including various HSBC companies that acted as nominees for clients of HSBC's private banking business and other clients who invested in the Fairfield funds. The Fairfield actions seek restitution of amounts paid to the defendants in connection with share redemptions, on the ground that such payments were made by mistake, based on inflated values resulting from Madoff's fraud.

There are many factors which may affect the range of possible outcomes, and the resulting financial impact, of the various Madoff-related proceedings, including but not limited to the circumstances of the fraud, the multiple jurisdictions in which the proceedings have been brought and the number of different plaintiffs and defendants in such proceedings. The cases where HSBC companies are named as a defendant are at an early stage. For these reasons, among others, it is not practicable at this time for HSBC to estimate reliably the aggregate liabilities, or ranges of liabilities, that might arise as a result of all such claims but they could be significant. In any event, HSBC considers that it has good defences to these claims and will continue to defend them vigorously.

Payment Protection Insurance

Following an extensive period of consultation, on 10 August 2010 the Financial Services Authority ('FSA') published Policy Statement 10/12 ('PS 10/12') on the assessment and redress of Payment Protection Insurance ('PPI') complaints. This included (i) new handbook guidance setting out how complaints are to be handled, and 'redressed fairly' where appropriate; (ii) an explanation of when and why firms should analyse their past complaints to identify if there are serious flaws in sales practices that may have affected complainants and non-complainants; and (iii) an Open Letter setting out common sales failings to help firms identify bad practices.

After extensive consideration, the British Bankers Association ('BBA'), as the representative body of UK banks, sent a formal pre-action protocol letter to the FSA and the Financial Ombudsman Service ('FOS') setting out its concerns and what it considered to be the flaws identified in PS 10/12 and Guidance issued by FOS on the handling of PPI complaints. The letter indicated that, absent a satisfactory reply, it was the BBA's intention to apply to the High Court for a Judicial Review of both PS 10/12 and the FOS Guidance. The FSA and FOS responded on 28 September 2010 denying that they had acted unlawfully in introducing the Policy Statement or relying on the Guidance.

On 8 October 2010, an application for Judicial Review was issued by the BBA seeking an order to quash PS 10/12 and the FOS Guidance. The FSA subsequently issued a statement on 24 November 2010 seeking to clarify aspects of PS 10/12 and the Open Letter. The FSA and FOS filed defences to the Judicial Review application on 10 December 2010. The Judicial Review application was heard by the Court on 25 – 28 January 2011, and judgement is currently awaited.

HSBC believes that the BBA has a strongly arguable case against both the FSA and the FOS. If the Court ultimately concludes, however, after any appeals of the judgement that may follow from any of the parties, that PS 10/12 and the FOS Guidance stand, in whole or in part, then these would need to be taken into consideration when determining complaints alleging the mis-sale of PPI.

If, contrary to HSBC's current assessment, a decision is reached in the case that results in a potential liability for HSBC, a large number of different outcomes is possible, each of which would have a different financial impact.

Notes on the Financial Statements (continued)

There are many factors affecting the range of possible outcomes, and the resulting financial impact, including the extent to which one or both of PS 10/12 and the FOS Guidance are upheld, and the underlying rationale for each decision; the ways in which PS 10/12 and or the FOS Guidance are found to impose additional requirements over and above the common law and the FSA Conduct of Business rules in force at the time relating to the sale of general insurance products, and in the handling of firms' PPI complaints; the effect of any decision on the nature and volume of customer complaints; and the extent to which, if at all, HSBC might be required to take action, and the nature of any such action, in relation to non-complainants. The extent of any redress that may be required as a result of a decision to uphold PS 10/12 and the FOS Guidance, in whole or in part, would also depend on the facts and circumstances of each individual customer's case. For these reasons, among others, HSBC does not at this time consider it practicable to provide a reliable estimate or range of estimates of the potential financial impact of an adverse decision.

Pending resolution of the dispute, HSBC continues to review all complaints received which allege that PPI has been mis-sold and, where possible, seeks to resolve them. Where HSBC considers it is not in a position to reach a final decision on a complaint until the conclusion of the application for Judicial Review of PS 10/12 and the FOS Guidance and any subsequent appeals, it informs the complainant that this is the case.

In December 2007, the Group decided to cease selling PPI products in the UK and a phased withdrawal was completed across the HSBC, first direct and M&S Money brands during 2008. HFC Bank Ltd ('HFC') ceased selling single premium PPI in 2008 and sales of regular premium PPI will reduce as HFC exits its remaining retail relationships. During the consultation process in 2009, the FSA reported that it had obtained agreement from firms representing 40% of the market for face to face single premium PPI sales to review all such sales since July 2007. No HSBC subsidiary or associate was included in that group of firms.

Regulatory and law enforcement agencies investigations

HSBC Bank USA entered into a consent cease and desist order with the Office of the Comptroller of the Currency and the indirect parent of that company, HSBC North America, entered into a consent cease and desist order with the Federal Reserve Board in the first week of October 2010. These actions require improvements for an effective compliance risk management programme across the Group's US businesses, including US Bank Secrecy Act ('BSA') and Anti Money Laundering ('AML') compliance. Steps continue to be taken to address the requirements of these Orders and to ensure that compliance and effective policies and procedures are maintained.

Various HSBC Group companies are the subject of ongoing investigations, including Grand Jury subpoenas and other requests for information, by US Government agencies, including the US Attorney's Office, the US Department of Justice and the New York County District Attorney's Office. These investigations pertain to, among other matters, HSBC Bank USA's bank note and foreign correspondent banking businesses and its compliance with BSA and AML controls, as well as various HSBC companies' compliance with Office of Foreign Asset Control ('OFAC') requirements, and adherence by certain customers to US tax reporting requirements.

The consent cease and desist orders do not preclude additional enforcement actions against HSBC Bank USA or HSBC North America by bank regulatory or law enforcement agencies, including actions to recover civil money penalties, fines and other financial penalties relating to activities which were the subject of the cease and desist orders. In addition, it is likely that there could be some form of formal enforcement action in respect of some or all of the ongoing investigations. Actual or threatened enforcement actions against other financial institutions for breaches of BSA, AML and OFAC requirements have resulted in settlements involving fines and penalties, some of which have been significant depending on the individual circumstances of each action. The ongoing investigations are at an early stage. Based on the facts currently known, it is not practicable at this time for HSBC to determine the terms on which the ongoing investigations will be resolved or the timing of such resolution or for HSBC to estimate reliably the amounts, or range of possible amounts, of any fines and/or penalties. As matters progress, it is possible that any fines and/or penalties could be significant.

Notes on the Financial Statements (continued)

45 Related party transactions

Related parties of the Group and HSBC Holdings include subsidiaries, associates, joint ventures, post-employment benefit plans for HSBC employees, Key Management Personnel, close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced, or for which significant voting power is held, by Key Management Personnel or their close family members.

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of HSBC Holdings, being the Directors and Group Managing Directors of HSBC Holdings.

Compensation of Key Management Personnel

	HSBC		
	2010 US\$m	2009 US\$m	2008 US\$m
Short-term employee benefits	39	22	31
Post-employment benefits	3	3	5
Other long-term benefits	1	–	–
Termination benefits	–	–	–
Share-based payments	49	27	16
	92	52	52

Transactions, arrangements and agreements involving related parties

Particulars of advances (loans and quasi-loans), credits and guarantees entered into by subsidiaries of HSBC Holdings during 2010 with Directors, disclosed pursuant to section 413 of the Companies Act 2006, are shown below:

	At 31 December	
	2010 US\$m	2009 US\$m
Advances and credits	9	5

Particulars of transactions with related parties, disclosed pursuant to the requirements of IAS 24, are shown below. The disclosure of the year-end balance and the highest amounts outstanding during the year in the table below is considered to be the most meaningful information to represent the amount of the transactions and the amount of outstanding balances during the year.

	2010		2009	
	Balance at 31 December US\$m	Highest amounts outstanding during year US\$m	Balance at 31 December US\$m	Highest amounts outstanding during year US\$m
Key Management Personnel¹				
Advances and credits	901	1,681	736	1,407
Guarantees	27	31	32	34

¹ Includes Key Management Personnel, close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced, or for which significant voting power is held, by Key Management Personnel or their close family members.

Some of the transactions were connected transactions, as defined by the Rules Governing The Listing of Securities on The Stock Exchange of Hong Kong Limited but were exempt from any disclosure requirements under the provisions of those Rules. The above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Notes on the Financial Statements (continued)

Shareholdings, options and other securities of Key Management Personnel

	At 31 December	
	2010 (000s)	2009 (000s)
Number of options held over HSBC Holdings ordinary shares under employee share plans	602	1,033
Number of HSBC Holdings ordinary shares held beneficially and non-beneficially	13,395	19,567
Number of HSBC Holdings preference shares held beneficially and non-beneficially	–	8
Number of HSBC Holdings 8.125% Perpetual Subordinated Capital Securities held beneficially and non-beneficially	–	25
	13,997	20,633

Transactions with other related parties of HSBC

Associates and joint ventures

The Group provides certain banking and financial services to associates and joint ventures, including loans, overdrafts, interest and non-interest bearing deposits and current accounts. Details of the interests in associates and joint ventures are given in Note 21. Transactions and balances during the year with associates and joint ventures were as follows:

	2010		2009	
	Highest balance during the year ¹ US\$m	Balance at 31 December ¹ US\$m	Highest balance during the year ¹ US\$m	Balance at 31 December ¹ US\$m
Amounts due from joint ventures:				
– subordinated	5	5	–	–
– unsubordinated	514	412	423	378
Amounts due from associates:				
– subordinated	16	–	17	17
– unsubordinated	2,248	1,702	1,343	1,239
	2,783	2,119	1,783	1,634
Amounts due to joint ventures	151	134	130	129
Amounts due to associates	700	527	1,494	136
	851	661	1,624	265

¹ The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

Post-employment benefit plans

At 31 December 2010, US\$4.7bn (2009: US\$4.2bn) of HSBC post-employment benefit plan assets were under management by HSBC companies. Fees of US\$17m (2009: US\$15m) were earned by HSBC companies for these management services provided to its post-employment benefit plans. HSBC's post-employment benefit plans had placed deposits of US\$1,840m (2009: US\$929m) with its banking subsidiaries, on which interest payable to the schemes amounted to US\$4m (2009: US\$3m). The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

HSBC Bank (UK) Pension Scheme entered into swap transactions with HSBC as part of the management of the inflation and interest rate sensitivity of its liabilities. At 31 December 2010, the gross notional value of the swaps was US\$22.9bn (2009: US\$23.7bn), the swaps had a positive fair value of US\$2.2bn (2009: positive fair value of US\$1.0bn) to the scheme and HSBC had delivered collateral of US\$3.3bn (2009: US\$2.8bn) to the scheme in respect of these swaps, on which HSBC earned interest amounting to nil (2009: US\$7m). All swaps were executed at prevailing market rates and within standard market bid/offer spreads.

In order to satisfy diversification requirements, there are special collateral provisions for the swap transactions between HSBC and the scheme. The collateral agreement stipulates that the scheme never posts collateral to HSBC. Collateral is posted to the scheme by HSBC at an amount that provides the Trustee with a high level of confidence that would be sufficient to replace the swaps in the event of default by HSBC Bank plc. With the exception of the

Notes on the Financial Statements (continued)

special collateral arrangements detailed above, all other aspects of the swap transactions between HSBC and the scheme are on substantially the same terms as comparable transactions with third-party counterparties.

On 17 June 2010, HSBC Bank plc made a £1,760m (US\$2,638m) special contribution to accelerate the reduction of the deficit of the HSBC Bank (UK) Pension Scheme. On the same day the Scheme used the contribution to acquire debt securities with a fair value of £1,760m (US\$2,638m) from HSBC in a transaction at an arm's length value determined by the Scheme's independent third-party advisors.

HSBC International Staff Retirements Benefits Scheme entered into swap transactions with HSBC to manage the inflation and interest rate sensitivity of the liabilities and selected assets. At 31 December 2010, the gross notional value of the swaps was US\$1.8bn (2009: US\$1.8bn) and the swaps had a net positive fair value of US\$77m to the scheme (2009: US\$27m).

HSBC Holdings

Details of HSBC Holdings' principal subsidiaries are shown in Note 26. Transactions and balances during the year with subsidiaries were as follows:

	2010		2009	
	Highest balance during the year ¹ US\$m	Balance at 31 December ¹ US\$m	Highest balance during the year ¹ US\$m	Balance at 31 December ¹ US\$m
Assets				
Cash at bank	459	459	443	224
Derivatives	3,219	2,327	3,682	2,981
Loans and advances	23,212	21,238	26,156	23,212
Financial investments	2,606	2,025	2,629	2,455
Investments in subsidiaries	92,899	92,899	90,914	86,247
Total related party assets	122,395	118,948	123,824	115,119
Liabilities				
Amounts owed to HSBC undertakings	4,580	2,932	5,669	3,711
Derivatives	1,677	827	1,324	362
Subordinated liabilities:				
– at amortised cost	3,907	2,464	3,907	3,907
– designated at fair value	4,507	4,259	4,360	4,360
Total related party liabilities	14,671	10,482	15,260	12,340
Guarantees	46,988	46,988	47,341	35,073
Commitments	3,240	2,720	3,241	3,240

¹ The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year. The above outstanding balances arose in the ordinary course of business and are on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties, with the exception of US\$160m (2009: US\$160m) in respect of loans to HSBC subsidiaries from HSBC Holdings and US\$506m (2009: US\$529m) in respect of loans from HSBC subsidiaries to HSBC Holdings made at an agreed zero per cent interest rate.

Some employees of HSBC Holdings are members of the HSBC Bank (UK) Pension Scheme, which is sponsored by a separate Group company. HSBC Holdings incurs a charge for these employees equal to the contributions paid into the scheme on their behalf. Disclosure in relation to the scheme is made in Note 7 to the accounts.

46 Events after the balance sheet date

A fourth interim dividend for 2010 of US\$0.12 per ordinary share (a distribution of approximately US\$2,125m) was declared by the Directors after 31 December 2010.

These accounts were approved by the Board of Directors on 28 February 2011 and authorised for issue.

Non-statutory accounts

The information set out in these accounts does not constitute the company's statutory accounts for the years ended 31 December 2010 or 2009. Those accounts have been reported on by the company's auditors: their reports were unqualified and did not contain a statement under section 498 (2) or (3) of the Companies Act 2006. The accounts for 2009 have been delivered to the Registrar of Companies and those for 2010 will be delivered in due course.

Shareholder Information

Shareholder information

Fourth interim dividend for 2010	371	Information about the enforceability of judgements made in the US	378(a)
Interim dividends for 2011	371	Exchange controls and other limitations affecting equity security holders	378(a)
Stock symbols	372	Dividends on the ordinary shares of HSBC Holdings	378(a)
Shareholder profile	372	American Depositary Shares	378(a)
Annual General Meeting	372	Nature of trading market	378(b)
Interim Management Statements and Interim Results	373	Memorandum and Articles of Association	378(c)
Shareholder enquiries and communications	373	History and development of HSBC	378(d)
Investor relations	374	Differences in HSBC Holdings/New York Stock Exchange corporate governance practices	378(e)
Where more information about HSBC is available	374	Glossary of accounting terms and US equivalents	379
Organisational structure	375	Glossary and Index	380
Taxation of shares and dividends	376		

Fourth interim dividend for 2010

The Directors have declared a fourth interim dividend for 2010 of US\$0.12 per ordinary share. Information on the scrip dividend scheme and currencies in which shareholders may elect to have the cash dividend paid will be sent to shareholders on or about 30 March 2011. The timetable for the dividend is:

Announcement	28 February 2011
Shares quoted ex-dividend in London, Hong Kong, Paris and Bermuda	16 March 2011
ADSs quoted ex-dividend in New York	16 March 2011
Record date in Hong Kong	17 March 2011
Record date in London, New York, Paris and Bermuda ¹	18 March 2011
Mailing of <i>Annual Report and Accounts 2010</i> and/or <i>Annual Review 2010</i> , Notice of Annual General Meeting and dividend documentation	30 March 2011
Final date for receipt by registrars of forms of election, Investor Centre electronic instructions and revocations of standing instructions for scrip dividends	20 April 2011
Exchange rate determined for payment of dividends in sterling and Hong Kong dollars	27 April 2011
Payment date: dividend warrants, new share certificates or transaction advices and notional tax vouchers mailed and shares credited to stock accounts in CREST	5 May 2011

¹ Removals to and from the Overseas Branch register of shareholders in Hong Kong will not be permitted on this date.

Interim dividends for 2011

The Board has adopted a policy of paying quarterly interim dividends on the ordinary shares. Under this policy it is intended to have a pattern of three equal interim dividends with a variable fourth interim dividend. It is envisaged that the first interim dividend in respect of 2011 will be US\$0.09 per ordinary share. The proposed timetables for the dividends in respect of 2011 are:

	Interim dividends for 2011			
	First	Second	Third	Fourth
Announcement	3 May 2011	1 August 2011	7 November 2011	27 February 2012
Shares quoted ex-dividend in London, Hong Kong, Paris and Bermuda	18 May 2011	17 August 2011	23 November 2011	14 March 2012
ADSs quoted ex-dividend in New York	18 May 2011	17 August 2011	23 November 2011	14 March 2012
Record date in Hong Kong	19 May 2011	18 August 2011	24 November 2011	15 March 2012
Record date in London, New York, Paris and Bermuda ¹	20 May 2011	19 August 2011	25 November 2011	16 March 2012
Payment date	6 July 2011	6 October 2011	18 January 2012	2 May 2012

¹ Removals to and from the Overseas Branch Register of shareholders in Hong Kong will not be permitted on these dates.

Dividends are declared in US dollars and, at the election of the shareholder, paid in cash in one of, or in a combination of, US dollars, sterling and Hong Kong dollars, or, subject to the Board's determination that a scrip dividend is to be offered in respect of that dividend, may be satisfied in whole or in part by the issue of new shares in lieu of a cash dividend.

Shareholder Information (continued)

Stock symbols

HSBC Holdings ordinary shares trade under the following stock symbols:

London Stock Exchange	HSBA
Hong Kong Stock Exchange	5
New York Stock Exchange (ADS)	HBC
Euronext Paris	HSB
Bermuda Stock Exchange	HSBC

Shareholder profile

At 31 December 2010 the share register recorded the following details:

Ordinary shares held	Number of shareholders	Total shares held
1-100	33,908	1,050,278
101-400	31,146	7,620,110
401-500	8,176	3,678,368
501-1,000	33,298	24,239,122
1,001-5,000	73,788	171,912,626
5,001-10,000	18,775	132,126,979
10,001-20,000	10,913	151,898,993
20,001-50,000	6,648	204,466,829
50,001-200,000	3,223	298,496,753
200,001-500,000	754	237,056,817
500,001 and above	1,104	16,453,609,027
Total	221,733	17,686,155,902

Annual General Meeting

The 2011 Annual General Meeting will be held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 27 May 2011 at 11.00am.

An informal meeting of shareholders will be held at 1 Queen's Road Central, Hong Kong on Thursday, 19 May 2011 at 4.30pm.

All resolutions considered at the 2010 Annual General Meeting were passed on a poll as follows:

Resolution	Total votes		
	For ¹	Against	Vote withheld ²
1 To receive the Report and Accounts for 2009	6,944,544,740	39,714,613	430,598,977
2 To approve the Directors' Remuneration Report for 2009	5,730,566,528	856,535,768	820,187,860
3 To re-elect the following as Directors:			
(a) R A Fairhead	7,296,815,167	101,823,159	15,277,590
(b) M F Geoghegan	7,334,050,341	32,961,299	47,188,185
(c) S K Green	6,977,475,948	323,769,338	112,927,709
(d) G Morgan	7,268,685,057	130,023,850	15,410,295
(e) N R N Murthy	7,378,931,192	19,477,921	15,363,215
(f) S M Robertson	7,153,405,009	244,795,070	15,607,399
(g) J L Thornton	6,704,405,938	234,358,448	469,120,496
(h) Sir Brian Williamson	7,380,522,401	18,038,078	15,323,823
4 To reappoint the Auditor at remuneration to be determined by the Group Audit Committee	7,359,819,272	18,027,604	36,351,240
5 To authorise the Directors to allot shares	7,264,724,799	135,841,801	16,628,621
6 To disapply pre-emption rights (Special Resolution)	7,319,169,089	79,046,168	18,836,871
7 To alter the Articles of Association (Special Resolution)	7,362,315,126	32,851,046	21,846,012
8 To approve the extension of the term of the Share Incentive Plan and the establishment of new share ownership plans	7,358,291,988	28,253,519	30,640,176
9 To approve general meetings (other than annual general meetings) being called on a minimum of 14 clear days' notice (Special Resolution)	7,050,768,076	322,799,315	43,639,277

1 Includes discretionary votes.

2 A 'Vote Withheld' is not a 'vote' in law and is not counted in the calculation of the votes 'For' and 'Against' the resolution.

Shareholder Information (continued)

Interim Management Statements and Interim Results

Interim Management Statements are expected to be issued on or around 12 May 2011 and 9 November 2011. The Interim Results for the six months to 30 June 2011 are expected to be issued on 1 August 2011.

Shareholder enquiries and communications

Enquiries

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

Principal Register:

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ
United Kingdom
Telephone: 44 (0) 870 702 0137
Email via website:
www.investorcentre.co.uk/contactus

Investor Centre:
www.investorcentre.co.uk

Hong Kong Overseas Branch Register:

Computershare Hong Kong Investor
Services Limited
Rooms 1712-1716, 17th Floor
Hopewell Centre
183 Queen's Road East
Hong Kong
Telephone: 852 2862 8555
Email: hsbc.ecom@computershare.com.hk

Investor Centre:
www.computershare.com/hk/investors

Bermuda Overseas Branch Register:

Investors Relations Team
HSBC Bank Bermuda Limited
6 Front Street
Hamilton HM 11
Bermuda
Telephone: 1 441 299 6737
Email:
hbbm.shareholder.services@hsbc.bm

Investor Centre:
www.computershare.com/investor/bm

Any enquiries relating to ADSs should be sent to the depository:

BNY Mellon Shareowner Services
PO Box 358516
Pittsburgh, PA 15252-8516
USA
Telephone (US): 1 877 283 5786
Telephone (International): 1 201 680 6825
Email: shrrelations@bnymellon.com
Website: www.bnymellon.com/shareowner

Any enquiries relating to shares held through Euroclear France, the settlement and central depository system for Euronext Paris, should be sent to the paying agent:

HSBC France
103, avenue des Champs Elysées
75419 Paris Cedex 08
France
Telephone: 33 1 40 70 22 56
Email: ost-agence-des-titres-hsbc-reims.hbfr-do@hsbc.fr
Website: www.hsbc.fr

If you have been nominated to receive general shareholder communications directly from HSBC Holdings, it is important to remember that your main contact in terms of your investment remains as it was (the registered shareholder, or perhaps custodian or broker, who administers the investment on your behalf). Therefore any changes or queries relating to your personal details and holding (including any administration thereof) must continue to be directed to your existing contact at your investment manager or custodian. HSBC Holdings cannot guarantee dealing with matters directed to it in error.

Further copies of this *Annual Report and Accounts 2010* may be obtained by writing to the following departments:

For those in Europe, the Middle East and Africa:

Group Communications
HSBC Holdings plc
8 Canada Square
London E14 5HQ
United Kingdom

For those in Asia-Pacific:

Group Communications (Asia)
The Hongkong and Shanghai Banking
Corporation Limited
1 Queen's Road Central
Hong Kong

For those in the Americas:

Internal Communications
HSBC – North America
26525 N Riverwoods Boulevard
Mettawa, Illinois 60045
USA

Shareholder Information (continued)**Electronic communications**

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

Chinese translation

A Chinese translation of this *Annual Report and Accounts 2010* is available upon request after 30 March 2011 from the Registrars:

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

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ
United Kingdom

Please also contact the Registrars if you wish to receive Chinese translations of future documents or if you have received a Chinese translation of this document and do not wish to receive such translations in future.

《2010年報及賬目》備有中譯本，各界人士可於2011年3月30日之後，向上列股份登記處索閱。

閣下如欲於日後收取相關文件的中譯本，或已收到本文件的中譯本但不希望繼續收取有關譯本，均請聯絡股份登記處。

Investor relations

Enquiries relating to HSBC's strategy or operations may be directed to:

Manager Investor Relations
HSBC Holdings plc
8 Canada Square
London E14 5HQ
United Kingdom
Telephone: 44 (0)20 7991 8041
Facsimile: 44 (0)845 587 0225
Email: investorrelations@hsbc.com

SVP Investor Relations
HSBC North America Holdings Inc.
26525 N Riverwoods Boulevard
Mettawa, Illinois 60045
USA
1 224 544 4400
1 224 552 4400
investor.relations.usa@us.hsbc.com

Head of Investor Relations, Asia-Pacific
The Hongkong and Shanghai Banking
Corporation Limited
1 Queen's Road Central
Hong Kong
852 2822 4908
852 2537 5109
investorrelations@hsbc.com.hk

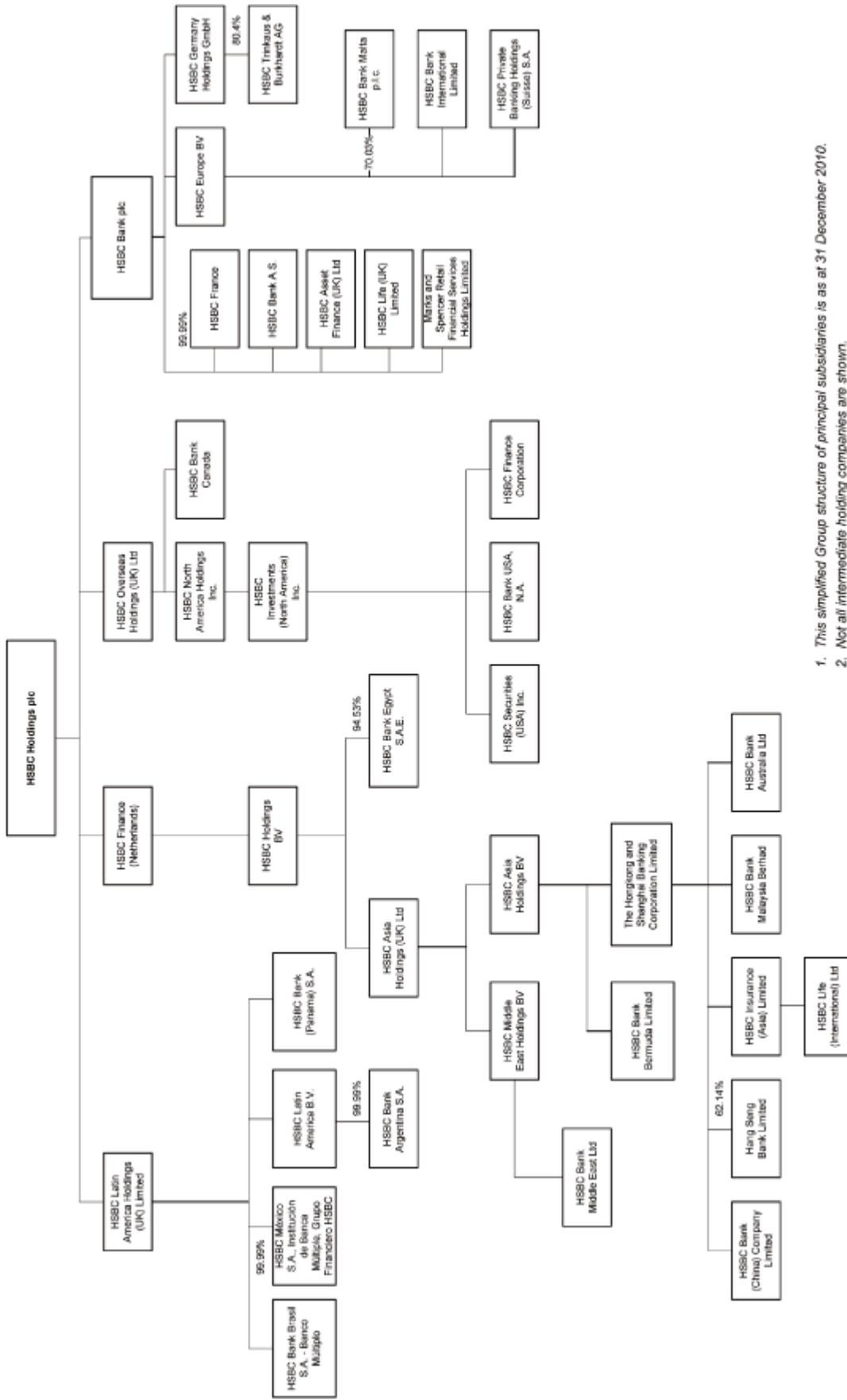
Where more information about HSBC is available

This *Annual Report and Accounts 2010*, and other information on HSBC, may be viewed on HSBC's website: www.hsbc.com.

Reports, statements and information that HSBC Holdings files with the Securities and Exchange Commission are available at www.sec.gov. Investors can also request hard copies of these documents upon payment of a duplicating fee, by writing to the SEC at the Office of Investor Education and Advocacy, 100 F Street N.E., Washington, DC 20549-0123 or by emailing PublicInfo@sec.gov. Investors should call the Commission at (202) 551 8090 if they require further assistance. Investors may also obtain the reports and other information that HSBC Holdings files at www.nyse.com (telephone number (1) 212 656 3000).

Shareholder Information (continued)

Simplified Structure Chart of HSBC Holdings plc



1. This simplified Group structure of principal subsidiaries is as at 31 December 2010.
 2. Not all intermediate holding companies are shown.
 3. Unless shown otherwise, all subsidiaries are wholly owned.

Shareholder Information (continued)

Taxation of shares and dividends

Taxation – UK residents

The following is a summary, under current law, of certain UK tax considerations that are likely to be material to the ownership and disposition of shares. The summary does not purport to be a comprehensive description of all the tax considerations that may be relevant to a holder of shares. In particular, the summary deals principally with shareholders who are resident solely in the UK for UK tax purposes and only with holders who hold the shares as investments and who are the beneficial owners of the shares, and does not address the tax treatment of certain classes of holders such as dealers in securities. Holders and prospective purchasers should consult their own advisers regarding the tax consequences of an investment in shares in light of their particular circumstances, including the effect of any national, state or local laws.

Taxation of dividends

Currently no tax is withheld from dividends paid by HSBC Holdings. However, dividends are paid with an associated tax credit which is available for set-off by certain shareholders against any liability they may have to UK income tax. Currently, the associated tax credit is equivalent to 10% of the combined cash dividend and tax credit, i.e. one-ninth of the cash dividend.

For individual shareholders who are resident in the UK for taxation purposes and liable to UK income tax at the basic rate, no further UK income tax liability arises on the receipt of a dividend from HSBC Holdings. Individual shareholders who are liable to UK income tax at the higher rate or additional rate are taxed on the combined amount of the dividend and the tax credit at the dividend upper rate (currently 32.5%) and the dividend additional rate (currently 42.5%), respectively. The tax credit is available for set-off against the dividend upper rate and the dividend additional rate liability. Individual UK resident shareholders are not entitled to any tax credit repayment.

Although non-UK resident shareholders are generally not entitled to any repayment of the tax credit in respect of any UK dividend received, some such shareholders may be so entitled under the provisions of a double taxation agreement between their country of residence and the UK. However, in most cases no amount of the tax credit is, in practice, repayable.

Information on the taxation consequences of the HSBC Holdings scrip dividends offered in lieu of the 2009 fourth interim dividend and the first, second and third interim dividends for 2010 was set out in the Secretary's letters to shareholders of 30 March, 2 June, 1 September and 1 December 2010. In no case, was the difference between the cash dividend foregone and the market value of the scrip dividend in excess of 15% of the market value. Accordingly, the amount of the dividend income chargeable to tax, and, the acquisition price of HSBC Holdings US\$0.50 ordinary shares (the 'shares') for UK capital gains tax purposes, was the cash dividend foregone.

Taxation of capital gains

The computation of the capital gains tax liability arising on disposals of shares in HSBC Holdings by shareholders subject to UK tax on capital gains can be complex, partly depending on whether, for example, the shares were purchased since April 1991, acquired in 1991 in exchange for shares in The Hongkong and Shanghai Banking Corporation Limited, or acquired subsequent to 1991 in exchange for shares in other companies.

For capital gains tax purposes, the acquisition cost for ordinary shares is adjusted to take account of subsequent rights and capitalisation issues. Any capital gain arising on a disposal by a UK company may also be adjusted to take account of indexation allowance. If in doubt, shareholders are recommended to consult their professional advisers.

Stamp duty and stamp duty reserve tax

Transfers of shares by a written instrument of transfer generally will be subject to UK stamp duty at the rate of 0.5% of the consideration paid for the transfer, and such stamp duty is generally payable by the transferee.

An agreement to transfer shares, or any interest therein, normally will give rise to a charge to stamp duty reserve tax at the rate of 0.5% of the consideration. However, provided an instrument of transfer of the shares is executed pursuant to the agreement and duly stamped before the date on which the stamp duty reserve tax becomes payable, under the current practice of UK HM Revenue and Customs it will not be necessary to pay the stamp duty reserve tax, nor to apply for such tax to be cancelled. Stamp duty reserve tax is generally payable by the transferee.

Paperless transfers of shares within CREST, the UK's paperless share transfer system, are liable to

Shareholder Information (continued)

stamp duty reserve tax at the rate of 0.5% of the consideration. In CREST transactions, the tax is calculated and payment made automatically. Deposits of shares into CREST generally will not be subject to stamp duty reserve tax, unless the transfer into CREST is itself for consideration. Following the case HSBC pursued before the European Court of Justice (Case C-569/07 HSBC Holdings plc and Vidacos Nominees v The Commissioners for HM Revenue & Customs) HMRC now accepts that the charge to stamp duty reserve tax at 1.5% on the issue of shares to a depositary receipt issuer or a clearance service located within the European Union is prohibited.

Taxation – US residents

The following is a summary, under current law, of the principal UK tax and US federal income tax considerations that are likely to be material to the ownership and disposition of shares or ADSs by a holder that is a resident of the US for US federal income tax purposes (a 'US holder') and who is not resident or ordinarily resident in the UK for UK tax purposes. The summary does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a holder of shares or ADSs. In particular, the summary deals only with US holders that hold shares or ADSs as capital assets, and does not address the tax treatment of holders that are subject to special tax rules, such as banks, tax-exempt entities, insurance companies, dealers in securities or currencies, persons that hold shares or ADSs as part of an integrated investment (including a 'straddle') comprised of a share or ADS and one or more other positions, and persons that own, directly or indirectly, 10% or more of the voting stock of HSBC Holdings. This discussion is based on laws, treaties, judicial decisions and regulatory interpretations in effect on the date hereof, all of which are subject to change. Under the current income tax treaty between the UK and the US, US holders are no longer entitled to claim a special foreign tax credit in respect of dividends.

Holders and prospective purchasers should consult their own advisers regarding the tax consequences of an investment in shares or ADSs in light of their particular circumstances, including the effect of any national, state or local laws.

Any US federal tax advice included in this *Annual Report* is for informational purposes only; it was not intended or written to be used, and cannot be used, for the purpose of avoiding US federal tax penalties.

Taxation of dividends

Currently no tax is withheld from dividends paid by HSBC Holdings. A US holder must include cash dividends paid on the shares or ADSs in ordinary income on the date that such holder or the ADS depositary receives them, translating dividends paid in UK pounds sterling into US dollars using the exchange rate in effect on the date of receipt. A US holder that elects to receive shares in lieu of a cash dividend must include in ordinary income the fair market value of such shares on the dividend payment date, and the tax basis of those shares will equal such fair market value.

Subject to certain exceptions for positions that are held for less than 61 days or are hedged, and subject to a foreign corporation being considered a 'qualified foreign corporation' (which includes not being classified for US federal income tax purposes as a passive foreign investment company), certain dividends ('qualified dividends') received by an individual US holder before 2013 generally will be subject to US taxation at a maximum rate of 15%. Based on the company's audited financial statements and relevant market and shareholder data, HSBC Holdings does not anticipate being classified as a passive foreign investment company. Accordingly, dividends paid on the shares or ADSs generally should be treated as qualified dividends.

Taxation of capital gains

Gains realised by a US holder on the sale or other disposition of shares or ADSs normally will not be subject to UK taxation unless at the time of the sale or other disposition the holder carries on a trade, profession or vocation in the UK through a branch or agency or permanent establishment and the shares or ADSs are or have been used, held or acquired for the purposes of such trade, profession, vocation, branch or agency or permanent establishment. Such gains will be included in income for US tax purposes, and will be long-term capital gains if the shares or ADSs were held for more than one year. A long-term capital gain realised by an individual holder before 2013 generally will be subject to US tax at a maximum rate of 15%.

Inheritance tax

Shares or ADSs held by an individual whose domicile is determined to be the US for the purposes of the United States-United Kingdom Double Taxation Convention relating to estate and gift taxes (the 'Estate Tax Treaty') and who is not for such purposes a national of the UK will not, provided any US Federal estate or gift tax chargeable has been

Shareholder Information (continued)

paid, be subject to UK inheritance tax on the individual's death or on a lifetime transfer of shares or ADSs except in certain cases where the shares or ADSs (i) are comprised in a settlement (unless, at the time of the settlement, the settlor was domiciled in the US and was not a national of the UK), (ii) is part of the business property of a UK permanent establishment of an enterprise, or (iii) pertains to a UK fixed base of an individual used for the performance of independent personal services. In such cases, the Estate Tax Treaty generally provides a credit against US Federal tax liability for the amount of any tax paid in the UK in a case where the shares or ADSs are subject to both UK inheritance tax and to US Federal estate or gift tax.

Stamp duty and stamp duty reserve tax – ADSs

If shares are transferred to a clearance service or depository receipt ('ADR') issuer located outside the European Union (which will include a transfer of shares to the Depository) UK stamp duty and/or stamp duty reserve tax will be payable. The stamp duty or stamp duty reserve tax is generally payable on the consideration for the transfer and is payable at the aggregate rate of 1.5%.

The amount of stamp duty reserve tax payable on such a transfer will be reduced by any stamp duty paid in connection with the same transfer.

No stamp duty will be payable on the transfer of, or agreement to transfer, an ADS, provided that the ADR and any separate instrument of transfer or written agreement to transfer remain at all times outside the UK, and provided further that any such transfer or written agreement to transfer is not executed in the UK. No stamp duty reserve tax will be payable on a transfer of, or agreement to transfer, an ADS effected by the transfer of an ADR.

US backup withholding tax and information reporting

Distributions made on shares or ADSs and proceeds from the sale of shares or ADSs that are paid within the US, or through certain financial intermediaries to US holders, are subject to information reporting and may be subject to a US 'backup' withholding tax unless, in general, the US holder complies with certain certification procedures or is a corporation or other person exempt from such withholding. Holders that are not US persons generally are not subject to information reporting or backup withholding tax, but may be required to comply with applicable certification procedures to establish that they are not US persons in order to avoid the application of such information reporting requirements or backup withholding tax to payments received within the US or through certain financial intermediaries.

Shareholder Information (continued)

Information about the enforceability of judgements made in the US

HSBC Holdings is a public limited company incorporated in England and Wales. Most of the Directors and executive officers live outside the US. As a result, it may not be possible to serve process on such persons or HSBC Holdings in the US or to enforce judgements obtained in US courts against them or HSBC Holdings based on civil liability provisions of the securities laws of the US. There is doubt as to whether English courts would enforce:

- certain civil liabilities under US securities laws in original actions; or
- judgements of US courts based upon these civil liability provisions.

In addition, awards of punitive damages in actions brought in the US or elsewhere may be unenforceable in the UK. The enforceability of any judgement in the UK will depend on the particular facts of the case as well as the laws and treaties in effect at the time.

Exchange controls and other limitations affecting equity security holders

There are currently no UK laws, decrees or regulations which would prevent the import or export of capital or remittance of distributable profits by way of dividends and other payments to holders of HSBC Holdings' equity securities who are not residents of the UK. There are also no restrictions under the laws of the UK or the terms of the Memorandum and Articles of Association concerning the right of non-resident or foreign owners to hold HSBC Holdings' equity securities or, when entitled to vote, to do so.

Dividends on the ordinary shares of HSBC Holdings

HSBC Holdings has paid dividends on its ordinary shares every year without interruption since it became the HSBC Group holding company by a scheme of arrangement in 1991. The dividends declared, per ordinary share, in respect of each of the last five years were:

		First interim	Second interim	Third interim	Fourth interim ¹	Total ²
2010	US\$	0.080	0.080	0.080	0.120	0.360
	£	0.053	0.051	0.051	0.077	0.232
	HK\$	0.622	0.621	0.622	0.933	2.798
2009	US\$	0.080	0.080	0.080	0.100	0.340
	£	0.048	0.050	0.048	0.062	0.208
	HK\$	0.620	0.620	0.620	0.775	2.635
2008	US\$	0.180	0.180	0.180	0.100	0.640
	£	0.090	0.100	0.124	0.069	0.383
	HK\$	1.403	1.398	1.395	0.775	4.971
2007	US\$	0.170	0.170	0.170	0.390	0.900
	£	0.085	0.084	0.086	0.194	0.449
	HK\$	1.328	1.322	1.325	3.041	7.016
2006	US\$	0.150	0.150	0.150	0.360	0.810
	£	0.082	0.079	0.078	0.183	0.422
	HK\$	1.164	1.167	1.168	2.799	6.298

1 The fourth interim dividend for 2010 of US\$0.12 per share has been translated into pounds sterling and Hong Kong dollars at the closing rate on 31 December 2010. The dividend will be paid on 5 May 2011.

2 The above dividends declared are accounted for as disclosed in Note 11 on the Financial Statements.

American Depositary Shares

A holder of HSBC Holdings' American Depositary Shares ('ADS's) may have to pay, either directly or indirectly (via the intermediary through whom their ADSs are held) fees to the Bank of New York Mellon as depositary. Fees may be paid or recovered

in several ways: by deduction from amounts distributed; by selling a portion of the distributable property; by annual charge deducted from dividend distributions, by directly invoicing the holder, or by charging the intermediaries who act for them. The fees for which the holders of the HSBC ADSs will be responsible include:

Shareholder Information (continued)

For:	HSBC ADS holders must pay:
Each issuance of HSBC ADSs, including as a result of a distribution of shares (through stock dividend or stock split or rights or other property)	US\$5.00 (or less) per 100 HSBC ADSs or portion thereof
Each cancellation of HSBC ADSs, including if the deposit agreement terminates	US\$5.00 (or less) per 100 HSBC ADSs or portion thereof
Transfer and registration of shares on our share register from the holder's name to the name of The Bank of New York Mellon or its agent when the holder deposits or withdraws shares	Registration or transfer fees (of which there currently are none)
Conversion of non-US currency to US dollars	Charges and expenses incurred by The Bank of New York Mellon with respect to the conversion
Each cash distribution to HSBC ADS holders	US\$0.02 or less per ADS
Cable, telex and facsimile transmission expenses	As provided in the Deposit Agreement
Transfers or issues of HSBC ordinary shares to the depositary in exchange for HSBC ADSs	Subject to the exceptions described in the 'Stamp duty and stamp duty reserve tax' paragraphs in the Shareholder Information section on page 481, stamp duty or stamp duty reserve tax equal to 1.5% (rounded up, in the case of stamp duty, to the nearest £5) of the amount of the consideration given for the transfer, or the value of the shares if there is no such consideration, or their issue price
Distribution of securities to holders of deposited securities which are distributed by the depositary to ADS holders	A fee equivalent to the fee that would be payable if securities distributed to you had been shares and the shares had been deposited for issuance of ADSs
Any charges incurred by the depositary or its agents for servicing the deposited securities	As applicable

The depositary may generally refuse to provide fee-attracting services until its fees for those services are paid.

The depositary has agreed to reimburse us for expenses incurred in the administration and maintenance of our ADS programme. There are limits on the amount of expenses for which the

depositary will reimburse us. The amount of reimbursement available is not tied to the amount of fees the depositary collects from holders of ADSs. In respect of the year ended 31 December 2010, the depositary reimbursed a total of US\$333,888 to us relating to the administration of the programme, as detailed below:

Category of expense	2010 US\$
Stock exchange listing fees	126,320
Fulfilment costs	207,568
– shareholder meeting costs (printing and distribution of materials and vote tabulation)	22,367
– beneficial holder searches	177,887
– sundry costs including: postage and envelopes for mailing annual and interim financial reports, dividend warrants, electronic filing of US Federal tax information, mailing required tax forms, stationery, postage, facsimile and telephone calls	7,314

Nature of trading market

HSBC Holdings ordinary shares are listed or admitted to trading on the London Stock Exchange, the Hong Kong Stock Exchange ('HKSE'), Euronext Paris, the New York Stock Exchange ('NYSE') and the Bermuda Stock Exchange. HSBC Holdings maintains its principal share register in England and overseas branch share registers in Hong Kong and Bermuda (collectively, the 'share register').

As at 31 December 2010, there were a total of 221,733 holders of record of HSBC Holdings ordinary shares on the share register.

As at 31 December 2010, a total of 18,643,685 of the HSBC Holdings ordinary shares were

registered in the HSBC Holdings' share register in the name of 14,248 holders of record with addresses in the US. These shares represented 0.11% of the total HSBC Holdings ordinary shares in issue.

As at 31 December 2010, there were 9,116 holders of record of ADSs holding approximately 146.5m ADSs, representing approximately 732.5m HSBC Holdings ordinary shares. 8,927 of these holders had addresses in the US, holding approximately 146.5m ADSs, representing 732.5m HSBC Holdings ordinary shares. As at 31 December 2010, approximately 4.14% of the HSBC Holdings ordinary shares were represented by ADSs held by holders of record with addresses in the US.

Shareholder Information (continued)

The following table shows, for the years, calendar quarters and months indicated, the highest and lowest prices for the HSBC Holdings ordinary shares and ADSs. These are based on mid-market prices at close of business on the London Stock

Exchange, HKSE, Euronext Paris, NYSE and the Bermuda Stock Exchange, as adjusted for the 5-for-12 rights issue completed in April 2009.

Past share price performance should not be regarded as a guide to future performance.

High and low mid-market closing prices

	London US\$0.50 shares		Hong Kong US\$0.50 shares		New York ADSs ¹		Paris US\$0.50 shares		Bermuda US\$0.50 shares	
	High pence	Low pence	High HK\$	Low HK\$	High US\$	Low US\$	High euro	Low euro	High US\$	Low US\$
2010	740	596	92.4	69.6	59.3	44.4	8.3	7.2	11.6	8.8
2009	761	304	98.0	30.6	64.0	22.0	8.6	3.3	12.5	4.6
2008	809	534	125.4	67.4	79.5	41.3	10.3	5.5	15.9	8.0
2007	840	700	140.6	119.2	90.3	74.8	12.4	9.7	17.6	14.8
2006	896	796	139.1	114.5	89.3	73.0	13.2	11.5	17.6	14.7
2010										
4 th Quarter	695	644	88.2	79.0	56.9	50.6	8.1	7.4	11.0	9.7
3 rd Quarter	680	596	82.7	71.2	53.7	45.7	8.2	7.2	10.6	8.9
2 nd Quarter	713	615	84.6	69.6	55.0	44.4	8.1	7.2	10.7	8.8
1 st Quarter	740	648	92.4	78.4	59.3	50.3	8.3	7.4	11.6	10.2
2009										
4 th Quarter	761	668	98.0	85.3	64.0	54.9	8.6	7.5	12.5	11.0
3 rd Quarter	730	493	91.8	61.4	59.5	39.9	8.1	5.7	11.6	8.2
2 nd Quarter	578	411	70.8	42.9	45.5	29.5	6.6	4.4	9.2	6.9
1 st Quarter	594	304	71.8	30.6	45.0	22.0	6.3	3.3	8.6	4.6
2011										
January	715	651	88.0	80.1	56.6	51.6	8.6	7.7	11.5	9.7
2010										
December	672	651	82.0	79.2	52.7	50.9	8.0	7.6	10.2	9.7
November	695	644	88.2	79.0	56.9	50.6	8.1	7.5	11.0	10.4
October	671	649	84.0	79.7	53.1	51.7	7.7	7.4	10.6	10.1
September	680	645	82.6	76.5	53.1	50.1	8.2	7.5	10.6	9.7
August	680	630	82.7	75.8	53.7	48.6	8.2	7.6	10.6	9.7
July	666	596	80.9	71.2	51.6	45.7	7.9	7.2	10.6	8.9

¹ In New York each ADS represents 5 underlying ordinary shares.

Memorandum and Articles of Association

The disclosure under the caption 'Memorandum and Articles of Association' contained on Form 20-F for the years ended 31 December 2000 and 2001 is incorporated by reference herein, together with the disclosure below.

Directors' interests

Subject to the provisions of the Companies Act 2006 and provided that the Articles are complied with, a Director, notwithstanding his office:

- may enter into or otherwise be interested in any contract, arrangement, transaction or proposal with HSBC Holdings or in which HSBC Holdings is otherwise interested;
- may hold any other office or place of profit under HSBC Holdings (except that of auditor or auditor of a subsidiary of HSBC Holdings) in

conjunction with the office of Director and may act by himself or through his firm in a professional capacity for HSBC Holdings, and in any such case on such terms as to remuneration and otherwise as the Board may arrange;

- may be a director or other officer, or employed by, or a party to any transaction or arrangement with or otherwise interested in, any company promoted by HSBC Holdings or in which HSBC Holdings is otherwise interested or as regards which HSBC Holdings has any powers of appointment; and
- shall not be liable to account to HSBC Holdings for any profit, remuneration or other benefit realised by any such office, employment, contract, arrangement, transaction or proposal or from any interest in any body corporate and no such contract, arrangement, transaction, proposal or interest shall be avoided on the

Shareholder Information (continued)

grounds of any such interest or benefit nor shall the receipt of any such profit, remuneration or any other benefit constitute a breach of his or her duty under the Companies Act 2006 not to accept benefits from third parties.

Since 1 October 2008, the Board may authorise any matter proposed to it which would, if not so authorised, involve a breach by a Director of his or her duty to avoid conflicts of interest under the Companies Act 2006, including, without limitation, any matter which relates to a situation in which a Director has, or can have, an interest which conflicts, or possibly may conflict, with the interest of HSBC Holdings (including the exploitation of any property, information or opportunity, whether or not HSBC Holdings could take advantage of it, but excluding any situation which cannot reasonably be regarded as likely to give rise to a conflict of interest). Any such authorisation will be effective only if:

- any requirement as to quorum at the meeting at which the matter is considered is met without counting the Director in question or any other interested Director; and
- the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

The Board may (whether at the time of the giving of the authorisation or subsequently) make any such authorisation subject to any limits or conditions it expressly imposes but such authorisation is otherwise given to the fullest extent permitted. The Board may vary or terminate any such authorisation at any time.

A Director shall be under no duty to HSBC Holdings with respect to any information which he obtains or has obtained otherwise than as a Director of HSBC Holdings and in respect of which he has a duty of confidentiality to another person.

Retirement

There is no mandatory retirement age for Directors of HSBC Holdings.

History and development of HSBC

- 1865** The founding member of the HSBC Group, The Hongkong and Shanghai Banking Corporation, is established in both Hong Kong and Shanghai.
- 1959** The Mercantile Bank of India Limited and The British Bank of the Middle East, now HSBC Bank Middle East Limited, are purchased.
- 1965** A 51% interest (subsequently increased to 62.14%) is acquired in Hang Seng Bank Limited. Hang Seng Bank is the fourth-largest listed bank in Hong Kong by market capitalisation.
- 1980** A 51% interest in Marine Midland Banks, Inc., now HSBC USA, Inc., is acquired (with the remaining interest acquired in 1987).
- 1981** The Hongkong and Shanghai Banking Corporation incorporates its then existing Canadian operations. HSBC Bank Canada subsequently makes numerous acquisitions, expanding rapidly to become the largest foreign-owned bank in Canada.
- 1987** A 14.9% interest in Midland Bank plc, now HSBC Bank plc, one of the UK's principal clearing banks, is purchased.
- 1991** HSBC Holdings plc is established as the parent company of the HSBC Group.
- 1992** We purchase the remaining interest in Midland Bank plc.
- 1993** As a consequence of the Midland acquisition, our Head Office is transferred from Hong Kong to London in January.
- 1997** We assume selected assets, liabilities and subsidiaries of Banco Bamerindus do Brasil S.A., now HSBC Bank Brazil, following the intervention of the Central Bank of Brazil, and in Argentina completes the acquisition of Grupo Roberts, now part of HSBC Bank Argentina S.A.
- 1999** We acquire Republic New York Corporation, subsequently merged with HSBC USA, Inc., and Safra Republic Holdings S.A.
- 2000** We complete our acquisition of 99.99% of the issued share capital of Crédit Commercial de France S.A., now HSBC France.
- 2002** We acquire 99.59% of Grupo Financiero Bital, S.A. de C.V., the holding company of what is now HSBC Mexico.
- 2003** We acquire Household International, Inc., now HSBC Finance Corporation.
- 2003** We acquire Banco Lloyds TSB S.A.—Banco Múltiplo in Brazil and the country's leading consumer finance company, Losango Promotora de Vendas Limitada.
- 2004** HSBC Bank USA, Inc. merges with HSBC Bank & Trust (Delaware) N.A. to form HSBC Bank USA, N.A.
- 2004** We completed the acquisition of The Bank of Bermuda Limited.
- 2004** We acquire Marks and Spencer Retail Financial Services Holdings Limited, which trades as Marks and Spencer Money ('M&S Money') in the UK.
- 2004** We acquire 19.9% of Bank of Communications, and Hang Seng Bank acquires 15.98% of Industrial Bank.

Shareholder Information (continued)

- 2005** We increase our holding in Ping An Insurance to 19.9%, having made its initial investment in 2002. Ping An Insurance is the second-largest life insurer and the third-largest property and casualty insurer in mainland China.
- 2005** HSBC Finance completes the acquisition of Metris Companies Inc., making HSBC the fifth-largest issuer of MasterCard and Visa cards in the USA.
- 2006** We acquire Grupo Banistmo S.A. ('Banistmo'), the leading banking group in Central America, through a tender offer to acquire 99.98% of the outstanding shares of Banistmo.
- 2007** Our three associates in mainland China, Industrial Bank, Ping An Insurance and Bank of Communications, issue new shares. We do not subscribe and, as a result, our interests in the associates' equity decrease from 15.98% to 12.78%, from 19.90% to 16.78% and from 19.90% to 18.60%, respectively. Subsequently, we increase our holding in Bank of Communications from 18.60% to 19.01%.
- 2008** We acquire the assets, liabilities and operations of The Chinese Bank in Taiwan.
- 2008** We complete the sale of our seven French regional banks.
- 2009** In May, we complete the acquisition of 88.89% of PT Bank Ekonomi Raharja Tbk in Indonesia.

Differences in HSBC Holdings/New York Stock Exchange corporate governance practices

Under the NYSE's corporate governance rules for listed companies and the applicable rules of the SEC, as a NYSE-listed foreign private issuer, HSBC Holdings must disclose any significant ways in which its corporate governance practices differ from those followed by US companies subject to NYSE listing standards. HSBC Holdings believes the following to be the significant differences between its corporate governance practices and NYSE corporate governance rules applicable to US companies.

US companies listed on the NYSE are required to adopt and disclose corporate governance guidelines. The Listing Rules of the FSA require each listed company incorporated in the UK to include in its *Annual Report and Accounts* a statement of how it has applied the principles of the Combined Code and a statement as to whether or not it has complied with the code provisions of the Combined Code throughout the accounting period covered by the *Annual Report and Accounts*. A company that has not complied with the Code provisions, or complied with only some of the Code provisions or (in the case of provisions whose requirements are of a continuing nature) complied for only part of an accounting period covered by the report, must specify the Code provisions with which it has not complied, and (where relevant) for what

part of the reporting period such non-compliance continued, and give reasons for any non-compliance. As stated above, HSBC Holdings complied throughout 2010 with the applicable code provisions of the Combined Code. The Combined Code does not require HSBC Holdings to disclose the full range of corporate governance guidelines with which it complies.

Under NYSE standards, companies are required to have a nominating/corporate governance committee, composed entirely of independent directors. In addition to identifying individuals qualified to become Board members, this committee must develop and recommend to the Board a set of corporate governance principles. Our Nomination Committee complies with the Combined Code, which requires a majority of members to be independent. The majority of members of the Committee during 2010 were independent non-executive Directors. Lord Green succeeded Sir Brian Williamson as chairman of the Nomination Committee on 26 February 2010 and served until his retirement on 3 December 2010 when he was succeeded by D J Flint, upon his appointment as Group Chairman. The Committee's terms of reference do not require the Committee to develop and recommend corporate governance principles for HSBC Holdings. As stated above, HSBC Holdings is subject to the corporate governance principles of the Combined Code.

Pursuant to NYSE listing standards, non-management directors must meet on a regular basis without management present and independent directors must meet separately at least once per year.

During 2010, the HSBC Holdings' non-executive Directors and the Group Chairman met three times without the other executive Directors and the non-executive Directors and Group Chairman and Group Chief Executive met once without the other executive Directors. HSBC Holdings' practice, in this regard, complies with the Combined Code.

In accordance with the requirements of the Combined Code, HSBC Holdings discloses in its annual report how the Board, its committees and the Directors are evaluated (on page 194) and provides extensive information regarding Directors' compensation in the Directors' Remuneration Report (on pages 220 to 233). The terms of reference of HSBC Holdings' Audit, Nomination, Remuneration and Risk Committees are available at www.hsbc.com/boardcommittees.

NYSE listing standards require US companies to adopt a code of business conduct and ethics for directors, officers and employees, and promptly

Shareholder Information (continued)

disclose any waivers of the code for directors or executive officers. In December 2009, the Board endorsed three Group Values statements underpinned by the continued use of our Business Principles, in replacement of the Group Business Principles and Values. In addition to the Group Values statements and Business Principles (and previously the Group Business Principles and Values), which apply to the employees of all our companies, pursuant to the requirements of the Sarbanes-Oxley Act the Board of HSBC Holdings has adopted a Code of Ethics applicable to the Group Chairman and the Group Chief Executive, as the principal executive officers, and to the Group Finance Director and Group Chief Accounting Officer. HSBC Holdings' Code of Ethics is available on www.hsbc.com/codeofethics or from the Group Company Secretary at 8 Canada Square, London E14 5HQ. If the Board amends or waives the provisions of the Code of Ethics, details of the amendment or waiver will appear at the same website address. During 2010, HSBC Holdings made no amendments to its Code of Ethics and granted no waivers from its provisions. The references to the standards to be followed by all employees reflect the Board's endorsement of Group Values statements underpinned by the continued use of our Business Principles. The Group Values statements and Business Principles are available on www.hsbc.com/groupvalues.

Under NYSE listing rules applicable to US companies, independent directors must comprise a majority of the Board of directors. Currently, two thirds of HSBC Holdings' Directors are independent.

Under the Combined Code the HSBC Holdings Board determines whether a Director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the Director's judgement. Under the NYSE rules a director cannot qualify as independent unless the board affirmatively determines that the director has no material relationship with the listed company; in addition the NYSE rules prescribe a list of circumstances in which a director cannot be independent. The Combined Code requires a company's board to assess director independence by affirmatively concluding that the director is independent of management and free from any business or other relationship that could materially interfere with the exercise of independent judgement. Lastly, a chief executive officer of a US company listed on the NYSE must annually certify that he or she is not aware of any violation by the company of NYSE corporate governance standards. In accordance with NYSE listing rules applicable to foreign private issuers, HSBC Holdings' Group Chief Executive is not required to provide the NYSE with this annual compliance certification. However, in accordance with rules applicable to both US companies and foreign private issuers, the Group Chief Executive is required promptly to notify the NYSE in writing after any executive officer becomes aware of any material non-compliance with the NYSE corporate governance standards applicable to HSBC Holdings.

HSBC Holdings is required to submit annual and interim written affirmations of compliance with applicable NYSE corporate governance standards, similar to the affirmations required of NYSE-listed US companies.

Form 20-F Item Number and Caption	Location	Page
PART I		
1. Identity of Directors, Senior Management and Advisers	Not required for Annual Report	—
2. Offer Statistics and Expected Timetable	Not required for Annual Report	—
3. Key Information		
A. Selected Financial Data	Consolidated income statement, Consolidated balance sheet, Shareholder information	16, 29, 378(a)
B. Capitalisation and Indebtedness	Not required for Annual Report	—
C. Reasons for the Offer and use of Proceeds	Not required for Annual Report	—
D. Risk Factors	Challenges and Uncertainties	88-93
4. Information on the Company		
A. History and Development of the Company	Operating and Financial Review	11-85, 392
	Shareholder Information	371 – 378(f)
B. Business Overview	Operating and Financial Review	11-85(a)
	Regulation and Supervision	85(b) – 85(f)
C. Organisational Structure	Principal Activities	10
	Organisational Structure Chart	375
	Note 26 – Notes on the Financial Statements	338-340
D. Property, Plants and Equipment	Property	81
	Note 25 – Notes on the Financial Statements	336-338
4 A. Unresolved Staff Comments	Not Applicable	—
5. Operating and Financial Review and Prospects		
A. Operating Results	Operating and Financial Review	11-85(a)
B. Liquidity and Capital Resources	Risk	140-145, 168-171, 177-182
C. Research and Development, Patents and Licences, etc.	Not Applicable	—
D. Trend Information	Operating and Financial Review	11-85(a)
E. Off-Balance Sheet Arrangements	Note 41 – Notes on the Financial Statements	358-359
	Note 43 – Notes on the Financial Statements	361-364
F. Contractual Obligations	Operating and Financial Review	31(l)
6. Directors, Senior Management and Employees		

Form 20-F Item Number and Caption	Location	Page
A. Directors and Senior Management	Governance	183-188
B. Compensation	Directors' Remuneration Report	220-233
C. Board Practices	Report of the Directors	189-190
	Directors' Remuneration Report	228-229
	Directors' Remuneration Report	231
D. Employees	Governance	206-207
E. Share Ownership	Governance	204-206
	Directors' Remuneration Report	232-233
7. Major Shareholders and Related Party Transactions		
A. Major Shareholders	Governance	218
B. Related Party Transactions	Note 45 - Notes on the Financial Statements	368-370
C. Interests of Experts and Counsel	Not required for Annual Report	—
8. Financial Information		
A. Consolidated Statements and Other Financial Information Financial	Statements	237-370
	Legal Proceedings	82-83
	Note 44 – Notes on the Financial Statements	365-367
	Shareholder Information	371-372
B. Significant Changes	Not Applicable	—
9. The Offer and Listing		
A. Offer and Listing Details	Shareholder Information	378(b) – 378(c)
B. Plan of Distribution	Not required for Annual Report	—
C. Markets	Shareholder Information	378(b) – 378(c)
D. Selling Shareholders	Not required for Annual Report	—
E. Dilution	Not required for Annual Report	—
F. Expenses of the Issue	Not required for Annual Report	—
10. Additional Information		
A. Share Capital	Not required for Annual Report	—
B. Memorandum and Articles of Association	Shareholder Information	378(c)-378(d)
C. Material Contracts	Not Applicable	—
D. Exchange Controls	Exchange controls and other limitations affecting security holders	378(a)
E. Taxation	Shareholder Information	377-378

Form 20-F Item Number and Caption	Location	Page
F. Dividends and Paying Agents	Not required for Annual Report	—
G. Statements by Experts	Not required for Annual Report	—
H. Documents on Display	Shareholder Information	374
I. Subsidiary Information	Not Applicable	—
11. Quantitative and Qualitative Disclosures About Market Risk	Management of Risk	145-154
	Note 20 and 36 – Notes on the Financial Statements	322-326, 351
12. Description of Securities Other than Equity Securities		
A. Debt Securities	Not required for Annual Report	—
B. Warrants and Rights	Not required for Annual Report	—
C. Other Securities	Not required for Annual Report	—
D. American Depositary Shares	Shareholder Information	378(a) – 378(b)
PART II		
13. Defaults, Dividends Arrearages and Delinquencies	Not Applicable	—
14. Material Modifications to the Rights of Securities Holders and Use of Proceeds	Not Applicable	—
15. Controls and Procedures	Report of Independent Registered Public Accounting Firm to the Board of Directors and shareholders of HSBC Holdings plc	235-236
	Disclosure Controls	80(h)
16. [Reserved]		
A. Audit Committee Financial Expert	Report of the Directors	195
B. Code of Ethics	Report of the Directors	378(f)
C. Principal Accountant Fees and Services	Report of the Directors	197
	Note 8 – Notes on the Financial Statements	285
D. Exemptions from the Listing Standards for Audit Committees	Not Applicable	—
E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers	Report of the Directors	218
F. Changes in Registrant’s Certifying Accountant	Not Applicable	—
G. Corporate Governance	Shareholder Information	378(e) – 378(f)
PART III		
17. Financial Statements	Not Applicable	—
18. Financial Statements	Financial Statements	238-370
19. Exhibits (including Certifications)		*

Shareholder Information (continued)**Glossary of accounting terms and US equivalents**

Accounting term	US equivalent or brief description
Accounts	Financial Statements
Articles of Association	Bylaws
Associates	Long-term equity investments accounted for using the equity method
Attributable profit	Net income
Balance sheet	Statement of financial position
Bills	Notes
Called up share capital	Ordinary shares, issued and fully paid
Capital allowances	Tax depreciation allowances
Creditors	Payables
Debtors	Receivables
Deferred tax	Deferred income tax
Depreciation	Amortisation
Finance lease	Capital lease
Freehold	Ownership with absolute rights in perpetuity
Interests in associates and joint ventures	Long-term equity investments accounted for using the equity method
Loans and advances	Lendings
Loan capital	Long-term debt
Nominal value	Par value
One-off	Non-recurring
Ordinary shares	Common stock
Overdraft	A line of credit, contractually repayable on demand unless a fixed-term has been agreed, established through a customer's current account
Preference shares	Preferred stock
Premises	Real estate
Provisions	Liabilities
Share capital	Ordinary shares or common stock issued and fully paid
Shareholders' equity	Stockholders' equity
Share premium account	Additional paid-in capital
Shares in issue	Shares outstanding
Write-offs	Charge-offs

Shareholder Information (continued)

Glossary

Abbreviation	Brief description
A	
ABS ¹	Asset-backed security
ADR	American Depositary Receipt
ADS	American Depositary Share
Advance	HSBC Advance, a global banking proposition for the mass-affluent segment of customers
AIEA	Average interest-earning assets
ALCO	Asset and Liability Management Committee
ARM	Adjustable-rate mortgage
ASF	Asset and Structured Finance
ATM	Automated teller machine
B	
Bank of Communications	Bank of Communications Co., Limited, mainland China's fourth largest bank by market capitalisation
Bank Ekonomi	PT Bank Ekonomi Raharja Tbk
Bao Viet	BaoViet Holdings, an insurance and financial services company in Vietnam
Barion	Barion Funding Limited, a term funding vehicle
Basel Committee	Basel Committee on Banking Supervision
Basel I	1988 Basel Capital Accord
Basel II ¹	2006 Basel Capital Accord
Basel III ¹	Basel Committee's reforms to strengthen global capital and liquidity rules
BBA	British Bankers' Association
Bps	Basis points. One basis point is equal to one hundredth of a percentage point
Brazilian operations	HSBC Bank Brasil S.A.–Banco Múltiplo and subsidiaries, plus HSBC Serviços e Participações Limitada
C	
CARD Act	Credit Card Accountability, Responsibility and Disclosure Act, US
CD	Certificate of deposit
CDS ¹	Credit default swap
CDO ¹	Collateralised debt obligation
CDPC	Credit derivative product companies
CGU	Cash-generating unit
CMB	Commercial Banking, a customer group
CNAV ¹	Constant Net Asset Value
Combined Code	Combined Code on Corporate Governance issued by the Financial Reporting Council
CP ¹	Commercial paper
CPI	Consumer price index
CRR ¹	Customer risk rating
D	
DPF	Discretionary participation feature of insurance and investment contracts
E	
EPS	Earnings per share
EU	European Union
F	
Fannie Mae	Federal National Mortgage Association, US
Financiera Independencia	Financiera Independencia S.A.B. de C.V.
Freddie Mac	Federal Home Loan Mortgage Corporation, US
FSA	Financial Services Authority (UK)
FTSE	Financial Times – Stock Exchange index
G	
G20	Leaders, Finance Ministers and Central Bank Governors of the Group of Twenty
GAAP	Generally Accepted Accounting Principles
GB&M	Global Banking and Markets, a global business
GDP	Gross domestic product
Ginnie Mae	Government National Mortgage Association, US
Global Markets	HSBC's treasury and capital markets services in Global Banking and Markets
GMB	Group Management Board
GMO	Group Management Office
GPB	Global Private Banking
Group	HSBC Holdings together with its subsidiary undertakings
G-SIFI	Global Systemically Important Financial Institution

Shareholder Information (continued)

Abbreviation	Brief description
H	
Hang Seng Bank	Hang Seng Bank Limited, one of Hong Kong's largest banks
HELoC ¹	Home equity lines of credit
HFC	HFC Bank Limited, the UK-based consumer finance business acquired through the acquisition by HSBC of HSBC Finance
HIBOR	Hong Kong Interbank Offer Rate
HNAH	HSBC North American Holdings Inc.
Hong Kong	The Hong Kong Special Administrative Region of the People's Republic of China
HSBC	HSBC Holdings together with its subsidiary undertakings
HSBC Assurances	HSBC Assurances, comprising Erisa S.A., the French life insurer, and Erisa I.A.R.D., the property and casualty insurer (together, formerly Erisa)
HSBC Bank	HSBC Bank plc, formerly Midland Bank plc
HSBC Bank Argentina	HSBC Bank Argentina S.A.
HSBC Bank Bermuda	HSBC Bank Bermuda Limited formerly The Bank of Bermuda Limited
HSBC Bank Malaysia	HSBC Bank Malaysia Berhad
HSBC Bank Middle East	HSBC Bank Middle East Limited, formerly The British Bank of the Middle East
HSBC Bank Panama	HSBC Bank (Panama) S.A., formerly Grupo Banistmo S.A.
HSBC Bank USA	HSBC's retail bank in the US, HSBC Bank USA, N.A. (formerly HSBC Bank USA, Inc.)
HSBC Finance	HSBC Finance Corporation, the US consumer finance company (formerly Household International, Inc.)
HSBC France	HSBC's French banking subsidiary, formerly CCF S.A.
HSBC Holdings	HSBC Holdings plc, the parent company of HSBC
HSBC Mexico	HSBC México S.A., the commercial banking subsidiary of Grupo Financiero HSBC, S.A. de C.V.
HSBC Premier	HSBC's premium global banking service
HSBC Private Bank (Suisse)	HSBC Private Bank (Suisse) S.A., HSBC's private bank in Switzerland
I	
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IFRIC	International Financial Reporting Interpretations Committee
IFRSs	International Financial Reporting Standards
Industrial Bank	Industrial Bank Co. Limited, a national joint-stock bank in mainland China held by Hang Seng Bank
IPO	Initial public offering
IRB ¹	Internal ratings-based
K	
KPI	Key performance indicator
KPMG	KPMG Audit Plc and its affiliates
L	
LGD ¹	Loss given default
LIBOR	London Interbank Offer Rate
Losango	Losango Promoções e Vendas Ltda, the Brazilian consumer finance company
M	
M&S Money	Marks and Spencer Retail Financial Services Holdings Limited
Madoff Securities	Bernard L Madoff Investment Securities LLC
Mainland China	People's Republic of China excluding Hong Kong
Malachite	Malachite Funding Limited, a term funding vehicle
Mazarin	Mazarin Funding Limited, an asset-backed CP conduit
MBS ¹	US mortgage-backed security
Monoline ¹	Monoline insurance company
MSCI	Morgan Stanley Capital International index
N	
NYSE	New York Stock Exchange
O	
OFAC	Office of Foreign Asset Control
OTC ¹	Over-the-counter
P	
PD ¹	Probability of default
Performance Shares	Awards of HSBC Holdings ordinary shares under employee share plans that are subject to corporate performance conditions
PFS	Personal Financial Services, a customer group
Ping An Insurance	Ping An Insurance (Group) Company of China, Limited, the second-largest life insurer in the PRC
PPI	Payment protection insurance product
PRC	People's Republic of China
Premier	See HSBC Premier
PVIF	Present value of in-force long-term insurance business

Shareholder Information (continued)

Abbreviation	Brief description
R	
Repo	Sale and repurchase transaction
Restricted Shares	Awards of Restricted Shares define the number of HSBC Holdings ordinary shares to which the employee will become entitled, generally between one and three years from the date of the award, and normally subject to the individual remaining in employment
Reverse repo	Security purchased under commitments to sell
RPI	Retail price index (UK)
S	
S&P	Standard and Poor's rating agency
SEC	Securities and Exchange Commission (US)
SIC	Securities investment conduit
SIV ¹	Structured investment vehicle
SME	Small and medium-sized enterprise
Solitaire	Solitaire Funding Limited, a special purpose entity managed by HSBC
SPE ¹	Special purpose entity
STIP	Short-term income protection insurance product
T	
The Hongkong and Shanghai Banking Corporation	The Hongkong and Shanghai Banking Corporation Limited, the founding member of the HSBC Group
TSR	Total shareholder return
U	
UAE	United Arab Emirates
UK	United Kingdom
US	United States of America
V	
VAR ¹	Value at risk
Visa	Visa Inc.

¹ Full definition included in Glossary of Terms on page 383.

Shareholder Information (continued)

Term	Definition
A	
Adjustable-rate mortgages ('ARM's')	Mortgage loans in the US on which the interest rate is periodically changed based on a reference price. These are included within 'affordability mortgages'.
Affordability mortgages	Mortgage loans where the customer's monthly payments are set out at a low initial rate, either variable or fixed, before resetting to a higher rate once the introductory period is over.
Agency exposures	Exposures to near or quasi-government agencies including public sector entities fully owned by government carrying out non-commercial activities, provincial and local government authorities, development banks and funds set up by government.
Alt-A	A US description for loans regarded as lower risk than sub-prime, but with higher risk characteristics than lending under normal criteria.
Arrears	Customers are said to be in arrears (or in a state of delinquency) when they are behind in fulfilling their obligations, with the result that an outstanding loan is unpaid or overdue. When a customer is in arrears, the total outstanding loans on which payments are overdue are described as delinquent.
Asset-backed securities ('ABS's')	Securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows but are commonly pools of residential or commercial mortgages.
B	
Back-testing	A statistical technique used to monitor and assess the accuracy of a model, and how that model would have performed had it been applied in the past.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.
Basel III	In December 2010, the Basel Committee issued final rules 'Basel III: A global regulatory framework for more resilient banks and banking systems' and 'Basel III: International framework for liquidity risk measurement, standards and monitoring'. Together these documents present the Basel Committee's reforms to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The new requirements will be phased in starting 1 January 2013 with full implementation by 1 January 2019.
C	
Capital conservation buffer	A capital buffer, prescribed by regulators under Basel III, and designed to ensure banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred. Should a bank's capital levels fall within the capital conservation buffer range, capital distributions will be constrained by the regulators.
Capital planning buffer	A capital buffer, prescribed by the FSA under Basel II, and designed to ensure banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred. Should a bank's capital levels fall within the capital planning buffer range, a period of heightened regulatory interaction would be triggered.
Collateralised debt obligation ('CDO')	A security issued by a third-party which references ABSs and/or certain other related assets purchased by the issuer. CDOs may feature exposure to sub-prime mortgage assets through the underlying assets.
Collectively assessed impairment	Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment.
Commercial paper ('CP')	An unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts receivable, inventories and meeting short-term liabilities. The debt is usually issued at a discount, reflecting prevailing market interest rates.
Commercial real estate	Any real estate investment, comprising buildings or land, intended to generate a profit, either from capital gain or rental income.
Common equity tier 1 capital	The highest quality form of regulatory capital under Basel III that comprises common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments.
Conduits	HSBC sponsors and manages multi-seller conduits and securities investment conduits ('SIC's). The multi-seller conduits hold interests in diversified pools of third-party assets such as vehicle loans, trade receivables and credit card receivables funded through the issuance of short-dated commercial paper and supported by a liquidity facility. The SICs hold predominantly asset-backed securities referencing such items as commercial and residential mortgages, vehicle loans and credit card receivables funded through the issuance of both long-term and short-term debt.
Constant net asset value fund ('CNAV')	A fund that prices its assets on an amortised cost basis, subject to the amortised book value of the portfolio remaining within 50 basis points of its market value.
Contractual maturities	The date on which the final payment (principal or interest) of any financial instrument is due to be paid, at which point all the remaining outstanding principal and interest have been repaid.
Core tier 1 capital	The highest quality form of regulatory capital that comprises total shareholders' equity and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments.
Countercyclical capital buffer	A capital buffer, prescribed by regulators under Basel III, which aims to ensure that capital requirements take account of the macro-financial environment in which banks operate. This will provide the banking sector with additional capital to protect it against potential future losses, when excess credit growth in the financial system as a whole is associated with an increase in system-wide risk.

Shareholder Information (continued)

Term	Definition
Credit default swap	A derivative contract whereby a buyer pays a fee to a seller in return for receiving a payment in the event of a defined credit event (e.g. bankruptcy, payment default on a reference asset or assets, or downgrades by a rating agency) on an underlying obligation (which may or may not be held by the buyer).
Credit derivative product companies ('CDPC's')	Independent companies that specialise in selling credit default protection on corporate exposures in the form of credit derivatives.
Credit enhancements	Facilities used to enhance the creditworthiness of financial obligations and cover losses due to asset default.
Credit risk	Risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises mainly from direct lending, trade finance and leasing business, but also from products such as guarantees, derivatives and debt securities.
Credit risk adjustment	An adjustment to the valuation of OTC derivative contracts to reflect the creditworthiness of OTC derivative counterparties.
Credit risk mitigation	A technique to reduce the credit risk associated with an exposure by application of credit risk mitigants such as collateral, guarantee and credit protection.
Credit risk spread	The premium over the benchmark or risk-free rate required by the market to accept a lower credit quality. The yield spread between securities with the same coupon rate and maturity structure but with different associated credit risks. The yield spread rises as the credit rating worsens.
Customer deposits	Money deposited by account holders. Such funds are recorded as liabilities.
Customer risk rating ('CRR')	A scale of 23 grades measuring internal obligor probability of default.
D	
Debt restructuring	A restructuring by which the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge reduction.
Debt securities	Assets on the Group's balance sheet representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposits.
Deed-in-lieu	An arrangement in which a borrower surrenders the deed for a property to the lender without going through foreclosure proceedings and is subsequently released from any further obligations on the loan.
Delinquency	See 'Arrears'.
E	
Economic capital	The internally calculated capital requirement which is deemed necessary by HSBC to support the risks to which it is exposed at a confidence level consistent with a target credit rating of AA.
Economic profit	The difference between the return on financial capital invested by shareholders and the cost of that capital. Economic profit may be expressed as a whole number or as a percentage.
Equity risk	The risk arising from positions, either long or short, in equities or equity-based instruments, which create exposure to a change in the market price of the equities or equity instruments.
Expected loss ('EL')	A regulatory calculation of the amount expected to be lost on an exposure using a 12 month time horizon and downturn loss estimates. EL is calculated by multiplying the Probability of Default (a percentage) by the Exposure at Default (an amount) and Loss Given Default (a percentage).
Exposure	A claim, contingent claim or position which carries a risk of financial loss.
Exposure at default ('EAD')	The amount expected to be outstanding after any credit risk mitigation, if and when the counterparty defaults. EAD reflects drawn balances as well as allowance for undrawn amounts of commitments and contingent exposures.
F	
Fair value adjustment	An adjustment to the fair value of a financial instrument which is determined using a valuation technique (level 2 and level 3) to include additional factors that would be considered by a market participant that are not incorporated within the valuation model.
First lien	A security interest granted over an item of property to secure the repayment of a debt that places its holder first in line to collect repayment from the sale of the underlying collateral in the event of a default on the debt.
Forbearance strategies	Strategies that are employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid foreclosure or repossession. Such arrangements include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, the deferral of foreclosures, other modifications and loan restructures.
Funded exposures	A funded exposure is one where the notional amount of a contract is or has been exchanged.
Funding risk	A form of liquidity risk arising when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.
G	
Government-sponsored enterprises ('GSE's')	A group of financial services enterprises created by the US Congress. Their function is to reduce the cost of capital for certain borrowing sectors of the economy, and to make them more efficient and transparent. Examples in the residential mortgage borrowing segment are Freddie Mac and Fannie Mae. GSEs carry the implicit backing, but are not direct obligations of, the US Government.

Shareholder Information (continued)

Term	Definition
H	
Historical rating transition matrices ('HRTM')	HRTMs show the probability of a counterparty with a particular rating moving to a different rating over a defined time horizon.
Home Equity Lines of Credit ('HELoC's')	A form of revolving credit facility provided to US customers, which is supported by a first or second lien charge over residential property.
I	
Impaired loans	Loans where the Group does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.
Impairment allowances	Management's best estimate of losses incurred in the loan portfolios at the balance sheet date.
Individually assessed impairment	Exposure to loss is assessed on all individually significant accounts and all other accounts that do not qualify for collective assessment.
Insurance risk	A risk, other than a financial risk, transferred from the holder of a contract to the insurance provider. The principal insurance risk is that, over time, the combined cost of claims, administration and acquisition of the contract may exceed the aggregate amount of premiums received and investment income.
Internal Capital Adequacy Assessment Process	The Group's own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
Internal Model Method ('IMM')	One of three approaches defined by Basel II to determine exposure values for counterparty credit risk.
Internal ratings-based approach ('IRB')	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
Invested capital	Equity capital invested in HSBC by its shareholders.
IRB advanced approach	A method of calculating credit risk capital requirements using internal PD, LGD and EAD models.
IRB foundation approach	A method of calculating credit risk capital requirements using internal PD models but with supervisory estimates of LGD and conversion factors for the calculation of EAD.
ISDA	International Swaps and Derivatives Association.
ISDA Master agreement	Standardised contract developed by ISDA used as an umbrella under which bilateral derivatives contracts are entered into.
K	
Key management personnel	Directors and Group Managing Directors of HSBC Holdings.
L	
Level 1 - quoted market price	Financial instruments with quoted prices for identical instruments in active markets.
Level 2 - valuation technique using observable inputs	Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
Level 3 - valuation technique with significant unobservable inputs	Financial instruments valued using valuation techniques where one or more significant inputs are unobservable.
Leveraged finance	Funding provided for entities with higher than average indebtedness, which typically arises from sub-investment grade acquisitions or event-driven financing.
Leverage ratio	A measure, prescribed by regulators under Basel III, which is the ratio of tier 1 capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives, and should generally follow the accounting measure of exposure. This supplementary measure to the risk-based capital requirements is intended to constrain the build-up of excess leverage in the banking sector.
Liquidity risk	The risk that HSBC does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.
Loan modification	An account management action that results in a change to the original terms and conditions of a loan either temporarily or permanently without resetting its delinquency status, except in case of a 'modification re-age' where delinquency status is also reset to up-to-date. Account modifications may include revisions to one or more terms of the loan including, but not limited to, a change in interest rate, extension of the amortisation period, reduction in payment amount and partial forgiveness or deferment of principal.
Loan re-age	An account management action that results in the resetting of the contractual delinquency status of an account to up-to-date upon fulfilment of certain requirements which indicate that payments are expected to be made in accordance with the contractual terms.
Loans past due	Loans on which repayments are overdue.
Loan-to-value ratio ('LTV')	A mathematical calculation that expresses the amount of the loan as a percentage of the value of security. A high LTV indicates that there is less cushion to protect the lender against house price falls or increases in the loan if repayments are not made and interest is added to the outstanding loan balance.
Loss given default ('LGD')	The estimated ratio (percentage) of the loss on an exposure to the amount outstanding at default (EAD) upon default of a counterparty.
Loss severity	The realised amount of losses incurred (including ancillary amounts owed) when a loan is foreclosed or disposed of through the arrangement with the borrower. The loss severity is represented as a percentage of the outstanding loan balance.

Shareholder Information (continued)

Term	Definition
M	
Market risk	The risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices will reduce income or portfolio values.
Medium term notes ('MTN's')	Notes issued by corporates across a range of maturities. MTNs are frequently issued by corporates under MTN Programmes whereby notes are offered on a regular and continuous basis to investors.
Monoline insurers ('monolines')	Entities which specialise in providing credit protection to the holders of debt instruments in the event of default by the debt security counterparty. This protection is typically held in the form of derivatives such as CDS's referencing the underlying exposures held.
Mortgage-backed securities ('MBS's')	Securities that represent interests in groups of mortgages, which may be on residential or commercial properties. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal). When the MBS references mortgages with different risk profiles, the MBS is classified according to the highest risk class.
Mortgage-related assets	Assets which are referenced to underlying mortgages.
Mortgage vintage	The year a mortgage was originated.
N	
Negative equity mortgages	Equity is the value of the asset less the outstanding balance on the loan. Negative equity arises when the value of the property purchased is below the balance outstanding on the loan.
Net asset value per share	Total shareholders' equity, less non-cumulative preference shares and capital securities, divided by the number of ordinary shares in issue.
Net interest income	The amount of interest received or receivable on assets net of interest paid or payable on liabilities.
Net principal exposure	The gross principal amount of a financial asset after taking account of credit protection purchased but excluding the effect of any counterparty credit valuation adjustment to that protection. It includes assets that benefit from monoline protection, except where this protection is purchased with a CDS.
Non-conforming mortgages	US mortgages that do not meet normal lending criteria. Examples include mortgages where the expected level of documentation is not provided (such as with income self-certification), or where poor credit history increases the risk and results in pricing at a higher than normal lending rate.
O	
Overnight Index Swap ('OIS') discounting	A method of valuing collateralised interest rate derivatives which uses a discount curve that reflects the overnight interest rate typically earned or paid in respect of collateral received.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.
Over-the-counter ('OTC')	A bilateral transaction (e.g. derivatives) that is not exchange traded and that is valued using valuation models.
P	
Performance Shares	Awards of HSBC Holdings ordinary shares under employee share plans that are subject to the achievement of corporate performance conditions.
Prime	A US description for mortgages granted to the most creditworthy category of borrowers.
Private equity investments	Equity securities in operating companies not quoted on a public exchange, often involving the investment of capital in private companies or the acquisition of a public company that results in its delisting.
Probability of default ('PD')	The probability that an obligor will default within a one-year time horizon.
R	
Regulatory capital	The capital which HSBC holds, determined in accordance with rules established by the FSA for the consolidated Group and by local regulators for individual Group companies.
Renegotiated loans	Loans whose terms have been renegotiated and are treated as up-to-date loans for measurement purposes once the specified number and/or amount of qualifying payments required under the new arrangements have been received.
Restricted Shares	Awards of HSBC Holdings ordinary shares to which employees will normally become entitled, generally between one and three years, subject to remaining an employee.
Retail loans	Money lent to individuals rather than institutions. This includes both secured and unsecured loans such as mortgages and credit card balances.
Return on equity	Profit attributable to ordinary shareholders divided by average invested capital.
Risk appetite	An assessment of the types and quantum of risks to which HSBC wishes to be exposed.
Risk-weighted assets ('RWA's')	Calculated by assigning a degree of risk expressed as a percentage (risk weight) to an exposure in accordance with the applicable Standardised or IRB approach rules.
S	
Seasoning	The emergence of credit loss patterns in portfolios over time.
Second lien	A security interest granted over an item of property to secure the repayment of a debt that is issued against the same collateral as a first lien but that is subordinate to it. In the case of default, repayment for this debt will only be received after the first lien has been repaid.

Shareholder Information (continued)

Term	Definition
Securitisation	A transaction or scheme whereby the credit risk associated with an exposure, or pool of exposures, is tranching and where payments to investors in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures. A traditional securitisation involves the transfer of the exposures being securitised to an SPE which issues securities. In a synthetic securitisation, the tranching is achieved by the use of credit derivatives and the exposures are not removed from the balance sheet of the originator.
Short sale	In relation to credit risk management, a 'short sale' is an arrangement in which a bank permits the borrower to sell the property for less than the amount outstanding under a loan agreement. The proceeds are used to reduce the outstanding loan balance and the borrower is subsequently released from any further obligations on the loan.
Single-issuer liquidity facility	A liquidity or stand-by line provided to a corporate customer which is different from a similar line provided to a conduit funding vehicle.
Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.
Special purpose entities ('SPE's')	A corporation, trust or other non-bank entity, established for a narrowly defined purpose, including for carrying on securitisation activities. The structure of the SPE and its activities are intended to isolate its obligations from those of the originator and the holders of the beneficial interests in the securitisation.
Standardised approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions ('ECAI') ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines.
Structured finance / notes	An instrument whose return is linked to the level of a specified index or the level of a specified asset. The return on a structured note can be linked to equities, interest rates, foreign exchange, commodities or credit. Structured notes may or may not offer full or partial capital protection in the event of a decline in the underlying index or asset.
Structured Investment Vehicles ('SIV's')	Special purpose entities which invest in diversified portfolios of interest-earning assets, generally funded through issues of commercial paper, medium-term notes and other senior debt to take advantage of the spread differentials between the assets in the SIV and the funding cost.
Student loan related assets	Securities with collateral relating to student loans.
Subordinated liabilities	Liabilities which rank after the claims of other creditors of the issuer in the event of insolvency or liquidation.
Sub-prime	A US description for customers with high credit risk, for example those who have limited credit histories, modest incomes, high debt-to-income ratios, high loan-to-value ratios (for real estate secured products) or have experienced credit problems caused by occasional delinquencies, prior charge-offs, bankruptcy or other credit-related problems.
T	
Tier 1 capital	A component of regulatory capital, comprising core tier 1 and other tier 1 capital. Other tier 1 capital includes qualifying capital instruments such as non-cumulative perpetual preference shares and hybrid capital securities.
Tier 2 capital	A component of regulatory capital, comprising qualifying subordinated loan capital, related non-controlling interests, allowable collective impairment allowances and unrealised gains arising on the fair valuation of equity instruments held as available-for-sale. Tier 2 capital also includes reserves arising from the revaluation of properties.
Troubled debt restructuring	A US description for restructuring a debt whereby the creditor for economic or legal reasons related to a debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider.
U	
Unfunded exposures	An exposure where the notional amount of a contract has not been exchanged.
US Government agency and US Government sponsored enterprises mortgage-related assets	Securities that are guaranteed by US Government agencies such as the Government National Mortgage Association ('Ginnie Mae'), or by US Government sponsored entities including the Federal National Mortgage Association ('Fannie Mae') and the Federal Home Loan Mortgage Corporation ('Freddie Mac');
V	
Value-at-risk ('VAR')	A measure of the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence.
W	
Wholesale loans	Money lent to sovereign borrowers, banks, non-bank financial institutions and corporate entities.
Write-down	Reduction in the carrying value of an asset due to impairment or fair value movements.
Wrong-way risk	An adverse correlation between the counterparty's probability of default and the mark-to-market value of the underlying transaction.

Shareholder Information (continued)

Index

- A**
- Accounting 250
 - developments (future) 252
 - policies (critical) 33
 - policies (significant) 128, 253
 - Accounts
 - approval 370
 - basis of preparation 37, 250
 - Acquisitions and disposals 14, 340
 - Actuarial assumptions 281
 - American Depositary Shares 378(a)
 - Annual General Meeting 219, 372
 - Areas of special interest 103
 - Asset-backed securities 129, 133
 - Assets
 - average balance sheet 18
 - by country 303
 - by customer group 37
 - by geographical region 50, 302
 - charged as security 352
 - deferred tax 292
 - held in custody and under administration 81
 - intangible 332
 - maturity analysis 350
 - other 340
 - trading 307
 - underlying/reported reconciliation 31
 - Associates and joint ventures
 - interests in 330
 - share of profit in 28, 28(h)
 - transactions with 369
 - Audit committee 195
 - Auditors' remuneration 285
 - Auditors' Report 235
- B**
- Balance sheet
 - average 18, 31(b)
 - consolidated 29, 240
 - data 29, 47(d), 48, 54, 58, 64, 69, 74, 79, 302
 - HSBC Holdings 245
 - insurance manufacturing subsidiaries 159
 - underlying/reported reconciliation 31
 - Bank payroll tax 212
 - Basel Committee 90, 178, 181
 - Board of Directors 183, 189
 - Brand perception 13
- C**
- Calendar (dividends) 371
 - Capital
 - measurement and allocation 178
 - regulatory 178
 - return on invested capital 3
 - risk 87
 - structure 180
 - Capital and performance ratios 2,3
 - Cash flow
 - accounting policy 270
 - consolidated statement 241
 - HSBC Holdings 246
 - notes 356
 - projected scenario analysis 142
 - Cautionary statement regarding forward-looking statements 3(a)
 - Certificates of deposit 31(p)
 - Challenges and uncertainties 88
 - Client assets 46
 - Collateral and credit enhancements 96, 114
 - Commercial Banking 42, 303
 - underlying/reported profit 15, 47(b)
 - Commercial real estate 105
 - Committees (Board) 194
 - Communication with shareholders 218, 373
 - Community investment 213
 - Compliance risk 88, 155
 - Concentration of exposure 97
 - Conduits 131, 362
 - Constant currency 14
 - Contents *inside front cover*
 - Contingent liabilities and contractual commitments 358
 - Contractual obligations 31(l)
 - Corporate governance
 - codes 194
 - report 183
 - Corporate sustainability 212
 - committee 202
 - governance 213
 - risk 173
 - Cost efficiency ratio 3, 27, 302
 - Credit coverage ratios 3
 - Credit exposure 95
 - Credit quality 93
 - classifications 114
 - Credit risk 93
 - management thereof 93, 312
 - insurance 165
 - Critical accounting policies 33
 - Cross-border exposures 95, 102
 - Customer accounts
 - underlying/reported reconciliation 31(a)
 - Customer recommendation 13
 - Customer groups and global businesses 37
- D**
- Daily distribution of revenues 147
 - Data security 83
 - Dealings in HSBC Holdings plc shares 218
 - Debt securities in issue 319, 341
 - accounting policy 270
 - Defined terms *inside front cover*
 - Deposits 31(n), 139, 141
 - accounting policy 270
 - average balances and average rates 18
 - other time deposits 31(p)
 - Derivatives 97, 98, 322
 - accounting policy 261
 - Directors
 - appointments and re-election 193
 - biographies 183
 - Board of directors 189
 - bonus 225
 - emoluments 224, 284
 - fees 230
 - interests 204
 - non-executive 229
 - other directorships 229
 - pensions 231
 - remuneration (executive) 223
 - remuneration (principles) 222
 - service contracts 228
 - share plans 232
 - Disclosure controls 80(h)
 - Dividends 2, 217, 218, 295, 371, 378(a)
 - Donations 213

Shareholder Information (continued)

- E**
- Earnings per share 2, 227, 296
 - Economic background
 - Europe 51, 53(a)
 - Hong Kong 56, 57(a)
 - Latin America 76, 78(a)
 - Middle East 66, 68(a)
 - North America 71, 73(a)
 - Rest of Asia-Pacific 60, 63(a)
 - Economic profit 32, 227
 - Efficiency and revenue mix ratios 3
 - Employees 206
 - compensation and benefits 211, 274
 - disabled 207
 - engagement 12
 - issues 213
 - numbers 26, 206, 374
 - remuneration policy 207
 - Enforceability of judgements 378(a)
 - Enquiries (from shareholders) 373
 - Environmental management 213
 - Equity 242
 - Equity securities 149
 - Europe
 - balance sheet data 54, 302
 - economic background 51, 53(a)
 - lending 100
 - loan impairment charges/allowances 122
 - loans and advances to customers 100, 101
 - principal operations 51
 - profit/(loss) 51, 54, 298
 - profit/(loss) by country 52
 - regulation and supervision (UK) 85(b)
 - review of business performance 51, 53(a)
 - underlying/reported profit 15, 80(b)
 - Eurozone exposures 103
 - Events after the balance sheet date 370
 - Exchange controls 378(a)
 - Exposures 95, 97, 103, 128
- F**
- Fair value
 - accounting policy 254
 - governance structure 309
 - valuation bases 312
 - Fee income (net) 19, 28(c)
 - Financial assets
 - accounting policy 255, 263
 - designated at fair value 321
 - not qualifying for de-recognition 329
 - reclassification 320
 - Financial assets and liabilities
 - accounting policy 35, 255, 263
 - by measurement basis 303
 - Financial guarantee contracts
 - accounting policy 268
 - Financial highlights 2
 - Financial instruments
 - accounting policy (fair value) 34, 259
 - at fair value 308
 - credit quality 114, 115
 - net income from 21, 28(d), 271
 - not at fair value 318
 - Financial investments 326
 - accounting policy 259
 - gains less losses from 22, 28(e)
 - Financial liabilities designated at fair value 341
 - Financial risks (insurance) 161
 - Financial Services Compensation Scheme 359
 - Financial statements 237
 - Five-year comparison 16, 29
- Footnotes 83, 174, 182, 249
- Forbearance 113
 - Foreclosures 83
 - Foreign currencies/exchange
 - accounting policy 267
 - exposures 351
 - rates 16, 29
 - Funds under management 81
- G**
- Geographical regions 50
 - Global Banking and Markets 44
 - balance sheet data 47(d)
 - underlying/reported profit 15, 47(c)
 - Global Private Banking 46
 - underlying/reported profit 15, 47(e)
 - Glossary 380
 - Going concern 204
 - Goodwill
 - accounting policy 34, 263
 - and intangible assets 332
 - Governance codes 183
 - HSBC Holdings/New York Stock Exchange corporate governance differences 378(e)
 - Group CEO's Business Review 7
 - Group Chairman's Statement 4
 - Group Management Board 194
- H**
- Health and safety 214
 - Highlights 1
 - History and development of HSBC 378(d)
 - Hong Kong
 - balance sheet data 58, 302
 - economic background 56, 57(a)
 - lending 100
 - loan impairment charges/allowances 122
 - principal operations 56
 - profit/(loss) 56, 58, 298
 - regulation and supervision 85(c)
 - review of performance 56, 57(a)
 - underlying/reported profit 15, 80(c)
 - HSBC Holdings plc
 - balance sheet 245
 - cash flow 144, 246
 - credit risk 128
 - deferred tax 295
 - dividends 295
 - employee compensation 284
 - financial assets and liabilities 306
 - liquidity and funding management 144
 - market risk 152
 - maturity analysis of assets and liabilities 350
 - net income from financial instruments 271
 - share plans 232, 289
 - statement of changes in equity 247
 - structural foreign exchange exposures 152
 - subordinated liabilities 349
 - transactions with subsidiaries 370
- I**
- Impairment
 - accounting policy 33, 255
 - allowances 119
 - assessment 94
 - charges 24, 28(g), 124
 - impaired loans and advances 118
 - losses as percentage of loans and advances 126
 - methodologies 131
 - movement by industry and geographical region 121, 122
 - Income statement (consolidated) 16, 28(a), 238
 - Information on HSBC (availability thereof) 374

Shareholder Information (continued)

- Insurance
 - accounting policy 268
 - claims incurred (net) and movements in liabilities to policyholders 24, 28(f), 272
 - liabilities under contracts issued 343
 - net earned premiums 22, 28(e), 272
 - products 156
 - PVIF business 170
 - risk management 155
- Interest income/expense (net) 18, 28(c)
 - accounting policy 253
 - analysis of changes 31(i)
 - average balance sheet 18
 - sensitivity 149
- Interim management statements 373
- Internal control 202
 - management's assessment 80(h)
- IFRS and Hong Kong Financial Reporting Standards comparison 250
- Investor relations 374
- K**
- Key performance indicators 11
- L**
- Latin America
 - balance sheet data 79, 302
 - economic background 76, 78(a)
 - lending 100, 101
 - loan impairment charges/allowances 122
 - loans and advances to customers 101
 - principal operations 76
 - profit/(loss) 76, 79, 298
 - profit/(loss) by country 77
 - review of performance 76, 78(a)
 - underlying/reported profit 15, 80(g)
- Lease commitments 359
 - accounting policy 265
- Legal
 - challenges and uncertainties 88
 - proceedings, investigations and regulatory 82, 365
 - risk 154
- Leveraged finance transactions 138, 364
- Liabilities
 - average balance sheet 18
 - by geographical region 302
 - deferred tax 292
 - maturity analysis 350
 - other 342
 - retirement benefit 274
 - subordinated 346
 - trading 340
 - underlying/reported reconciliation 31
- Life insurance business 156
- Liquidity and funding 140
 - challenges and uncertainties 88
 - management of risk 142
 - insurance 168
 - policies and procedures 140
 - primary sources of funding 141
- Loans and advances
 - accounting policy 255
 - collateral 96
 - concentration of exposure 98
 - credit quality of 93
 - delinquency in the US 112
 - impairment 118–127
 - maturity and interest sensitivity 31(m)
 - modifications and re-ageing 114
 - past due 117
 - renegotiated 113
 - to banks by geographical region 101
 - by country 101
 - to customers by industry sector and geographical region 99, 100
 - underlying/reported reconciliation 31(a)
 - write-off 94
- M**
- Madoff 82, 365
- Market capitalisation 3
- Market risk 145
 - insurance 162
 - sensitivity analysis 149
- Maturity analysis of assets and liabilities 350
- Maximum exposure to credit risk 95
- Memorandum and Articles of Association 378(c)
- Middle East
 - balance sheet data 69, 302
 - economic background 66, 68(a)
 - lending 100
 - loan impairment charges/allowances 119, 122, 125, 126
 - loans and advances to customers 101, 105
 - principal operations 66
 - profit/(loss) 66, 69, 298
 - review of performance 66, 68(a)
 - underlying/reported profit 15, 80(e)
 - wholesale lending 105
- Money market funds 363
- Monoline insurers 137
- Mortgages
 - lending 107, 111
 - mortgage-backed securities 131, 136
 - representations and warranties 139
- N**
- Nomination committee 201
- Non-controlling interests 352
- Non-interest income
 - accounting policy 254
- Non-life insurance business 156
- Non-money market investment funds 364
- Non-statutory accounts 370(a)
- Non-trading portfolios 148
- North America
 - balance sheet data 74, 302
 - economic background 71, 73(a)
 - lending 100, 101
 - loan delinquency in the US 112
 - loan impairment charges/allowances 119, 122, 125, 126, 127
 - loans and advances to customers 101
 - mortgage lending 108
 - personal lending 110
 - principal operations 71
 - profit/(loss) 71, 74, 298
 - regulation and supervision (US) 85(c)
 - review of performance 71, 73(a)
 - underlying/reported profit 15, 80(f)
- O**
- Operating expenses 26, 28(h)
- Operating income 23, 28(f), 273, 303
- Operational risk 154
 - challenges and uncertainties 88
- Organisational structure chart 375
- Other 47, 47(f)
- P**
- Payment protection insurance 366
- Pensions 274
 - accounting policy 266
 - defined benefit plans 151, 274
 - for directors 231

Shareholder Information (continued)

risk 172
 Performance and context 220
 Personal Financial Services 40
 underlying/reported profit 15, 47(a)
 Personal lending 106
 Pillar 1, 2 and 3 178
 Principal activities 10
 Products and services 38, 156, 297
 Profit before tax
 by country 52, 61, 67, 72
 by customer group 37, 48, 54, 58, 64, 69, 74, 79
 by geographical region 50, 51, 54, 56, 58, 60, 64, 66, 69, 71, 74, 76, 79
 consolidated 16
 data 16
 underlying/reported reconciliations 14
 Project Merlin 211
 Property, plant and equipment 81, 336
 accounting policy 265
 Provisions 346
 accounting policy 267
 PVIF 170

R

Ratios
 advances to core funding 142
 capital 2, 181
 credit coverage 3
 cost efficiency 3, 27
 dividends per share 2
 earnings per share 2
 earnings to combined fixed charges 31(l)
 financial 2
 key performance indicators 12
 performance 3, 302
 Regulation and supervision 85(b)
 challenges and uncertainties 90
 future developments 181
 investigations 82, 367
 Related party transactions 368
 Remuneration
 committee 201
 members 222
 policy 207
 principles 222
 regulation 221
 report 220
 Renegotiated loans 113
 Repricing gap 148
 Reputational risk 172
 Residual value risk 174
 Rest of Asia-Pacific
 balance sheet data 64, 302
 economic background 60, 63(a)
 lending 100, 101
 loan impairment charges/allowances 122
 loans and advances to customers 101
 principal operations 60
 profit/(loss) 60, 61, 64, 298
 review of performance 62, 63(a)
 underlying/reported profit 15, 80(d)
 Rights issue
 accounting policy 270
Risk
 appetite 87
 committee 197
 compliance 155
 contingent liquidity 143
 counterparty 90
 credit 93, 165
 credit spread 148
 economic 89
 elements in loan portfolio 139(a)

 gap risk 148
 governance 87
 insurance operations 155, 157, 159
 legal 154
 liquidity and funding management 140, 168
 management 87, 93
 market 89, 145, 162
 operational 154
 pension 172
 political 89
 profile 86
 rating scales 114
 regulation 90
 reputational 172
 residual value 174
 scenario stress testing 88
 security and fraud 155
 sustainability 173
 top and emerging 10, 199
 Risk-weighted assets 2, 29, 50, 181

S

Sale and repurchase agreements
 accounting policy 261
Securities held for trading 97
Securitisations 128, 363
Security and fraud risk 155
Segmental analysis 296
 accounting policy 254
Senior management
 biographies 187
 remuneration 212
Share-based payments 286
 accounting policy 266
Share capital 29, 214, 353
 accounting policy 270
 notifiable interests in 218
 ownership guidelines 228
 rights and obligations 214
Share information 3
Share plans
 discretionary plans 208
 for directors 232
 for employees 207
 HSBC Bank Bermuda plans 210, 356
 HSBC Finance plans 210, 291, 355
 HSBC France plans 209, 290, 355
 HSBC Invest Direct (India) plans 211
 Performance Shares and Restricted Share awards 226, 286, 289
Shareholder (communications with) 217, 373
 profile 372
Short-term borrowings 31(l)
Special purpose entities 361
Staff numbers 26, 274
Statement of changes in equity 242, 247
Statement of comprehensive income 239
Stock symbols 372
Strategic direction 10, 12, 40, 42, 44, 46
Structural foreign exchange exposure 351
Subsidiaries 338
 accounting policy 263
Supplier payment policy 214

T

Taxation
 accounting policy 36, 265
 challenges and uncertainties 88
 deferred tax 292
 expense 28, 28(i), 291
 of shares and dividends 376
Tier 1 capital 2, 180, 181

Shareholder Information (continued)

Total shareholder return 3, 227, 228
Trading assets 307
 accounting policy 258
Trading income (net) 20, 28(d)
Trading liabilities 340
 accounting policy 258
Trading market (nature of) 378(b)
Trading portfolios 146, 147
Troubled debt restructurings 139(b)

U
Underlying performance 14

V
Value at risk 145

W
Wholesale lending 103

391(a)

Shareholder Information (continued)

HSBC HOLDINGS PLC

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HSBC Bank plc
8 Canada Square
London E14 5HQ
United Kingdom

ADR Depositary

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Item 19. Exhibits

Documents filed as exhibits to this Form 20-F:

<u>Exhibit Number</u>	<u>Description</u>
1.1	Memorandum and Articles of Association of HSBC Holdings plc.
2.1	The total amount of long-term debt securities of HSBC Holdings plc authorized under any instrument does not exceed 10 percent of the total assets of the Group on a consolidated basis. HSBC Holdings plc hereby agrees to furnish to the Commission, upon its request, a copy of any instrument defining the rights of holders of long-term debt of HSBC Holdings plc or of its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed.
4.1	Service Agreement dated February 14, 2011 between HSBC Holdings plc and Douglas Jardine Flint.
4.2	Service Agreement dated May 24, 2007 between HSBC Holdings plc and Stephen Keith Green, as amended February 28, 2008. ***
4.3	Service Agreement dated May 24, 2007 between HSBC Asia Holdings BV and Michael F. Geoghegan, as amended February 1, 2010. *
4.4	Service Agreement dated February 4, 2011 between HSBC Holdings plc and Iain Mackay.
4.5	Service Agreement dated August 29, 2008 between The Hong Kong and Shanghai Banking Corporation Limited and Vincent Cheng Hoi Chuen.**
4.6	Service Agreement dated February 14, 2011 between HSBC Asia Holdings B.V. and Alexander Flockhart.
4.7	Service Agreement dated February 10, 2011 between HSBC Asia Holdings B.V. and Stuart Gulliver.
7.1	Computation of ratios of earnings to combined fixed charges (and preference share dividends).
8.1	Subsidiaries of HSBC Holdings plc (set forth in Note 26 to the consolidated financial statements included in this Form 20-F).
12.1	Certificate of HSBC Holdings plc's Group Chief Executive pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
12.2	Certificate of HSBC Holdings plc's Group Finance Director pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
13.1	Annual Certification of HSBC Holdings plc's Group Chief Executive and Group Finance Director pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
14.1	Consent of KPMG Audit plc.

<u>Exhibit Number</u>	<u>Description</u>
14.2	Pages of HSBC Holdings plc's 2000 Form 20-F/A dated February 26, 2001 relating to the Memorandum and Articles of Association of HSBC Holdings plc that are incorporated by reference into this Form 20-F. ****
14.3	Pages of HSBC Holdings plc's 2001 Form 20-F dated March 13, 2002 relating to the Memorandum and Articles of Association of HSBC Holdings plc that are incorporated by reference into this Form 20-F. ***
23.1	Consent of Estella Chiu.
23.2	Consent of Mercer.
23.3	Consent of Towers Watson.

* As previously filed with the Securities and Exchange Commission as an exhibit to HSBC Holdings plc's Form 20-F dated March 15, 2010.

** As previously filed with the Securities and Exchange Commission as an exhibit to HSBC Holdings plc's Form 20-F dated March 10, 2009.

*** As previously filed with the Securities and Exchange Commission as an exhibit to HSBC Holdings plc's Form 20-F dated March 20, 2008.

**** As previously filed with the Securities and Exchange Commission as an exhibit to HSBC Holdings plc's Form 20-F dated March 20, 2006.

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

HSBC Holdings plc

By: /s/ I J Mackay
Name: Iain J Mackay
Title: Group Finance Director

Dated: 8 March 2011

No. 617987

THE COMPANIES ACT 1948
and
THE COMPANIES ACTS 1985, 1989 AND 2006

PUBLIC COMPANY LIMITED BY SHARES

MEMORANDUM OF ASSOCIATION

and
ARTICLES OF ASSOCIATION

of
HSBC Holdings plc

Updated May 2010

No. 617987

[logo]

CERTIFICATE OF INCORPORATION

I Hereby Certify, That

VERNAT TRADING CO. LIMITED

is this day Incorporated under the Companies Act, 1948, and that the Company is Limited.

Given under my hand at London this First day of January One Thousand Nine Hundred and Fifty nine.

(Sd.) [Illegible]
Registrar of Companies

No. 617987

[logo]

CERTIFICATE OF INCORPORATION ON CHANGE OF NAME

Whereas

VERNAT TRADING CO. LIMITED

was incorporated as a limited company under the Companies Act, 1948, on the first day of January, 1959.

And whereas by special resolution of the Company and with the approval of the Board of Trade it has changed its name.

Now therefore I hereby certify that the Company is a limited Company incorporated under the name of

VERNAT EASTERN AGENCIES LIMITED

Given under my hand at London, this tenth day of February One thousand nine hundred and fifty nine.

(Sd.) [Illegible]
Assistant Registrar of Companies

No. 617987

[logo]

**CERTIFICATE OF INCORPORATION
ON CHANGE OF NAME**

I hereby certify that

VERNAT EASTERN AGENCIES LIMITED

having by special resolution and with the approval of the Secretary of State changed its name, is now incorporated under the name of

SILOM LIMITED

Given under my hand at Cardiff the 13TH AUGUST 1981

(Sd.) E.A. WILSON
Assistant Registrar of Companies

No. 617987

[logo]

**CERTIFICATE OF INCORPORATION
ON CHANGE OF NAME**

I hereby certify that

SILOM LIMITED

having by special resolution changed its name, is now incorporated under the name of

HSBC HOLDINGS LIMITED

Given under my hand at the Companies Registration Office, Cardiff the 12 DECEMBER 1990

(Sd.) A.M. EVANS
an authorised officer

No. 617987

[logo]

**CERTIFICATE OF INCORPORATION
ON RE-REGISTRATION OF PRIVATE COMPANY
AS A PUBLIC COMPANY**

I hereby certify that

HSBC HOLDINGS LIMITED

formerly registered as a private company has this day been re-registered under the Companies Act 1985 as a public company under the name of

HSBC HOLDINGS plc

and that the company is limited.

Given under my hand at Cardiff the 24TH DECEMBER 1990

(Sd.) H A JELLIMAN
An Authorised Officer

No. F - 4746

[logo]

**CERTIFICATE OF REGISTRATION
OF CHANGE OF NAME OF OVERSEA COMPANY**

I hereby certify that

HSBC HOLDINGS LIMITED

which was incorporated in United Kingdom and has been registered in Hong Kong under part XI of the Companies Ordinance, has changed its corporate name and is now registered under the name of

HSBC Holdings plc.

Given under my hand this Seventeenth day of January One Thousand Nine Hundred and Ninety-one.

(Sd.) W.H. Kwok
for Registrar General
(Registrar of Companies)
Hong Kong

THE COMPANIES ACT, 1948

**SPECIAL RESOLUTIONS
OF
VERNAT EASTERN AGENCIES LIMITED**

Passed 19th March, 1959

At an Extraordinary General Meeting of the above-named Company duly convened and held at Garrard House, Gresham Street, London, E.C.2, on the 19th day of March, 1959, the following Resolutions were duly passed as Special Resolutions:

RESOLUTIONS

1. That each of the shares of £1 in the capital of the Company be sub-divided into 8 shares of 2s. 6d. each.
2. That for the purpose of acquiring the undertaking of The Eastern Agencies (1946) Ltd., the nominal share capital of the Company be increased from £100 to £150,000 by the creation of 1,199,200 shares of 2s. 6d. each ranking pari passu in all respects with the existing shares in the capital of the Company as subdivided by the last-preceding Resolution.
3. That the provisions of the Memorandum of Association with respect to the objects of the Company be altered by deleting sub-clauses (a) to (s) inclusive of Clause 3 and the whole of the declaration immediately following the end of sub-clause (s) aforesaid and by substituting therefor the several sub-clauses to Clause 3 which are lettered (A) to (R) inclusive and the declaration immediately following the end of sub-clause (R) aforesaid all of which are set forth in a reprint of the Company's Memorandum of Association as proposed to be altered by this Resolution, a copy of which reprint has been produced to this Meeting and signed by the Chairman thereof for the purposes of identification.
4. That the regulations contained in the printed document submitted to this Meeting and signed by the Chairman thereof for the purposes of identification be and the same are hereby approved and adopted as the Articles of Association of the Company in substitution for and to the exclusion of all the existing Articles of Association thereof.

(Sd.) **J.G. Jekyll**
Secretary

THE COMPANIES ACT, 1948
COMPANY LIMITED BY SHARES
ORDINARY RESOLUTION
of
VERNAT EASTERN AGENCIES LIMITED
Passed 18th August, 1964

At an Extraordinary General Meeting of the Members of the above-named Company duly convened and held on Tuesday the 18th day of August, 1964, the following Resolutions were duly passed as Ordinary Resolutions, namely:—

RESOLUTIONS

1. THAT the nominal share capital of the Company be increased to £300,000 by the creation of an additional 1,200,000 shares of 2/6d each.
2. THAT 1,200,000 Shares of 2/6d each credited as fully paid be distributed as capital among the holders of the existing shares registered at the close of business on the 17th July, 1964, in the proportion of one new share for every share then held, such new shares to rank pari passu in all respects with the existing shares of the Company and to rank for the full amount of all dividends declared after the date of the passing of this Resolution AND THAT sufficient of the Capital and Revenue Reserves of the Company be capitalised, appropriated and applied in making payment in full, at par, of the new shares hereby directed to be distributed.

(Sd.) **J.E. HART**
Secretary

VERNAT EASTERN AGENCIES LIMITED

At an EXTRAORDINARY GENERAL MEETING of the above-named Company held on 20 July 1981 the following Resolution No. 1 was passed as an ORDINARY RESOLUTION and Resolutions Nos. 2, 3, and 4 as SPECIAL RESOLUTIONS:—

RESOLUTIONS

1. THAT:—
 - (a) the capital of the Company be increased from £300,000 to £301,500 by the creation of 150,000 new Ordinary Shares of 1p each;
 - (b) it is desirable that the sum of £1,500 (being part of the Company's Reserves) be capitalised and accordingly that the Directors be and they are hereby authorised and directed to appropriate and apply that sum as capital in paying up in full at par the 150,000 unissued Ordinary Shares of 1p each of the Company and to allot and distribute such shares credited as fully paid to and amongst those persons who shall be registered in the books of the Company as the holders of the existing 2,400,000 issued and fully paid shares of 12½p each in the capital of the Company immediately prior to the passing of this Resolution, in proportion to the number of such issued shares so held by them respectively;
 - (c) forthwith upon the allotment of Ordinary Shares pursuant to paragraph (b) of this Resolution each of the said existing 2,400,000 issued and fully paid shares be converted into and become and be designated 1 Deferred Share of 12½p having attached thereto the rights and privileges and being subject to the restrictions set out in the Articles of Association of the Company as altered by Resolution No. 3 below.
2. THAT the name of the Company be changed to "SILOM LIMITED".
3. THAT the provisions of the Memorandum of Association with respect to the objects of the Company be altered by deleting sub-clause (A) of Clause 3 and substituting therefor the following sub-clause:—

“(A) To purchase, exchange, improve, mortgage, charge, rent, let on lease, hire, surrender, license, accept surrenders of, and otherwise acquire any freehold, leasehold or other property, chattels and effects, whether situate in England or elsewhere, erect, pull-down, repair, alter, develop or otherwise deal with any building or buildings and adapt the same for the purposes of investment or re-investment.”

4. THAT subject to the passing of Resolution No. 1 above the Regulations contained in the document now submitted to this Meeting and signed for the purpose of identification by the Chairman thereof be and the same are hereby adopted as the Articles of Association of the Company to the exclusion of and in substitution for the existing Articles of Association.

(Sd.) **J.P.R. BROWN**
Chairman

**THE COMPANIES ACT 1948
AND
THE COMPANIES ACTS 1985 AND 1989**

COMPANY LIMITED BY SHARES

**RESOLUTION
of
SILOM LIMITED**

Passed : 3 December 1990

At an Extraordinary General Meeting of the above-named Company, duly convened and held on 3 December 1990, the following Resolution was duly passed as a Special Resolution:

SPECIAL RESOLUTION

THAT the name of the Company be changed to "HSBC Holdings Limited".

(Sd.) S. G. BURROWS
Chairman of the Meeting

THE COMPANIES ACT 1948
and
THE COMPANIES ACTS 1985 AND 1989

COMPANY LIMITED BY SHARES

RESOLUTION
of
HSBC HOLDINGS LIMITED

Passed on 18 December 1990

At an Extraordinary General Meeting of the above-named Company, duly convened and held on 18 December 1990, the following Resolution was duly passed as a Special Resolution:

SPECIAL RESOLUTION

“THAT the Company be re-registered forthwith as a public company and that:

- (a) the name of the Company be changed to “HSBC Holdings plc”;
- (b) the Memorandum of Association of the Company be altered by:

- (i) the insertion of the following new Clause 2:

“2. The Company is a public company.”

and by renumbering the existing Clauses 2 to 5 of the Memorandum accordingly; and

- (ii) amending Clause 4 (as re-numbered by sub-paragraph (b)(i) above with respect to the objects of the Company by inserting the following new sub-paragraph in Clause 4(A):

“4(A)(1) To act as the holding and co-ordinating company of a group of companies of which the Company is for the time being the holding company.”

and by re-numbering the existing Clause 4(A) (as re-numbered by sub-paragraph (b)(i) above) as sub-paragraph (2) of Clause 4(A).

- (c) the regulations contained in the document now submitted to this Meeting and signed for the purposes of identification by the Chairman thereof be and they are hereby adopted as the Articles of Association of the Company in place of the existing Articles of Association.

(Sd.) **J.E. Strickland**
Chairman

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS
of
HSBC Holdings plc

Passed 25 March, 1991

At an Extraordinary General Meeting of the above-named Company, duly convened and held on 25 March, 1991, the following Resolutions were duly passed of which Resolutions Nos. 1 and 3 were passed as Special Resolutions and Resolution No. 2 was passed as an Ordinary Resolution:

SPECIAL RESOLUTION

1. THAT conditional on and with effect from the date on which the Scheme of Arrangement dated 1 February, 1991 under section 166 of the Companies Ordinance (Cap. 32) of Hong Kong between The Hongkong and Shanghai Banking Corporation Limited and the holders of its shares of HK\$2.50 each becomes effective:
 - (A) (a) every 100 of the Ordinary Shares of 1p each of the Company shall be consolidated into one Ordinary Share of £1;
 - (b) every 8 of the Deferred Shares of 12¹/₂p each of the Company shall be consolidated into one Deferred Share of £1;
 - (B) each resulting Ordinary Share of £1 and each resulting Deferred Share of £1 shall be converted into and redesignated as a Non-voting Deferred Share of £1 having the rights and privileges and being subject to the restrictions set out in the new Articles of Association of the Company to be adopted pursuant to paragraph (C) of this Resolution;

- (C) the authorised share capital of the Company shall be increased to HK\$20,000,000,000 denominated in Hong Kong dollars and £301,500 denominated in pounds sterling by the creation of 2,000,000,000 Ordinary Shares of HK\$10 each having the rights and privileges and being subject to the restrictions set out in the new Articles of Association of the Company to be adopted pursuant to paragraph (C) of this Resolution;
- (D) the Regulations contained in the document now submitted to this Meeting and signed for the purpose of identification by the Chairman thereof be and the same are hereby adopted as the new Articles of Association of the Company to the exclusion of and in substitution for the existing Articles of Association; and
- (E) the provisions of the Memorandum of Association with respect to the objects of the Company be altered by deleting Clause 4 thereof and substituting therefor a new Clause 4 in the form contained in the document now submitted to this Meeting and signed for the purpose of identification by the Chairman thereof.

ORDINARY RESOLUTION

2. THAT conditional on and with effect from the date on which the Scheme of Arrangement dated 1 February, 1991 under section 166 of the Companies Ordinance (Cap. 32) of Hong Kong between The Hongkong and Shanghai Banking Corporation Limited and the holders of its shares of HK\$2.50 each ("the Scheme") becomes effective the Directors be and they are hereby generally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 ("the Act") to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of HK\$20,000,000,000 provided that this authority shall be limited so that, otherwise than pursuant to (i) issues of Ordinary Shares of HK\$10 each of the Company pursuant to the Scheme or (ii) a rights issue where relevant securities are offered to shareholders on a fixed record date in proportion to their then holdings of shares (subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or having regard to any restrictions or obligations under the laws of or the requirements of any recognised regulatory body or stock exchange in any territory outside Hong Kong or otherwise howsoever) or (iii) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company, the aggregate nominal amount of the relevant securities to be allotted by the Directors pursuant to this authority shall not in aggregate exceed five per cent. of the nominal amount of the issued Ordinary share capital of the Company immediately following the issue of Ordinary Shares of HK\$10 each of the Company pursuant to the Scheme and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 1991 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

3. THAT, subject to the passing of Resolution No. 2 set out in the Notice dated 25 March, 1991 convening this Meeting and to such Resolution becoming effective, the Directors be and they are hereby empowered, pursuant to section 95 of the Companies Act 1985 (“the Act”) to allot equity securities (as defined in section 94 of the Act) pursuant to the authority conferred by the aforesaid Resolution No. 2 as if section 89(1) of the Act did not apply to any such allotment provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 1991 save that this power shall enable the Company prior to the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after the expiry of this power and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

W. Purves
Chairman

HSBC Holdings plc

CONSENT TO VARIATION OF CLASS RIGHTS

We, the undersigned, being the registered holders of all the issued Deferred Shares of 12½p each of HSBC Holdings plc hereby consent to and sanction any variation or abrogation of the rights attaching to such shares to be effected by the passing of Special Resolution No. 1 set out in the Notice of Extraordinary General Meeting of HSBC Holdings plc to be held on 25 March, 1991.

Dated 25 March, 1991

J.M. Gray

Duly authorised
for and on behalf of
HSBC Holdings BV

W.L. Chan

Duly authorised
for and on behalf of
**Hongkong & Shanghai
Banking Corporation
(Nominees) Limited**

HSBC Holdings plc

CONSENT TO VARIATION OF CLASS RIGHTS

We, the undersigned, being the registered holder of all the issued Ordinary Shares of 1p each of HSBC Holdings plc hereby consent to and sanction any variation or abrogation of the rights attaching to such shares to be effected by the passing of Special Resolution No. 1 set out in the Notice of Extraordinary General Meeting of HSBC Holdings plc to be held on 25 March 1991.

Dated 25 March, 1991

J.M. Gray

Duly authorised
for and on behalf of
HSBC Holdings BV

HSBC Holdings plc

CONSENT TO VARIATION OF CLASS RIGHTS

We, the undersigned, being the registered holder of all the issued Non-voting Deferred Shares of £1 each of HSBC Holdings plc hereby consent to and sanction any variation, modification or abrogation of the rights attaching to such shares to be effected by the passing of the Special Resolution set out in the Notice of Extraordinary General Meeting of HSBC Holdings plc dated 11 May 1992.

Dated 11 May 1992

R.P. Hennessy

Duly authorised
for and on behalf of
WTL Limited

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES

**RESOLUTION
of
HSBC Holdings plc**

Passed 9 June 1992

At the Extraordinary General Meeting of HSBC Holdings plc held on Level 18, 1 Queen's Road Central, Hong Kong on Tuesday, 9 June 1992, the following SPECIAL RESOLUTION was passed:

SPECIAL RESOLUTION

THAT:

- (A) the proposed acquisition by the Company and/or any of its subsidiaries and/or subsidiary undertakings of any of the shares in the capital of Midland Bank plc ("Midland") on such terms and conditions as may be approved by the Directors of the Company (or any duly constituted committee thereof) (the "Directors") and the offer by the Company to the shareholders of Midland upon the terms and subject to the conditions set out or referred to in the offer document and listing particulars dated 8 May 1992 and in the circular to shareholders of the Company dated 11 May 1992 each issued by or on behalf of the Company (copies of which documents are produced to the Meeting and for identification purposes signed by the Chairman of the Meeting) or upon and subject to the terms and conditions of any amended, varied, revised, extended, additional and/or other offer or offers or election(s) thereunder approved by the Directors (together the "Offer" which expression shall include any such amended, varied, revised extended, additional and/or other offer(s) or election(s)) be and they are hereby approved and that any acquisitions by the Company of shares in and of options over shares in Midland from any of the Directors or persons connected with any of the Directors be and are hereby approved for the purposes of section 320 of the Companies Act 1985, and that the Directors be and are hereby authorised to waive, amend, vary, revise or extend any of the terms and conditions of the Offer, to make any additional and/or other offer(s) to acquire shares in the capital of Midland and to do all such acts or things as they may consider necessary or desirable in connection with the Offer including, without prejudice to the generality of the foregoing, any such acts and things as are referred to in the said documents relating to regulatory issues, taxation or otherwise;
- (B) the Directors be and they are hereby authorised to make and implement such offers or other proposals to, or arrangements with, the holders of options over shares in Midland including options under any employees' share scheme operated by Midland for the benefit of its employees, in each case on such terms and subject to such conditions as the Directors may consider appropriate;

- (C) the Directors be and they are hereby authorised to procure the Company and/or any of its subsidiaries and/or subsidiary undertakings to enter into, amend and/or perform any agreement, indemnity or arrangement with any third party or parties and/or waive any limitation of liability contained therein, whether in the ordinary course of business or otherwise, which they may consider in their absolute discretion necessary or desirable in connection with the Offer and/or the purchase of any shares in the capital of Midland and under which the Company and/or any of its subsidiaries and/or subsidiary undertakings agrees to grant or receive any option in respect of such shares and/or indemnity, and/or accept liability for costs, expenses, commissions and/or losses, whether in whole or in part and whether or not on a contingent basis, incurred by such third party or parties directly or indirectly in connection with the purchase, holding and/or disposal of any such shares; and
- (D) subject to and conditional upon the Offer becoming or being declared unconditional in all respects (other than as regards the coming into effect or passing of this Resolution):
- (i) the authorised share capital of the Company denominated in pounds sterling be increased from £301,500 to £1,125,301,500 by the creation of 1,500,000,000 Ordinary Shares of 75p each such shares having attached thereto the rights and privileges and being subject to the limitations and restrictions set forth in the Articles of Association of the Company as altered by this Resolution;
- (ii) the Articles of Association of the Company be altered:
- (a) by deleting the expressions and meanings of “Ordinary Share” and “£” in Article 2.1 and substituting the following expressions and meanings respectively:
- “Ordinary Share an Ordinary Share of the Company having a nominal amount of HK\$10 or 75p;
£ and p or pence pounds sterling and pence”;
- (b) by deleting Article 4.1 and substituting therefor the following:
- “4.1 The authorised share capital of the Company is HK\$20,000,000,000 denominated in Hong Kong dollars divided into 2,000,000,000 Ordinary Shares of HK\$10 each and £1,125,301,500 denominated in pounds sterling divided into 1,500,000,000 Ordinary Shares of 75p each and 301,500 Non-voting Deferred Shares of £1 each.
- 4.2 The Ordinary Shares rank pari passu in all respects.
- 4.3 Fully paid Ordinary Shares confer identical rights in respect of capital, dividends (save where and to the extent that any such share is issued on terms providing that it shall rank for dividend as from a particular date), voting and otherwise notwithstanding

that they are denominated in different currencies and shall be treated as if they are one single class of shares.”;

- (c) by substituting the following words in Article 5.1(2) for the words “after all other holders of shares in the Company have been repaid their capital in full and such holders have received an additional amount of £10,000,000 per share”:

“after there shall have been distributed (in cash or specie) to the holders of the Ordinary Shares the amount of £10,000,000 in respect of each Ordinary Share held by them respectively. For this purpose distributions in currency other than sterling shall be treated as converted into sterling, and the value of any distribution in specie shall be ascertained in sterling, in each case in such manner as the Board or the Company in general meeting may approve.”;

- (d) by inserting the following new Article as Article 6.2 immediately after Article 6.1:

- “6.2 (1) This Article 6.2 applies to any rights issue of any New Securities (as hereinafter defined) or any invitation to subscribe for any such securities which the Company may make in favour of holders of Ordinary Shares.
- (2) Whenever this Article 6.2 applies, the Company shall subject to the following provisions of this Article 6.2 extend the same invitation to all holders of Ordinary Shares at the same price and on the same terms.
- (3) Notwithstanding anything herein contained, whenever this Article 6.2 applies:
- (a) the Board may make such exclusions or other arrangements as the Board may deem necessary or expedient in relation to fractional entitlements or having regard to any restrictions or obligations under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever;
- (b) the Board may offer to holders of Ordinary Shares denominated in one currency Ordinary Shares denominated in the same or some other currency (or the right to subscribe for or to convert into or to exchange any securities for any such Ordinary Shares) and may give to any holders of Ordinary Shares a choice as to the currency in which the Ordinary Shares which they acquire (whether in

pursuance of the rights issue or any such right as aforesaid) are denominated;

- (c) the Board may determine that the price per New Security may be converted into such currency or currencies at such rate or rates of exchange as the Board may in its absolute discretion determine and so that the invitation may be made to holders of Ordinary Shares in different currencies and so that such holders may be given the option of subscribing in one or more different currencies;
- (d) if the Board determines to exercise the powers conferred by paragraphs (b) or (c) above, it need not exercise such powers in the same manner or to the same extent in relation to all holders of Ordinary Shares but may exercise such powers in relation to such holders of Ordinary Shares and in such manner and to such extent as it shall in its absolute discretion think fit.

(4) In this Article 6.2, “New Securities” means Ordinary Shares or any securities conferring the right to subscribe for or convert into or to exchange such security for Ordinary Shares.”;

- (e) by deleting in Article 35.1 the words “Without prejudice to the provisions of Articles 35.2 and 40, the” and substituting therefor the word “The”, by adding at the end of Article 35.1(c) the words “and in respect of shares denominated in the same currency” and by deleting Article 35.2;
- (f) by deleting Article 40;
- (g) by inserting the following paragraph at the end of Article 45.1:

“Any resolution for consolidation and division of Ordinary Shares into shares of a larger nominal amount pursuant to paragraph (b) of this Article and any resolution for sub-division of Ordinary Shares into shares of a smaller amount pursuant to paragraph (d) of this Article shall constitute a variation of the rights attached to the Ordinary Shares unless such resolution shall affect all the Ordinary Shares in issue in like manner and to like extent.”;

- (h) by inserting the following new Article as Article 47.2 immediately after Article 47.1:

“47.2 Without prejudice to the generality of Article 47.1, the passing and/or implementation of any special resolution for the reduction of the capital paid up on any Ordinary Shares and for the

cancellation of such Shares accordingly for the purpose only of, and followed by, the application (as nearly as may be) of the reserve then arising in or towards the payment up in full of the same number of new Ordinary Shares denominated in a different currency (which need not be any currency in which any issued Ordinary Share is then denominated) but having the same rights as and ranking pari passu in all respects with Ordinary Shares for the purposes of these Articles and the distribution of such new Ordinary Shares credited as fully paid to the holders of the Ordinary Shares so cancelled in proportion to the number of such Shares then held by them respectively shall not involve any variation or abrogation of the rights attached to any Ordinary Shares cancelled as aforesaid (or of the rights attached to any other Ordinary Share) and all Ordinary Shares whenever issued are subject to the restriction that the passing and/or implementation of any such resolution shall not require the consent or sanction of the holders of any Ordinary Shares to be given in accordance with Article 49.1 or otherwise.”;

- (i) by inserting the following new Article as Article 49.2 immediately after Article 49.1:

“49.2 Ordinary Shares whenever issued are subject to the restriction that the rights attached to them may be varied or abrogated by a special resolution of the Company without the separate consent or sanction (given in accordance with Article 49.1 or otherwise) of the holders of any of the Ordinary Shares provided that the rights attached to all the Ordinary Shares are thereby varied or abrogated in like manner and to like extent and accordingly neither the passing nor the implementation of any such resolution constitutes a variation or abrogation of any of the rights attached to any of the Ordinary Shares.”;

- (j) by deleting in Article 51.1 the words “on which any shares may be issued” and substituting therefor the words “of issue of or rights attached to any shares”; by deleting in Article 51.1 the words “or by the allotment of further shares ranking in priority thereto in any respect” and by inserting in Article 51.1 before the words “pari passu” the words “in priority to or”;
- (k) by deleting in each of Articles 52.1 and 53.1 the words “and in Hong Kong or such other place” and substituting therefor the words “and in such place”;
- (l) by deleting the third sentence of Article 54.1;
- (m) by inserting the following Article as Article 55.5 immediately after the existing Article 55.4:

“55.5 The holders of Ordinary Shares denominated in a currency other than sterling shall (if they would not do so apart from this paragraph) have the same rights as are enjoyed by holders of Ordinary Shares denominated in sterling under section 376(2)(b) of the Act and accordingly any amount paid up on any Ordinary Share in any currency other than sterling shall for the purposes of such provision be treated as if it had been converted into sterling at such rate of exchange prevailing at or about the date of the requisition as the Board shall determine”;

- (n) by deleting the words “or a Disclosure Notice (as defined in Article 40)” in Article 81.1; by deleting the words “or a Disclosure Notice” in Articles 81.3, 81.5 and 81.6; by deleting the words “and of Article 40.6,” in Article 81.4(a); by deleting the words “or from a Disclosure Notice” in Article 81.4(a), and by deleting the words in Article 81.4(b) and substituting therefor the words ““interested” shall be construed in accordance with section 212 of the Act”;
- (o) by deleting Article 84.2;
- (p) by deleting Article 91.1 and substituting the following:

“At each annual general meeting of the Company one-third of the Directors who are subject to retirement by rotation or, if their number is not three or a multiple of three, the number nearest to but not exceeding one-third shall retire from office.”;
- (q) by deleting in Article 95.1 the words “but with the age of 65 being substituted for all references therein to the age of 70”;
- (r) by deleting the words “within Hong Kong” in Article 100.1 and substituting therefor the words “within the United Kingdom or Hong Kong”;
- (s) by deleting the words “in Hong Kong” in Article 113.1 and substituting therefor “in the United Kingdom or Hong Kong”;
- (t) by deleting with effect from 1 January 1993 in Article 120.1 the words “No meetings of the Board shall be held in the United Kingdom”;
- (u) by deleting “Hong Kong” wherever that name appears in Article 121.1 and substituting therefor the words “the United Kingdom or Hong Kong”;
- (v) by deleting with effect from 1 January 1993 in Article 125.1 the words commencing with “Provided always” and ending with the words “..... in the United Kingdom”;
- (w) by deleting “Hong Kong” wherever that name appears in Article 126.1 and substituting therefor the words “the United Kingdom or Hong Kong”

and by deleting wherever those words appear in Article 126.1 the words “(other than the United Kingdom)”;

- (x) by deleting with effect from 1 January 1993 in Article 127.1 the words “and in particular no meetings of a committee of the Board shall be held in the United Kingdom”;
- (y) by adding the following sentence at the end of Article 142.1:

“If and whenever the shares on which any such dividend is declared are denominated in different currencies, the dividend shall be declared in a single currency (which may be any currency).”;
- (z) by adding the following sentence as a second sentence in Article 143.1:

“The Board shall declare such dividend on all shares ranking *pari passu* in a single currency (which may be any currency) even if such shares are denominated in different currencies.”;
- (aa) by deleting Article 144.1 and substituting the following:

“144.1 Except as otherwise provided by the terms of issue of or rights attached to any shares, all dividends shall be declared and paid according to the amounts paid up (otherwise than in advance of calls) on the shares on which the dividend is paid. For this purpose the same amount shall be deemed to have been paid up on all fully paid Ordinary Shares notwithstanding that they may be denominated in different currencies. Subject as aforesaid, all dividends shall be apportioned and paid proportionately to the percentage of the nominal amount (which shall in the case of Ordinary Shares be treated as the same amount as is hereby treated as paid up on all fully paid Ordinary Shares) paid up on the shares during any portion or portions of the period in respect of which the dividend is paid, but if any share is issued on terms providing that it shall rank for dividend as from a particular date, it shall rank for dividend accordingly.”;
- (bb) by deleting the words “other than Hong Kong dollars” in Article 148.2;
- (cc) by deleting in Article 149.1 the words “are left uncashed on two consecutive occasions or on one occasion if such cheque, warrant or order is returned to the Company undelivered” and substituting therefor the words “are returned to the Company or left uncashed on two consecutive occasions”;
- (dd) by deleting Article 151 and substituting the following:

“151.1 The Board may, with the prior authority of an ordinary resolution of the Company and subject to such terms and conditions as the

Board may determine, offer to any holders of Ordinary Shares the right to elect to receive in accordance with the provisions of this Article Ordinary Shares of the same or a different currency, credited as fully paid, instead of cash in any currency in respect of the whole (or some part, to be determined by the Board) of any dividend specified by the ordinary resolution. The following provisions shall apply:

- (a) the said resolution may specify a particular dividend, or may specify all or any dividends declared within a specified period or periods;
- (b) the entitlement of each holder of Ordinary Shares to new Ordinary Shares shall be such that the relevant value of the entitlement shall be as nearly as possible equal to (but not greater than) the cash amount (disregarding any tax credit) of the dividend that such holder would have received by way of dividend in the currency in which such dividend was declared or as converted into the equivalent amount in another currency if and in such manner as the Board shall so determine. For this purpose "relevant value" shall be calculated by reference to the average of the middle market quotations for the Ordinary Shares on The Stock Exchange, as derived from the Daily Official List, for the day on which the Ordinary Shares are first quoted "ex" the relevant dividend and the four subsequent dealing days, or in such other manner as the Board may determine on such basis as it considers to be fair and reasonable and the cash amount of the relevant dividend in a particular currency shall be converted into the equivalent amount in another currency if and in such manner as the Board shall so determine. A certificate or report by the Auditors as to the amount of the relevant value in respect of any dividend shall be conclusive evidence of that amount;
- (c) no fractions of a share shall be allotted;
- (d) the Board shall, after determining the basis of allotment, notify the holders of Ordinary Shares in writing of the right of election offered to them, and specify the procedure to be followed and place at which, and the latest time by which, elections must be lodged in order to be effective;
- (e) the Board may exclude from any offer any holders of Ordinary Shares or any Ordinary Shares held by a Depository where the Board considers that the making of the offer to them or in respect of such shares would or

might involve the contravention of the laws of any territory or that for any other reason the offer should not be made to them or in respect of such shares;

- (f) the Board may determine that every duly effected election in respect of any Ordinary Shares shall be binding on every successor in title to the holder thereof;
- (g) the dividend (or that part of the dividend in respect of which a right of election has been offered) shall not be payable on Ordinary Shares in respect of which an election has been duly made (“the elected Ordinary Shares”) and instead additional Ordinary Shares shall be allotted, credited as fully paid, to the holders of the elected Ordinary Shares on the basis of their entitlement pursuant to paragraph (b) of this Article 151.1. For such purpose the Board may capitalise, out of any amount for the time being standing to the credit of any reserve or fund (including any share premium account or capital redemption reserve) or of any of the profits which could otherwise have been applied in paying dividends in cash as the Board may determine, a sum equal to the aggregate nominal amount or amounts of the additional Ordinary Shares to be allotted on that basis and apply it in paying up in full the appropriate number of unissued Ordinary Shares for allotment and distribution to the holders of the elected Ordinary Shares on that basis. A Board resolution capitalising any part of such reserve or fund or profits shall have the same effect as if such capitalisation had been declared by ordinary resolution of the Company in accordance with Article 153 and in relation to any such capitalisation the Board may exercise all the powers conferred on them by Article 153 without need of such ordinary resolution;
- (h) the additional Ordinary Shares so allotted shall rank *pari passu* in all respects with each other and with the fully paid Ordinary Shares in issue on the record date for the dividend in respect of which the right of election has been offered, except that they will not rank for any dividend or other distribution or other entitlement which has been declared, paid or made by reference to such record date; and
- (i) the Board may terminate, suspend or amend any offer of the right to elect to receive Ordinary Shares in lieu of any cash dividend at any time.”;

- (ee) by deleting in Article 153.1(b) the words commencing with “to the holders of Ordinary Shares in proportion to the nominal amounts of the shares” and ending with the words “and were distributed by way of dividend” and substituting therefor the words “to the holders of Ordinary Shares (whether or not fully paid) in proportion to the number of such shares held by them respectively”;
- (ff) by adding the following further proviso at the end of Article 153.1(b):

“and provided further that the sum appropriated as hereinbefore mentioned need not be in the same currency as the securities which it is to be used to pay up but in that event and for the purpose of determining the extent to which such securities are paid up by such sum the Board shall select such rate of exchange as it shall consider appropriate.”;
- (gg) by inserting the following new Article as Article 153.2:

“153.2 Whenever the Ordinary Shares are denominated in different currencies and the Board is given authority under Article 153.1 to make an allotment of new Ordinary Shares credited as fully paid the holders of Ordinary Shares shall unless in respect of all or any of such Shares the Board otherwise resolves receive by virtue of such allotment Ordinary Shares (credited as fully paid) denominated in the same currency as the Ordinary Shares in right of which they are allotted. If the Board resolves otherwise in respect of any Ordinary Shares it may determine either that the holders of such Shares should receive, or that the holders of such Shares should have the right to elect to receive, Ordinary Shares denominated in some currency other than that in which their Shares are denominated and so that the Board may if it thinks fit exercise its powers under this Article differently in relation to different Ordinary Shares. The rights attached to an Ordinary Share shall not be deemed to be varied or abrogated by reason only that any Ordinary Share offered or allotted to the holder thereof in pursuance of this Article is denominated in a different currency from or the same currency as any other Ordinary Share allotted to any other holder of Ordinary Shares on the same occasion or is denominated in the same or a different currency from the Ordinary Share in right of which it is allotted.”;
- (hh) by adding the following sentence at the end of Article 154.1:

“Different dates may be fixed as record dates in respect of shares registered on different Registers.”; and

(ii) by inserting the following as a new Article 166.1 and renumbering the existing Article 166.1 as Article 166.2:

“166.1 If the Company is wound up, the assets available for distribution among the holders of Ordinary Shares shall be distributed among such holders in proportion to the number of Ordinary Shares held by them respectively notwithstanding that such Ordinary Shares may be denominated in different currencies. The distribution of any amount under this Article to the holder of any Ordinary Share which at the date of such distribution is not fully paid up shall be adjusted so as to ensure that the holder gives credit against such distribution for the amount remaining unpaid on his share.”;

(iii) in substitution for any other authority conferred upon the Directors to allot relevant securities of the Company (but without prejudice to any exercise of such other authority prior to the date on which this Resolution becomes effective), the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 (“the Act”) to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of HK\$3,698,512,180 and £1,125,000,000 provided that this authority shall be limited so that, otherwise than pursuant to:

- (a) the Offer, proposals and arrangements referred to in paragraphs (A) and (B) of this Resolution or any acquisition of shares of Midland pursuant to sections 428 to 430F of the Act or otherwise; or
- (b) a rights issue in favour of (a) ordinary shareholders where the relevant securities respectively attributable to the interests of all ordinary shareholders are proportionate (or as nearly as may be) to the respective numbers of Ordinary Shares held by them and (b) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue, but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or having regard to any restrictions or obligations under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or
- (c) the terms of any share scheme for employees of the Company or any of its subsidiaries; or

- (d) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company,

the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority shall not in aggregate exceed HK\$815,074,391 and £26,400,000 (equal to approximately 5 per cent of the nominal amount of each class of the Ordinary Shares of the Company expected to be in issue assuming full acceptance of the Offer) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 1993 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired;

- (iv) the Directors be and they are hereby empowered, pursuant to section 95 of the Act, to allot equity securities (as defined by section 94 of the Act) pursuant to the authority conferred by this Resolution as if section 89(1) of the Act did not apply to any such allotment provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 1993 save that this power shall enable the Company prior to the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after the expiry of this power and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired, and all authorities previously conferred under section 95 of the Act shall be revoked on the date on which this Resolution becomes effective but without prejudice to any exercise of such other authorities prior to the date on which this Resolution becomes effective; and
- (v) the Directors be and are hereby empowered:
- (a) to exercise the power conferred on them by Article 151 of the Articles of Association of the Company as altered by this Resolution in respect of all or part of any dividend payable in respect of any financial period of the Company ending on or before 31 December 1996;
- (b) to capitalise from time to time the appropriate nominal amount or amounts of new shares of the Company falling to be allotted pursuant to elections made under the Company's scrip dividend scheme out of the amount or amounts standing to the credit of any reserve account or fund of the Company, to apply that sum in paying up in full the relevant number of such new shares and to allot such new shares pursuant to such elections; and
- (c) generally to implement the Company's scrip dividend scheme on such terms and conditions as the Directors may from time to time

determine and to take such other actions as the Directors may deem necessary or desirable from time to time in respect of the Company's scrip dividend scheme.

W Purves
Chairman

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES

**RESOLUTION
of
HSBC Holdings plc**

Passed 9 June 1992

At the Separate General Meeting of the holders of the Ordinary Shares of HK\$10 each in the capital of HSBC Holdings plc held on Level 18, 1 Queen's Road Central, Hong Kong on Tuesday, 9 June 1992, the following EXTRAORDINARY RESOLUTION was passed:

EXTRAORDINARY RESOLUTION

THAT this Separate General meeting of the holders of the Ordinary Shares of HK\$10 each in the capital of the Company ("the Ordinary Shares") hereby approves and sanctions on behalf of the holders of all the Ordinary Shares the passing as a Special Resolution of the Company of the Resolution set out in the Notice dated 11 May 1992 convening an Extraordinary General Meeting of the Company for Tuesday, 9 June 1992 and approves and sanctions on behalf as aforesaid each and every variation, modification or abrogation of the rights attached to the Ordinary Shares as is or may be involved in or effected by or pursuant to the passing or coming into effect of the said Resolution as aforesaid or as results or may result from any issue of shares or other securities contemplated by the said Resolution.

W Purves
Chairman

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS

of

HSBC Holdings plc

Passed 28 May 1993

At the Annual General Meeting of the above-named Company duly convened and held on 28 May 1993, the following Resolutions were duly passed:

ORDINARY RESOLUTION

- 4 THAT the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 ("the Act") to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of HK\$3,089,694,650 and £204,018,865 provided that this authority shall be limited so that, otherwise than pursuant to:
- (a) a rights issue, or other issue in favour of (i) ordinary shareholders where the relevant securities respectively attributable to the interests of all ordinary shareholders are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them and (ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue, or other issue, but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions or obligations under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or
 - (b) the terms of any share scheme for employees of the Company or any of its subsidiary undertakings; or
 - (c) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company,

the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority shall not in aggregate exceed HK\$845,515,260 and £30,602,829 (equal to approximately 5 per cent. of the nominal amount of each class of Ordinary Shares of the Company in issue at the date of the Notice of this Meeting) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 1994 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTIONS

- 5 THAT, subject to the passing of Resolution No. 4 set out in the Notice convening this Meeting, the Directors be and they are hereby empowered, pursuant to section 95 of the Companies Act 1985 ("the Act") to allot equity securities (as defined by section 94 of the Act) pursuant to the authority conferred by Resolution No 4 as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 1994 save that this power shall enable the Company prior to the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after the expiry of this power and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.
- 9 THAT:
- (A) the authorised share capital of the Company denominated in pounds sterling be increased from £1,125,301,500 to £1,625,301,500 by the creation of 500,000,000 non-cumulative preference shares of £1 each, such shares having attached thereto the rights and privileges and being subject to the limitations and restrictions set forth in the Articles of Association of the Company as altered by this resolution;
 - (B) in addition to and without prejudice to any other authority conferred upon the Directors to allot relevant securities of the Company including the authority conferred by Resolution No. 4 set out in the Notice convening this Meeting, the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 to exercise all the powers of the Company to allot all the 500,000,000 non-cumulative preference shares of £1 each created by paragraph (A) of this resolution, and this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 1994 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require the allotment of all or any of such shares after such expiry and the Directors may allot such shares in pursuance of such offers or agreements as if the authority conferred hereby had not expired;
 - (C) the Articles of Association of the Company be altered:
 - (i) by adding the following expression and meaning in Article 2.1:

“Sterling Preference Share a non-cumulative preference share of £1”;

(ii) by deleting Article 4.1 and substituting therefor the following:

“4.1 The authorised share capital of the Company is HK\$20,000,000,000 denominated in Hong Kong dollars divided into 2,000,000,000 Ordinary Shares of HK\$10 each and £1,625,301,500 denominated in pounds sterling divided into 1,500,000,000 Ordinary Shares of 75p each, 500,000,000 Sterling Preference Shares of £1 each and 301,500 Non-voting Deferred Shares of £1 each.”;

(iii) by renumbering the existing Articles 5 and 5.1 as Articles 5A and 5A.1 respectively and by inserting the following as a new Article 5:

5 Rights of the Sterling Preference Shares

5.1 The following rights and restrictions shall be attached to the Sterling Preference Shares:

- (1) The Sterling Preference Shares shall rank pari passu inter se. They shall confer the rights and be subject to the limitations set out in this Article. They shall also confer such further rights (not being inconsistent with the rights set out in this Article) and be subject to such further limitations and restrictions as may be attached by the Board to such shares prior to allotment. Whenever the Board has power under this Article to determine any of the rights attached to any of the Sterling Preference Shares, the rights so determined need not be the same as those attached to the Sterling Preference Shares which have then been allotted or issued. The Sterling Preference Shares may be issued in one or more separate series and each series shall be identified in such manner as the Board may determine without any such determination or identification requiring any alteration to these Articles.
- (2) Each Sterling Preference Share shall confer the following rights as to dividend, capital, the receipt of notices of meetings, attendance at meetings and voting:

Income

- (a) the right (subject to the provisions of paragraph (4) of this Article, if applicable) in priority to the payment of any dividend to the holders of Ordinary Shares and in priority to or pari passu with any payment of any dividend to the holders of any other class of shares in issue (other than shares which by their terms rank in priority to the Sterling Preference Shares as regards income) to a non-cumulative preferential dividend in sterling payable at such rate (whether fixed, variable or floating or to be determined by a specified procedure, mechanism or formula) on such dates and on such other terms and conditions as may be determined by the Board prior to allotment thereof;

Capital

- (b) the right in a winding up of the Company (but not, unless otherwise provided by the terms of issue of such share, upon a redemption, reduction or purchase by the Company of any of its share capital) to receive out of the assets of the Company available for distribution to its members in priority to any payment to the holders of the Ordinary Shares and in priority to or pari passu with the holders of any other class of shares of the Company in issue (other than shares which by their terms rank in priority to the Sterling Preference Shares as regards repayment of capital):
 - (i) a sum in sterling equal to
 - (A) the amount of any dividend which is due for payment after the date of commencement of the winding up but which is payable in respect of a period ending on or before such date; and
 - (B) if the date of commencement of the winding up falls before the last day of a period in respect of which a dividend would have been payable and which began before such date, any further amount of dividend which would have been payable had such date been the last day of that periodbut only to the extent that any such amount or further amount was, or would have been, payable as a cash dividend in accordance with or pursuant to this Article; and
 - (ii) subject thereto, a sum equal to the amount paid up or credited as paid up on such share together with such premium (if any) as may be determined by the Board (or by a procedure, mechanism or formula determined by the Board) prior to allotment thereof (and so that the Board may determine that such premium is payable only in specified circumstances);

Receipt of notices

- (c) the right to have sent to the holder of such share (at the same time as the same are sent to the holders of Ordinary Shares) all notices of general meetings of the Company and a copy of every circular or other like document sent out by the Company to the holders of Ordinary Shares.

Attendance and voting at meetings

- (d) the right to attend and vote at general meetings of the Company:-
 - (i) if the dividend which is (or, but for any applicable provision of paragraph (4) of this Article, would be) most recently payable on such share shall not have been paid in full;

- (ii) if a resolution is to be proposed at the meeting varying or abrogating any of the rights attached to the class of shares of which such share forms part (and then only to speak and vote upon the relevant resolution); or
- (iii) in such other circumstances, and upon and subject to such terms, as the Board may determine prior to allotment of such share; but not otherwise, together with the right, if so determined by the Board prior to allotment of such share, to join in a requisition of a general meeting of the Company in such circumstances, and upon and subject to such terms, as the Board may determine prior to allotment of such share.

Whenever holders of Sterling Preference Shares are entitled to vote on a resolution, on a show of hands every such holder who is present in person shall have one vote and on a poll every such holder who is present in person or by proxy shall have one vote for every £1 in nominal amount of Sterling Preference share capital held by him.

Limitations

- (3) No Sterling Preference Share shall:-
 - (a) confer any right to participate in the profits or assets of the Company other than that set out in sub-paragraphs (2)(a) and (b) of this Article;
 - (b) subject to the Act, confer any right to participate in any offer or invitation by way of rights or otherwise to subscribe for additional shares or securities in the Company;
 - (c) confer any right of conversion; or
 - (d) confer any right to participate in any issue of bonus shares or shares issued by way of capitalisation of reserves save as set out in sub-paragraph (4)(d) of this Article.

Further provision as to income

- (4) All or any of the following provisions shall apply in relation to any Sterling Preference Shares of any series (“relevant Sterling Preference Shares”) if so determined by the Board prior to allotment thereof:-
 - (a) (i) if, on any date (“the relevant date”) on which a dividend (“the relevant dividend”) would otherwise fall to be paid on any relevant Sterling Preference Shares, the profits of the Company available for distribution are, in the opinion of the Board, insufficient to enable payment in full to be made of the relevant dividend, then:-
 - (A) none of the relevant dividend shall be payable; or

(B) the Board shall (after payment in full, or the setting aside of a sum required for payment in full, of all dividends payable on or before the relevant date on any shares in the capital of the Company in priority to the relevant Sterling Preference Shares) apply such profits, if any, in paying dividends to the holders of participating shares (as defined below) pro rata to the amounts of dividend on participating shares accrued and payable on or before the relevant date. For the purposes of this paragraph, the expression “participating shares” shall mean the relevant Sterling Preference Shares and any other shares in the capital of the Company which rank pari passu as to participation in profits with the relevant Sterling Preference Shares and on which either (1) a dividend is payable on the relevant date or (2) arrears of cumulative dividend are unpaid at the relevant date,

but so that, if the Board determines prior to allotment of any relevant Sterling Preference Shares that the provisions of this sub-paragraph (a)(i) shall apply in relation thereto, they shall apply one (but not both) of (A) and (B) above;

- (ii) if it shall subsequently appear that any such dividend which has been paid in whole or in part should not, in accordance with the provisions of this sub-paragraph, have been so paid, then provided the Board shall have acted in good faith, they shall not incur any liability for any loss which any shareholder may suffer in consequence of such payment having been made;
- (b) if in the opinion of the Board the payment of any dividend on any relevant Sterling Preference Shares would breach or cause a breach of the Bank of England’s capital adequacy requirements from time to time applicable to the Company and/or any of its subsidiaries then none of such dividend shall be payable;
- (c) if a dividend or any part thereof on any relevant Sterling Preference Shares is not paid for the reasons specified in sub-paragraphs (a) or (b) above, the holders of such shares shall have no claim in respect of such non-payment save as provided in sub-paragraph (d) below (if applicable);
- (d) (i) the provisions of this sub-paragraph (d) shall apply where any dividend otherwise payable on a particular date on any relevant Sterling Preference Shares (a “relevant instalment”) is, for the reasons specified in sub-paragraphs (a)(i)(A) or (b) above, not payable and the amounts (if any) standing to the credit of any of the Company’s reserves, including capital redemption reserve (if any) and share premium account (if any), or profit and loss account and available for the purpose are in aggregate sufficient

to be applied and capable of being applied in paying up in full at par additional Sterling Preference Shares on the basis hereinafter provided in this sub-paragraph (d);

- (ii) on the date for payment of the relevant instalment had such instalment been paid, the Board shall, subject to the Act, allot and issue credited as fully paid to each holder of relevant Sterling Preference Shares such additional nominal amount of Sterling Preference Shares (disregarding any fractional entitlement) as is equal to an amount determined by multiplying the cash amount of the relevant instalment which would have been payable to him had such instalment been payable (exclusive of any associated tax credit) by a factor to be determined by the Board prior to allotment of the relevant Sterling Preference Shares;
- (iii) for the purposes of paying up additional Sterling Preference Shares to be allotted pursuant to this sub-paragraph (d), the Board shall appropriate, out of such of the accounts or reserves of the Company available for the purpose as they shall determine, a sum equal to the aggregate nominal amount of the additional Sterling Preference Shares then to be allotted and shall make all appropriations and applications of such sum and all allotments and issues of fully paid Sterling Preference Shares and generally do all acts and things required to give effect thereto as they shall determine to be necessary or expedient;
- (iv) as from the date of allotment thereof the additional Sterling Preference Shares allotted pursuant to this sub-paragraph (d) shall confer the same rights and be subject to the same limitations as, and shall rank *pari passu* in all respects with, the relevant Sterling Preference Shares save only as regards participation in the relevant instalment;
- (v) if any additional Sterling Preference Shares falling to be allotted pursuant to this sub-paragraph (d) cannot be allotted by reason of any insufficiency in the Company's authorised share capital or in the amount of relevant securities which the Board is authorised to allot in accordance with section 80 of the Companies Act 1985, the Board shall convene a general meeting, to be held as soon as practicable, for the purpose of considering a resolution or resolutions effecting an appropriate increase in the authorised share capital and granting the Board appropriate authority to allot relevant securities;
- (vi) the Board may undertake and do such acts and things as it may consider necessary or expedient for the purposes of giving effect to the provisions of this sub-paragraph (d).

- (e) if any dividend on any relevant Sterling Preference Shares is not paid in full (or a sum is not set aside to provide for its payment in full), the Company may not (without the written consent of three quarters in nominal value of, or the sanction of an extraordinary resolution passed at a separate general meeting of, the holders of relevant Sterling Preference Shares) thereafter redeem, reduce, purchase or otherwise acquire for any consideration any other share capital of the Company ranking pari passu with or after the relevant Sterling Preference Shares (and may not set aside or establish any sinking fund for any such redemption, reduction, purchase or other acquisition) until such time as dividends on the relevant Sterling Preference Shares in respect of such period as the Board shall determine prior to allotment of the relevant Sterling Preference Shares shall have been paid in full (or a sum shall have been set aside to provide for such payment in full);
- (f) if any dividend on any relevant Sterling Preference Shares is not paid in full (or a sum is not set aside to provide for its payment in full), no dividend may thereafter be declared or paid on any other share capital of the Company ranking as to dividend after the relevant Sterling Preference Shares (and no sum may be set aside for the payment of any such dividend on any other such share capital) until such time as dividends on the relevant Sterling Preference Shares in respect of such period as the Board shall determine prior to allotment of the relevant Sterling Preference Shares shall have been paid in full (or a sum shall have been set aside to provide for such payment in full);
- (g) dividends payable on Sterling Preference Shares shall accrue from and to the dates determined by the Board prior to allotment thereof, and the amount of (or in respect of) any dividend payable in respect of any period shorter than a full dividend period will be calculated on the basis of a 365 day year (or, in a leap year, a 366 day year), and the actual number of days elapsed in such period.

Redemption

- (5) (a) Unless otherwise determined by the Board in relation to Sterling Preference Shares of any series prior to allotment thereof, the Sterling Preference Shares shall, subject to the provisions of the Act, be redeemable at the option of the Company;
- (b) In the case of any series of Sterling Preference Shares which are to be so redeemable:
 - (i) the Company may, subject to the provisions of the Act, redeem on any Redemption Date (as hereinafter defined) all or some only of the Sterling Preference Shares of such series by giving to the holders of the Sterling Preference Shares to be redeemed not less than 14 days' nor more than 60 days' prior notice in writing (a "Notice of Redemption") of the relevant Redemption Date.

“Redemption Date” means, in relation to a Sterling Preference Share of a particular series, any date which falls no earlier than five years and one day after the first date of allotment of Sterling Preference Shares of that series (or such later date as the Board determines prior to allotment);

- (ii) there shall be paid on each Sterling Preference Share so redeemed, in sterling, the aggregate of the nominal amount thereof and any premium credited as paid up on such share together with the sum which would have been payable pursuant to sub-paragraph (2)(b)(i) of this Article if the Redemption Date had been the date of commencement of a winding up of the Company;
- (iii) in the case of redemption of some only of the Sterling Preference Shares in any series, the Company shall for the purpose of determining the particular Sterling Preference Shares to be redeemed cause a drawing to be made at the Office or such other place as the Board may approve in the presence of the Auditors;
- (iv) any Notice of Redemption given under sub-paragraph (b)(i) above shall specify the applicable Redemption Date, the particular Sterling Preference Shares to be redeemed and the redemption price (specifying the amount of the accrued and unpaid dividend per share to be included therein and stating that dividends on the Sterling Preference Shares to be redeemed will cease to accrue on redemption), and shall state the place or places at which documents of title or such other evidence as may be accepted by the Board in respect of such Sterling Preference Shares are to be presented and surrendered for redemption and payment of the redemption monies is to be effected. Upon such Redemption Date, the Company shall redeem the particular Sterling Preference Shares to be redeemed on that date subject to the provisions of this paragraph and of the Act. No defect in the Notice of Redemption or in the giving thereof shall affect the validity of the redemption proceedings
- (v) payments in respect of the amount due on redemption of a Sterling Preference Share shall be made by sterling cheque drawn on a bank in London or upon the request of the holder or joint holders not later than the date specified for the purpose in the Notice of Redemption by transfer to a sterling account maintained by the payee with a bank in London or by such other method as the Board may determine. Such payment will be made against presentation and surrender of the relative certificate at the place or one of the places specified in the Notice of Redemption or against such other evidence as may be accepted by the Board and if any certificate or other evidence aforesaid so surrendered includes any Sterling Preference Shares not to be redeemed on the relevant Redemption Date the Company shall within 14 days thereafter

issue to the holder, free of charge a fresh certificate or other evidence aforesaid in respect of such Sterling Preference Shares.

All payments in respect of redemption monies will in all respects be subject to any applicable fiscal or other laws;

- (vi) as from the relevant Redemption Date the dividend on the Sterling Preference Shares due for redemption shall cease to accrue except on any such Sterling Preference Shares in respect of which, upon due surrender of the certificate or other evidence aforesaid, payment of the redemption monies due on such Redemption Date shall be improperly withheld or refused, in which case such dividend, at the rate then applicable, shall be deemed to have continued and shall accordingly continue to accrue from the relevant Redemption Date to the date of payment of such redemption monies. Such Sterling Preference Shares shall not be treated as having been redeemed until the redemption monies in question together with the accrued dividend thereon shall have been paid;
 - (vii) if the due date for the payment of the redemption monies on any Sterling Preference Share is not a day on which banks in London are open for business (a "Sterling Business Day") then payment of such monies will be made on the next succeeding day which is a Sterling Business Day and without any interest or other payment in respect of such delay; and
 - (viii) the receipt of the holder for the time being of any Sterling Preference Shares (or, in the case of joint registered holders, the receipt of any one of them) for the monies payable on redemption thereof shall constitute an absolute discharge to the Company in respect thereof.
- (c) Upon the redemption or purchase of any Sterling Preference Shares the Board shall have power without any further resolution or consent to convert the authorised but unissued Sterling Preference Shares existing as a result of such redemption or purchase into shares of any other class of share capital into which the authorised share capital of the Company is or may be divided of the same nominal amount in sterling as the Sterling Preference Shares or into unclassified shares of the same nominal amount in sterling as the Sterling Preference Shares;
 - (d) Any Sterling Preference Shares redeemed pursuant to this paragraph (5) shall be cancelled on redemption.

Purchase

- (6) Subject to the provisions of the Act, the Company may at any time purchase any Sterling Preference Shares (i) in the market, (ii) by tender (available alike to all holders of the same class of Sterling Preference Shares) or (iii) by private treaty, in each case upon such terms as the Board shall determine.

Consolidation and division

- (7) Pursuant to the authority given by the passing of the resolution adopting this Article the Board may consolidate and divide and/or subdivide any Sterling Preference Shares into shares of a larger or smaller amount.

Restrictions on the Company

- (8) All or part of the provisions of this paragraph shall apply in relation to Sterling Preference Shares of any series (“relevant Sterling Preference Shares”) if so determined by the Board prior to the allotment thereof and the Board may determine to attach other restrictions to relevant Sterling Preference Shares by their terms of issue. Save with the written consent of the holders of three quarters in nominal value of, or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of, the relevant Sterling Preference Shares, the Board shall not capitalise any part of the profits available for distribution or purchase or redeem any shares of the Company if after such capitalisation, purchase or redemption the amount of the profits available for distribution would be less than a multiple, determined by the Board prior to allotment of relevant Sterling Preference Shares, of the aggregate amount of the annual dividends (exclusive of any associated tax credit) payable on the Sterling Preference Shares then in issue and any other preference shares then in issue ranking as regards dividend *pari passu* with or in priority to them or any of them.

Further preference shares

- (9) The special rights attached to any Sterling Preference Shares of any series allotted or in issue shall not (unless otherwise provided by their terms of issue) be deemed to be varied by the creation or issue of any other preference shares or further shares in any currency (“new shares”) ranking as regards participation in the profits and assets of the Company *pari passu* with or in priority to such Sterling Preference Shares and so that any new shares ranking *pari passu* with such Sterling Preference Shares may either carry rights and restrictions identical in all respects with such Sterling Preference Shares or any of them or rights and restrictions differing therefrom in any respect including but without prejudice to the generality of the foregoing in that:
- (a) the rate of and/or basis of calculation of dividend may differ and the dividend may be cumulative or non-cumulative;
 - (b) the new shares or any series thereof may rank for dividend as from such date as may be provided by the terms of issue thereof and the dates of payment of dividend may differ;

- (c) a premium may be payable on return of capital or there may be no such premium;
- (d) the new shares may be redeemable at the option of the holder or of the Company, or may be non-redeemable, and if redeemable at the option of the Company they may be redeemable at different dates and on different terms from those applying to the Sterling Preference Shares; and
- (e) the new shares may be convertible into Ordinary Shares or any other class of shares ranking as regards participation in the profits and assets of the Company *pari passu* with or after such Sterling Preference Shares in each case on such terms and conditions as may be prescribed by the terms of issue thereof.

Variation of class rights

(10) (a) Subject to the provisions of the Act:

- (i) all or any of the rights, preference, privileges, limitations or restrictions for the time being attached to the Sterling Preference Shares may from time to time (whether or not the Company is being wound up) be varied or abrogated with the consent in writing of the holders of not less than three-quarters in nominal value of the Sterling Preference Shares of all series in issue or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of the Sterling Preference Shares, voting as a single class without regard for series; and
- (ii) all or any of the rights, preferences, privileges, limitations or restrictions for the time being attached to Sterling Preference Shares of any series may be varied or abrogated so as to affect adversely such rights on a basis different from any other series of Sterling Preference Shares with the consent in writing of the holders of not less than three-quarters in nominal value of the Sterling Preference Shares of such series or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of Sterling Preference Shares of such series.

All the provisions of these Articles as to general meetings of the Company shall *mutatis mutandis* apply to any such separate general meeting, but so that the necessary quorum shall be two persons holding or representing by proxy at least one-third in nominal value of the issued shares of the class, that every holder of shares of the class shall be entitled on a poll to one vote for every share of the class held by him, that any holder of shares of the class present in person or by proxy may demand a poll and that at any adjourned meeting of the holders one holder present in person or by proxy (whatever the number of shares held by him) shall be a quorum.

- (b) Unless otherwise provided by its terms of issue, the rights attached to any Sterling Preference Share shall not be deemed to be varied or abrogated by a reduction of any share capital or purchase by the Company or redemption of any share capital in each case ranking as regards participation in the profits and assets of the Company in priority to or pari passu with or after such Sterling Preference Share.

W Purves
Chairman

THE COMPANIES ACT 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES
RESOLUTIONS
OF
HSBC HOLDINGS PLC

Passed 22 March 1996

At a Board Meeting of HSBC Holdings plc duly convened and held on 22 March 1996, the following resolutions were duly passed pursuant to Section 380 (as amended by Regulation 40(3)):

RESOLUTIONS

1. Pursuant to Regulation 16(2) of the Uncertificated Securities Regulations 1995 (“the Regulations”), IT WAS RESOLVED that:
 - (a) title to the Ordinary Shares of 75p each in the capital of the Company (the “75p Shares”), in issue or to be issued, may be transferred by means of a relevant system (as defined in the Regulations);
 - (b) such relevant system shall include the relevant system of which CRESTCo Limited is to be the Operator (as defined in the Regulations);
 - (c) the 75p Shares shall not include any shares referred to in Regulation 17; and
 - (d) this resolution shall become effective immediately.
2. Pursuant to Regulation 16(2) of the Uncertificated Securities Regulations 1995 (“the Regulations”), IT WAS RESOLVED that:
 - (a) title to the Ordinary Shares of HK\$10 each in the capital of the Company (the “HK\$10 Shares”), in issue or to be issued, may be transferred by means of a relevant system (as defined in the Regulations);

- (b) such relevant system shall include the relevant system of which CRESTCo Limited is to be the Operator (as defined in the Regulations);
- (c) the HK\$10 Shares shall not include any shares referred to in Regulation 17; and
- (d) this resolution shall become effective immediately.

W Purves
Chairman

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES
RESOLUTIONS
of
HSBC Holdings plc

Passed 30 May 1997

At the Annual General Meeting of HSBC Holdings plc held at Barbican Hall, Barbican Centre, London EC2Y 8DS on Friday, 30 May 1997, the following Resolutions were passed:

ORDINARY RESOLUTIONS

- 4 THAT pursuant to Article 104.1 of the Articles of Association of the Company with effect from 1 January 1997 the Directors (other than alternate directors) shall be entitled to receive £25,000 per annum by way of fees for their services as Directors.
- 5 THAT the Directors be and are hereby empowered:
 - (a) to exercise the power conferred upon them by Article 151 of the Articles of Association of the Company in respect of all or part of any dividend payable in respect of any financial period of the Company ending on or before 31 December 2001;
 - (b) to capitalise from time to time the appropriate nominal amount or amounts of new shares of the Company falling to be allotted pursuant to elections made under the Company's scrip dividend scheme out of the amount or amounts standing to the credit of any reserve account or fund of the Company, to apply that sum in paying up in full the relevant number of such new shares and to allot such new shares pursuant to such elections; and
 - (c) generally to implement the Company's scrip dividend scheme on such terms and conditions as the Directors may from time to time determine and to take such other actions as the Directors may deem necessary or desirable from time to time in respect of the Company's scrip dividend scheme.

- 6 THAT the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of HK\$1,790,628,600 and £565,333,400 (of which up to £500,000,000 shall be in the form of non-cumulative Sterling Preference Shares of £1 each) provided that this authority shall be limited so that, otherwise than pursuant to:
- (a) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to
 - (i) Ordinary Shareholders where the relevant securities respectively attributable to the interests of all Ordinary Shareholders are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them and (ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue, but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions or obligations under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or
 - (b) the terms of any share scheme for employees of the Company or any of its subsidiary undertakings; or
 - (c) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or
 - (d) the allotment of up to 500,000,000 non-cumulative Sterling Preference Shares of £1 each in the capital of the Company,
- the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority shall not in aggregate exceed HK\$895,314,300 and £32,666,700 (equal to approximately 5 per cent of the nominal amount of each class of Ordinary Shares of the Company in issue at the date of the Notice of this Meeting) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 1998 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

- 7 THAT, subject to the passing of Resolution No. 6 set out in the Notice convening this Meeting, the Directors be and they are hereby empowered, pursuant to section 95 of the Companies Act 1985 ("the Act") to allot equity securities (as defined by section 94 of the Act) pursuant to the authority conferred by Resolution No. 6 as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall expire at the

conclusion of the Annual General Meeting of the Company to be held in 1998 save that this power shall enable the Company prior to the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

**W Purves
Chairman**

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS

of

HSBC Holdings plc

Passed 29 May 1998

At the Annual General Meeting of HSBC Holdings plc held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 29 May 1998, the following Resolutions were passed:

ORDINARY RESOLUTION

- 4 THAT the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of HK\$1,801,612,500 and £565,605,000 (of which up to £500,000,000 shall be in the form of non-cumulative Sterling Preference Shares of £1 each) provided that this authority shall be limited so that, otherwise than pursuant to:
- (a) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to
 - (i) Ordinary Shareholders where the relevant securities respectively attributable to the interests of all Ordinary Shareholders are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them and (ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue, but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions or obligations under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or
 - (b) the terms of any share scheme for employees of the Company or any of its subsidiary undertakings; or

- (c) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or
- (d) the allotment of up to 500,000,000 non-cumulative Sterling Preference Shares of £1 each in the capital of the Company,
- the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority shall not in aggregate exceed HK\$900,806,250 and £32,802,500 (equal to approximately 5 per cent of the nominal amount of each class of Ordinary Shares of the Company in issue at the date of the Notice of this Meeting) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 1999 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

- 5 THAT, subject to the passing of Resolution No. 4 set out in the Notice convening this Meeting, the Directors be and they are hereby empowered, pursuant to section 95 of the Companies Act 1985 ("the Act") to allot equity securities (as defined by section 94 of the Act) pursuant to the authority conferred by Resolution No. 4 as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 1999 save that this power shall enable the Company prior to the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

**W Purves
Chairman**

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS

of

HSBC Holdings plc

Passed 28 May 1999

At the Annual General Meeting of HSBC Holdings plc held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 28 May 1999, the following Resolutions were passed:

SPECIAL RESOLUTIONS

- 4 THAT, subject to the passing as Special Resolutions of Resolutions 5 and 6 in the Notice convening this Meeting:
- (a) the ordinary share capital of the Company be reduced by cancelling and extinguishing all of the issued and unissued Ordinary Shares of HK\$10 each and Ordinary Shares of 75p each ("**Existing Ordinary Shares**"); and
 - (b) forthwith and contingently upon such reduction of capital taking effect:
 - (i) the authorised share capital of the Company be increased by such amount in United States dollars ("**the US\$ Amount**") divided into new Ordinary Shares with a nominal value of US\$1.50 each ("**US\$ Shares**") as represents the aggregate amount resulting from the creation of such number of US\$ Shares as is equal to the aggregate number of issued Existing Ordinary Shares as is cancelled by such reduction of capital ("**the Required Number**"), such US\$ Shares to have the same rights and privileges attached thereto (save as to the amount paid up on each share) as are attached by the Articles of Association of the Company to the Existing Ordinary Shares;
 - (ii) the reserve arising in the books of the Company as a result of the cancellation and extinguishing of the issued Ordinary Shares of HK\$10 each be converted into United States dollars at the spot rate of exchange for the purchase of United States dollars with Hong Kong dollars ("**the HK\$/US\$ Rate**") as quoted by Midland Bank plc in the

London Foreign Exchange Market at or about 4.00 pm (London time) on the business day (being a day on which banks are ordinarily open for the transaction of normal banking business in London) before the date (“**the Effective Date**”) on which the Court order confirming the reduction of capital is registered by the Registrar of Companies in England and Wales, and the reserve arising in the books of the Company as a result of the cancellation and extinguishing of the issued Ordinary Shares of 75p each be converted into United States dollars at the spot rate of exchange for the purchase of United States dollars with pounds sterling (“**the £/US\$ Rate**”) as quoted by Midland Bank plc in the London Foreign Exchange Market at or about 4.00 pm (London time) on the business day before the Effective Date, in each case such rate to be the rate as conclusively certified by an officer of Midland Bank plc;

- (iii) the sum standing in the books of the Company as a result of the conversion referred to in sub-paragraph (ii) above (“**the US\$ Reserve**”) be applied in paying up new US\$ Shares in full at par in accordance with sub-paragraph (v) below, provided that if there would otherwise be any amount remaining in the US\$ Reserve once as many as possible US\$ Shares have been paid up in full at par, one of such US\$ Shares be paid up at a premium equal to such amount;
- (iv) if the US\$ Reserve is less than the US\$ Amount, on the recommendation of the Directors and notwithstanding anything to the contrary in the Articles of Association, such part of the Company’s reserves (“**the Additional Reserve**”) (the reserve or reserves to be used for this purpose to be determined by the Directors and so that any reserves as are denominated in pounds sterling shall first be converted into United States dollars at the £/US\$ Rate) be applied in paying up in full at par in accordance with sub-paragraph (v) below such number of additional new US\$ Shares as is equal to the number by which the number of new US\$ Shares paid up pursuant to sub-paragraph (iii) above is less than the Required Number;
- (v) each of the US\$ Reserve and (where necessary) the Additional Reserve be separately applied so as to pay up in aggregate the Required Number of new US\$ Shares, such shares to be allotted and issued credited as fully paid to those persons who appear on the register of members of the Company on the Effective Date ten minutes before the time at which the Court order confirming the reduction of capital is registered by the Registrar of Companies in England and Wales as the holders of cancelled Existing Ordinary Shares in the proportion of one new US\$ Share for each Existing Ordinary Share held by them; and
- (vi) in addition to and without prejudice to any other authority conferred upon the Directors to allot relevant securities of the Company, the Directors be and they are hereby generally and unconditionally

authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 to exercise all the powers of the Company to allot all the new US\$ Shares created by this Resolution (aggregating a maximum nominal amount in United States dollars of relevant securities as is equal to the Required Number multiplied by US\$1.50) and this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2000.

- 5 THAT subject to the passing as Special Resolutions of Resolutions 4 and 6 in the Notice convening this Meeting and forthwith and contingently upon the reduction of capital referred to in Resolution 4 taking effect and subject to the allotment and issue of the new US\$ Shares (as defined in Resolution 4) therein referred to having been effected pursuant to sub-paragraph (b)(v) of Resolution 4, each such US\$ Share be subdivided into three Ordinary Shares of US\$0.50 each, such Ordinary Shares of US\$0.50 each to have the same rights and privileges attached thereto as are set out in the Articles of Association of the Company, as altered pursuant to the provisions of Resolution 6.
- 6 THAT:
- (a) subject to the passing as Special Resolutions of Resolutions 4 and 5 in the Notice convening this Meeting and forthwith and contingently upon the reduction of capital referred to in Resolution 4 taking effect and subject to the allotment and issue of the new US\$ Shares and the subdivision referred to in Resolutions 4 and 5 having been effected:
 - (i) the authorised share capital of the Company be increased to US\$5,250,000,000 and £500,301,500 by the creation of such number of new Ordinary Shares of US\$0.50 each as is equal to 10,500,000,000 shares less the number of Ordinary Shares of US\$0.50 each in issue following the subdivision referred to in Resolution 5 having become effective;
 - (ii) certificates representing Existing Ordinary Shares shall cease to be valid; and
 - (iii) the Articles of Association of the Company be and are hereby altered as follows:
 - (A) by deleting in the meaning of the expression “Ordinary Shares” in Article 2.1 the words “having a nominal amount of HK\$10 or 75p”;
 - (B) by inserting after the expression “HK\$” in Article 2.1 the following new expression:
“US\$ United States dollars”;
 - (C) by deleting Article 4.1 and substituting therefor the following:

“4.1 The authorised share capital of the Company is US\$5,250,000,000 divided into 10,500,000,000 Ordinary Shares of US\$0.50 each and £500,301,500 divided into 500,000,000 Sterling Preference Shares of £1 each and 301,500 Non-voting Deferred Shares of £1 each”;

(D) by adding the following at the end of Article 34.1:

“In the case of an instrument of transfer expressed to be a transfer of Ordinary Shares of HK\$10 each or Ordinary Shares of 75p each and bearing a date which is on or before the date on which the Court order confirming the reduction of capital approved by Special Resolution passed at the Annual General Meeting held on 28 May 1999 (or at any adjourned meeting) is registered by the Registrar of Companies in England and Wales, such transfer shall until 30 September 1999 be deemed to be, and treated as, a transfer of a number of Ordinary Shares of US\$0.50 each equal to three times the number of Ordinary Shares of HK\$10 each or Ordinary Shares of 75p each specified in such transfer.”;

(E) by deleting Article 55.5 and substituting therefor the following:

“55.5 For the purposes of section 376(2)(b) of the Act any amount paid up on any Ordinary Share in any currency other than sterling shall be treated as if it had been converted into sterling at such rate of exchange prevailing at or about the date of the requisition as the Board shall determine.”; and

(F) with effect from 30 September 1999, by deleting the expression “HK\$” in Article 2.1 and the meaning thereof and by deleting the additions made by sub-paragraph (D) above; and

(b) definitions used in Resolution 4 have the same meaning in this Resolution.

7 THAT the Articles of Association of the Company be and are hereby altered as follows:

(a) by inserting, at the end of the meaning of the expression “Act” in Article 2.1 the words “(including, without limitation, the Regulations)”;

(b) by deleting the meaning of the expression “The Stock Exchange” in Article 2.1 and substituting therefor “London Stock Exchange Limited or other principal stock exchange in the United Kingdom for the time being”;

(c) by inserting after the expression “Register” in Article 2.1 the following new expression:

“Regulations The Uncertificated Securities Regulations 1995 (SI 1995 No. 3272) including any modifications thereof and rules made thereunder or any regulations in substitution therefor made under section 207 of the Companies Act 1989 for the time being in force”;

- (d) by deleting in Article 12.1 the words “under the Seal”;
- (e) by deleting Article 12.2;
- (f) by adding in Article 13.3:
 - (i) the words “, including those” after the word “expenses” in line 4;
 - (ii) a comma after the word “security” in line 5;
 - (iii) the words “, damaged” after the word “defaced” in line 6; and
 - (iv) the words “but without further charge” at the end;
- (g) by adding the following proviso at the end of Article 35.1 after the word “so”:

“provided that the Board shall not refuse to register any transfer of partly paid shares which are listed on The Stock Exchange on the grounds that they are partly paid shares in circumstances where such refusal would prevent dealing in such shares from taking place on an open and proper basis. References herein to a transfer shall be deemed to include renunciation of a renounceable letter of allotment”;
- (h) by adding the following new Article 35.2:

“35.2 A transfer of shares will not be registered in the circumstances envisaged by Article 81.”;
- (i) by adding the following words at the end of Article 48.1 after the word “shares”:

“or the trust deed or other instrument constituting, or the terms of issue of, the convertible shares provide for the Company purchasing its own equity shares”;
- (j) by deleting in Article 57.1(b) the words “accounts and balance sheet” and “balance sheet” and substituting therefor in each case the words “annual accounts”;
- (k) by the deletion in Article 57.1(c) of the words “and the fixing of their fees pursuant to Article 104”;
- (l) by adding the following new Article 65.2:

“65.2 The Board may direct that any person wishing to attend any meeting should submit to such searches or other security arrangements or restrictions as the Board shall consider appropriate in the circumstances and shall be entitled in its absolute discretion to refuse entry to any meeting to any person who fails to submit to such searches or to otherwise comply with such security arrangements or restrictions.”;

- (m) by adding in Article 81.1 the words “, which expression includes shares issued after the date of such notice in right of those shares” after the words ““the default shares””;
- (n) by renumbering Article 81.1(b) and (c) as Article 81.1(b)(i) and (ii) respectively, and by adding the following new Article 81.1(b):

“(b) where the default shares represent at least 0.25 per cent. in nominal value of the issued shares of their class:”;
- (o) by adding in Article 81.2 (a) after the word “transfer” the words “but only in respect of the shares transferred”;
- (p) by deleting in Article 81.4(d) the number “42” and substituting therefor “14”;
- (q) by deleting in Article 81.4(e)(i) the words “section 14 of the Company Securities (Insider Dealing) Act 1985” and substituting therefor the words “section 428 of the Act”;
- (r) by deleting in Article 81.4(e)(ii) the words “person or any” and substituting therefor the words “investment exchange (as defined in section 207 of the Financial Services Act 1986) or any other”;
- (s) by deleting in Article 82.1(b) the words “two national daily newspapers” and substituting therefor the words “one national newspaper” and adding after the words “United Kingdom” the words “and one newspaper circulating in the area of the address on the Register or other last known address of the member or the person entitled by transmission to the share or the address for the service of notices notified under Article 160.3 (unless any such address shall be in Hong Kong),”;
- (t) by deleting in Article 88.1(b) the reference to “35” and substituting therefor “42”;
- (u) by making the following changes to Article 132.1:
 - (i) adding after the word “he” in line 4 the words “has an interest which (together with any interest of any person connected with him within the meaning of section 346 of the Act)”;

- (ii) deleting the words “materially interested” in line 5 and substituting therefor the words “a material interest otherwise than by virtue of his interest in shares or debentures or other securities of or otherwise in or through the Company”;
- (iii) deleting the words “subsidiaries” in paragraphs (a) and (b) and substituting therefor the words “subsidiary undertakings”;
- (iv) by deleting paragraphs (c) to (g) inclusive and substituting therefor the following paragraphs:
 - “(c) any proposal concerning an offer of shares or debentures or other securities of or by the Company or any of its subsidiary undertakings in which offer he is or may be entitled to participate as a holder of securities or in the underwriting or sub-underwriting of which he is to participate;
 - (d) any proposal concerning any other body corporate in which he (together with persons connected with him within the meaning of section 346 of the Act) does not to his knowledge have an interest (as the term is used in Part VI of the Act) in one per cent. or more of the issued equity share capital of any class of such body corporate or of the voting rights available to members of such body corporate;
 - (e) any proposal relating to an arrangement for the benefit of the employees of the Company or any of its subsidiary undertakings which does not award him any privilege or benefit not generally awarded to the employees to whom such arrangement relates; or
 - (f) any proposal concerning insurance which the Company proposes to maintain or purchase for the benefit of Directors or for the benefit of persons who include Directors.”;
- (v) by deleting Article 136;
- (w) by adding in Article 148.1 after the words “Every cheque, warrant or order is sent at the risk of the person entitled to the money represented by it” the words “, shall be crossed in accordance with the Cheques Act 1992 or in such other manner as the Board may from time to time approve” and deleting in the same sentence the words “the order of”;
- (x) by adding at the end of Article 151.1(c) after the word “allotted” the following:

“The Board may make such provisions as it thinks fit for the application of any residual dividend entitlement remaining following the calculation of the entitlement of a holder of Ordinary Shares to new Ordinary Shares pursuant to

Article 151.1(b) including provisions whereby, in whole or in part, the benefit thereof accrues to the Company and/or under which such entitlements are accrued and/or retained and in each case accumulated on behalf of any member and such accruals or retentions are applied to the allotment by way of bonus to or cash subscription on behalf of such member of fully paid Ordinary Shares and/or provisions whereby cash payments may be made to members in respect of such entitlements”;

(y) by deleting the existing Article 154.1 and substituting the following new Article 154.1:

“154.1 Notwithstanding any other provision of these Articles but without prejudice to the rights attached to any shares and subject always to the Act, the Company or the Board may by Resolution specify any date (the “record date”) as the date at the close of business (or such other time as the Board may determine) on which persons registered as the holders of shares or other securities shall be entitled to receipt of any dividend, distribution, interest, allotment, issue, notice, information, document or circular and such record date may be on or at any time before the date on which the same is paid or made or (in the case of any dividend, distribution, interest, allotment or issue) at any time before or after the same is recommended, resolved, declared or announced but without prejudice to the rights *inter se* in respect of the same of transferors and transferees of any such shares or other securities. Different dates may be fixed as record dates in respect of shares registered on different Registers”;

(z) by deleting in Article 162.2 the word “sufficient” and substituting therefor the word “conclusive”;

(aa) by deleting in Article 168.1 the word “Auditor”; and

(bb) by adding the following new Article 170:

“170 Uncertificated shares

170.1 Notwithstanding anything in these Articles to the contrary, any shares in the Company may be issued, held, registered, converted to, transferred or otherwise dealt with in uncertificated form and converted from uncertificated form to certificated form in accordance with the Regulations and practices instituted by the operator of the relevant system. Any provisions of these Articles shall not apply to any uncertificated shares to the extent that such provisions are inconsistent with:

- (a) the holding of shares in uncertificated form;
- (b) the transfer of title to shares by means of a relevant system; or
- (c) any provision of the Regulations.

170.2 Without prejudice to the generality and effectiveness of the foregoing:

- (a) Articles 12, 13 and 34 and the second and third sentence of Article 36 shall not apply to uncertificated shares and the remainder of Article 36 shall apply in relation to such shares as if the reference therein to the date on which the transfer was lodged with the Company were a reference to the date on which the appropriate instruction was received by or on behalf of the Company in accordance with the facilities and requirements of the relevant system;
- (b) without prejudice to Article 35 in relation to uncertificated shares, the Board may also refuse to register a transfer of uncertificated shares in such other circumstances as may be permitted or required by the Regulations and the relevant system;
- (c) references in these Articles to a requirement on any person to execute or deliver an instrument of transfer or certificate or other document which shall not be appropriate in the case of uncertificated shares shall, in the case of uncertificated shares, be treated as references to a requirement to comply with any relevant requirements of the relevant system and any relevant arrangements or regulations which the Board may make from time to time pursuant to Article 170.2(k) below;
- (d) for the purposes referred to in Article 42, a person entitled by transmission to a share in uncertificated form who elects to have some other person registered shall either:
 - (i) procure that instructions are given by means of the relevant system to effect transfer of such uncertificated share to that person; or
 - (ii) change the uncertificated share to certificated form and execute an instrument of transfer of that certificated share to that person;
- (e) the Company shall enter on the Principal Register the number of shares which are held by each member in uncertificated form and in certificated form and shall maintain the Principal Register in each case as is required by the Regulations and the relevant system and, unless the Board otherwise determines, holdings of the same holder or joint holders in certificated form and uncertificated form may be treated by the Company as separate holdings for such purpose or purposes as the Board may in its absolute discretion determine;

- (f) a class of share shall not be treated as two classes by virtue only of that class comprising both certificated shares and uncertificated shares or as a result of any provision of these Articles or the Regulations which applies only in respect of certificated shares or uncertificated shares;
- (g) references in Article 44 to instruments of transfer shall include, in relation to uncertificated shares, instructions and/or notifications made in accordance with the relevant system relating to the transfer of such shares;
- (h) for the purposes referred to in Article 46, the Board may in respect of uncertificated shares authorise some person to transfer and/or require the holder to transfer the relevant shares in accordance with the facilities and requirements of the relevant system;
- (i) for the purposes of Article 148.1, any payment in the case of uncertificated shares may be made by means of the relevant system (subject always to the facilities and requirements of the relevant system) and without prejudice to the generality of the foregoing such payment may be made by the sending by the Company or any person on its behalf of an instruction to the operator of the relevant system to credit the cash memorandum account of the holder or joint holders of such shares or, if permitted by the Company, of such person as the holder or joint holders may in writing direct and for the purposes of Article 148.1 the making of a payment in accordance with the facilities and requirements of the relevant system concerned shall be a good discharge to the Company;
- (j) subject to the Act, the Board may issue shares as certificated shares or as uncertificated shares in its absolute discretion and Articles 6, 151 and 153 shall be construed accordingly;
- (k) the Board may make such arrangements or regulations (if any) as it may from time to time in its absolute discretion think fit in relation to the evidencing and transfer of uncertificated shares and otherwise for the purpose of implementing and/or supplementing the provisions of this Article 170 and the Regulations and the facilities and requirements of the relevant system and such arrangements and regulations (as the case may be) shall have the same effect as if set out in this Article 170;
- (l) the Board may utilise the relevant system to the fullest extent available from time to time in the exercise of the Company's powers or functions under the Act or these Articles or otherwise in effecting any actions; and

- (m) the Board may resolve that a class of shares is to become a participating security and may at any time determine that a class of shares shall cease to be a participating security.

170.3 Where any class of shares in the capital of the Company is a participating security and the Company is entitled under any provisions of the Act or the rules made and practices instituted by the operator of any relevant system or under these Articles to dispose of, forfeit, enforce a lien or sell or otherwise procure the sale of any shares which are held in uncertificated form, such entitlement (to the extent permitted by the Regulations and the rules made and practices instituted by the operator of the relevant system) shall include the right to:

- (a) request or require the deletion of any computer-based entries in the relevant system relating to the holding of such shares in uncertificated form; and/or
- (b) require any holder of any uncertificated shares which are the subject of any exercise by the Company of any such entitlement, by notice in writing to the holder concerned, to change his holding of such uncertificated shares into certificated form within such period as may be specified in the notice, prior to completion of any disposal, sale or transfer of such shares or direct the holder to take such steps, by instructions given by means of a relevant system or otherwise, as may be necessary to sell or transfer such shares; and/or
- (c) appoint any person to take such other steps, by instruction given by means of a relevant system or otherwise, in the name of the holder of such shares as may be required to effect transfer of such shares and such steps shall be as effective as if they had been taken by the registered holder of the uncertificated shares concerned; and/or
- (d) transfer any uncertificated shares which are the subject of any exercise by the Company of any such entitlement by entering the name of the transferee in the Principal Register in respect of that share as a transferred share; and/or
- (e) otherwise rectify or change the Principal Register in respect of that share in such manner as may be appropriate; and
- (f) take such other action as may be necessary to enable those shares to be registered in the name of the person to whom the shares have been sold or disposed of or as directed by him.

170.4 For the purposes of this Article 170:

- (a) words and expressions shall have the same respective meanings as in the Regulations;
- (b) references herein to an uncertificated share or to a share (or to a holding of shares) being in uncertificated form are references to that share being an uncertificated unit of a security, and references to a certificated share or to a share being in certificated form are references to that share being a unit of a security which is not an uncertificated unit; and
- (c) “cash memorandum account” means an account so designated by the operator of the relevant system.”

ORDINARY RESOLUTION

8 THAT, in addition to and without prejudice to the other authorities conferred by the Resolutions in the Notice convening this Meeting:

- (a) the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of HK\$1,838,916,100 and £767,014,378 (of which £500,000,000 is in the form of non-cumulative preference shares of £1 each); and
- (b) subject to and with effect from the reduction of capital, consolidation, subdivision and associated matters referred to in Resolutions 4 and 5 in the Notice convening this Meeting (“**the Capital Reorganisation**”) becoming effective, in substitution for the authority granted by sub-paragraph (a) of this Resolution but without prejudice to any prior exercise of such authority, the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of US\$809,866,171 and £500,000,000 (in the form of non-cumulative preference shares of £1 each) provided that, if the authority granted by sub-paragraph (a) of this Resolution shall have been exercised before the Capital Reorganisation becomes effective, the said nominal amount of US\$809,866,171 shall be reduced by US\$1.50 for every HK\$10 or 75p in nominal amount (as the case may be) in respect of which such authority has been so exercised in respect of the allotment of Ordinary Shares of HK\$10 each or Ordinary Shares of 75p each (as the case may be) (“**Existing Ordinary Shares**”) and the said nominal amount of £500,000,000 shall be reduced by £1 for every £1 in nominal amount in respect of which such authority has been so exercised in respect of the allotment of non-cumulative preference shares of £1 each;

provided that these authorities shall be limited so that, otherwise than pursuant to:

- (i) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to:
 - (A) Ordinary Shareholders where the relevant securities respectively attributable to the interests of all Ordinary Shareholders are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them; and
 - (B) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue,

but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions, obligations or legal problems under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or

- (ii) the terms of any share scheme for employees of the Company or any of its subsidiary undertakings; or
- (iii) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or
- (iv) the allotment of up to 500,000,000 non-cumulative preference shares of £1 each in the capital of the Company,

the nominal amount of relevant securities to be allotted by the Directors pursuant to the authority granted by sub-paragraph (a) of this Resolution wholly for cash shall not in aggregate exceed HK\$908,054,190 and £33,129,206 (being equal to approximately 5 per cent. of the nominal amount of each class of Ordinary Shares of the Company in issue at the date of the Notice of this Meeting) and, with effect from the Capital Reorganisation becoming effective, the nominal amount of relevant securities to be allotted by the Directors pursuant to the authority granted by sub-paragraph (b) of this Resolution wholly for cash shall not in aggregate exceed US\$202,466,541 (being equal to approximately 5 per cent. of the nominal amount of the Ordinary Shares of the Company expected to be in issue following the Capital Reorganisation having become effective based on the number of Ordinary Shares in issue at the date of the Notice of this Meeting) provided that the said nominal amount of US\$202,466,541 shall be reduced by US\$1.50 for every HK\$10 or 75p in nominal amount (as the case may be) of Existing Ordinary Shares in respect of which an allotment wholly for cash shall be made by the Directors pursuant to the authority granted by sub-paragraph (a) of this Resolution prior to the Capital Reorganisation becoming effective, and such authorities shall expire (in so far as they have not previously expired) at the conclusion of the Annual General Meeting of the Company to be held in 2000 save that these authorities shall allow the Company before the expiry of these authorities to make offers or agreements which would or might require relevant securities to be

allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authorities conferred hereby had not expired.

SPECIAL RESOLUTION

- 9 THAT subject to the passing as an Ordinary Resolution of Resolution 8 in the Notice convening this Meeting, the Directors be and they are hereby empowered, pursuant to section 95 of the Companies Act 1985 (“the Act”) to allot equity securities (as defined by section 94 of the Act) pursuant to the authorities conferred by Resolution 8 as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2000 save that this power shall enable the Company before the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

ORDINARY RESOLUTION

- 10 THAT the Company be and is generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of Ordinary Shares of 75p each and Ordinary Shares of HK\$10 each in the capital of the Company (“**Sterling Ordinary Shares**” and “**HK dollar Ordinary Shares**” respectively and together “**Ordinary Shares**”) and the Directors are authorised to exercise such authority provided that:
- (a) the maximum number of Ordinary Shares hereby authorised to be purchased is 88,344,551 Sterling Ordinary Shares and 181,610,839 HK dollar Ordinary Shares;
 - (b) the minimum price (exclusive of expenses) which may be paid for each Ordinary Share is 75p or HK\$10 (as the case may be) (or, where relevant, the equivalent in the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of pounds sterling or Hong Kong dollars (as the case may be) with such other currency as quoted by Midland Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day (being a day on which banks are ordinarily open for the transaction of normal banking business in London) prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of Midland Bank plc);
 - (c) the maximum price (exclusive of expenses) which may be paid for each Ordinary Share is the lower of (i) 105 per cent. of the average of the middle market quotations for the relevant class of Ordinary Shares (as derived from the Daily Official List of the London Stock Exchange Limited) for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased or (ii) 105 per cent. of the average of the closing prices for the relevant class of Ordinary Shares on The Stock Exchange of Hong Kong Limited for the five dealing days immediately preceding the day

on which the Ordinary Share is contracted to be purchased, in each case converted (where relevant) into the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of such currency with the currency in which the quotation and/or price is given as quoted by Midland Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of Midland Bank plc;

- (d) unless previously revoked or varied this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2000; and
- (e) the Company may prior to the expiry of this authority make a contract to purchase Ordinary Shares under this authority which will or may be executed wholly or partly after such expiry and may make a purchase of Ordinary Shares pursuant to any such contract,

provided that, in the event that the Capital Reorganisation (as defined in Resolution 8 in the Notice convening this Meeting) becomes effective, without prejudice to any prior exercise of the authority granted by this Resolution, the references (i) in this Resolution to “Ordinary Shares of 75p each and Ordinary Shares of HK\$10 each in the capital of the Company (“**Sterling Ordinary Shares**” and “**HK dollar Ordinary Shares**” respectively and together “**Ordinary Shares**”); (ii) in paragraph (a) of this Resolution to “88,344,551 Sterling Ordinary Shares and 181,610,839 HK dollar Ordinary Shares”; (iii) in paragraph (b) of this Resolution to “75p or HK\$10 (as the case may be)”; and (iv) in paragraph (b) of this Resolution to “pounds sterling or Hong Kong dollars (as the case may be)” shall be deemed instead to be to (i) “Ordinary Shares of US\$0.50 each in the capital of the Company (“**Ordinary Shares**”); (ii) “809,866,170 Ordinary Shares” (or if this authority to make market purchases of Sterling Ordinary Shares or HK dollar Ordinary Shares is exercised prior to the Capital Reorganisation, 809,866,170 Ordinary Shares less the number of Sterling Ordinary Shares and/or HK dollar Ordinary Shares the subject of the exercise of such authority multiplied by three); (iii) “US\$0.50”; and (iv) “United States dollars”, and the words “relevant class of” shall be deemed to be deleted in paragraph (c) of this Resolution before the words “Ordinary Shares” in each case where such words appear.

J R H Bond
Chairman

[logo]

**CERTIFICATE OF REGISTRATION
OF ORDER OF COURT AND MINUTE
ON
REDUCTION OF CAPITAL**

No. 617987

Whereas HSBC HOLDINGS PLC

having by Special Resolution reduced its capital as confirmed by an Order of the High Court of Justice, Chancery Division dated the **30th June 1999**

Now therefore I hereby certify that the said Order and a Minute approved by the Court were registered pursuant to section 138 of the Companies Act, 1985, on the **2nd July 1999**

Given under my hand at Companies House, Cardiff the **2nd July 1999**

J.J. Lewis
An Authorised Officer

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS

of

HSBC Holdings plc

Passed 26 May 2000

At the Annual General Meeting of HSBC Holdings plc held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 26 May 2000, the following Resolutions were passed:

SPECIAL RESOLUTION

4 THAT

- (a) the authorised share capital of the Company be diminished by the cancellation of the 500,000,000 authorised but unissued Sterling Preference Shares of £1 each;
- (b) the authorised share capital of the Company be increased by the creation of:
 - (i) 10,000,000 non-cumulative preference shares of £0.01 each;
 - (ii) 10,000,000 non-cumulative preference shares of US\$0.01 each; and
 - (iii) 10,000,000 non-cumulative preference shares of €0.01 each,in each case having attached thereto the respective rights and being subject to the respective limitations set out in the Articles of Association of the Company as altered by this Resolution;
- (c) the Articles of Association of the Company be and are hereby altered as follows:
 - (i) in Article 2.1:
 - (A) by the insertion, after the expression “dividend”, of the following:

“Dollar Preference Share a non-cumulative preference share of US\$0.01

Euro Preference Share a non-cumulative preference share of €0.01”;

- (B) in the expression “Sterling Preference Share”, by the deletion of “£1” and the substitution therefor of “£0.01”;
- (C) by the insertion, after “£” in the expression “£ and p or pence”, of “(or sterling)”;
- (D) by the insertion, after “US\$” in that expression, of “or US dollars”;
- (E) by the insertion at the end, of the following:

“€ or euro the single currency adopted by those states participating in European Monetary Union from time to time”;

- (ii) by the deletion of Article 4.1 and the substitution therefor of the following:

“4.1 The authorised share capital of the Company is US\$5,250,100,000 divided into 10,500,000,000 Ordinary Shares of US\$0.50 each and 10,000,000 Dollar Preference Shares of US\$0.01 each, £401,500 divided into 10,000,000 Sterling Preference Shares of £0.01 each and 301,500 Non-voting Deferred Shares of £1 each, and €100,000 divided into 10,000,000 Euro Preference Shares of €0.01 each”;

- (iii) by the deletion of Article 5.1 and the substitution therefor of the following:

“5. **Rights of the Sterling Preference Shares**

5.1 The following rights and restrictions shall be attached to the Sterling Preference Shares:

- (1) The Sterling Preference Shares shall rank pari passu inter se and with the Dollar Preference Shares and the Euro Preference Shares and with all other shares expressed to rank pari passu therewith. They shall confer the rights and be subject to the limitations set out in this Article. They shall also confer such further rights (not being inconsistent

with the rights set out in this Article) and be subject to such further limitations and restrictions as may be attached by the Board to such shares prior to allotment. Whenever the Board has power under this Article to determine any of the rights attached to any of the Sterling Preference Shares, the rights so determined need not be the same as those attached to the Sterling Preference Shares which have then been allotted or issued. The Sterling Preference Shares may be issued in one or more separate series and each series shall be identified in such manner as the Board may determine without any such determination or identification requiring any alteration to these Articles.

- (2) Each Sterling Preference Share shall confer the following rights as to dividend and capital:

Income

- (a) the right (subject to the provisions of paragraph (4) of this Article, if applicable) in priority to the payment of any dividend to the holders of Ordinary Shares and any other class of shares of the Company in issue (other than (i) the Dollar Preference Shares, the Euro Preference Shares and any other shares expressed to rank pari passu therewith as regards income and (ii) any shares which by their terms rank in priority to the Sterling Preference Shares as regards income) to a non-cumulative preferential dividend in sterling payable at such rate (whether fixed, variable or floating or to be determined by a specified procedure, mechanism or formula) on such dates (each a “Dividend Payment Date”) and on such other terms and conditions as may be determined by the Board prior to allotment thereof;

Capital

- (b) the right in a winding up of the Company (but not, unless otherwise provided by the terms of issue of such share, upon a redemption, reduction or purchase by the Company of any of its share capital) to receive in sterling out of the assets of the Company available for distribution to its members in priority to any payment to the holders of the Ordinary Shares and any other class of shares of the Company in issue (other than (i) the Dollar Preference Shares, the Euro Preference Shares and any other shares expressed to rank pari passu therewith as regards repayment of capital and (ii) any shares which by their terms rank in priority to the Sterling Preference Shares as regards repayment of capital):

- (i) a sum equal to:
 - (A) the amount of any dividend which is due for payment after the date of commencement of the winding up but which is payable in respect of a period ending on or before such date; and
 - (B) if the date of commencement of the winding up falls before the last day of a period in respect of which a dividend would have been payable and which began before such date, any further amount of dividend which would have been payable had the day before such date been the last day of that period,

but only to the extent that any such amount or further amount was, or would have been, payable as a dividend in accordance with or pursuant to this Article; and
- (ii) subject thereto, a sum equal to the amount paid up or credited as paid up on such share together with such premium (if any) as may be determined by the Board (or by a procedure, mechanism or formula determined by the Board) prior to allotment thereof (and so that the Board may determine that such premium is payable only in specified circumstances).

Limitations

- (3) No Sterling Preference Share shall:
 - (a) confer any right to participate in the profits or assets of the Company other than that set out in subparagraphs (2)(a) and (b) of this Article;
 - (b) subject to the Act, confer any right to participate in any offer or invitation by way of rights or otherwise to subscribe for additional shares or securities in the Company;
 - (c) confer any right of conversion; or
 - (d) confer any right to participate in any issue of bonus shares or shares issued by way of capitalisation of reserves.

Further provisions as to income

- (4) All or any of the following provisions shall apply in relation to any Sterling Preference Shares of any series (“relevant Sterling Preference Shares”) if so determined by the Board prior to allotment thereof:
- (a) (i) if, on any Dividend Payment Date (“the relevant date”) on which a dividend (“the relevant dividend”) would otherwise fall to be paid on any relevant Sterling Preference Shares, the profits of the Company available for distribution are, in the opinion of the Board, insufficient to enable payment in full to be made of the relevant dividend, then the Board shall (after payment in full, or the setting aside of a sum required for payment in full, of all dividends payable on or before the relevant date on any shares in the capital of the Company in priority to the relevant Sterling Preference Shares) apply such profits, if any, in paying dividends to the holders of participating shares (as defined below) pro rata to the amounts of dividend on participating shares accrued and payable on or before the relevant date. For the purposes of this paragraph, the expression “participating shares” shall mean the relevant Sterling Preference Shares and any other shares in the capital of the Company which rank pari passu as to participation in profits with the relevant Sterling Preference Shares and on which either (1) a dividend is payable on the relevant date or (2) arrears of cumulative dividend are unpaid at the relevant date;
 - (ii) if it shall subsequently appear that any such dividend which has been paid in whole or in part should not, in accordance with the provisions of this sub-paragraph, have been so paid, then provided the Board shall have acted in good faith, they shall not incur any liability for any loss which any shareholder may suffer in consequence of such payment having been made;
- (b) if the payment of any dividend on any relevant Sterling Preference Shares would breach or cause a breach of the capital adequacy requirements of the Financial

Services Authority (or any successor organisation responsible for the supervision of banks in the United Kingdom) from time to time applicable to the Company and/or any of its subsidiaries, then none of such dividend shall be payable;

- (c) if a dividend or any part thereof on any relevant Sterling Preference Shares is not paid for the reasons specified in sub-paragraphs (a) or (b) above, the holders of such shares shall have no claim in respect of such non-payment;
- (d) if any dividend on any relevant Sterling Preference Shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, the Company may not thereafter purchase or redeem any other share capital of the Company ranking pari passu with or after the relevant Sterling Preference Shares (and may not contribute any moneys to a sinking fund for any such purchase or redemption) until such time as dividends on the relevant Sterling Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or an amount equivalent thereto shall have been paid or set aside to provide for such payment in full);
- (e) if any dividend on any relevant Sterling Preference Shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, no dividend or other distribution may thereafter be declared or paid on any other share capital of the Company ranking as to dividend after the relevant Sterling Preference Shares until such time as dividends on the relevant Sterling Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or a sum shall have been paid or set aside to provide for such payment in full).

Redemption

- (5) (a) Unless otherwise determined by the Board in relation to Sterling Preference Shares of any series prior to allotment thereof, the Sterling Preference Shares shall, subject to the provisions of the Act, be redeemable at the option of the Company.

- (b) In the case of any series of Sterling Preference Shares which are to be so redeemable:
- (i) the Company may, subject to the provisions of the Act and sub-paragraph (ii) below, redeem on any Redemption Date (as hereinafter defined) all, but not merely some, of the Sterling Preference Shares of such series by giving to the holders of the Sterling Preference Shares to be redeemed not less than 30 days' nor more than 60 days' prior notice in writing (a "Notice of Redemption") of the relevant Redemption Date. "Redemption Date" means, in relation to Sterling Preference Shares of a particular series, any date mentioned in any one of (A), (B) or (C) below, as determined by the Board prior to the first allotment of Sterling Preference Shares of that series:
 - (A) any date which falls on or after the First Redemption Date (as hereinafter defined); or
 - (B) the First Redemption Date or any subsequent Dividend Payment Date for Sterling Preference Shares of that series; or
 - (C) the First Redemption Date or any successive fifth anniversary thereof."First Redemption Date" means:
 - (D) in relation to any Sterling Preference Shares designated as "Series 1", 30 June 2015;
 - (E) in relation to any other Sterling Preference Shares of a particular series, one day after such one of the following dates as shall be determined by the Board prior to the first allotment of Sterling Preference Shares of that series:
 - (1) five years after the Relevant Date (as hereinafter defined);
 - (2) ten years after the Relevant Date;
 - (3) fifteen years after the Relevant Date;

- (4) twenty years after the Relevant Date;
- (5) thirty years after the Relevant Date.

“Relevant Date” means, in relation to Sterling Preference Shares of a particular series, such one of the following dates as shall be determined by the Board prior to the first allotment of Sterling Preference Shares of that series:

- (F) the first date of allotment of Sterling Preference Shares of that series; or
- (G) the first Dividend Payment Date for Sterling Preference Shares of that series;
- (ii) if either of the restrictions in sub-paragraphs (4)(a)(i) and (4)(a)(ii) of this Article applies to any dividend otherwise payable on any Redemption Date on the Sterling Preference Shares of that series, the Company may not redeem such Sterling Preference Shares on that Redemption Date;
- (iii) there shall be paid on each Sterling Preference Share so redeemed, in sterling, the aggregate of the nominal amount thereof and any premium credited as paid up on such share together with any dividend payable on the Redemption Date;
- (iv) any Notice of Redemption given under sub-paragraph (b)(i) above shall specify the applicable Redemption Date, the particular Sterling Preference Shares to be redeemed and the redemption price, and shall state the place or places at which documents of title or such other evidence as may be accepted by the Board in respect of such Sterling Preference Shares are to be presented and surrendered for redemption and payment of the redemption moneys is to be effected. Upon such Redemption Date, the Company shall redeem the particular Sterling Preference Shares to be redeemed on that date subject to the provisions of this paragraph and of the Act. No defect in the Notice of Redemption or in the giving thereof shall affect the validity of the redemption proceedings;

- (v) payments in respect of the amount due on redemption of a Sterling Preference Share shall be made by sterling cheque drawn on a bank in London or upon the request of the holder or joint holders not later than the date specified for the purpose in the Notice of Redemption by transfer to a sterling account maintained by the payee with a bank in London or by such other method as the Board may determine. Such payment will be made against presentation and surrender of the relative certificate at the place or one of the places specified in the Notice of Redemption or against such other evidence as may be accepted by the Board.

All payments in respect of redemption monies will in all respects be subject to any applicable fiscal or other laws;

- (vi) as from the relevant Redemption Date the dividend on the Sterling Preference Shares due for redemption shall cease to accrue except on any such Sterling Preference Shares in respect of which, upon due surrender of the certificate or other evidence aforesaid, payment of the redemption moneys due on such Redemption Date shall be improperly withheld or refused, in which case such dividend, at the rate then applicable, shall be deemed to have continued and shall accordingly continue to accrue from the relevant Redemption Date to the date of payment of such redemption moneys. Such Sterling Preference Shares shall not be treated as having been redeemed until the redemption moneys in question together with the accrued dividend thereon shall have been paid;
- (vii) if the due date for the payment of the redemption moneys on any Sterling Preference Share is not a day (other than a Saturday or Sunday) on which commercial banks and foreign exchange markets settle payments in sterling and are open for general business in London (a "Sterling Business Day"), then payment of such moneys will be made on the next succeeding day which is a Sterling Business Day and without any interest or other payment in respect of such delay; and

- (viii) the receipt of the holder for the time being of any Sterling Preference Shares (or, in the case of joint registered holders, the receipt of any one of them) for the moneys payable on redemption thereof shall constitute an absolute discharge to the Company in respect thereof.
- (c) Upon the redemption or purchase of any Sterling Preference Shares the Board shall have power without any further resolution or consent to convert the authorised but unissued Sterling Preference Shares existing as a result of such redemption or purchase into shares of any other class of share capital into which the authorised share capital of the Company is or may be divided of the same nominal amount in sterling as the Sterling Preference Shares or into unclassified shares of the same nominal amount in sterling as the Sterling Preference Shares.
- (d) Any Sterling Preference Shares redeemed pursuant to this paragraph (5) shall be cancelled on redemption.

Purchase

- (6) Subject to the provisions of the Act, the Company may at any time purchase any Sterling Preference Shares (i) in the market, (ii) by tender (available alike to all holders of the same class of Sterling Preference Shares) or (iii) by private treaty, in each case upon such terms as the Board shall determine.

Consolidation and division

- (7) Pursuant to the authority given by the passing of the resolution adopting this Article the Board may consolidate and divide and/or sub-divide any Sterling Preference Shares into shares of a larger or smaller amount.

Attendance and voting at general meetings

- (8) (a) Save as provided by its terms of issue, no Sterling Preference Share shall carry any right to attend or vote at general meetings of the Company.
- (b) If so determined by the Board prior to allotment thereof, holders of Sterling Preference Shares of any series shall have the right to attend and vote at general meetings of the Company in the following circumstances:

- (i) if any dividend on any Sterling Preference Shares of that series in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, the right to attend and vote at general meetings of the Company until such time as dividends on those Sterling Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or a sum shall have been paid or set aside to provide for such payment in full);
- (ii) in such other circumstances, and upon and subject to such terms, as the Board may determine prior to allotment of such Sterling Preference Shares.
- (c) Whenever holders of Sterling Preference Shares are entitled to vote on a resolution at a general meeting, on a show of hands every such holder who is present in person shall have one vote and on a poll every such holder who is present in person or by proxy shall have one vote per Sterling Preference Share held by him or such number of votes per share as the Board shall determine prior to allotment of such share.
- (d) Holders of Sterling Preference Shares having a registered address or address for correspondence within the United Kingdom shall 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 Company and a copy of every circular or other like document sent out by the Company to the holders of Ordinary Shares.

Further preference shares

- (9) The special rights attached to any Sterling Preference Shares of any series allotted or in issue shall not (unless otherwise provided by their terms of issue) be deemed to be varied by the creation or issue of any other preference shares or further shares in any currency ("new shares") ranking as regards participation in the profits and assets of the Company pari passu with such Sterling Preference Shares and so that any new shares ranking pari passu with such Sterling Preference Shares may either carry rights and restrictions identical in all respects with such Sterling Preference Shares or any of them or rights and restrictions differing therefrom in any respect including but without prejudice to the generality of the foregoing in that:

- (a) the rate of and/or basis of calculation of dividend may differ and the dividend may be cumulative or non-cumulative;
- (b) the new shares or any series thereof may rank for dividend as from such date as may be provided by the terms of issue thereof and the dates of payment of dividend may differ;
- (c) a premium may be payable on return of capital or there may be no such premium;
- (d) the new shares may be redeemable at the option of the holder or of the Company, or may be non-redeemable, and if redeemable at the option of the Company they may be redeemable at different dates and on different terms from those applying to the Sterling Preference Shares; and
- (e) the new shares may be convertible into Ordinary Shares or any other class of shares ranking as regards participation in the profits and assets of the Company *pari passu* with or after such Sterling Preference Shares in each case on such terms and conditions as may be prescribed by the terms of issue thereof.

Variation of class rights

- (10) (a) Subject to the provisions of the Act:
- (i) all or any of the rights, preferences, privileges, limitations or restrictions for the time being attached to the Sterling Preference Shares may from time to time (whether or not the Company is being wound up) be varied or abrogated with the consent in writing of the holders of not less than three-quarters in nominal value of the Sterling Preference Shares of all series in issue or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of the Sterling Preference Shares, voting as a single class without regard for series; and
 - (ii) all or any of the rights, preferences, privileges, limitations or restrictions for the time being attached to Sterling Preference Shares of any series may be varied or abrogated so as to affect adversely such rights on a basis different from any other series of Sterling Preference Shares with the consent in writing of the holders of not less than three-quarters in nominal value of the

Sterling Preference Shares of such series or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of Sterling Preference Shares of such series.

All the provisions of these Articles as to general meetings of the Company shall mutatis mutandis apply to any such separate general meeting, but so that the necessary quorum shall be two persons holding or representing by proxy at least one-third in nominal value of the issued shares of the class, that every holder of shares of the class shall be entitled on a poll to one vote for every share of the class held by him, that any holder of shares of the class present in person or by proxy may demand a poll and that at any adjourned meeting of the holders one holder present in person or by proxy (whatever the number of shares held by him) shall be a quorum.

- (b) Unless otherwise provided by its terms of issue, the rights attached to any Sterling Preference Share shall not be deemed to be varied or abrogated by a reduction of any share capital or purchase by the Company or redemption of any share capital in each case ranking as regards participation in the profits and assets of the Company in priority to or *pari passu* with or after such Sterling Preference Share.

5A Rights of the Dollar Preference Shares

5A.1 The following rights and restrictions shall be attached to the Dollar Preference Shares:

- (1) The Dollar Preference Shares shall rank *pari passu* inter se and with the Sterling Preference Shares and the Euro Preference Shares and with all other shares expressed to rank *pari passu* therewith. They shall confer the rights and be subject to the limitations set out in this Article. They shall also confer such further rights (not being inconsistent with the rights set out in this Article) and be subject to such further limitations and restrictions as may be attached by the Board to such shares prior to allotment. Whenever the Board has power under this Article to determine any of the rights attached to any of the Dollar Preference Shares, the rights so determined need not be the same as those attached to the Dollar Preference Shares which have then been allotted or issued. The Dollar Preference Shares may be issued in one or more separate series and each series shall be identified in such manner as the Board may determine

without any such determination or identification requiring any alteration to these Articles.

- (2) Each Dollar Preference Share shall confer the following rights as to dividend and capital:

Income

- (a) the right (subject to the provisions of paragraph (4) of this Article, if applicable) in priority to the payment of any dividend to the holders of Ordinary Shares and any other class of shares of the Company in issue (other than (i) the Sterling Preference Shares, the Euro Preference Shares and any other shares expressed to rank pari passu therewith as regards income and (ii) any shares which by their terms rank in priority to the Dollar Preference Shares as regards income) to a non-cumulative preferential dividend in US dollars payable at such rate (whether fixed, variable or floating or to be determined by a specified procedure, mechanism or formula) on such dates (each a "Dividend Payment Date") and on such other terms and conditions as may be determined by the Board prior to allotment thereof;

Capital

- (b) the right in a winding up of the Company (but not, unless otherwise provided by the terms of issue of such share, upon a redemption, reduction or purchase by the Company of any of its share capital) to receive in US dollars out of the assets of the Company available for distribution to its members in priority to any payment to the holders of the Ordinary Shares and any other class of shares of the Company in issue (other than (i) the Sterling Preference Shares, the Euro Preference Shares and any other shares expressed to rank pari passu therewith as regards repayment of capital and (ii) any shares which by their terms rank in priority to the Dollar Preference Shares as regards repayment of capital):
- (i) a sum equal to:
- (A) the amount of any dividend which is due for payment after the date of commencement of the winding up but which is payable in respect of a period ending on or before such date; and
- (B) if the date of commencement of the winding up falls before the last day of a period in respect of which a dividend would have been payable and which began before such date, any further amount of dividend which would have been

payable had the day before such date been the last day of that period

but only to the extent that any such amount or further amount was, or would have been, payable as a dividend in accordance with or pursuant to this Article; and

- (ii) subject thereto, a sum equal to the amount paid up or credited as paid up on such share together with such premium (if any) as may be determined by the Board (or by a procedure, mechanism or formula determined by the Board) prior to allotment thereof (and so that the Board may determine that such premium is payable only in specified circumstances).

Limitations

- (3) No Dollar Preference Share shall;
 - (a) confer any right to participate in the profits or assets of the Company other than that set out in subparagraphs (2)(a) and (b) of this Article;
 - (b) subject to the Act, confer any right to participate in any offer or invitation by way of rights or otherwise to subscribe for additional shares or securities in the Company;
 - (c) confer any right of conversion; or
 - (d) confer any right to participate in any issue of bonus shares or shares issued by way of capitalisation of reserves.

Further provisions as to income

- (4) All or any of the following provisions shall apply in relation to any Dollar Preference Shares of any series (“relevant Dollar Preference Shares”) if so determined by the Board prior to allotment thereof:
 - (a) (i) if, on any Dividend Payment Date (“the relevant date”) on which a dividend (“the relevant dividend”) would otherwise fall to be paid on any relevant Dollar Preference Shares, the profits of the Company available for distribution are, in the opinion of the Board, insufficient to enable payment in full to be made of the relevant dividend, then the Board shall (after payment in full, or the setting aside of a sum required for payment in full, of all dividends payable on or

before the relevant date on any shares in the capital of the Company in priority to the relevant Dollar Preference Shares) apply such profits, if any, in paying dividends to the holders of participating shares (as defined below) pro rata to the amounts of dividend on participating shares accrued and payable on or before the relevant date. For the purposes of this paragraph, the expression “participating shares” shall mean the relevant Dollar Preference Shares and any other shares in the capital of the Company which rank pari passu as to participation in profits with the relevant Dollar Preference Shares and on which either (1) a dividend is payable on the relevant date or (2) arrears of cumulative dividend are unpaid at the relevant date;

- (ii) if it shall subsequently appear that any such dividend which has been paid in whole or in part should not, in accordance with the provisions of this sub-paragraph, have been so paid, then provided the Board shall have acted in good faith, they shall not incur any liability for any loss which any shareholder may suffer in consequence of such payment having been made;
- (b) if the payment of any dividend on any relevant Dollar Preference Shares would breach or cause a breach of the capital adequacy requirements of the Financial Services Authority (or any successor organisation responsible for the supervision of banks in the United Kingdom) from time to time applicable to the Company and/or any of its subsidiaries, then none of such dividend shall be payable;
- (c) if a dividend or any part thereof on any relevant Dollar Preference Shares is not paid for the reasons specified in sub-paragraphs (a) or (b) above, the holders of such shares shall have no claim in respect of such non-payment;
- (d) if any dividend on any relevant Dollar Preference Shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, the Company may not thereafter purchase or redeem any other share capital of the Company ranking pari passu with or after the relevant Dollar Preference Shares (and may not contribute any moneys to a sinking fund for any such purchase or redemption)

until such time as dividends on the relevant Dollar Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or an amount equivalent thereto shall have been paid or set aside to provide for such payment in full);

- (e) if any dividend on any relevant Dollar Preference Shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, no dividend or other distribution may thereafter be declared or paid on any other share capital of the Company ranking as to dividend after the relevant Dollar Preference Shares until such time as dividends on the relevant Dollar Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or a sum shall have been paid or set aside to provide for such payment in full).

Redemption

- (5) (a) Unless otherwise determined by the Board in relation to Dollar Preference Shares of any series prior to allotment thereof, the Dollar Preference Shares shall, subject to the provisions of the Act, be redeemable at the option of the Company.
- (b) In the case of any series of Dollar Preference Shares which are to be so redeemable:
 - (i) the Company may, subject to the provisions of the Act, and sub-paragraph (ii) below, redeem on any Redemption Date (as hereinafter defined) all, but not merely some, of the Dollar Preference Shares of such series by giving to the holders of the Dollar Preference Shares to be redeemed not less than 30 days' nor more than 60 days' prior notice in writing (a "Notice of Redemption") of the relevant Redemption Date. "Redemption Date" means, in relation to Dollar Preference Shares of a particular series, any date mentioned in any one of (A), (B) or (C) below, as determined by the Board prior to the first allotment of Dollar Preference Shares of that series:
 - (A) any date which falls on or after the First Redemption Date (as hereinafter defined); or

(B) the First Redemption Date or any subsequent Dividend Payment Date for Dollar Preference Shares of that series; or

(C) the First Redemption Date or any successive fifth anniversary thereof.

“First Redemption Date” means:

(D) in relation to any relevant Dollar Preference Shares designated as:

(1) “Series 1”, 30 June 2010;

(2) “Series 2”, 30 June 2030;

(E) in relation to any other Dollar Preference Shares of a particular series, one day after such one of the following dates as shall be determined by the Board prior to the first allotment of Dollar Preference Shares of that series:

(1) five years after the Relevant Date (as hereinafter defined);

(2) ten years after the Relevant Date;

(3) fifteen years after the Relevant Date;

(4) twenty years after the Relevant Date;

(5) thirty years after the Relevant Date.

“Relevant Date” means, in relation to Dollar Preference Shares of a particular series, such one of the following dates as shall be determined by the Board prior to the first allotment of Dollar Preference Shares of that series:

(F) the first date of allotment of Dollar Preference Shares of that series; or

(G) the first Dividend Payment Date for Dollar Preference Shares of that series;

(ii) if either of the restrictions in sub-paragraphs (4)(a)(i) and (4)(a)(ii) of this Article applies to any dividend otherwise payable on any Redemption Date on the Dollar Preference Shares of that series, the Company may not redeem such Dollar Preference Shares on that Redemption Date;

- (iii) there shall be paid on each Dollar Preference Share so redeemed, in US dollars, the aggregate of the nominal amount thereof and any premium credited as paid up on such share together with any dividend payable on the Redemption Date;
- (iv) any Notice of Redemption given under sub-paragraph (b)(i) above shall specify the applicable Redemption Date, the particular Dollar Preference Shares to be redeemed and the redemption price, and shall state the place or places at which documents of title or such other evidence as may be accepted by the Board in respect of such Dollar Preference Shares are to be presented and surrendered for redemption and payment of the redemption moneys is to be effected. Upon such Redemption Date, the Company shall redeem the particular Dollar Preference Shares to be redeemed on that date subject to the provisions of this paragraph and of the Act. No defect in the Notice of Redemption or in the giving thereof shall affect the validity of the redemption proceedings;
- (v) payments in respect of the amount due on redemption of a Dollar Preference Share shall be made by US Dollar cheque drawn on a bank in New York City or upon the request of the holder or joint holders not later than the date specified for the purpose in the Notice of Redemption by transfer to a US dollar account maintained by the payee with a bank in New York City or by such other method as the Board may determine. Such payment will be made against presentation and surrender of the relative certificate at the place or one of the places specified in the Notice of Redemption or against such other evidence as may be accepted by the Board.

All payments in respect of redemption moneys will in all respects be subject to any applicable fiscal or other laws;

- (vi) as from the relevant Redemption Date the dividend on the Dollar Preference Shares due for redemption shall cease to accrue except on any such Dollar Preference Shares in respect of which, upon due surrender of the certificate or other evidence aforesaid, payment of the

redemption moneys due on such Redemption Date shall be improperly withheld or refused, in which case such dividend, at the rate then applicable, shall be deemed to have continued and shall accordingly continue to accrue from the relevant Redemption Date to the date of payment of such redemption moneys. Such Dollar Preference Shares shall not be treated as having been redeemed until the redemption moneys in question together with the accrued dividend thereon shall have been paid;

- (vii) if the due date for the payment of the redemption moneys on any Dollar Preference Share is not a day (other than a Saturday or Sunday) on which commercial banks and foreign exchange markets settle payments in US dollars and are open for general business in London and New York City (a “Dollar Business Day”), then payment of such moneys will be made on the next succeeding day which is a Dollar Business Day and without any interest or other payment in respect of such delay; and
- (viii) the receipt of the holder for the time being of any Dollar Preference Shares (or, in the case of joint registered holders, the receipt of any one of them) for the moneys payable on redemption thereof shall constitute an absolute discharge to the Company in respect thereof.
- (c) Upon the redemption or purchase of any Dollar Preference Shares the Board shall have power without any further resolution or consent to convert the authorised but unissued Dollar Preference Shares existing as a result of such redemption or purchase into shares of any other class of share capital into which the authorised share capital of the Company is or may be divided of the same nominal amount in US dollars as the Dollar Preference Shares or into unclassified shares of the same nominal amount in US dollars as the Dollar Preference Shares.
- (d) Any Dollar Preference Shares redeemed pursuant to this paragraph (5) shall be cancelled on redemption.

Purchase

- (6) Subject to the provisions of the Act, the Company may at any time purchase any Dollar Preference Shares (i) in the

market, (ii) by tender (available alike to all holders of the same class of Dollar Preference Shares) or (iii) by private treaty, in each case upon such terms as the Board shall determine.

Consolidation and division

- (7) Pursuant to the authority given by the passing of the resolution adopting this Article the Board may consolidate and divide and/or sub-divide any Dollar Preference Shares into shares of a larger or smaller amount.

Attendance and voting at general meetings

- (8) (a) Save as provided by its terms of issue, no Dollar Preference Share shall carry any right to attend or vote at general meetings of the Company.
- (b) If so determined by the Board prior to allotment thereof, holders of Dollar Preference Shares of any series shall have the right to attend and vote at general meetings of the Company in the following circumstances:
- (i) if any dividend on any Dollar Preference Shares of that series in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, the right to attend and vote at general meetings of the Company until such time as dividends on those Dollar Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or a sum shall have been paid or set aside to provide for such payment in full);
- (ii) in such other circumstances, and upon and subject to such terms, as the Board may determine prior to allotment of such Dollar Preference Shares.
- (c) Whenever holders of Dollar Preference Shares are entitled to vote on a resolution at a general meeting, on a show of hands every such holder who is present in person shall have one vote and on a poll every such holder who is present in person or by proxy shall have one vote per Dollar Preference Share held by him or such number of votes per share as the Board shall determine prior to allotment of such share.
- (d) Holders of Dollar Preference Shares having a registered address or address for correspondence

within the United Kingdom shall 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 Company and a copy of every circular or other like document sent out by the Company to the holders of Ordinary Shares.

Further preference shares

- (9) The special rights attached to any Dollar Preference Shares of any series allotted or in issue shall not (unless otherwise provided by their terms of issue) be deemed to be varied by the creation or issue of any other preference shares or further shares in any currency (“new shares”) ranking as regards participation in the profits and assets of the Company pari passu with such Dollar Preference Shares and so that any new shares ranking pari passu with such Dollar Preference Shares may either carry rights and restrictions identical in all respects with such Dollar Preference Shares or any of them or rights and restrictions differing therefrom in any respect including but without prejudice to the generality of the foregoing in that:
- (a) the rate of and/or basis of calculation of dividend may differ and the dividend may be cumulative or non-cumulative;
 - (b) the new shares or any series thereof may rank for dividend as from such date as may be provided by the terms of issue thereof and the dates of payment of dividend may differ;
 - (c) a premium may be payable on return of capital or there may be no such premium;
 - (d) the new shares may be redeemable at the option of the holder or of the Company, or may be non-redeemable, and if redeemable at the option of the Company they may be redeemable at different dates and on different terms from those applying to the Dollar Preference Shares; and
 - (e) the new shares may be convertible into Ordinary Shares or any other class of shares ranking as regards participation in the profits and assets of the Company pari passu with or after such Dollar Preference Shares in each case on such terms and conditions as may be prescribed by the terms of issue thereof.

Variation of class rights

(10) (a) Subject to the provisions of the Act:

- (i) all or any of the rights, preferences, privileges, limitations or restrictions for the time being attached to the Dollar Preference Shares may from time to time (whether or not the Company is being wound up) be varied or abrogated with the consent in writing of the holders of not less than three-quarters in nominal value of the Dollar Preference Shares of all series in issue or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of the Dollar Preference Shares, voting as a single class without regard for series; and
- (ii) all or any of the rights, preferences, privileges, limitations or restrictions for the time being attached to Dollar Preference Shares of any series may be varied or abrogated so as to affect adversely such rights on a basis different from any other series of Dollar Preference Shares with the consent in writing of the holders of not less than three-quarters in nominal value of the Dollar Preference Shares of such series or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of Dollar Preference Shares of such series.

All the provisions of these Articles as to general meetings of the Company shall mutatis mutandis apply to any such separate general meeting, but so that the necessary quorum shall be two persons holding or representing by proxy at least one-third in nominal value of the issued shares of the class, that every holder of shares of the class shall be entitled on a poll to one vote for every share of the class held by him, that any holder of shares of the class present in person or by proxy may demand a poll and that at any adjourned meeting of the holders one holder present in person or by proxy (whatever the number of shares held by him) shall be a quorum.

- (b) Unless otherwise provided by its terms of issue, the rights attached to any Dollar Preference Share shall not be deemed to be varied or abrogated by a reduction of any share capital or purchase by the Company or redemption of any share capital in each case ranking as regards participation in the profits and assets of the

Company in priority to or pari passu with or after such Dollar Preference Share.

5B Rights of the Euro Preference Shares

5B.1 The following rights and restrictions shall be attached to the Euro Preference Shares:

- (1) The Euro Preference Shares shall rank pari passu inter se and with the Dollar Preference Shares and the Sterling Preference Shares and with all other shares expressed to rank pari passu therewith. They shall confer the rights and be subject to the limitations set out in this Article. They shall also confer such further rights (not being inconsistent with the rights set out in this Article) and be subject to such further limitations and restrictions as may be attached by the Board to such shares prior to allotment. Whenever the Board has power under this Article to determine any of the rights attached to any of the Euro Preference Shares, the rights so determined need not be the same as those attached to the Euro Preference Shares which have then been allotted or issued. The Euro Preference Shares may be issued in one or more separate series and each series shall be identified in such manner as the Board may determine without any such determination or identification requiring any alteration to these Articles.
- (2) Each Euro Preference Share shall confer the following rights as to dividend and capital:

Income

- (a) the right (subject to the provisions of paragraph (4) of this Article, if applicable) in priority to the payment of any dividend to the holders of Ordinary Shares and any other class of shares of the Company in issue (other than (i) the Dollar Preference Shares, the Sterling Preference Shares and any other shares expressed to rank pari passu therewith as regards income and (ii) any shares which by their terms rank in priority to the Euro Preference Shares as regards income) to a non-cumulative preferential dividend in euro payable at such rate (whether fixed, variable or floating or to be determined by a specified procedure, mechanism or formula) on such dates (each a "Dividend Payment Date") and on such other terms and conditions as may be determined by the Board prior to allotment thereof;

Capital

- (b) the right in a winding up of the Company (but not, unless otherwise provided by the terms of issue of such share,

upon a redemption, reduction or purchase by the Company of any of its share capital) to receive in euro out of the assets of the Company available for distribution to its members in priority to any payment to the holders of the Ordinary Shares and any other class of shares of the Company in issue (other than (i) the Dollar Preference Shares, the Sterling Preference Shares and any other shares expressed to rank pari passu therewith as regards repayment of capital and (ii) any shares which by their terms rank in priority to the Euro Preference Shares as regards repayment of capital):

- (i) a sum equal to:
 - (A) the amount of any dividend which is due for payment after the date of commencement of the winding up but which is payable in respect of a period ending on or before such date; and
 - (B) if the date of commencement of the winding up falls before the last day of a period in respect of which a dividend would have been payable and which began before such date, any further amount of dividend which would have been payable had the day before such date been the last day of that periodbut only to the extent that any such amount or further amount was, or would have been, payable as a dividend in accordance with or pursuant to this Article; and
- (ii) subject thereto, a sum equal to the amount paid up or credited as paid up on such share together with such premium (if any) as may be determined by the Board (or by a procedure, mechanism or formula determined by the Board) prior to allotment thereof (and so that the Board may determine that such premium is payable only in specified circumstances).

Limitations

- (3) No Euro Preference Share shall:
 - (a) confer any right to participate in the profits or assets of the Company other than that set out in subparagraphs (2)(a) and (b) of this Article;
 - (b) subject to the Act, confer any right to participate in any offer or invitation by way of rights or otherwise to

- subscribe for additional shares or securities in the Company;
- (c) confer any right of conversion; or
- (d) confer any right to participate in any issue of bonus shares or shares issued by way of capitalisation of reserves.

Further provisions as to income

- (4) All or any of the following provisions shall apply in relation to any Euro Preference Shares of any series (“relevant Euro Preference Shares”) if so determined by the Board prior to allotment thereof;
 - (a) (i) if, on any Dividend Payment Date (“the relevant date”) on which a dividend (“the relevant dividend”) would otherwise fall to be paid on any relevant Euro Preference Shares, the profits of the Company available for distribution are, in the opinion of the Board, insufficient to enable payment in full to be made of the relevant dividend, then the Board shall (after payment in full, or the setting aside of a sum required for payment in full, of all dividends payable on or before the relevant date on any shares in the capital of the Company in priority to the relevant Euro Preference Shares) apply such profits, if any, in paying dividends to the holders of participating shares (as defined below) pro rata to the amounts of dividend on participating shares accrued and payable on or before the relevant date. For the purposes of this paragraph, the expression “participating shares” shall mean the relevant Euro Preference Shares and any other shares in the capital of the Company which rank pari passu as to participation in profits with the relevant Euro Preference Shares and on which either (1) a dividend is payable on the relevant date or (2) arrears of cumulative dividend are unpaid at the relevant date;
 - (ii) if it shall subsequently appear that any such dividend which has been paid in whole or in part should not, in accordance with the provisions of this sub-paragraph, have been so paid, then provided the Board shall have acted in good

faith, they shall not incur any liability for any loss which any shareholder may suffer in consequence of such payment having been made;

- (b) if the payment of any dividend on any relevant Euro Preference Shares would breach or cause a breach of the capital adequacy requirements of the Financial Services Authority (or any successor organisation responsible for the supervision of banks in the United Kingdom) from time to time applicable to the Company and/or any of its subsidiaries, then none of such dividend shall be payable;
- (c) if a dividend or any part thereof on any relevant Euro Preference Shares is not paid for the reasons specified in sub-paragraphs (a) or (b) above, the holders of such shares shall have no claim in respect of such non-payment;
- (d) if any dividend on any relevant Euro Preference Shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, the Company may not thereafter purchase or redeem any other share capital of the Company ranking *pari passu* with or after the relevant Euro Preference Shares (and may not contribute any moneys to a sinking fund for any such purchase or redemption) until such time as dividends on the relevant Euro Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or an amount equivalent thereto shall have been paid or set aside to provide for such payment in full);
- (e) if any dividend on any relevant Euro Preference Shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, no dividend or other distribution may thereafter be declared or paid on any other share capital of the Company ranking as to dividend after the relevant Euro Preference Shares until such time as dividends on the relevant Euro Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or a sum shall have been paid or set aside to provide for such payment in full).

Redemption

- (5) (a) Unless otherwise determined by the Board in relation to Euro Preference Shares of any series prior to

allotment thereof, the Euro Preference Shares shall, subject to the provisions of the Act, be redeemable at the option of the Company.

- (b) In the case of any series of Euro Preference Shares which are to be so redeemable:
- (i) the Company may, subject to the provisions of the Act and sub-paragraph (ii) below, redeem on any Redemption Date (as hereinafter defined) all, but not merely some, of the Euro Preference Shares of such series by giving to the holders of the Euro Preference Shares to be redeemed not less than 30 days' nor more than 60 days' prior notice in writing (a "Notice of Redemption") of the relevant Redemption Date. "Redemption Date" means, in relation to Euro Preference Shares of a particular series, any date mentioned in any one of (A), (B) or (C) below, as determined by the Board prior to the first allotment of Euro Preference Shares of that series:
- (A) any date which falls on or after the First Redemption Date (as hereinafter defined); or
- (B) the First Redemption Date or any subsequent Dividend Payment Date for Euro Preference Shares of that series; or
- (C) the First Redemption Date or any successive fifth anniversary thereof.
- "First Redemption Date" means:
- (D) in relation to any Euro Preference Shares designated as "Series 1", 30 June 2012;
- (E) in relation to any other Euro Preference Shares of a particular series, one day after such one of the following dates as shall be determined by the Board prior to the first allotment of Euro Preference Shares of that series:
- (1) five years after the Relevant Date (as hereinafter defined);
 - (2) ten years after the Relevant Date;
 - (3) fifteen years after the Relevant Date;

- (4) twenty years after the Relevant Date;
- (5) thirty years after the Relevant Date.

“Relevant Date” means, in relation to Euro Preference Shares of a particular series, such one of the following dates as shall be determined by the Board prior to the first allotment of Euro Preference Shares of that series:

- (F) the first date of allotment of Euro Preference Shares of that series; or
- (G) the first Dividend Payment Date for Euro Preference Shares of that series;
- (ii) if either of the restrictions in sub-paragraphs (4)(a)(i) and (4)(a)(ii) of this Article applies to any dividend otherwise payable on any Redemption Date on the Euro Preference Shares of that series, the Company may not redeem such Euro Preference Shares on that Redemption Date;
- (iii) there shall be paid on each Euro Preference Share so redeemed, in euro, the aggregate of the nominal amount thereof and any premium credited as paid up on such share together with any dividend payable on the Redemption Date;
- (iv) any Notice of Redemption given under sub-paragraph (b)(i) above shall specify the applicable Redemption Date, the particular Euro Preference Shares to be redeemed and the redemption price, and shall state the place or places at which documents of title or such other evidence as may be accepted by the Board in respect of such Euro Preference Shares are to be presented and surrendered for redemption and payment of the redemption moneys is to be effected. Upon such Redemption Date, the Company shall redeem the particular Euro Preference Shares to be redeemed on that date subject to the provisions of this paragraph and of the Act. No defect in the Notice of Redemption or in the giving thereof shall affect the validity of the redemption proceedings;
- (v) payments in respect of the amount due on redemption of a Euro Preference Share shall be made by euro cheque drawn on a bank in a

member state of the European Union (or such other country participating in European Monetary Union from time to time) or upon the request of the holder or joint holders not later than the date specified for the purpose in the Notice of Redemption by transfer to a euro account maintained by the payee with a bank in a member state of the European Union (or such other country participating in European Monetary Union from time to time) or by such other method as the Board may determine. Such payment will be made against presentation and surrender of the relative certificate at the place or one of the places specified in the Notice of Redemption or against such other evidence as may be accepted by the Board.

All payments in respect of redemption moneys will in all respects be subject to any applicable fiscal or other laws;

- (vi) as from the relevant Redemption Date the dividend on the Euro Preference Shares due for redemption shall cease to accrue except on any such Euro Preference Shares in respect of which, upon due surrender of the certificate or other evidence aforesaid, payment of the redemption moneys due on such Redemption Date shall be improperly withheld or refused, in which case such dividend, at the rate then applicable, shall be deemed to have continued and shall accordingly continue to accrue from the relevant Redemption Date to the date of payment of such redemption moneys. Such Euro Preference Shares shall not be treated as having been redeemed until the redemption moneys in question together with the accrued dividend thereon shall have been paid;
- (vii) if the due date for the payment of the redemption moneys on any Euro Preference Share is not a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) System (or any successor system) is open (a "Euro Business Day"), then payment of such moneys will be made on the next succeeding day which is a Euro Business Day and without any interest or other payment in respect of such delay; and

- (viii) the receipt of the holder for the time being of any Euro Preference Shares (or, in the case of joint registered holders, the receipt of any one of them) for the moneys payable on redemption thereof shall constitute an absolute discharge to the Company in respect thereof.
- (c) Upon the redemption or purchase of any Euro Preference Shares the Board shall have power without any further resolution or consent to convert the authorised but unissued Euro Preference Shares existing as a result of such redemption or purchase into shares of any other class of share capital into which the authorised share capital of the Company is or may be divided of the same nominal amount in euro as the Euro Preference Shares or into unclassified shares of the same nominal amount in euro as the Euro Preference Shares.
- (d) Any Euro Preference Shares redeemed pursuant to this paragraph (5) shall be cancelled on redemption.

Purchase

- (6) Subject to the provisions of the Act, the Company may at any time purchase any Euro Preference Shares (i) in the market, (ii) by tender (available alike to all holders of the same class of Euro Preference Shares) or (iii) by private treaty, in each case upon such terms as the Board shall determine.

Consolidation and division

- (7) Pursuant to the authority given by the passing of the resolution adopting this Article the Board may consolidate and divide and/or sub-divide any Euro Preference Shares into shares of a larger or smaller amount.

Attendance and voting at general meetings

- (8) (a) Save as provided by its terms of issue, no Euro Preference Share shall carry any right to attend or vote at general meetings of the Company.
- (b) If so determined by the Board prior to allotment thereof, holders of Euro Preference Shares of any series shall have the right to attend and vote at general meetings of the Company in the following circumstances:

- (i) if any dividend on any Euro Preference Shares of that series in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, the right to attend and vote at general meetings of the Company until such time as dividends on those Euro Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or a sum shall have been paid or set aside to provide for such payment in full);
- (ii) in such other circumstances, and upon and subject to such terms, as the Board may determine prior to allotment of such Euro Preference Shares.
- (c) Whenever holders of Euro Preference Shares are entitled to vote on a resolution at a general meeting, on a show of hands every such holder who is present in person shall have one vote and on a poll every such holder who is present in person or by proxy shall have one vote per Euro Preference Share held by him or such number of votes per share as the Board shall determine prior to allotment of such share.
- (d) Holders of Euro Preference Shares having a registered address or address for correspondence within the United Kingdom shall 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 Company and a copy of every circular or other like document sent out by the Company to the holders of Ordinary Shares.

Further preference shares

- (9) The special rights attached to any Euro Preference Shares of any series allotted or in issue shall not (unless otherwise provided by their terms of issue) be deemed to be varied by the creation or issue of any other preference shares or further shares in any currency ("new shares") ranking as regards participation in the profits and assets of the Company pari passu with such Euro Preference Shares and so that any new shares ranking pari passu with such Euro Preference Shares may either carry rights and restrictions identical in all respects with such Euro Preference Shares or any of them or rights and restrictions differing therefrom in any respect including but without prejudice to the generality of the foregoing in that:

- (a) the rate of and/or basis of calculation of dividend may differ and the dividend may be cumulative or non-cumulative;
- (b) the new shares or any series thereof may rank for dividend as from such date as may be provided by the terms of issue thereof and the dates of payment of dividend may differ;
- (c) a premium may be payable on return of capital or there may be no such premium;
- (d) the new shares may be redeemable at the option of the holder or of the Company, or may be non-redeemable, and if redeemable at the option of the Company they may be redeemable at different dates and on different terms from those applying to the Euro Preference Shares; and
- (e) the new shares may be convertible into Ordinary Shares or any other class of shares ranking as regards participation in the profits and assets of the Company *pari passu* with or after such Euro Preference Shares in each case on such terms and conditions as may be prescribed by the terms of issue thereof.

Variation of class rights

- (10) (a) Subject to the provisions of the Act:
- (i) all or any of the rights, preferences, privileges, limitations or restrictions for the time being attached to the Euro Preference Shares may from time to time (whether or not the Company is being wound up) be varied or abrogated with the consent in writing of the holders of not less than three-quarters in nominal value of the Euro Preference Shares of all series in issue or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of the Euro Preference Shares, voting as a single class without regard for series; and
 - (ii) all or any of the rights, preferences, privileges, limitations or restrictions for the time being attached to Euro Preference Shares of any series may be varied or abrogated so as to affect adversely such rights on a basis different from any other series of Euro Preference Shares with the consent in writing of the holders of not less than three-quarters in nominal value of the Euro

Preference Shares of such series or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of Euro Preference Shares of such series.

All the provisions of these Articles as to general meetings of the Company shall mutatis mutandis apply to any such separate general meeting, but so that the necessary quorum shall be two persons holding or representing by proxy at least one-third in nominal value of the issued shares of the class, that every holder of shares of the class shall be entitled on a poll to one vote for every share of the class held by him, that any holder of shares of the class present in person or by proxy may demand a poll and that at any adjourned meeting of the holders one holder present in person or by proxy (whatever the number of shares held by him) shall be a quorum.

- (b) Unless otherwise provided by its terms of issue, the rights attached to any Euro Preference Share shall not be deemed to be varied or abrogated by a reduction of any share capital or purchase by the Company or redemption of any share capital in each case ranking as regards participation in the profits and assets of the Company in priority to or pari passu with or after such Euro Preference Share.”; and

- (iv) by the re-numbering of the existing Article 5A (Rights of the Non-voting Deferred Shares) as Article 5C.

ORDINARY RESOLUTION

- 5 THAT the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of US\$848,847,000 and either £500,000,000 (in the form of non-cumulative Sterling Preference Shares of £1 each) or, conditional upon the passing of Resolution 4 set out in the Notice of this Meeting of which this Resolution forms part (“the Condition”), £100,000, US\$100,000 and €100,000 (in each such case in the form of 10,000,000 non-cumulative preference shares) provided that this authority shall be limited so that, otherwise than pursuant to:

- (a) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to:
 - (i) Ordinary Shareholders where the relevant securities respectively attributable to the interests of all Ordinary Shareholders are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them; and

(ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue,

but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions, obligations or legal problems under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or

- (b) the terms of any share scheme for employees of the Company or any of its subsidiary undertakings; or
- (c) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or
- (d) the allotment of up to 500,000,000 non-cumulative Sterling Preference Shares of £1 each in the capital of the Company or, if the Condition is satisfied, the allotment of up to 10,000,000 non-cumulative preference shares of £0.01 each, 10,000,000 non-cumulative preference shares of US\$0.01 each and 10,000,000 non-cumulative preference shares of €0.01 each in the capital of the Company,

the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority wholly for cash shall not in aggregate exceed US\$212,211,750 (being equal to approximately 5 per cent of the nominal amount of Ordinary Shares of the Company in issue at the date of the Notice of this Meeting) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2001 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

- 6 THAT, subject to the passing of Resolution 5 set out in the Notice convening this Meeting, the Directors be and they are hereby empowered, pursuant to section 95 of the Companies Act 1985 ("the Act") to allot equity securities (as defined by section 94 of the Act) pursuant to the authority conferred by Resolution 5 as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2001 save that this power shall enable the Company before the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

ORDINARY RESOLUTIONS

- 7 THAT the Company be and is generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of Ordinary Shares of US\$0.50 each in the capital of the Company (“Ordinary Shares”) and the Directors are authorised to exercise such authority provided that:
- (a) the maximum number of Ordinary Shares hereby authorised to be purchased is 848,847,000 Ordinary Shares;
 - (b) the minimum price (exclusive of expenses) which may be paid for each Ordinary Share is US\$0.50 (or the equivalent in the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of United States dollars with such other currency as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day (being a day on which banks are ordinarily open for the transaction of normal banking business in London) prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc);
 - (c) the maximum price (exclusive of expenses) which may be paid for each Ordinary Share is the lower of (i) 105 per cent of the average of the middle market quotations for the Ordinary Shares (as derived from the Daily Official List of the London Stock Exchange Limited) for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased or (ii) 105 per cent of the average of the closing prices of Ordinary Shares on The Stock Exchange of Hong Kong Limited for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased, in each case converted (where relevant) into the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of such currency with the currency in which the quotation and/or price is given as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc;
 - (d) unless previously revoked or varied this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2001; and
 - (e) the Company may prior to the expiry of this authority make a contract to purchase Ordinary Shares under this authority which will or may be executed wholly or partly after such expiry and may make a purchase of Ordinary Shares pursuant to any such contract.
- 8 THAT the amended rules of the HSBC Holdings Savings-Related Share Option Plan (“SAYE Plan”) (the main features of which are summarised in Appendix II to the Chairman’s letter to Shareholders dated 19 April 2000 and a copy of which has been signed for the purposes of identification by the Chairman of the Meeting) including the deferral of the final date on which options may be granted under the SAYE Plan to 26 May 2010 are hereby approved and that the Directors are hereby authorised to do

whatever may be necessary or expedient to carry the amended SAYE Plan into effect including making such changes as may be necessary to secure the approval of the Inland Revenue under Schedule 9 to the Income and Corporation Taxes Act 1988.

- 9 THAT the amended rules of the HSBC Holdings Savings-Related Share Option Plan: Overseas Section (“Overseas SAYE Plan”) (the main features of which are summarised in Appendix II to the Chairman’s letter to Shareholders dated 19 April 2000 and a copy of which has been signed for the purposes of identification by the Chairman of the Meeting) including the deferral of the final date on which options may be granted under the Overseas SAYE Plan to 26 May 2010 are hereby approved and that the Directors are hereby authorised to do whatever may be necessary or expedient to carry the amended Overseas SAYE Plan into effect.
- 10 THAT the HSBC Holdings UK All-Employee Share Ownership Plan (“the UK AESOP”) (the main features of which are summarised in Appendix II to the Chairman’s letter to Shareholders dated 19 April 2000 and the draft rules of which have been signed for the purposes of identification by the Chairman of the Meeting) is hereby approved and that the Directors are hereby authorised to do whatever may be necessary or expedient to carry the UK AESOP into effect including making such amendments to the draft rules as they consider necessary to take account of the relevant provisions of the Finance Act 2000 when enacted and to obtain Inland Revenue approval of the UK AESOP.
- 11 THAT the Directors be and are hereby authorised to establish for the benefit of non-United Kingdom resident employees of the Company or of any of its direct or indirect subsidiaries such further all-employee share ownership plans as the Directors shall from time to time consider appropriate, provided that:
- (a) any such further plans are based on or similar to the HSBC Holdings UK All-Employee Share Ownership Plan or any part or parts thereof but with such variations as the Directors may consider necessary or desirable taking into account local tax, exchange control and securities laws in relevant overseas countries or territories; and
 - (b) where Ordinary Shares made available under such further plans are newly issued such Shares shall be counted against the overall limits applicable to the Company’s employee share plans,

and in any event this authority shall extend to establishing, for the benefit of French-resident employees of the Company or of any of its direct or indirect subsidiaries, one or more plans d’épargne d’entreprise or similar plans on such terms as the Directors shall consider appropriate in accordance with French law and practice and shall also extend to making Ordinary Shares available under such plan or plans, and so that for this purpose establishing a plan also includes participating in a plan established or operated by any direct or indirect subsidiary, or establishing or participating in a sub-plan or adopting such other method or approach as the Directors consider appropriate to achieve the relevant objectives.

- 12 THAT the HSBC Holdings Group Share Option Plan (“the New Option Plan”) (the main features of which are summarised in Appendix II to the Chairman’s letter to

Shareholders dated 19 April 2000 and the draft rules of which have been signed for the purposes of identification by the Chairman of the Meeting) is hereby approved and that the Directors are hereby authorised to do whatever may be necessary or expedient to carry the New Option Plan into effect including making such changes to Part A of the New Option Plan as may be necessary to secure the approval of the Inland Revenue under schedule 9 to the Income and Corporation Taxes Act 1988, and creating such schedules to or sub-plans (which are, or may be deemed for relevant purposes to be, independent plans) of the New Option Plan as they consider necessary or desirable for the benefit of non-United Kingdom resident employees of the Company or its subsidiaries, taking account of local tax, exchange control and securities laws in the relevant country or territory.

- 13 THAT the HSBC Holdings Restricted Share Plan 2000 (the main features of which are summarised in Appendix II to the Chairman's letter to Shareholders dated 19 April 2000 and the draft rules of which have been signed for the purposes of identification by the Chairman of the Meeting) is hereby approved and that the Directors are hereby authorised to do whatever may be necessary or expedient to carry the HSBC Holdings Restricted Share Plan 2000 into effect and to create such schedules to or sub-plans (which are, or may be deemed for relevant purposes to be, independent plans) of the HSBC Holdings Restricted Share Plan 2000 as they consider necessary or desirable for the benefit of non-United Kingdom resident employees of the Company or its subsidiaries, taking account of local tax, exchange control and securities laws in the relevant country or territory.
- 14 THAT pursuant to Article 104.1 of the Articles of Association of the Company with effect from 1 January 2000 the Directors (other than alternate Directors) shall be entitled to receive £35,000 per annum by way of fees for their services as Directors.

J R H Bond
Chairman

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES
RESOLUTIONS
of
HSBC Holdings plc

Passed 25 May 2001

At the Annual General Meeting of HSBC Holdings plc held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 25 May 2001, the following Resolutions were passed:

SPECIAL RESOLUTION

4 THAT

- (a) the authorised share capital of the Company denominated in United States dollars be increased to US\$7,500,100,000 by the creation of an additional 4,500,000,000 Ordinary Shares of US\$0.50 each; and
- (b) the Articles of Association of the Company be and are hereby altered by the deletion of Article 4.1 and the substitution therefor of the following:
 - “4.1 The authorised share capital of the Company is US\$7,500,100,000 divided into 15,000,000,000 Ordinary Shares of US\$0.50 each and 10,000,000 Dollar Preference Shares of US\$0.01 each, £401,500 divided into 10,000,000 Sterling Preference Shares of £0.01 each and 301,500 Non-voting Deferred Shares of £1 each, and €100,000 divided into 10,000,000 Euro Preference Shares of €0.01 each.”

ORDINARY RESOLUTION

- 5 THAT the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of £100,000, US\$100,000 and €100,000 (in each such case in the form of 10,000,000 non-cumulative preference shares) and either US\$615,075,000 or, conditional upon the passing of Resolution 4 set out in the Notice of this Meeting, US\$926,985,000 (in either such case in the form of Ordinary Shares of US\$0.50 each) provided that this authority shall be limited so that, otherwise than pursuant to:

- (a) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to:
- (i) Ordinary Shareholders where the relevant securities respectively attributable to the interests of all Ordinary Shareholders are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them; and
 - (ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue,
- but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions, obligations or legal problems under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or
- (b) the terms of any share plan for employees of the Company or any of its subsidiary undertakings; or
 - (c) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or
 - (d) the allotment of up to 10,000,000 non-cumulative preference shares of £0.01 each, 10,000,000 non-cumulative preference shares of US\$0.01 each and 10,000,000 non-cumulative preference shares of €0.01 each in the capital of the Company,

the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority wholly for cash shall not in aggregate exceed US\$231,746,250 (being equal to approximately 5 per cent of the nominal amount of Ordinary Shares of the Company in issue at the date of the Notice of this Meeting) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2002 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

- 6 THAT, subject to the passing of Resolution 5 set out in the Notice of this Meeting, the Directors be and they are hereby empowered pursuant to section 95 of the Companies Act 1985 (“the Act”) to allot equity securities (as defined by section 94 of the Act) pursuant to the authority conferred by Resolution 5 as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2002 save that this power shall enable the Company before the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

ORDINARY RESOLUTION

- 7 THAT the Company be and is generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of Ordinary Shares of US\$0.50 each in the capital of the Company (“Ordinary Shares”) and the Directors are authorised to exercise such authority provided that:
- (a) the maximum number of Ordinary Shares hereby authorised to be purchased is 926,985,000 Ordinary Shares;
 - (b) the minimum price (exclusive of expenses) which may be paid for each Ordinary Share is US\$0.50 (or the equivalent in the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of United States dollars with such other currency as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day (being a day on which banks are ordinarily open for the transaction of normal banking business in London) prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc);
 - (c) the maximum price (exclusive of expenses) which may be paid for each Ordinary Share is the lower of (i) 105 per cent of the average of the middle market quotations for the Ordinary Shares (as derived from the Daily Official List of the London Stock Exchange plc) for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased or (ii) 105 per cent of the average of the closing prices of Ordinary Shares on The Stock Exchange of Hong Kong Limited for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased, in each case converted (where relevant) into the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of such currency with the currency in which the quotation and/or price is given as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc;
 - (d) unless previously revoked or varied this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2002; and
 - (e) the Company may prior to the expiry of this authority make a contract to purchase Ordinary Shares under this authority which will or may be executed wholly or partly after such expiry and may make a purchase of Ordinary Shares pursuant to any such contract.

SPECIAL RESOLUTION

8 THAT the Articles of Association of the Company be and are hereby altered as follows:

- (a) by inserting after the expression “Act” in Article 2.1 the following new expression:

“address in relation to any electronic communication includes any number or address used for the purposes of such communication”;

- (b) by inserting after the expression “clear days” in Article 2.1 the following new expression:
- “communication has the meaning given to it in the Electronic Communications Act 2000”;
- (c) by inserting after the expression “Dollar Preference Share” in Article 2.1 the following new expression:
- “electronic communication has the meaning given to it in the Electronic Communications Act 2000 and “electronic communications” shall be construed accordingly”;
- (d) by deleting from the meaning of the expression “The Stock Exchange” in Article 2.1 the word “Limited” and substituting therefor the word “plc”;
- (e) by adding at the end of the meaning of the expression “writing or written” in Article 2.1 the following words “and, if the Board shall in its absolute discretion determine for any purpose or purposes under these Articles, subject to such terms and conditions as the Board may determine, electronic communications”;
- (f) by deleting in Article 56.1 the word “instrument” and substituting therefor the word “appointment”;
- (g) by deleting the final sentence of Article 71.3 and substituting therefor the following:
- “Evidence to the satisfaction of the Board of the authority of the person claiming to exercise the right to vote shall be deposited at the Office, or deposited or received at such other place or address as is specified in accordance with these Articles for the deposit or receipt of appointments of proxy, not less than 48 hours before the time appointed for holding the meeting or adjourned meeting at which the right to vote is to be exercised, and in default the right to vote shall not be exercisable.”;
- (h) by deleting in Article 74.1 the words “Deposit of an instrument of” in the second line and substituting therefor the words “The appointment of a”;
- (i) in Article 75.1:
- (i) by deleting the words “instrument appointing” in the first line and substituting therefor the words “appointment of”;
- (ii) by deleting Article 75.1(a) and substituting therefor the following:
- “be in writing and, if the Board in its absolute discretion determines, may be contained in an electronic communication, in any such case in any common form or in such other form as the Board may approve and: (i) if in writing but not contained in an electronic communication, under the hand of the appointor or of his attorney duly authorised in writing or, if the appointor is a corporation, under its common seal or under the hand of some officer or attorney duly authorised in that behalf; or (ii) in the case of an appointment contained in an electronic communication, submitted by or on behalf of the appointor, subject to such terms and conditions and authenticated in such manner as the Board may in its absolute discretion determine;”;

- (j) by altering the title of Article 76 to “Deposit or receipt of proxy” and making the following alterations to Article 76.1:
- (i) deleting the words “instrument appointing” in the first line and substituting therefor the words “appointment of”;
 - (ii) in Article 76.1(a):
 - (A) adding the following words at the beginning of that Article:

“in the case of an instrument in writing (including, whether or not the appointment of proxy is contained in an electronic communication, any such power of attorney or other authority),”;
 - (B) deleting the word “instrument” in the fifth line and substituting therefor the word “appointment”;
 - (iii) inserting after Article 76.1(a) the following new Article 76.1(aa):

“(aa) in the case of an appointment contained in an electronic communication, where an address has been specified for the purpose of receiving communications:

 - (A) in the notice convening the meeting; or
 - (B) in any instrument of proxy sent out by the Company in relation to the meeting; or
 - (C) in any invitation contained in an electronic communication to appoint a proxy issued by the Company in relation to the meeting,

be received at such address not less than 48 hours before the time for holding the meeting or adjourned meeting at which the person named in the appointment proposes to vote; or”;
 - (iv) adding in Article 76.1(b) the words “or received” after the word “deposited”;
 - (v) deleting the existing text after Article 76.1(c) and substituting therefor the following:

“and an appointment of proxy not deposited, delivered or received in a manner so permitted shall be invalid. No appointment of proxy shall be valid after the expiry of 12 months from the date named in it as the date of its execution or the date of its submission, except at an adjourned meeting or on a poll demanded at a meeting or an adjourned meeting in cases where the meeting was originally held within 12 months from such date.”;
 - (k) by deleting Article 77.1 and substituting therefor the following:

“A member may appoint more than one proxy to attend on the same occasion. When two or more valid but differing appointments of proxy are delivered or received in respect of the same share for use at the same meeting and in respect of the same matter, the one which is last validly delivered or received (regardless of its date or of the date of its execution or submission) shall be treated as replacing and revoking the other or others as regards that share. If

the Company is unable to determine which appointment was last validly delivered or received, none of them shall be treated as valid in respect of that share.”;

- (l) in Article 78.1, by deleting the first sentence and substituting therefor the following:

“The Board may at the expense of the Company send or make available, by post, electronic communication or otherwise, appointments of proxy (reply-paid or otherwise) to members for use at any general meeting(s) or at any separate meeting(s) of the holders of any class of shares, either in blank or nominating in the alternative any one or more of the Directors or any other persons.”;

- (m) by deleting Article 79.1 and substituting therefor the following:

“A vote given or poll demanded in accordance with the terms of an appointment of proxy shall be valid notwithstanding the death or mental disorder of the principal or the revocation of the appointment of proxy, or of the authority under which the appointment of proxy was executed or submitted, or the transfer of the share in respect of which the appointment of proxy is given, unless notice in writing of such death, mental disorder, revocation or transfer shall have been received by the Company at the Office, or at such other place or places or address as has or have been appointed for the deposit or receipt of appointments of proxy, at least 48 hours before the commencement of the meeting or adjourned meeting or the taking of the poll at which the appointment of proxy is used.”;

- (n) by adding the following new Article 91.2:

“91.2 In addition to the Directors required to retire by rotation under Article 91.1, there shall also be required to retire by rotation any Director who at an annual general meeting of the Company shall have been a Director at each of the preceding two annual general meetings of the Company and who was not elected or re-elected at either such annual general meeting and who has not otherwise ceased to be a Director (either by resignation, retirement, removal or otherwise) and been re-elected by general meeting of the Company at or since either such annual general meeting.”;

- (o) by altering the title of Article 159 to “Form of Notices” and making the following alterations to Article 159:

- (i) deleting the first sentence of Article 159.1 and substituting therefor the following:

“Notwithstanding anything to the contrary in these Articles, any notice or document to be given, sent, issued, deposited, served or delivered (or the equivalent) to or by any person pursuant to these Articles (other than a notice calling a meeting of the Directors) shall be in writing and, if the Board in its absolute discretion considers appropriate for any purpose or purposes under these Articles, any such notice or document shall be deemed given, sent, issued, deposited, served or delivered (or the equivalent) where it is sent using electronic communications to an address for the time being notified for that purpose to the person giving the notice, but subject always to the provisions of Article 162. In the

case of notices or other documents sent by means of electronic communication the Board may make this subject to such terms and conditions as it shall in its absolute discretion consider appropriate.”;

(ii) adding the following new Article 159.2:

“159.2 For the purposes of Article 159.1, notices or documents shall be treated as being sent using electronic communications by the Company to a person where (i) the Company and that person have agreed to his having access to the notice or document on a web site (instead of such notice or document being sent to him) (ii) the notice or document (as the case may be) is a notice or document to which that agreement applies and (iii) a notice is sent to the person, in a manner for the time being agreed for that purpose between him and the Company, of (a) the publication of that notice or document on the web site (b) the address of the web site and (c) the place on that web site where the notice or document may be accessed, and how it may be accessed, and in any such case the notification referred to above shall be treated as the relevant notice for the purposes of these Articles.”;

(p) by adding in Article 160.1 after the words “that address” in the third line the words “or, in the circumstances referred to in Article 159, by sending it using electronic communications to an address for the time being notified to the Company by the member”;

(q) by deleting Article 160.3 and substituting therefor the following:

“Where a member (or, in the case of joint holders, the person first named in the Register) has a registered address outside Hong Kong or the United Kingdom but has notified the Company of an address within Hong Kong or the United Kingdom at which notices or other documents may be given to him or, if the Board in its absolute discretion permits, an address to which notices or documents may be sent using electronic communications, he shall be entitled to have notices or documents given or sent to him at that address but otherwise no such member shall be entitled to receive any notice or document from the Company. If on at least two consecutive occasions the Company has attempted to send notices or documents using electronic communications to an address for the time being notified to the Company by a member for that purpose but the Company is aware that there has been a failure of delivery of such notice or document in the manner described in Article 162.3, then the Company shall thereafter send notices or documents through the post to such member at his registered address or his address for the service of notices by post, in which case the provisions of the remainder of this Article shall apply. If on three consecutive occasions notices or documents have been sent through the post to any member at his registered address or his address for the service of notices but have been returned undelivered, such member shall not thereafter be entitled to receive notices or documents from the Company until he shall have communicated with the Company and supplied in writing a new registered address or address within Hong Kong or the United Kingdom for the service of notices or,

if the Board in its absolute discretion permits, an address to which notices or documents may be sent using electronic communications.”;

- (r) by adding in Article 161.1 after the words “United Kingdom” in the sixth line the words “or to which notices may be sent using electronic communications”; and
- (s) by adding the following new Article 162.3:

“162.3 Any notice or other document addressed to a member shall, if sent using electronic communications, be deemed to have been served or delivered at the expiration of 24 hours after the time it was first sent. In proving such service or delivery it shall be conclusive to prove that the address used for the electronic communication was the address supplied for that purpose and the electronic communication was properly dispatched, unless the Company is aware that there has been a failure of delivery of such notice or document following at least 2 attempts in which case such notice or document shall be sent to the member at his registered address or address for service in Hong Kong or the United Kingdom provided that the date of deemed service or delivery shall be 24 hours from the dispatch of the original electronic communication in accordance with this Article.”.

Sir John Bond
Chairman

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS
of
HSBC Holdings plc

Passed 31 May 2002

At the Annual General Meeting of HSBC Holdings plc held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 31 May 2002, the following Resolutions were passed:

ORDINARY RESOLUTION

- 4 THAT the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of £100,000, US\$100,000 and €100,000 (in each such case in the form of 10,000,000 non-cumulative preference shares) and US\$935,560,000 (in the form of Ordinary Shares of US\$0.50 each) provided that this authority shall be limited so that, otherwise than pursuant to:
- (a) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to:
 - (i) Ordinary Shareholders where the relevant securities respectively attributable to the interests of all Ordinary Shareholders are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them; and
 - (ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue,but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions, obligations or legal problems under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or
 - (b) the terms of any share plan for employees of the Company or any of its subsidiary undertakings; or

- (c) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or
- (d) the allotment of up to 10,000,000 non-cumulative preference shares of £0.01 each, 10,000,000 non-cumulative preference shares of US\$0.01 each and 10,000,000 non-cumulative preference shares of €0.01 each in the capital of the Company,

the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority wholly for cash shall not in aggregate exceed US\$233,890,000 (being equal to approximately 5 per cent of the nominal amount of Ordinary Shares of the Company in issue at the date of the Notice of this Meeting) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2003 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

- 5 THAT, subject to the passing of Resolution 4 set out in the Notice of this Meeting, the Directors be and they are hereby empowered pursuant to section 95 of the Companies Act 1985 ("the Act") to allot equity securities (as defined by section 94 of the Act) pursuant to the authority conferred by Resolution 4 as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2003 save that this power shall enable the Company before the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

ORDINARY RESOLUTIONS

- 6 THAT the Company be and is hereby generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of Ordinary Shares of US\$0.50 each in the capital of the Company ("Ordinary Shares") and the Directors are authorised to exercise such authority provided that:
- (a) the maximum number of Ordinary Shares hereby authorised to be purchased is 935,560,000 Ordinary Shares;
 - (b) the minimum price (exclusive of expenses) which may be paid for each Ordinary Share is US\$0.50 (or the equivalent in the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of United States dollars with such other currency as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day (being a day on which banks are ordinarily open for the transaction of normal banking business in London) prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc);

- (c) the maximum price (exclusive of expenses) which may be paid for each Ordinary Share is the lower of (i) 105 per cent of the average of the middle market quotations for the Ordinary Shares (as derived from the Daily Official List of the London Stock Exchange plc) for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased or (ii) 105 per cent of the average of the closing prices of Ordinary Shares on The Stock Exchange of Hong Kong Limited for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased, in each case converted (where relevant) into the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of such currency with the currency in which the quotation and/or price is given as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc;
- (d) unless previously revoked or varied this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2003; and
- (e) the Company may prior to the expiry of this authority make a contract to purchase Ordinary Shares under this authority which will or may be executed wholly or partly after such expiry and may make a purchase of Ordinary Shares pursuant to any such contract.

7 THAT the Directors be and are hereby empowered:

- (a) to exercise the power conferred upon them by Article 151 of the Articles of Association of the Company in respect of all or part of any dividend payable in respect of any financial period of the Company ending on or before 31 December 2006;
- (b) to capitalise from time to time the appropriate nominal amount or amounts of new shares of the Company falling to be allotted pursuant to elections made under the Company's scrip dividend scheme out of the amount or amounts standing to the credit of any reserve account or fund of the Company, to apply that sum in paying up in full the relevant number of such new shares and to allot such new shares pursuant to such elections; and
- (c) generally to implement the Company's scrip dividend scheme on such terms and conditions as the Directors may from time to time determine and to take such other actions as the Directors may deem necessary or desirable from time to time in respect of the Company's scrip dividend scheme.

8 THAT the Company be and is hereby generally and unconditionally authorised for the purposes of Part XA of the Companies Act 1985 (as amended) ("the Act") to make donations to EU political organisations and to incur EU political expenditure (as such terms are defined in section 347A of the Act) up to a maximum aggregate amount of £250,000 provided that such authority shall expire at the conclusion of the next Annual General Meeting of the Company to be held after the passing of this resolution.

9 THAT HSBC Bank plc be and is hereby generally and unconditionally authorised for the purposes of Part XA of the Companies Act 1985 (as amended) ("the Act") to make donations to EU political organisations and to incur EU political expenditure (as such terms are defined in section 347A of the Act) up to a maximum aggregate

amount of £50,000 provided that such authority shall expire at the conclusion of the next Annual General Meeting of the Company to be held after the passing of this resolution.

Sir John Bond
Chairman

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTION
of
HSBC Holdings plc

Passed 28 March 2003

At the Extraordinary General Meeting of HSBC Holdings plc held at Cabot Hall, Cabot Place West, Canary Wharf, London E14 on Friday, 28 March 2003, the following Resolution was passed:

ORDINARY RESOLUTION

THAT:

- (a) the acquisition by way of merger (the "Acquisition") of Household International, Inc. ("Household") on the terms and subject to the conditions of the agreement dated 14 November 2002 between (1) the Company, (2) Household and (3) H2 Acquisition Corporation (a copy of which, signed by the chairman of the Meeting for the purposes of identification, was produced to the Meeting) (the "Merger Agreement") (including the arrangements to be put in place regarding: (i) the outstanding options to acquire common stock of Household granted by Household to any current or former employee or director of Household or any of its subsidiaries; (ii) any right of any kind, contingent or accrued, to receive common stock of Household; and (iii) any award of any kind consisting of common stock of Household granted under any Household benefit plan (including restricted stock, restricted stock units, deferred stock units and dividend equivalents) (together "Assumed Options")), as described in the circular to shareholders of the Company of which this notice forms part, be and is hereby approved and the Directors (or a duly authorised committee thereof) be and are hereby authorised to take all such steps to implement the same and to execute all documents and deeds as may be necessary or appropriate in relation thereto, subject to such non-material modifications, amendments, waivers, variations or extensions of such terms and conditions as they think fit; and
- (b) conditional upon and with effect from the Acquisition becoming effective pursuant to the Merger Agreement, the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 to exercise all the powers of the Company to allot relevant

securities (within the meaning of that section) up to an aggregate nominal amount of US\$702,863,189 (in the form of ordinary shares of US\$0.50 each) in satisfaction of the Company's obligations arising in relation to the Acquisition to issue ordinary shares, including shares to be issued as a result of the exercise of the Assumed Options and shares to be issued pursuant to the terms of the purchase contracts underlying the Household 8.875 per cent Adjustable Conversion-Rate Equity Security Units and shares to be issued pursuant to the Household zero-coupon convertible debt securities, such authority to be in addition to, and without prejudice to, that granted to the Directors at the annual general meeting of the Company held on 31 May 2002 (which shall remain in full force and effect until its expiry as stated therein), provided that this authority shall expire at the conclusion of the Company's annual general meeting to be held in 2004, unless such authority is renewed, varied, or revoked by the Company in general meeting, save that the Company may at any time before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of any such offer or agreement as if the authority hereby conferred had not expired.

Sir John Bond
Chairman

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES
RESOLUTIONS
of
HSBC Holdings plc

Passed 30 May 2003

At the Annual General Meeting of HSBC Holdings plc held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 30 May 2003, the following Resolutions were passed:

ORDINARY RESOLUTIONS

- 4 THAT the Directors' Remuneration Report for the year ended 31 December 2002 be and is hereby approved.
- 5 THAT the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of £100,000, US\$100,000 and €100,000 (in each such case in the form of 10,000,000 non-cumulative preference shares) and US\$948,200,000 (in the form of Ordinary Shares of US\$0.50 each) provided that this authority shall be limited so that, otherwise than pursuant to:
- (a) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to:
- (i) Ordinary Shareholders where the relevant securities respectively attributable to the interests of all Ordinary Shareholders are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them; and
 - (ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue,

but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depository receipts or having regard to any restrictions,

obligations or legal problems under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or

- (b) the terms of any share plan for employees of the Company or any of its subsidiary undertakings and, conditional on completion of the proposed acquisition of Household International, Inc. (“Household”), any share plan of Household or any of its subsidiary undertakings; or
- (c) conditional on completion of the proposed acquisition of Household, the terms of Household’s outstanding Zero-Coupon Convertible Debt Securities or 8.875 per cent Adjustable Conversion-Rate Equity Security Units; or
- (d) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or
- (e) the allotment of up to 10,000,000 non-cumulative preference shares of £0.01 each, 10,000,000 non-cumulative preference shares of US\$0.01 each and 10,000,000 non-cumulative preference shares of €0.01 each in the capital of the Company,

the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority wholly for cash shall not in aggregate exceed US\$237,050,000 (being equal to approximately 5 per cent of the nominal amount of Ordinary Shares of the Company in issue at the latest practicable date prior to the printing of the Notice of this Meeting), this authority shall be in addition to, and without prejudice to, any authority granted to the Directors at the Extraordinary General Meeting of the Company to approve the acquisition of Household (which shall remain in full force and effect until its expiry as stated therein) and this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2004 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

- 6 THAT, subject to the passing of Resolution 5 set out in the Notice of this Meeting, the Directors be and they are hereby empowered pursuant to section 95 of the Companies Act 1985 (“the Act”) to allot equity securities (as defined by section 94 of the Act) pursuant to the authority conferred by Resolution 5 as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2004 save that this power shall enable the Company before the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

ORDINARY RESOLUTIONS

- 7 THAT the Company be and is hereby generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of

Ordinary Shares of US\$0.50 each in the capital of the Company (“Ordinary Shares”) and the Directors are authorised to exercise such authority provided that:

- (a) the maximum number of Ordinary Shares hereby authorised to be purchased is 948,200,000 Ordinary Shares;
 - (b) the minimum price (exclusive of expenses) which may be paid for each Ordinary Share is US\$0.50 (or the equivalent in the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of United States dollars with such other currency as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day (being a day on which banks are ordinarily open for the transaction of normal banking business in London) prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc);
 - (c) the maximum price (exclusive of expenses) which may be paid for each Ordinary Share is the lower of (i) 105 per cent of the average of the middle market quotations for the Ordinary Shares (as derived from the Daily Official List of the London Stock Exchange plc) for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased or (ii) 105 per cent of the average of the closing prices of Ordinary Shares on The Stock Exchange of Hong Kong Limited for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased, in each case converted (where relevant) into the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of such currency with the currency in which the quotation and/or price is given as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc;
 - (d) unless previously revoked or varied this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2004; and
 - (e) the Company may prior to the expiry of this authority make a contract to purchase Ordinary Shares under this authority which will or may be executed wholly or partly after such expiry and may make a purchase of Ordinary Shares pursuant to any such contract.
- 8 THAT the Company be and is hereby generally and unconditionally authorised for the purposes of Part XA of the Companies Act 1985 (as amended) (“the Act”) to make donations to EU political organisations and to incur EU political expenditure (as such terms are defined in section 347A of the Act) up to a maximum aggregate amount of £250,000 provided that such authority shall expire either at the conclusion of the Annual General Meeting of the Company to be held in 2007 or on 29 May 2007, whichever is the earlier, unless previously renewed, varied or revoked by the Company in general meeting.
- 9 THAT HSBC Bank plc be and is hereby generally and unconditionally authorised for the purposes of Part XA of the Companies Act 1985 (as amended) (“the Act”) to make donations to EU political organisations and to incur EU political expenditure (as such terms are defined in section 347A of the Act) up to a maximum aggregate amount of

£50,000 provided that such authority shall expire either at the conclusion of the Annual General Meeting of the Company to be held in 2007 or on 29 May 2007, whichever is the earlier, unless previously renewed, varied or revoked by the Company in general meeting.

Sir John Bond
Chairman

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS

of

HSBC Holdings plc

Passed 28 May 2004

At the Annual General Meeting of HSBC Holdings plc held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 28 May 2004, the following Resolutions were passed:

ORDINARY RESOLUTIONS

- 4 THAT the Directors' Remuneration Report for the year ended 31 December 2003 be and is hereby approved.
- 5 THAT the Company be and is hereby generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of Ordinary Shares of US\$0.50 each in the capital of the Company ("Ordinary Shares") and the Directors are authorised to exercise such authority provided that:
 - (a) the maximum number of Ordinary Shares hereby authorised to be purchased is 1,099,900,000 Ordinary Shares;
 - (b) the minimum price (exclusive of expenses) which may be paid for each Ordinary Share is US\$0.50 (or the equivalent in the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of United States dollars with such other currency as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day (being a day on which banks are ordinarily open for the transaction of normal banking business in London) prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc);
 - (c) the maximum price (exclusive of expenses) which may be paid for each Ordinary Share is the lower of (i) 105 per cent of the average of the middle market quotations for the Ordinary Shares (as derived from the Daily Official List of the London Stock Exchange plc) for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased or (ii) 105 per cent of the average of the closing prices of Ordinary Shares on The Stock Exchange of

Hong Kong Limited for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased, in each case converted (where relevant) into the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of such currency with the currency in which the quotation and/or price is given as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc;

- (d) unless previously revoked or varied this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2005; and
- (e) the Company may prior to the expiry of this authority make a contract to purchase Ordinary Shares under this authority which will or may be executed wholly or partly after such expiry and may make a purchase of Ordinary Shares pursuant to any such contract.

Subject to the receipt of such regulatory approvals and consents in Hong Kong as the Directors may deem necessary, any shares acquired by the Company pursuant to this, or any subsequent, authority to make market purchases which are held in treasury may be sold or transferred in satisfaction of the exercise of options under, or otherwise pursuant to, any of the Company's existing employee share schemes.

6 THAT the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 ("the Act") to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of £100,000, US\$100,000 and €100,000 (in each such case in the form of 10,000,000 non-cumulative preference shares) and US\$1,099,900,000 (in the form of Ordinary Shares of US\$0.50 each) provided that this authority shall be limited so that, otherwise than pursuant to:

- (a) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to:
 - (i) Ordinary Shareholders where the relevant securities respectively attributable to the interests of all Ordinary Shareholders are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them; and
 - (ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue,

but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions, obligations or legal problems under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or

- (b) the terms of any share plan for employees of the Company or any of its subsidiary undertakings; or

- (c) the terms of the Household International, Inc. outstanding Zero-Coupon Convertible Debt Securities or 8.875 per cent Adjustable Conversion-Rate Equity Security Units; or
- (d) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or
- (e) the allotment of up to 10,000,000 non-cumulative preference shares of £0.01 each, 10,000,000 non-cumulative preference shares of US\$0.01 each and 10,000,000 non-cumulative preference shares of €0.01 each in the capital of the Company,

the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority wholly for cash shall not in aggregate, together with any allotment of other equity securities authorised by sub-paragraph (b) of Resolution 7, exceed US\$274,975,000 (being equal to approximately 5 per cent of the nominal amount of Ordinary Shares of the Company in issue at the latest practicable date prior to the printing of the Notice of this Meeting) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2005 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

- 7 THAT the Directors be and are hereby empowered pursuant to section 95 of the Companies Act 1985 (“the Act”):
- (a) subject to the passing of Resolution 6 set out in the Notice to this Meeting, to allot equity securities (as defined by section 94 of the Act) the subject of the authority granted by Resolution 6; and
 - (b) to allot any other equity securities (as defined by section 94 of the Act) which are held by the Company in treasury

as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2005 save that this power shall enable the Company before the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

ORDINARY RESOLUTION

- 8 THAT pursuant to Article 104.1 of the Articles of Association of the Company with effect from 1 January 2004 each of the Directors (other than alternate Directors) shall be entitled to receive £55,000 per annum by way of fees for their services as Directors.

**Sir John Bond
Chairman**

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS

of

HSBC Holdings plc

Passed 27 May 2005

At the Annual General Meeting of HSBC Holdings plc held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 27 May 2005, the following Resolutions were passed:

ORDINARY RESOLUTIONS

- 4 THAT the Directors' Remuneration Report for the year ended 31 December 2004 be and is hereby approved.
- 5 THAT the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 ("the Act") to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of £100,000, US\$100,000 and €100,000 (in each such case in the form of 10,000,000 non-cumulative preference shares) and US\$1,119,000,000 (in the form of Ordinary Shares of US\$0.50 each ("Ordinary Shares")) provided that this authority shall be limited so that, otherwise than pursuant to:
- (a) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to:
- (i) Ordinary Shareholders where the relevant securities respectively attributable to the interests of all Ordinary Shareholders are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them; and
 - (ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue,

but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions, obligations or legal problems under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or

- (b) the terms of any share plan for employees of the Company or any of its subsidiary undertakings; or
- (c) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or
- (d) the terms of the HSBC Finance Corporation 8.875 per cent Adjustable Conversion-Rate Equity Security Units; or
- (e) the allotment of up to 10,000,000 non-cumulative preference shares of £0.01 each, 10,000,000 non-cumulative preference shares of US\$0.01 each and 10,000,000 non-cumulative preference shares of €0.01 each in the capital of the Company,

the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority wholly for cash shall not in aggregate, together with any allotment of other equity securities authorised by sub-paragraph (b) of Resolution 6 set out in the Notice convening this Meeting, exceed US\$279,750,000 (being equal to approximately 5 per cent of the nominal amount of Ordinary Shares of the Company in issue at the latest practicable date prior to the printing of the Notice of this Meeting) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2006 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

- 6 THAT the Directors be and are hereby empowered pursuant to section 95 of the Companies Act 1985 (“the Act”):
- (a) subject to the passing of Resolution 5 set out in the Notice convening this Meeting, to allot equity securities (as defined by section 94 of the Act) the subject of the authority granted by Resolution 5; and
 - (b) to allot any other equity securities (as defined by section 94 of the Act) which are held by the Company in treasury,

in each case as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2006 save that this power shall enable the Company before the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

ORDINARY RESOLUTIONS

- 7 THAT the Company be and is hereby generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of Ordinary Shares of US\$0.50 each in the capital of the Company (“Ordinary Shares”) and the Directors are authorised to exercise such authority provided that:
- (a) the maximum number of Ordinary Shares hereby authorised to be purchased is 1,119,000,000 Ordinary Shares;

- (b) the minimum price (exclusive of expenses) which may be paid for each Ordinary Share is US\$0.50 (or the equivalent in the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of United States dollars with such other currency as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day (being a day on which banks are ordinarily open for the transaction of normal banking business in London) prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc);
- (c) the maximum price (exclusive of expenses) which may be paid for each Ordinary Share is the lower of (i) 105 per cent of the average of the middle market quotations for the Ordinary Shares (as derived from the Daily Official List of the London Stock Exchange plc) for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased or (ii) 105 per cent of the average of the closing prices of the Ordinary Shares on The Stock Exchange of Hong Kong Limited for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased, in each case converted (where relevant) into the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of such currency with the currency in which the quotation and/or price is given as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc;
- (d) unless previously revoked or varied this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2006; and
- (e) the Company may prior to the expiry of this authority make a contract to purchase Ordinary Shares under this authority which will or may be executed wholly or partly after such expiry and may make a purchase of Ordinary Shares pursuant to any such contract.

Subject to the receipt of such regulatory approvals and consents in Hong Kong as the Directors may deem necessary, any Ordinary Shares acquired by the Company pursuant to this, or any subsequent, authority to make market purchases which are held in treasury may be sold or transferred in satisfaction of the exercise of options under, or otherwise pursuant to, any of the Company's existing employee share schemes.

- 8 THAT the amended rules of the HSBC Holdings Savings-Related Share Option Plan ("Sharesave UK") (the main features of which are summarised in Appendix II to the Chairman's letter to Shareholders dated 31 March 2005 and a copy of which has been signed for the purposes of identification by the Chairman of the Meeting) including the deferral of the final date on which options may be granted under Sharesave UK to 27 May 2015 are hereby approved and that the Directors are hereby authorised to do whatever may be necessary or expedient to carry the amended Sharesave UK into effect including making such changes as may be necessary to secure the continuing approval of the Inland Revenue under Schedule 3 to the Income Tax (Earnings and Pensions) Act 2003.

- 9 THAT the amended rules of the HSBC Holdings Savings-Related Share Option Plan: International (“Sharesave International”) (the main features of which are summarised in Appendix II to the Chairman’s letter to Shareholders dated 31 March 2005 and a copy of which has been signed for the purposes of identification by the Chairman of the Meeting) including the deferral of the final date on which options may be granted under Sharesave International to 27 May 2015 are hereby approved and that the Directors are hereby authorised to do whatever may be necessary or expedient to carry the amended Sharesave International into effect.
- 10 THAT, subject to the passing of Resolution 9 set out in the Notice convening this Meeting, the HSBC US Employee Stock Plan (“the US Sub-Plan”) (constituted by the amended rules of the HSBC Holdings Savings-Related Share Option Plan: International as modified by Schedule 2 thereof and the main features of which are summarised in Appendix II to the Chairman’s letter to Shareholders dated 31 March 2005 and a copy of which has been signed for the purposes of identification by the Chairman of the Meeting) is hereby approved and that the Directors are hereby authorised to do whatever may be necessary or expedient to carry the US Sub-Plan into effect including making such changes to the US Sub-Plan as may be necessary to ensure compliance with such statutory, fiscal or securities laws as may apply to the US Sub-Plan or any participant.
- 11 THAT The HSBC Share Plan (the main features of which are summarised in Appendix II to the Chairman’s letter to Shareholders dated 31 March 2005 and the draft rules of which have been signed for the purposes of identification by the Chairman of the Meeting) is hereby approved and that the Directors are hereby authorised to do whatever may be necessary or expedient to carry The HSBC Share Plan into effect including making such changes to Schedule 1 of The HSBC Share Plan as may be necessary to secure the approval of the Inland Revenue under Schedule 4 to the Income Tax (Earnings and Pensions) Act 2003, and creating such schedules to or sub-plans (which are, or may be deemed for relevant purposes to be, independent plans) of The HSBC Share Plan as they consider necessary or desirable for the benefit of non-United Kingdom resident employees of the Company or its subsidiaries, taking account of local tax, exchange control and securities laws in the relevant country or territory including to obtain and preserve favourable French treatment for share awards pursuant to the French Commercial Code (article L225-197-1 to L225-197-5 and any related articles) such awards being in respect of either newly issued or existing shares, with a vesting period of not less than two years and a prohibition on sale within two years of the vesting date.

SPECIAL RESOLUTION

- 12 THAT the Articles of Association of the Company be and are hereby altered as follows:
- (a) by deleting the words:
“Regulations The Uncertificated Securities Regulations 1995 (SI 1995 No. 3272)”
from Article 2.1 and substituting therefor the words:
“Regulations The Uncertificated Securities Regulations 2001 (SI 2001 No. 3755)”;
- (b) by inserting the following new Article as Article 5A.1(5)(b)(i)(D)(3):
“(3) “Series 3”, 27 June 2013.”;

(c) by deleting the existing Article 5B.1(5)(b)(i)(D) and substituting therefor the following new Article 5B.1(5)(b)(i)(D):

“(D) In relation to any Euro Preference Shares designated as:

- (1) “Series 1”, 30 June 2012;
- (2) “Series 2”, 24 March 2014;
- (3) “Series 3”, 29 March 2016.”;

(d) by deleting the words “, on a poll,” from Article 55.3(e) so that Article 55.3(e) reads as follows:

“(e) with reasonable prominence, that a member entitled to attend and vote is entitled to appoint one or more proxies to attend and vote instead of him and that a proxy need not also be a member.”;

(e) by inserting the following new Article as Article 56A:

“56A Postponement of General Meetings

If the Board, in its absolute discretion, considers that it is impractical or unreasonable for any reason to hold a general meeting on the date or at the time or place specified in the notice calling the general meeting, it may postpone the general meeting to another date, time and/or place. The Board shall take reasonable steps to ensure that notice of the date, time and place of the postponed meeting is provided to any member trying to attend the meeting at the original time and place. When a meeting is so postponed, notice of the date, time and place of the postponed meeting shall be given in such manner as the Board may in its absolute discretion determine. Notice of the business to be transacted at such postponed meeting shall not be required. If a meeting is postponed in accordance with this Article, the appointment of a proxy will be valid if it is delivered and received as required by these Articles not less than 48 hours before the time appointed for holding the postponed meeting. The Board may (for the avoidance of doubt) also postpone any meeting which has been rearranged under this Article 56A.”;

(f) by deleting the existing Article 57 and substituting therefor the following new Article 57:

“57 Special Business

57.1 All business that is transacted at a general meeting shall be deemed special, except the following transactions at an annual general meeting:

- (a) the declaration of dividends;
- (b) the receipt and consideration of the annual accounts, the Directors’ Report, the Directors’ Remuneration Report, the Auditors’ report and any other documents required to be annexed to the annual accounts;
- (c) the election or re-election of Directors;
- (d) the re-appointment of the Auditors retiring (unless they were last appointed otherwise than by the Company in general meeting) and the determination of the remuneration of the Auditors or of the manner in which such remuneration is to be determined.”;

(g) by deleting the existing Article 61 and substituting therefor the following new Article 61:

“61 Entitlement to attend and speak

61.1 A Director shall, notwithstanding that he is not a member, be entitled to attend and speak at any general meeting and at any separate meeting of the holders of any class of shares of the Company. Any proxy appointed by a member shall also be entitled to speak at any general meeting of the Company.”;

(h) by inserting the words “or by proxy” after the words “every member who is present in person” where they first appear in Article 71.1 so that Article 71.1 reads as follows:

“71.1 Subject to the provisions of the Act and to any special terms as to voting on which any shares may have been issued or may for the time being be held and to any suspension or abrogation of voting rights pursuant to these Articles, at any general meeting every member who is present in person or by proxy shall on a show of hands have one vote and every member present in person or by proxy shall on a poll have one vote for every Ordinary Share of which he is the holder.”;

(i) by inserting the following new Article as Article 73A:

“73A Votes not counted where abstention required

73A.1 Where any member is, under the rules governing the listing of securities on any stock exchange on which all or any shares of the Company are for the time being listed or traded, required to abstain from voting on any particular resolution or restricted to voting only for or only against any particular resolution, any votes cast by or on behalf of such member in contravention of such requirement or restriction shall, notwithstanding the provision of any other Article, not be counted.”;

(j) by deleting “, but shall not confer any further right to speak at the meeting, except with the permission of the Chairman of the meeting or as otherwise determined by the Board where the relevant shares are held by a Depository” at the end of Article 75.1(b) and substituting therefor the words “and to speak at the meeting” so that Article 75.1(b) reads as follows:

“(b) be deemed (subject to any contrary direction contained in the same) to confer authority to demand or join in demanding a poll and to vote on any resolution or amendment of a resolution put to the meeting for which it is given, as the proxy thinks fit and to speak at the meeting; and”;

(k) by inserting the following new Article as Article 79A:

“79A Directors’ powers to establish verification procedures in connection with proxies

79A.1 From time to time the Directors may (consistently with the Act and these Articles) make such regulations and establish such procedures as they consider appropriate to receive and verify the appointment or revocation of a proxy. Any such regulations may be general or specific to a particular meeting. Without limitation, any regulations may include provisions that the Directors (or some person or persons appointed by them) may conclusively determine any matter or dispute relating:

- (a) to the appointment or revocation, or purported appointment or revocation, of a proxy; and/or
- (b) to any instruction contained or allegedly contained in any such appointment, and any such regulations may also include rebuttable or conclusive presumptions of any fact concerning those matters. The Directors may from time to time modify or revoke any such regulations as they think fit, provided that no subsisting valid appointment or revocation of a proxy or any voting instruction shall thereby be rendered invalid.”;
- (l) by deleting “(or, if such corporation is a Depositary acting in its capacity as such, persons)” from Article 80.1 and substituting therefor the words “or persons” so that the first sentence of Article 80.1 reads as follows:

“A corporation (whether or not a company within the meaning of the Act) which is a member may, by resolution of its directors or other governing body, authorise such person or persons as it thinks fit to act as its representative (or, as the case may be, representatives) at any meeting of the Company or at any separate meeting of the holders of any class of shares.”;

- (m) by deleting the words “not less than seven nor more than 42 clear days before the date appointed for the meeting” from Article 88.1(b) and substituting therefor the words “during the period commencing on the day after the despatch of the notice of the meeting and ending no later than seven clear days prior to the date of such meeting” so that Article 88.1 reads as follows:

“88.1 No person, other than a Director retiring (by rotation or otherwise), shall be appointed or re-appointed a Director at any general meeting unless:

- (a) he is recommended by the Board; or
- (b) during the period commencing on the day after despatch of the notice of the meeting and ending no later than seven clear days prior to the date of such meeting, notice duly executed by a member (other than the person to be proposed) qualified to vote at the meeting has been given to the Company of the intention to propose that person for appointment or re-appointment, stating the particulars which would, if he were so appointed or re-appointed, be required to be included in the Company’s register of Directors, together with notice executed by that person of his willingness to be appointed or re-appointed, is lodged at the Office.”;
- (n) by deleting the existing Article 91.2 and substituting therefor the following new Article 91.2:

“91.2 In addition to the Directors required to retire by rotation under Article 91.1, there shall also be required to retire by rotation:

- (a) any Director who at an annual general meeting of the Company shall have been a Director at each of the preceding two annual general meetings of the Company and who was not elected or re-elected at either such annual general meeting and who has not otherwise ceased to be a Director (either by resignation, retirement, removal or otherwise) and been re-elected by general meeting of the Company at or since either such annual general meeting; and

(b) any Director who has held office with the Company, other than employment or executive office, for a continuous period of nine years or more at the date of the annual general meeting.”;

(o) by deleting the existing Article 112.1 and substituting therefor the following new Article 112.1:

“112.1 The Board may delegate any of its powers, authorities and discretions (with power to sub-delegate) for such time on such terms and subject to such conditions as it thinks fit to any committee consisting of one or more Directors and (if thought fit) one or more other persons, provided that:

(a) where any committee constituted by the Board pursuant to this Article 112.1 consists of more than one member, not less than two members of such committee shall be Directors or alternate Directors; and

(b) no resolution of a committee shall be effective unless one of those present when it is passed is a Director (or his alternate).”;

(p) by deleting the existing Article 132 and substituting therefor the following new Article 132:

“132 Interested Director not to vote or count for quorum

132.1 Save as provided in this Article, a Director shall not vote on, or be counted in the quorum in relation to, any resolution of the Board or of a committee of the Board concerning any contract, arrangement, transaction or any proposal whatsoever to which the Company is or is to be a party and in which he or any of his associates has a material interest otherwise than by virtue of his interest or the interests of his associate(s) in shares or debentures or other securities of or otherwise in or through the Company unless the resolution concerns any of the following matters:

(a) the giving to him or his associate(s) of any guarantee, security or indemnity in respect of money lent or obligations incurred by him or any of them at the request of or for the benefit of the Company or any of its subsidiary undertakings;

(b) the giving to a third party of any guarantee, security or indemnity in respect of a debt or obligation of the Company or any of its subsidiary undertakings for which he or his associate(s) has himself/themselves assumed responsibility in whole or in part, either alone or jointly with others, under a guarantee or indemnity or by the giving of security;

(c) any proposal concerning an offer of shares or debentures or other securities of or by the Company or any of its subsidiary undertakings in which offer he or his associate(s) is/are or may be entitled to participate as a holder of securities or in the underwriting or sub-underwriting of which he is to participate;

(d) any proposal concerning any other body corporate in which he (together with his associates) does not to his knowledge have an interest (as the term is used in Part VI of the Act) in five per cent. or more of the issued equity share capital of any class of

such body corporate or of the voting rights available to members of such body corporate;

- (e) any proposal relating to an arrangement for the benefit of the employees of the Company or any of its subsidiary undertakings which does not award him any privilege or benefit not generally awarded to the employees to whom such arrangement relates; or
- (f) any proposal concerning insurance which the Company proposes to maintain or purchase for the benefit of the Directors or for the benefit of persons who include Directors.”;

- (q) by inserting the words “or the interests of his associate(s)” after the words “Director’s interest” in Article 134.1 so that Article 134.1 reads as follows:

“134.1 If any question arises at any meeting as to the materiality of a Director’s interest or the interests of his associate(s) (other than the Chairman’s interest) or as to the entitlement of any Director (other than the Chairman) to vote or be counted in a quorum, and such question is not resolved by his voluntarily agreeing to abstain from voting or being counted in the quorum, such question shall be referred to the Chairman of the meeting. The Chairman’s ruling in relation to the Director concerned shall be final and conclusive.”;

- (r) by inserting the words “or the interests of his associate(s)” after the words “Chairman’s interest” in Article 135.1 so that Article 135.1 reads as follows:

“135.1 If any question arises at any meeting as to the materiality of the Chairman’s interest or the interests of his associate(s) or as to the entitlement of the Chairman to vote or be counted in a quorum, and such question is not resolved by his voluntarily agreeing to abstain from voting or being counted in the quorum, such question shall be decided by resolution of the Directors or committee members present at the meeting (excluding the Chairman), whose majority vote shall be final and conclusive.”;

- (s) by deleting the word “and” at the end of Article 137.1(a);

- (t) by deleting “.” at the end of Article 137.1(b) and substituting therefor “; and”;

- (u) by inserting the following new Article as Article 137.1(c):

“(c) an “associate” of a Director shall mean any person who is for the purposes of the Act connected (which word shall have the meaning given thereto by section 346 of the Act) with a Director and any person who is an associate of a Director within the meaning of rule 1.01 of the rules governing the listing of securities on The Hong Kong Stock Exchange.”; and

- (v) by deleting the existing Article 168 and substituting therefor the following new Article 168:

“168 Right to indemnity

168.1 Subject to the provisions of the Act, but without prejudice to any indemnity to which he may be otherwise entitled, every Director, alternate Director, Secretary or other officer of the Company shall be entitled to be indemnified out of the assets of the Company against all

costs, charges, losses, damages and liabilities incurred by him in the actual or purported execution and/or discharge of his duties or exercise of his powers and/or otherwise in relation to or in connection with his duties, powers or office, provided that this Article 168.1 shall be deemed not to provide for, or entitle any such person to, indemnification to the extent that it would cause this Article 168.1, or any element of it, to be treated as void under the Act.”

Sir John Bond
Chairman

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS

of

HSBC Holdings plc

Passed 26 May 2006

At the Annual General Meeting of HSBC Holdings plc held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 26 May 2006, the following Resolutions were passed:

ORDINARY RESOLUTION

5 THAT the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 (“the Act”) to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of £100,000 and €100,000 (in each such case in the form of 10,000,000 non-cumulative preference shares), US\$85,500 (in the form of 8,550,000 non-cumulative preference shares) and US\$1,137,200,000 (in the form of Ordinary Shares of US\$0.50 each (“Ordinary Shares”)) provided that this authority shall be limited so that, otherwise than pursuant to:

- (a) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to:
 - (i) Ordinary Shareholders where the relevant securities respectively attributable to the interests of all Ordinary Shareholders are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them; and
 - (ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue,

but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions, obligations or legal problems under the laws of or the

- requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or
- (b) the terms of any share plan for employees of the Company or any of its subsidiary undertakings; or
 - (c) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or
 - (d) the allotment of up to 10,000,000 non-cumulative preference shares of £0.01 each, 8,550,000 non-cumulative preference shares of US\$0.01 each and 10,000,000 non-cumulative preference shares of €0.01 each in the capital of the Company,

the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority wholly for cash shall not in aggregate, together with any allotment of other equity securities authorised by sub-paragraph (b) of Resolution 6 set out in the Notice convening this Meeting, exceed US\$284,300,000 (being equal to approximately 5 per cent of the nominal amount of Ordinary Shares of the Company in issue at the latest practicable date prior to the printing of the Notice of this Meeting) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2007 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

- 6 THAT the Directors be and are hereby empowered pursuant to section 95 of the Companies Act 1985 (“the Act”):
- (a) subject to the passing of Resolution 5 set out in the Notice convening this Meeting, to allot equity securities (as defined by section 94 of the Act) the subject of the authority granted by Resolution 5; and
 - (b) to allot any other equity securities (as defined by section 94 of the Act) which are held by the Company in treasury,
- in each case as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2007 save that this power shall enable the Company before the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

ORDINARY RESOLUTIONS

- 7 THAT the Company be and is hereby generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of Ordinary Shares of US\$0.50 each in the capital of the Company (“Ordinary Shares”) and the Directors are authorised to exercise such authority provided that:

- (a) the maximum number of Ordinary Shares hereby authorised to be purchased is 1,137,200,000 Ordinary Shares;
 - (b) the minimum price (exclusive of expenses) which may be paid for each Ordinary Share is US\$0.50 (or the equivalent in the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of United States dollars with such other currency as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day (being a day on which banks are ordinarily open for the transaction of normal banking business in London) prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc);
 - (c) the maximum price (exclusive of expenses) which may be paid for each Ordinary Share is the lower of (i) 105 per cent of the average of the middle market quotations for the Ordinary Shares (as derived from the Daily Official List of the London Stock Exchange plc) for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased or (ii) 105 per cent of the average of the closing prices of the Ordinary Shares on The Stock Exchange of Hong Kong Limited for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased, in each case converted (where relevant) into the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of such currency with the currency in which the quotation and/or price is given as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc;
 - (d) unless previously revoked or varied this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2007; and
 - (e) the Company may prior to the expiry of this authority make a contract to purchase Ordinary Shares under this authority which will or may be executed wholly or partly after such expiry and may make a purchase of Ordinary Shares pursuant to any such contract.
- 8 THAT pursuant to Article 104.1 of the Articles of Association of the Company with effect from 1 January 2006 each non-executive Director (other than an alternate Director) shall be entitled to receive £65,000 per annum by way of fees for his or her services as a Director and no such fee shall be payable to any executive Director.

Sir John Bond
Chairman

THE COMPANIES ACTS 1985 AND 1989

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS

of

HSBC Holdings plc

Passed 25 May 2007

At the Annual General Meeting of HSBC Holdings plc held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 25 May 2007, the following Resolutions were passed:

ORDINARY RESOLUTION

5 THAT the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 ("the Act") to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of £100,000 and \$100,000 (in each such case in the form of 10,000,000 non-cumulative preference shares), US\$85,500 (in the form of 8,550,000 non-cumulative preference shares) and US\$1,158,660,000 (in the form of Ordinary Shares of US\$0.50 each ("Ordinary Shares")) provided that this authority shall be limited so that, otherwise than pursuant to:

- (a) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to:
 - (i) Ordinary Shareholders where the relevant securities respectively attributable to the interests of all Ordinary Shareholders are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them; and
 - (ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue,

but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions, obligations or legal problems under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or

- (b) the terms of any share plan for employees of the Company or any of its subsidiary undertakings; or
- (c) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or

- (d) the allotment of up to 10,000,000 non-cumulative preference shares of £0.01 each, 10,000,000 non-cumulative preference shares of €0.01 each and 8,550,000 non-cumulative preference shares of US\$0.01 each in the capital of the Company,

the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority wholly for cash shall not in aggregate, together with any allotment of other equity securities authorised by sub-paragraph (b) of Resolution 6 set out in the Notice convening this Meeting, exceed US\$289,665,000 (being equal to approximately 5 per cent of the nominal amount of Ordinary Shares of the Company in issue at the latest practicable date prior to the printing of the Notice of this Meeting) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2008 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

- 6 THAT the Directors be and are hereby empowered pursuant to section 95 of the Companies Act 1985 (“the Act”):
- (a) subject to the passing of Resolution 5 set out in the Notice convening this Meeting, to allot equity securities (as defined by section 94 of the Act) the subject of the authority granted by Resolution 5; and
- (b) to allot any other equity securities (as defined by section 94 of the Act) which are held by the Company in treasury,
- in each case as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2008 save that this power shall enable the Company before the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

ORDINARY RESOLUTIONS

- 7 THAT the Company be and is hereby generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of Ordinary Shares of US\$0.50 each in the capital of the Company (“Ordinary Shares”) and the Directors are authorised to exercise such authority provided that:
- (a) the maximum number of Ordinary Shares hereby authorised to be purchased is 1,158,660,000 Ordinary Shares;
- (b) the minimum price (exclusive of expenses) which may be paid for each Ordinary Share is US\$0.50 (or the equivalent in the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of United States dollars with such other currency as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day (being a day on which banks are ordinarily open for the transaction of normal banking business in London) prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc);

- (c) the maximum price (exclusive of expenses) which may be paid for each Ordinary Share is the lower of (i) 105 per cent of the average of the middle market quotations for the Ordinary Shares (as derived from the Daily Official List of London Stock Exchange plc) for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased or (ii) 105 per cent of the average of the closing prices of the Ordinary Shares on The Stock Exchange of Hong Kong Limited for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased, in each case converted (where relevant) into the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of such currency with the currency in which the quotation and/or price is given as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc;
- (d) unless previously revoked or varied this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2008; and
- (e) the Company may prior to the expiry of this authority make a contract to purchase Ordinary Shares under this authority which will or may be executed wholly or partly after such expiry and may make a purchase of Ordinary Shares pursuant to any such contract.

8 THAT the Directors be and are hereby empowered:

- (a) to exercise the power conferred upon them by Article 151 of the Articles of Association of the Company (as from time to time varied) so that, to the extent and in the manner determined by the Directors, the holders of Ordinary Shares of US\$0.50 each in the Company (“Ordinary Shares”) be permitted to elect to receive new Ordinary Shares, credited as fully paid instead of all or part of any dividend (including interim dividends) payable up to the conclusion of the Annual General Meeting in 2012;
- (b) to capitalise from time to time the appropriate nominal amount or amounts of new shares of the Company falling to be allotted pursuant to elections made under the Company’s scrip dividend scheme out of the amount or amounts standing to the credit of any reserve account or fund of the Company, as the Directors may determine, to apply that sum in paying up in full the relevant number of such new shares and to allot such new shares pursuant to such elections; and
- (c) generally to implement the Company’s scrip dividend scheme on such terms and conditions as the Directors may from time to time determine and to take such other actions as the Directors may deem necessary or desirable from time to time in respect of the Company’s scrip dividend scheme.

9 THAT the Company be and is hereby generally and unconditionally authorised for the purposes of Part XA of the Companies Act 1985 (as amended) (“the Act”) to make donations to EU political organisations and to incur EU political expenditure (as such terms are defined in section 347A of the Act) up to a maximum aggregate amount of £250,000 provided that such authority shall expire on the earlier of the conclusion of the Annual General Meeting of the Company to be held in 2008 and the date on which the last of sections 239 and 362 to 379 (inclusive) of the Companies Act 2006 come into force.

“Save as aforesaid, and unless the context otherwise requires, words or expressions contained in these Articles shall bear the same meaning as in the Act or the 2006 Act, as appropriate.”;

- (f) by inserting into Article 79A.1 the words “, the 2006 Act” so that the introductory words of Article 79A.1 begin as follows:

“From time to time the Directors may (consistently with the Act, the 2006 Act and these Articles) make such regulations and establish such procedures as they consider appropriate to receive and verify the appointment or revocation of a proxy. Any such regulations may be general or specific to a particular meeting.”;
- (g) by deleting from Article 81.1, 81.3, 81.4(a), 81.5 and 81.6 the words “section 212 of the Act” and substituting therefor the words “section 793 of the 2006 Act”,

by deleting from Article 81.4(b) the words “section 212 of the Act” and substituting therefor the words “sections 820 to 825 of the 2006 Act”,

by deleting from Article 81.4(e)(i) the words “section 428 of the Act” and substituting therefor the words “section 974 of the 2006 Act”,

by deleting from Article 81.4(e)(ii) the words “section 207 of the Financial Services Act 1986” and substituting therefor the words “section 285 of the Financial Services and Markets Act 2000”, and

by deleting from Article 81.7 the words “section 216 of the Act” and substituting therefor the words “section 794 of the 2006 Act”;
- (h) by deleting Article 95;
- (i) by deleting from Article 132.1(d) the words “Part VI of the Act” and substituting therefor the words “Part 22 of the 2006 Act”;
- (j) by deleting the existing Article 159 and substituting therefor the following new Article 159:

“159 Form of Notices

159.1 Notwithstanding anything to the contrary in these Articles, any notice, document or information to be given, sent, issued, deposited, served or delivered (or the equivalent) to or by any person pursuant to these Articles (other than a notice calling a meeting of the Directors) shall be in writing and, if the Board in its absolute discretion considers appropriate for any purpose or purposes under these Articles, any such notice, document or information shall be deemed given, sent, issued, deposited, served or delivered (or the equivalent) where it is sent in electronic form to an address for the time being notified for that purpose to the person giving such notice, document or information, but subject always to the provisions of Article 162. In the case of notices or other documents or information sent in electronic form the Board may make this subject to such terms and conditions as it shall in its absolute discretion consider appropriate, subject to and in accordance with the provisions of the 2006 Act. Nothing in these Articles shall affect any requirement of the Act and the 2006 Act that any particular

offer, notice or other document or information be served in any particular manner.

- 159.2 For the purposes of these Articles, notices, documents or information may be sent in electronic form by the Company to a person where (i) such person has agreed (generally or specifically) that the notice, document or information may be sent or supplied in that form (and has not revoked that agreement), including on a website (ii) the notice, document or information (as the case may be) is a notice, document or information to which that agreement applies and (iii) in the case of a notice, document or information being made available on a website, a notice is sent to the person, in a manner for the time being agreed for that purpose between that person and the Company notifying such person, of (a) the publication of that notice, document or information on the website (b) the address of the website and (c) the place on that website where the notice, document or information may be accessed, and how it may be accessed, and in any such case the notification referred to in this Article 159.2 shall be treated as the relevant notice for the purposes of these Articles.
- 159.3 Subject to the 2006 Act, any notice, document or information is validly sent or supplied by the Company if it is made available on a website.
- 159.4 Subject to the members having resolved that the Company may send or supply notices, documents or information to members by making them available on a website, where the Company requests the agreement of a person to receive specified notices, documents or information by means of a website and the Company does not receive a response within the period of 28 days (or such shorter period as may be required by statute) from the date the Company's request was sent, such person shall be deemed to have agreed to receive such notices, documents or information by the means specified in the request.
- 159.5 The Company shall, at the request of a member, also provide such member, within 21 days of the receipt by the Company of the request, with a hard copy of any document sent in electronic form in accordance with these Articles.
- 159.6 Any amendment or revocation of a notification given to the Company under this Article 159 shall only take effect if it is delivered to the Company in writing, signed by the member and on actual receipt by the Company thereof.”;
- (k) by inserting the following new Article 159A:

“159A Authentication

- 159A.1 For the purposes of these Articles, the Company shall treat any document received by it as sufficiently authenticated if:
- (a) where the document is sent in hard copy form, it is signed by the person who sent it; or
 - (b) where the document is sent in electronic form, it has been authenticated in such manner as the Board may, in its absolute discretion, from time to time, determine,

provided that, where a document is sent or supplied to the Company by a person on behalf of another, the Board may, in its absolute discretion, request that the sender also provide such reasonable evidence of their authority to act on such other's behalf as the Board may specify before the document may be treated as sufficiently authenticated.”;

(l) by inserting the following new Article 162.4:

“162.4 Any notice, document or other information sent or supplied to a member by means of the Company's website, in accordance with Article 159, shall be deemed to have been received by the intended recipient when the material was first made available on the website or, if later, at the time the intended recipient received (or is deemed to have received) notice of the fact the material was available on the Company's website.”; and

(m) by deleting from Article 163.1 the words “section 212 of the Act” and substituting therefor the words “section 793 of the 2006 Act”.

Stephen Green
Chairman

THE COMPANIES ACT 2006

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS

of

HSBC Holdings plc

Passed 30 May 2008

At the Annual General Meeting of HSBC Holdings plc held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 30 May 2008, the following Resolutions were passed:

ORDINARY RESOLUTION

5 THAT the Directors be and they are hereby generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 (the "Act") to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of £100,000 and €100,000 (in each such case in the form of 10,000,000 non-cumulative preference shares), US\$85,500 (in the form of 8,550,000 non-cumulative preference shares) and US\$1,186,700,000 (in the form of Ordinary Shares of US\$0.50 each ("Ordinary Shares")) provided that this authority shall be limited so that, otherwise than pursuant to:

- (a) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to:
 - (i) Ordinary Shareholders where the relevant securities respectively attributable to the interests of all Ordinary Shareholders are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them; and
 - (ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue,

but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions, obligations or legal problems under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or

- (b) the terms of any share plan for employees of the Company or any of its subsidiary undertakings; or

- (c) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or
- (d) the allotment of up to 10,000,000 non-cumulative preference shares of £0.01 each, 10,000,000 non-cumulative preference shares of €0.01 each and 8,550,000 non-cumulative preference shares of US\$0.01 each in the capital of the Company,

the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority wholly for cash shall not in aggregate, together with any allotment of other equity securities authorised by sub-paragraph (b) of Resolution 6 set out in the Notice convening this Meeting, exceed US\$296,675,000 (being equal to approximately 5 per cent of the nominal amount of Ordinary Shares of the Company in issue at the latest practicable date prior to the printing of the Notice of this Meeting) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2009 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

- 6 THAT the Directors be and are hereby empowered pursuant to section 95 of the Companies Act 1985 (“the Act”):
- (a) subject to the passing of Resolution 5 set out in the Notice convening this Meeting, to allot equity securities (as defined by section 94 of the Act) the subject of the authority granted by Resolution 5; and
 - (b) to allot any other equity securities (as defined by section 94 of the Act) which are held by the Company in treasury,
- in each case as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2009 save that this power shall enable the Company before the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

ORDINARY RESOLUTION

- 7 THAT the Company be and is hereby generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of Ordinary Shares of US\$0.50 each in the capital of the Company (“Ordinary Shares”) and the Directors are authorised to exercise such authority provided that:
- (a) the maximum number of Ordinary Shares hereby authorised to be purchased is 1,186,700,000 Ordinary Shares;
 - (b) the minimum price (exclusive of expenses) which may be paid for each Ordinary Share is US\$0.50 (or the equivalent in the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of United States dollars with such other currency as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London

time) on the business day (being a day on which banks are ordinarily open for the transaction of normal banking business in London) prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc);

- (c) the maximum price (exclusive of expenses) which may be paid for each Ordinary Share is the lower of (i) 105 per cent of the average of the middle market quotations for the Ordinary Shares (as derived from the Daily Official List of London Stock Exchange plc) for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased or (ii) 105 per cent of the average of the closing prices of the Ordinary Shares on The Stock Exchange of Hong Kong Limited for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased, in each case converted (where relevant) into the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of such currency with the currency in which the quotation and/or price is given as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc;
- (d) unless previously revoked or varied this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2009; and
- (e) the Company may prior to the expiry of this authority make a contract to purchase Ordinary Shares under this authority which will or may be executed wholly or partly after such expiry and may make a purchase of Ordinary Shares pursuant to any such contract.

SPECIAL RESOLUTIONS

8 THAT the Articles of Association of the Company be and are hereby altered as follows:

- (a) by deleting from the definition of “recognised person” in Article 2.1 the words “section 185(4) of the Act” and substituting therefor the words “section 778(2) of the 2006 Act”;
- (b) by inserting at the end of the definition of “Principal Register” in Article 2.1 the words “and sections 121 and 128 of the 2006 Act” so that Article 2.1 reads as follows:

“Principal Register the register of members of the Company to be kept pursuant to section 352 of the Act and sections 121 and 128 of the 2006 Act”;
- (c) by inserting into the definition of “Secretary” in Article 2.1 before the word “Act” the word “2006”;
- (d) by deleting from Article 2.5 the words “or an extraordinary resolution shall also be effective, and where an extraordinary resolution is required a special resolution” so that Article 2.5 reads as follows:

“Where for any purpose an ordinary resolution of the Company is required, a special resolution shall also be effective.”;
- (e) by deleting from Article 35.1 the words “and without giving any reason”;

- (f) by inserting into Article 36.1 the words “, together with the reasons for the refusal,” so that Article 36.1 reads as follows:
“36.1 If the Board refuses to register a transfer of a share it shall, within two months after the date on which the transfer was lodged with the Company send notice of the refusal, together with the reasons for the refusal, to the transferee. Any instrument of transfer which the Board refuses to register shall (except in the case of suspected fraud) be returned to the person depositing it. All instruments of transfer which are registered may be retained by the Company.”;
- (g) by deleting from each of Articles 48.1, 49.1 and 166.2 the words “an extraordinary” and substituting therefor the words “a special”;
- (h) by inserting into in each of Articles 52.1, 55.2, 66.1, 71.1, 80.1, 92.1, 96.1, 97.1(b), 117.1, 141.1, 142.1, 143.1, 154.1, 168.1, 169.1 and 170.2(j) the word “2006” before the word “Act”;
- (i) by deleting from Article 54.1 the words “section 368 of the Act” and substituting therefor the words “sections 303-305 of the 2006 Act”;
- (j) by deleting the existing Article 55.1 and substituting therefor the following new Article 55.1:
“55.1 An annual general meeting shall be convened by not less than 21 clear days’ notice in writing. An extraordinary general meeting shall be convened by not less than 14 clear days’ notice in writing or such longer period as may be required by law from time to time.”;
- (k) by deleting from each of Articles 55.3(d) and 69.1 the words “or extraordinary”;
- (l) by inserting into Article 55.4 the words “and to any other person who may be entitled to receive it” so that Article 55.4 reads as follows:
“55.4 The notice shall be given to the members (other than any who, under the provisions of these Articles or of any restrictions imposed on any shares, are not entitled to receive notice from the Company), to the Directors, to the Auditors and to any other person who may be entitled to receive it.”;
- (m) by deleting from Article 55.5 the words “section 376(2)(b) of the Act” and substituting therefor the words “sections 314(2)(b) and 338 (3)(b) of the 2006 Act”;
- (n) by deleting from Article 66.1 the words “at the meeting” wherever they appear and substituting therefor the words “on the resolution”, by inserting the words “(excluding any voting rights attached to any shares in the Company held as treasury shares)” into Article 66.1 (c) and by inserting the words “(excluding shares in the Company conferring a right to vote on the resolution which are held as treasury shares)” into Article 66.1(d) so that Article 66.1 reads as follows:
“66.1 At any general meeting a resolution put to a vote of the meeting shall be decided on a show of hands, unless (before or on the declaration of the result of the show of hands) a poll is duly demanded. Subject to the provisions of the 2006 Act, a poll may be demanded by:
(a) the Chairman of the meeting; or
(b) by at least five members present in person or by proxy and entitled to vote on the resolution; or
(c) a member or members present in person or by proxy representing not less than one-tenth of the total voting rights of all the members

having the right to vote on the resolution (excluding any voting rights attached to any shares in the Company held as treasury shares); or

- (d) a member or members present in person or by proxy holding shares conferring a right to vote on the resolution, being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all the shares conferring that right (excluding shares in the Company conferring a right to vote on the resolution which are held as treasury shares).”;
- (o) by deleting from Article 79.1 the words “at least 48 hours before the commencement of the meeting or adjourned meeting or the taking of the poll at which the appointment of proxy is used” and substituting therefor the words “in the case of a meeting or adjourned meeting at which the appointment of proxy is used, at least 48 hours before the time for holding the meeting or adjourned meeting and, in the case of a poll taken more than 48 hours after it was demanded at which the appointment of proxy is used, at least 24 hours before the time appointed for the taking of the poll” so that Article 79.1 reads as follows:

“79.1 A vote given or poll demanded in accordance with the terms of an appointment of proxy shall be valid notwithstanding the death or mental disorder of the principal or the revocation of the appointment of proxy, or of the authority under which the appointment of proxy was executed or submitted, or the transfer of the share in respect of which the appointment of proxy is given, unless notice in writing of such death, mental disorder, revocation or transfer shall have been received by the Company at the Office, or at such other place or places or address as has or have been appointed for the deposit or receipt of appointments of proxy, in the case of a meeting or adjourned meeting at which the appointment of proxy is used, at least 48 hours before the time for holding the meeting or adjourned meeting and, in the case of a poll taken more than 48 hours after it was demanded at which the appointment of proxy is used, at least 24 hours before the time appointed for the taking of the poll.”;
- (p) by inserting into each of Articles 87.1, 109.1, 115.1 and 119.1 the words “and the 2006 Act” after the words “the Act” wherever they appear;
- (q) by inserting into Article 117.1 the words “(other than directors, former directors or shadow directors)” so that Article 117.1 reads as follows:

“117.1 The Board may exercise any power conferred on the Company by the 2006 Act to make provision for the benefit of persons (other than directors, former directors or shadow directors) employed or formerly employed by the Company or any of its subsidiaries in connection with the cessation or the transfer to any person of the whole or part of the undertaking of the Company or that subsidiary.”;
- (r) by inserting into Article 137.1(a) before the word “Act”, wherever it appears, the word “2006” and deleting the words “section 346” and substituting therefor the words “sections 252-256” so that the Article 137.1(a) reads as follows:

“(a) an interest of a person who is for the purposes of the 2006 Act connected (which word shall have the meaning given thereto by sections 252-256 of the 2006 Act) with a Director shall be treated as an interest of the Director.”;
- (s) by inserting into Article 137.1(c) before the word “Act”, wherever it appears, the word “2006” and deleting the words “section 346” and substituting therefor the words “sections 252-256” so that the Article 137.1(c) reads as follows:

- “(c) an “associate” of a Director shall mean any person who is for the purposes of the 2006 Act connected (which word shall have the meaning given thereto by sections 252-256 of the 2006 Act) with a Director and any person who is an associate of a Director within the meaning of rule 1.01 of the rules governing the listing of securities on The Hong Kong Stock Exchange.”;
- (t) by inserting into Article 138.1 after the words “the Act” the words “, the 2006 Act,”;
- (u) by inserting into Article 139.1 the words “or by a Director in the presence of a witness who attests the signature” so that Article 139.1 reads as follows:
- “139.1 A document signed by a Director and by the Secretary or by two Directors or by a Director in the presence of a witness who attests the signature and expressed (in whatever form of words) to be executed by the Company shall have the same effect as if it were executed under the Seal, provided that no instrument shall be so signed which makes it clear on its face that it is intended by the person or persons making it to have effect as a deed without the authority of a resolution of the Board or of a committee of the Board authorised in that behalf. An instrument or document which is executed by the Company as a deed shall not be deemed to be delivered by the Company solely as a result of it having been executed by the Company.”;
- (v) by inserting into Article 155.1 the words “and the 2006 Act (as appropriate)” so that Article 155.1 reads as follows:
- “155.1 The Board shall cause accounting records to be kept in accordance with the Act and the 2006 Act (as appropriate).”;
- (w) by deleting the existing Article 157.1 and substituting therefor the following new Article 157.1:
- “157.1 Except as provided in Article 158, the Directors’ and Auditors’ reports, together with copies of the balance sheet and every document required by the Act or the 2006 Act (as appropriate) to be annexed to the balance sheet and copies of the profit and loss account or income and expenditure account (subject to the provisions of section 230 of the Act or section 408 of the 2006 Act, as appropriate) shall, not less than 21 clear days before the annual general meeting before which they are to be laid, be delivered, sent by post or made available on the Company’s website to every member and holder of debentures of the Company, to the Auditors and to any other person who may be entitled to receive them. However, this Article shall not require a copy of those documents to be sent to any person who under the provisions of these Articles is not entitled to receive notices from the Company or of whose address the Company is unaware or to any holder of debentures of whose address the Company is unaware or to more than one of the joint holders of any shares or debentures. If all or any of the shares in or debentures of the Company are listed or dealt in on any stock exchange, there shall at the same time be forwarded to the secretary of that stock exchange such number of copies of each of those documents as the regulations of that stock exchange may require.”;
- (x) by deleting the existing Article 158.1 and substituting therefor the following new Article 158.1:
- “158.1 The Company may, in accordance with section 251 of the Act or sections 426- 429 and sections 434-435 of the 2006 Act (as appropriate) and any

regulations made under the Act or the 2006 Act (as appropriate) send a summary financial statement to any member, holder of debentures of the Company or other person who is entitled to receive notice of general meetings instead of or in addition to the documents referred to in Article 157. Where it does so, the statement shall be delivered, sent by post or made available on the Company's website to the member, holder of debentures of the Company or other person entitled to receive notice not less than 21 clear days before the annual general meeting before which those documents are to be laid."; and

(y) by inserting into Article 170.2(l) the words "or the 2006 Act (as appropriate)" so that Article 170.2(l) reads as follows:

"(l) the Board may utilise the relevant system to the fullest extent available from time to time in the exercise of the Company's powers or functions under the Act or the 2006 Act (as appropriate) or these Articles or otherwise in effecting any actions".

9 THAT, with effect from 1 October 2008, the Articles of Association of the Company be and are hereby altered as follows:

(a) by inserting into Article 130.1 the word "2006" before the word "Act" and deleting the words "Article 131 is" and substituting therefor the words "Articles 130A, if appropriate, and 131 are" so that the introductory words of Article 130.1 begin as follows:

"130.1 Subject to the provisions of the 2006 Act and provided that Articles 130A, if appropriate, and 131 are complied with, a Director, notwithstanding his office:";

(b) by deleting the existing Article 130.1(d) and substituting therefor the following new Article 130.1(d):

"(d) shall not be liable to account to the Company for any profit, remuneration or other benefit realised by any such office, employment, contract, arrangement, transaction or proposal or from any interest in any body corporate and no such contract, arrangement, transaction, proposal or interest shall be avoided on the grounds of any such interest or benefit nor shall the receipt of any such profit, remuneration or any other benefit constitute a breach of his duty under the 2006 Act not to accept benefits from third parties.";

(c) by inserting a new Article 130A as follows:

"130A Power of the Board to authorise conflicts of interest

130A.1 The Board may authorise any matter proposed to it in accordance with these Articles which would, if not so authorised, involve a breach by a Director of his duty to avoid conflicts of interest under section 175 of the 2006 Act, including, without limitation, any matter which relates to a situation in which a Director has, or can have, an interest which conflicts, or possibly may conflict, with the interest of the Company (including the exploitation of any property, information or opportunity, whether or not the Company could take advantage of it, but excluding any situation which cannot reasonably be regarded as likely to give rise to a conflict of interest). The provisions of this Article do not

apply to a conflict of interest arising in relation to a transaction or arrangement with the Company.

130A.2 Any such authorisation will be effective only if:

- (a) the matter arose on or after 1 October 2008;
- (b) any requirement as to quorum at the meeting at which the matter is considered is met without counting the Director in question or any other interested Director; and
- (c) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

130A.3 The Board may (whether at the time of the giving of the authorisation or subsequently) make any such authorisation subject to any limits or conditions it expressly imposes but such authorisation is otherwise given to the fullest extent permitted.

130A.4 The Board may vary or terminate any such authorisation at any time.”;

- (d) by deleting the existing Article 131 and substituting therefor the following new Articles 131, 131A, 131B and 131C:

“131 Declaration of interests

131.1 A Director shall declare the nature and extent of his interest in a matter within Article 130A to the other Directors.

131.2 A Director who is aware that he is in any way interested in a proposed transaction or arrangement with the Company must declare the nature and extent of his interest to the other Directors.

131.3 A Director who is aware that he is in any way interested in a transaction or arrangement that has been entered into by the Company must declare the nature and extent of his interest to the other Directors, unless the interest has already been declared under Article 131.2.

131.4 The declaration of interest must (in the case of Article 131.3) and may, but need not (in the case of Article 131.1 or 131.2), be made:

- (a) at a meeting of the Directors; or
- (b) by general or specific notice to the Directors in accordance with the 2006 Act.

131.5 If a declaration of interest, or deemed declaration of interest, proves to be, or becomes, inaccurate or incomplete, a further disclosure must be made.

131.6 Any declaration of interest required by Article 131.1 above must be made as soon as reasonably practicable.

131.7 Any declaration of interest required by Article 131.2 above must be made before the Company enters into the transaction or arrangement or, in the case of an interest which arose before 1 October 2008, at the first meeting of the Directors at which the question of entering into the proposed transaction or arrangement is first taken into consideration.

131.8 Any declaration of interest under Article 131.3 above must be made as soon as reasonably practicable. Failure to comply with this requirement does not affect the underlying duty to make the declaration of interest.

131.9 For the purposes of Articles 131.1, 131.2 and 131.3, a Director need not declare an interest which arose on or after 1 October 2008:

- (a) if it cannot reasonably be regarded as likely to give rise to a conflict of interest;
- (b) if, or to the extent that, the other Directors are already aware of it; or
- (c) if, or to the extent that, it concerns terms of his service contract that have been or are to be considered:
 - (i) by a meeting of the Directors; or
 - (ii) by a committee of the Directors appointed for the purpose under these Articles.

131A Entitlement to keep information confidential

131A.1 Subject to Article 131A.2, a Director shall be under no duty to the Company with respect to any information which he obtains or has obtained otherwise than as a Director of the Company and in respect of which he has a duty of confidentiality to another person. In particular, the Director shall not be in breach of the general duties he owes to the Company under sections 171-177 of the 2006 Act because he fails:

- (a) to disclose any such information to the Board or to any Director or other officer or employee of the Company; and/or
- (b) to use or apply any such information in performing his duties as a Director of the Company.

131A.2 To the extent that the relationship between a Director and a person to whom he owes a duty of confidentiality gives rise to a conflict of interest or possible conflict of interest, Article 131A.1 applies only if the existence of that relationship has been authorised by the Board pursuant to Article 130A.

131B Avoiding conflicts of interest

131B.1 Where the existence of a Director's relationship with another person has been authorised by the Board pursuant to Article 130A (and subject to any limits or conditions imposed pursuant to Article 130A.3) and his relationship with that person gives rise to a conflict of interest or possible conflict of interest, the Director shall not be in breach of the general duties he owes to the Company under sections 171-177 of the 2006 Act because he:

- (a) absents himself from meetings of the Board at which any matter relating to the conflict of interest or possible conflict of interest will or may be discussed or from the discussion of any such matter at a meeting or otherwise; and/or
- (b) makes arrangements not to receive documents and information relating to any matter which gives rise to the conflict of interest or possible conflict of interest sent or supplied by the Company and/or makes arrangements for such documents and information to be received and read by a professional adviser,

for so long as he reasonably believes such conflict of interest or possible conflict of interest subsists.

131C Overriding principles

131C.1 The provisions of Articles 131A and 131B are without prejudice to any equitable principle or rule of law which may excuse the Director from:

- (a) disclosing information in circumstances where disclosure would otherwise be required under these Articles; or
 - (b) attending meetings or discussions or receiving documents and information as referred to in Article 131B, in circumstances where such attendance or receiving such documents and information would otherwise be required under these Articles.”;
- (e) by deleting the word “or” from the end of Article 132.1(e) and inserting into the end of Article 132.1(f) the word “; or” and inserting into Article 132.1 the following new Article 132.1(g):
- “(g) the giving of any other indemnity or any proposal concerning the funding of expenditure by one or more Directors on defending proceedings against him or them, or doing anything to enable such Director or Directors to avoid incurring such expenditure, where all other Directors are also being offered indemnities or funding on substantially the same terms.”; and
- (f) by deleting the existing Article 137.1 and substituting therefor the following new Article 137.1:
- “137.1 For the purposes of Articles 130 to 137:
- (a) a conflict of interest includes a conflict of interest and duty and a conflict of duties;
 - (b) an interest means a direct or an indirect interest, and for these purposes an interest of a person who is for the purposes of the 2006 Act connected (which word shall have the meaning given thereto by sections 252-256 of the 2006 Act) with a Director shall be treated as an interest of the Director;
 - (c) an interest, transaction, arrangement or proposal of which a Director is aware includes an interest, transaction, arrangement or proposal of which that Director ought reasonably to be aware;
 - (d) in relation to an alternate Director, an interest of his appointor shall be treated as an interest of the alternate Director in addition to any interest which the alternate Director otherwise has; and
 - (e) an “associate” of a Director shall mean any person who is for the purposes of the 2006 Act connected (which word shall have the meaning given thereto by sections 252-256 of the 2006 Act) with a Director and any person who is an associate of a Director within the meaning of rule 1.01 of the rules governing the listing of securities on The Hong Kong Stock Exchange.”.

ORDINARY RESOLUTION

10 THAT the amended rules of the HSBC Share Plan (the main features of which are summarised in Appendix III to the Chairman’s letter to Shareholders dated 3 April 2008 and a copy of which has been signed for the purposes of identification by the

Chairman of the Meeting) are hereby approved and that the Directors are hereby authorised to do whatever may be necessary or expedient to carry the amended HSBC Share Plan into effect.

Stephen Green
Chairman

THE COMPANIES ACTS 1985, 1989 AND 2006

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS
of
HSBC Holdings plc

Passed 19 March 2009

At a General Meeting of HSBC Holdings plc held in the Platinum Suite, ExCel London, One Western Gateway, Royal Victoria Dock, London E16 1XL on Thursday, 19 March 2009, the following Resolutions were passed:

ORDINARY RESOLUTIONS

- 1 THAT the authorised share capital of the Company be and is hereby increased from US\$7,500,100,000, £401,500 and €100,000 to US\$10,500,100,000, £401,500 and €100,000 by the creation of an additional 6,000,000,000 ordinary shares of US\$0.50 each in the capital of the Company forming a single class with the existing ordinary shares of US\$0.50 each in the capital of the Company.
- 2 THAT, subject to the passing of Resolution 1 set out in the Notice convening this General Meeting, in addition to all subsisting authorities to the extent unused, the Directors be generally and unconditionally authorised pursuant to and for the purposes of section 80 of the UK Companies Act 1985 (the "Act"), to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of US\$2,530,200,000 in connection with the allotment of New Ordinary Shares (as defined in the circular of which the Notice convening this General Meeting forms part (the "Circular")), pursuant to the Rights Issue (as defined in the Circular) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2009 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

- 3 THAT, subject to the passing of Resolution 2 set out in the Notice convening this General Meeting, the Directors be and are hereby empowered to allot equity

securities (as defined by section 94 of the UK Companies Act 1985 (the “Act”)) the subject of the authority granted by Resolution 2 as if section 89(1) of the Act, where relevant, did not apply to any such allotment and in particular to make such allotment subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions, obligations or legal problems under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2009 save that this power shall enable the Company before the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

S K Green
Chairman

THE COMPANIES ACTS 1985, 1989 AND 2006

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS
of
HSBC Holdings plc

Passed 22 May 2009

At the Annual General Meeting of HSBC Holdings plc held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 22 May 2009, the following Resolutions were passed:

ORDINARY RESOLUTION

- 5 THAT the Directors be generally and unconditionally authorised pursuant to and for the purposes of section 80 of the Companies Act 1985 (the “Act”) to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of £100,000 (in the form of 10,000,000 non-cumulative preference shares of £0.01 each), €100,000 (in the form of 10,000,000 non-cumulative preference shares of €0.01 each), US\$85,500 (in the form of 8,550,000 non-cumulative preference shares of US\$0.01 each) and US\$1,720,481,200 (in the form of ordinary shares of US\$0.50 each in the capital of the Company (“Ordinary Shares”)) (the latter being equal to approximately 20 per cent of the nominal amount of Ordinary Shares of the Company in issue at the latest practicable date prior to the printing of the Notice of this Meeting, adjusted to take account of the 5,060,239,065 new Ordinary Shares to be issued in connection with the rights issue of the Company announced on 2 March 2009 (the “Enlarged Share Capital”)), provided that this authority shall be limited so that, otherwise than pursuant to:
- (a) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to:
- (i) holders of Ordinary Shares where the relevant securities respectively attributable to the interests of all holders of Ordinary Shares are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them; and
 - (ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue,
- but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or securities

represented by depositary receipts or having regard to any restrictions, obligations or legal problems under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever; or

- (b) the terms of any share plan for employees of the Company or any of its subsidiary undertakings; or
- (c) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or
- (d) the allotment of up to 10,000,000 non-cumulative preference shares of £0.01 each, 10,000,000 non-cumulative preference shares of €0.01 each and 8,550,000 non-cumulative preference shares of US\$0.01 each in the capital of the Company,

the nominal amount of relevant securities to be allotted by the Directors pursuant to this authority wholly for cash shall not in aggregate, together with any allotment of other equity securities authorised by sub-paragraph (b) of resolution 6 set out in the Notice convening this Meeting, exceed US\$430,120,300 (being equal to approximately 5 per cent of the Enlarged Share Capital) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2010 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

6 THAT, subject to the passing of resolution 5 set out in the Notice convening this Meeting, the Directors be and are hereby empowered pursuant to section 95 of the Companies Act 1985 (the "Act"):

- (a) to allot equity securities (as defined by section 94 of the Act) the subject of the authority granted by resolution 5; and
- (b) to allot any other equity securities (as defined by section 94 of the Act) which are held by the Company in treasury,

in each case as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall be limited to the allotment and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2010 save that this authority shall allow the Company before the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

ORDINARY RESOLUTION

7 THAT the Company be and is hereby generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of ordinary shares of US\$0.50 each in the capital of the Company ("Ordinary Shares") and the Directors are authorised to exercise such authority provided that:

- (a) the maximum number of Ordinary Shares hereby authorised to be purchased is 1,720,481,200 Ordinary Shares;
- (b) the minimum price (exclusive of expenses) which may be paid for each Ordinary Share is US\$0.50 (or the equivalent in the relevant currency in which the

purchase is effected calculated by reference to the spot rate of exchange for the purchase of United States dollars with such other currency as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day (being a day on which banks are ordinarily open for the transaction of normal banking business in London) prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc);

- (c) the maximum price (exclusive of expenses) which may be paid for each Ordinary Share is the lower of (i) 105 per cent of the average of the middle market quotations for the Ordinary Shares (as derived from the Daily Official List of London Stock Exchange plc) for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased or (ii) 105 per cent of the average of the closing prices of the Ordinary Shares on The Stock Exchange of Hong Kong Limited for the five dealing days immediately preceding the day on which the Ordinary Share is contracted to be purchased, in each case converted (where relevant) into the relevant currency in which the purchase is effected calculated by reference to the spot rate of exchange for the purchase of such currency with the currency in which the quotation and/or price is given as quoted by HSBC Bank plc in the London Foreign Exchange Market at or about 11.00 am (London time) on the business day prior to the date on which the Ordinary Share is contracted to be purchased, in each case such rate to be the rate as conclusively certified by an officer of HSBC Bank plc;
- (d) unless previously revoked or varied this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2010; and
- (e) the Company may prior to the expiry of this authority make a contract to purchase Ordinary Shares under this authority which will or may be executed wholly or partly after such expiry and may make a purchase of Ordinary Shares pursuant to any such contract.

SPECIAL RESOLUTIONS

- 8 THAT, with effect from 1 October 2009:
- (a) the Articles of Association of the Company be amended by deleting all the provisions of the Company's Memorandum of Association which, by virtue of section 28 of the Companies Act 2006, are to be treated as part of the Company's Articles of Association;
 - (b) the Articles of Association of the Company be amended by deleting all provisions referred to in paragraph 42 of Schedule 2 to the Companies Act 2006 (Commencement No.8, Transitional Provisions and Savings) Order 2008 (No.2860); and
 - (c) following (a) and (b) above having occurred, the Articles of Association produced to the Meeting and initialled by the Chairman of the Meeting for the purpose of identification be adopted as the Articles of Association of the Company in substitution for, and to the exclusion of, the existing Articles of Association.
- 9 THAT the Company hereby approves general meetings (other than annual general meetings) being called on 14 clear days' notice.

S K Green
Chairman

THE COMPANIES ACTS 1985, 1989 AND 2006

PUBLIC COMPANY LIMITED BY SHARES

RESOLUTIONS
of
HSBC Holdings plc

Passed 28 May 2010

At the Annual General Meeting of HSBC Holdings plc held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 28 May 2010, the following Resolutions were passed:

ORDINARY RESOLUTION

5 THAT the Directors be generally and unconditionally authorised pursuant to and for the purposes of section 551 of the Companies Act 2006 (the "Act") to exercise all the powers of the Company to allot shares in the Company and to grant rights to subscribe for, or to convert any security into, shares in the Company up to an aggregate nominal amount of £100,000 (in the form of 10,000,000 non-cumulative preference shares of £0.01 each), €100,000 (in the form of 10,000,000 non-cumulative preference shares of €0.01 each), US\$85,500 (in the form of 8,550,000 non-cumulative preference shares of US\$0.01 each) and US\$1,742,319,000 (in the form of 3,484,638,000 ordinary shares of US\$0.50 each in the capital of the Company ("Ordinary Shares")) (the latter being equal to approximately 20 per cent of the nominal amount of Ordinary Shares of the Company in issue at the latest practicable date prior to the printing of the Notice of this Meeting), provided that this authority shall be limited so that, otherwise than pursuant to:

- (a) a rights issue or other issue the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to:
 - (i) holders of Ordinary Shares where the shares respectively attributable to the interests of all holders of Ordinary Shares are proportionate (or as nearly as may be) to the respective number of Ordinary Shares held by them; and
 - (ii) holders of securities, bonds, debentures or warrants which, in accordance with the rights attaching thereto, are entitled to participate in such a rights issue or other issue or as the Directors consider necessary,

but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to record dates, fractional entitlements or securities represented by depositary receipts or having regard to any restrictions, obligations, practical or legal problems under the laws of or the requirements of

- any regulatory body or stock exchange in any territory or otherwise howsoever; or
- (b) the terms of any share plan for employees of the Company or any of its subsidiary undertakings; or
 - (c) any scrip dividend scheme or similar arrangements implemented in accordance with the Articles of Association of the Company; or
 - (d) the allotment of up to 10,000,000 non-cumulative preference shares of £0.01 each, 10,000,000 non-cumulative preference shares of €0.01 each and 8,550,000 non-cumulative preference shares of US\$0.01 each in the capital of the Company,

the nominal amount of shares to be allotted or rights to subscribe for, or to convert any security into, shares to be granted by the Directors pursuant to this authority wholly for cash shall not in aggregate exceed US\$435,579,750 (being equal to approximately 5 per cent of the Ordinary Shares of the Company in issue at the latest practical date prior to the printing of the Notice of this Meeting) and such authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2011 save that this authority shall allow the Company before the expiry of this authority to make offers or agreements which would or might require shares to be allotted or rights to subscribe for, or to convert any security into, shares to be granted after such expiry and the Directors may allot shares or grant rights to subscribe for, or to convert any security into, shares (as the case may be) in pursuance of such offers or agreements as if the authority conferred hereby had not expired.

SPECIAL RESOLUTION

- 6 THAT, subject to the passing of resolution 5 set out in the Notice convening this Meeting, the Directors be and are hereby empowered pursuant to section 570 of the Companies Act 2006 (the "Act") to allot equity securities (within the meaning of section 560 of the Act) the subject of the authority granted by resolution 5 as if section 561 (1) of the Act did not apply to any such allotment, provided that this power shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2011 save that this authority shall allow the Company before the expiry of this power to make offers or agreements which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired.

SPECIAL RESOLUTION

- 7 THAT the Articles of Association of the Company be and are hereby altered as follows:
- (a) by deleting Article 55.2 in its entirety and renumbering the remainder of Article 55 accordingly;
 - (b) by inserting into Article 55.2 (as renumbered pursuant to paragraph (a) of this Resolution) the words "include such statements as are required by the Act and shall in any event" so that Article 55.2 shall begin as follows:
"The notice shall include such statements as are required by the Act and shall in any event specify";

- (c) by deleting from Article 60.1 the words “the same day in the next week at the same time and place, or to such other day” and substituting therefor the words “such day (being not less than ten clear days after the original meeting)” so that Article 60.1 reads as follows:

“If within 15 minutes (or such longer interval as the Chairman in his absolute discretion thinks fit) from the time appointed for the holding of a general meeting a quorum is not present, or if during a meeting such a quorum ceases to be present, the meeting shall stand adjourned to such day (being not less than ten clear days after the original meeting) and at such time and place as the Chairman (or, in default, the Board) may determine. If at such adjourned meeting a quorum is not present within 15 minutes from the time appointed for holding the meeting, one person entitled to attend and to vote on the business to be transacted, being a member or a proxy for a member or a duly authorised representative of a corporation which is a member, shall be a quorum.”;

- (d) by inserting into Article 73.3 the words “, subject to the Act,” and deleting the words “, on a poll,” so that Article 73.3 reads as follows:

“Where in England or elsewhere a receiver or other person (by whatever name called) has been appointed by any court claiming jurisdiction to exercise powers with respect to the property or affairs of any member on the ground (however formulated) of mental disorder, the Board may, subject to the Act, in its absolute discretion, on or subject to production of such evidence of the appointment as the Board may require, permit such receiver or other person to vote in person or by proxy on behalf of such member at any general meeting. Evidence to the satisfaction of the Board of the authority of the person claiming to exercise the right to vote shall be deposited at the Office, or deposited or received at such other place or address as is specified in accordance with these Articles for the deposit or receipt of appointments of proxy, not less than 48 hours before the time appointed for holding the meeting or adjourned meeting at which the right to vote is to be exercised, and in default the right to vote shall not be exercisable. For the purpose of calculating the 48 hour period, the Directors can decide, in their absolute discretion, not to take account of any part of a day that is not a working day.”;

- (e) by deleting Article 74 in its entirety and renumbering Articles 75, 76 and 77 accordingly;

- (f) by inserting into Article 76 (as renumbered pursuant to paragraph (e) of this Resolution) the following new Articles 76.2 to 76.4:

“76.2 Every proxy who has been appointed by one or more members entitled to vote on the resolution shall, on a show of hands, have one vote unless Article 76.3 applies.

76.3 Every proxy who has been appointed by more than one member entitled to vote on the resolution shall, on a show of hands, have two votes, one vote for and one against the resolution, if either:

- (a) one or more of the members have instructed the proxy to vote for the resolution and one or more of the members have instructed the proxy to vote against the resolution; or
- (b) one or more of the members have instructed the proxy to vote for the resolution and one or more of the members have given the proxy discretion as to how to vote in respect of the resolution and the proxy exercises that discretion by voting against the resolution; or

- (c) one or more of the members have instructed the proxy to vote against the resolution and one or more of the members have given the proxy discretion as to how to vote in respect of the resolution and the proxy exercises that discretion by voting for the resolution.

76.4 Every proxy who has been appointed by one or more members entitled to vote on the resolution shall, on a poll, have one vote for each share in respect of which the proxy has been appointed"; and

- (g) by inserting a new Article 77 as follows:

"77 Validity of votes by proxies and corporate representatives

77.1 A vote given by a proxy or by a corporate representative shall be valid notwithstanding that the proxy or corporate representative has failed to vote in accordance with the instructions of the member by whom the proxy or corporate representative was appointed and the Company shall be under no obligation to check any vote so given is in accordance with any such instructions."

ORDINARY RESOLUTION

8 THAT:

- (a) the amendment to the trust deed and rules of the HSBC Holdings UK Share Incentive Plan ("UK SIP") (the main features of which are summarised in Appendix II to the Chairman's letter to Shareholders dated 30 March 2010 and copies of the trust deed and rules as proposed to be amended have been signed for the purposes of identification by the Chairman of the Meeting) to extend the termination date of the UK SIP from 29 May 2010 to 28 May 2020 is hereby approved and that the Directors are hereby authorised to do whatever may be necessary or expedient to carry the amended UK SIP into effect including making such changes as may be necessary or expedient to secure the approval of HM Revenue & Customs under Schedule 2 to the Income Tax (Earnings and Pensions) Act 2003; and
- (b) the Directors are hereby authorised to establish for the benefit of non-United Kingdom resident employees of the Company or of any of its direct or indirect subsidiaries such further all-employee share incentive plans as the Directors shall from time to time consider appropriate, provided that:
 - (i) any such further plans are based on or similar to the UK SIP or any part or parts thereof but with such variations as the Directors may consider necessary or desirable, taking into account local tax, exchange control and securities laws in relevant overseas countries or territories; and
 - (ii) where ordinary shares of US\$0.50 each in the capital of the Company ("Ordinary Shares") made available under such further plans are newly issued such Ordinary Shares shall be counted against the overall limit applicable to the Company's employee share plans,

and so that for this purpose establishing a plan also includes participating in any plan established or operated by any direct or indirect subsidiary or establishing or participating in a sub-plan or adopting such other method or approach as the Directors consider appropriate to achieve the relevant objectives.

SPECIAL RESOLUTION

- 9 THAT the Company hereby approves general meetings (other than annual general meetings) being called on a minimum of 14 clear days' notice.

S K Green
Chairman

THE COMPANIES ACT 1948
and
THE COMPANIES ACTS 1985 AND 1989
and
THE COMPANIES ACT 2006
PUBLIC COMPANY LIMITED BY SHARES

MEMORANDUM OF ASSOCIATION

(As altered by Special Resolutions passed on 20 July 1981, 18 December 1990, 25 March 1991 and 28 May 1999, which came into effect on 2 July 1999, and as altered by virtue of section 28 of the Companies Act 2006 and by Special Resolution passed on 22 May 2009, which came into effect on 1 October 2009)

OF

HSBC Holdings plc

We, the several persons whose names, addresses and descriptions are subscribed, are desirous of being formed into a Company in pursuance of this Memorandum of Association, and we respectively agree to take the number of shares in the capital of the Company set opposite our respective names.

NAMES AND ADDRESSES AND DESCRIPTION OF SUBSCRIBERS	Number of Shares taken by each Subscriber
JEAN HERBERT 156 Strand London WC2 <i>Company Director</i>	One
THOMAS ARTHUR HERBERT 156 Strand London WC2 <i>Barrister-at-Law</i>	One

Dated the 18th day of January 1956

WITNESS to the above Signatures

CHRISTINE FREDA HERBERT

7 The Avenue

Muswell Hill

London N10

Company Director

**ARTICLES OF ASSOCIATION
CONTENTS**

<i>Article No</i>	<i>Page</i>
PRELIMINARY	
1 Other regulations not to apply	8
2 Interpretation	8
3 Limited liability	12
4 Registered office	12
SHARE CAPITAL	
5 Share capital	12
6 Rights of the Sterling Preference Shares	12
7 Rights of the Dollar Preference Shares	20
8 Rights of the Euro Preference Shares	27
9 Rights of the Non-voting Deferred Shares	35
10 Allotment	36
11 Redeemable shares	36
12 Power to attach rights	37
13 Share warrants to bearer	37
14 Commission and brokerage	37
15 Trusts not to be recognised	37
SHARE CERTIFICATES	
16 Right to certificates	38
17 Replacement certificates	38
UNCERTIFICATED SHARES	
18 Uncertificated shares	39
LIEN ON SHARES	
19 Lien on shares not fully paid	41
20 Enforcement of lien by sale	41
21 Application of proceeds of sale	41
CALLS ON SHARES	
22 Calls	41
23 Interest on calls	42
24 Rights of member when call unpaid	42
25 Sums due on allotment treated as calls	42
26 Power to differentiate	42
27 Payment in advance of calls	42
28 Delegation of power to make calls	43
29 Indemnity against claims in respect of shares	43
FORFEITURE OF SHARES	
30 Notice if call not paid	44
31 Forfeiture for non-compliance	44
32 Notice after forfeiture	44
33 Forfeiture may be annulled	44
34 Surrender	44

<i>Article No</i>	<i>Page</i>
35 Disposal of forfeited shares	44
36 Effect of forfeiture	45
37 Extinction of claims	45
38 Evidence of forfeiture	45
TRANSFER OF SHARES	
39 Form of transfer	46
40 Right to refuse registration	46
41 Notice of refusal	46
42 Fees on registration	47
43 Other powers in relation to transfers	47
TRANSMISSION OF SHARES	
44 On death	47
45 Election of person entitled by transmission	47
46 Rights on transmission	47
DESTRUCTION OF DOCUMENTS	
47 Destruction of documents	48
ALTERATION OF SHARE CAPITAL	
48 Increase, consolidation, sub-division and redenomination	49
49 Fractions	50
VARIATION OF CLASS RIGHTS	
50 Sanction to variation	51
51 Class meetings	51
52 Deemed variation	51
GENERAL MEETINGS	
53 Annual general meetings	52
54 Convening of general meetings	52
55 Notice of general meetings	52
56 Omission to send notice	53
57 Postponement of general meetings	53
58 Special business	53
PROCEEDINGS AT GENERAL MEETINGS	
59 Quorum	53
60 If quorum not present	54
61 Chairman	54
62 Entitlement to attend and speak	54
63 Power to adjourn	54
64 Notice of adjourned meeting	55
65 Business of adjourned meeting	55
66 Accommodation of members at meeting and security arrangements	55
67 Orderly conduct	56
VOTING	
68 Method of voting	56
69 Chairman's declaration conclusive on show of hands	56
70 Objection to error in voting	56
71 Amendment to resolutions	57
72 Procedure on a poll	57

<i>Article No</i>	<i>Page</i>
73 Votes of members	58
74 Restriction on voting rights for unpaid calls etc.	58
75 Votes not counted where abstention required	58
76 Voting by proxy	59
77 Validity of votes by proxies and corporate representatives	59
78 Form of proxy	59
79 Deposit or receipt of proxy	60
80 More than one proxy may be appointed	61
81 Board may supply proxy cards	61
82 Revocation of proxy	61
83 Directors' powers to establish verification procedures in connection with proxies	61
84 Corporate representative	62
85 Failure to disclose interests in shares	62
UNTRACED MEMBERS	
86 Power of sale	64
87 Application of proceeds of sale	66
APPOINTMENT, RETIREMENT AND REMOVAL OF DIRECTORS	
88 Number of Directors	66
89 Power of Company to appoint Directors	66
90 Power of Board to appoint Directors	66
91 Appointment of executive Directors	66
92 Eligibility of new Directors	66
93 Share qualification	67
94 Resolution for appointment	67
95 Retirement by rotation	67
96 Directors subject to retirement by rotation	67
97 Position of retiring Director	68
98 Deemed re-appointment	68
99 Removal by ordinary resolution	68
100 Vacation of office by Director	68
101 Resolution as to vacancy conclusive	69
ALTERNATE DIRECTORS	
102 Appointments	69
103 Participation in Board meetings	69
104 Alternate Director responsible for own acts	69
105 Interests of alternate Director	70
106 Revocation of appointment	70
DIRECTORS' REMUNERATION, EXPENSES AND PENSIONS	
107 Directors' fees	70
108 Expenses	70
109 Additional remuneration	71
110 Remuneration of executive Directors	71
111 Pensions and other benefits	71
POWERS AND DUTIES OF THE BOARD	
112 Powers of the Board	71
113 Powers of Directors being less than minimum number	71
114 Powers of executive Directors	72
115 Delegation to committees	72

<i>Article No</i>	<i>Page</i>
116 Local management	72
117 Power of attorney	73
118 Associate directors	73
119 Exercise of voting power	73
120 Provision for employees	73
121 Registers of members	74
122 Borrowing powers	75
PROCEEDINGS OF DIRECTORS AND COMMITTEES	
123 Board meetings	75
124 Notice of Board meetings	75
125 Quorum	75
126 Chairman of Board	76
127 Voting	76
128 Electronic participation in meetings	76
129 Resolution in writing	76
130 Proceedings of committees	77
131 Minutes of proceedings	77
132 Validity of proceedings	77
DIRECTORS' INTERESTS	
133 Director may have interests	77
134 Power of the Board to authorise conflicts of interest	78
135 Declaration of interests	78
136 Entitlement to keep information confidential	79
137 Avoiding conflicts of interest	80
138 Overriding principles	80
139 Interested Director not to vote or count for quorum	80
140 Director's interest in own appointment	81
141 Chairman's ruling conclusive on Director's interest	81
142 Directors' resolution conclusive on Chairman's interest	82
143 Definitions	82
THE SEAL	
144 Application of Seal	82
145 Deed without sealing	83
146 Official seal for use abroad	83
THE SECRETARY	
147 The Secretary	83
DIVIDENDS AND OTHER PAYMENTS	
148 Declaration of dividends	83
149 Interim dividends	84
150 Entitlement to dividends	84
151 Calls or debts may be deducted from dividends	84
152 Distribution in specie	84
153 Dividends not to bear interest	85
154 Method of payment	85
155 Uncashed dividends	85
156 Unclaimed dividends	86
157 Payment of scrip dividends	86
158 Reserves	87
159 Capitalisation of reserves	88

<i>Article No</i>	<i>Page</i>
160 Record dates	89
ACCOUNTS	
161 Accounting records	89
162 Inspection of records	89
163 Accounts to be sent to members	89
164 Summary financial statements	90
NOTICES	
165 Form of notices	90
166 Authentication	91
167 Service of notice on members	92
168 Notice in case of death, bankruptcy or mental disorder	92
169 Evidence of service	93
170 Notice binding on transferees	93
171 Notice by advertisement	93
172 Suspension of postal services	94
INDEMNITY	
173 Right to indemnity	94
174 Power to insure	94

THE COMPANIES ACT 2006

PUBLIC COMPANY LIMITED BY SHARES

ARTICLES OF ASSOCIATION

of

HSBC Holdings plc

(As adopted, with effect from and including 1 October 2009, by Special Resolution passed on 22 May 2009 and altered by Special Resolution passed on 28 May 2010)

PRELIMINARY

1 Other regulations not to apply

1.1 No regulations for management of a company set out in any schedule to any statute concerning companies or contained in any regulations or instrument made pursuant to a statute shall apply to the Company, but the following shall be the Articles of Association of the Company.

2 Interpretation

2.1 In these Articles, unless the context otherwise requires, the following expressions have the following meanings:

Expression	Meaning
Act	subject to Article 2.3, the Companies Act 2006 and, where the context requires, every other statute for the time being in force concerning companies and affecting the Company (including, without limitation, the Regulations)
address	in relation to any electronic communication includes any number or address used for the purposes of such communication
these Articles	these Articles of Association as altered or varied from time to time (and “Article” means one of these Articles)
Auditors	the auditors for the time being of the Company or, in the case of joint auditors, any one of them

Expression	Meaning
Board	the board of Directors for the time being of the Company or the Directors present at a duly convened meeting of Directors at which a quorum is present
cash memorandum account	an account so designated by the Operator of the relevant system
certificated share	a unit of a security held in certificated form
Chairman	the chairman (if any) of the Board or where the context requires, the chairman of a general meeting of the Company
clear days	(in relation to the period of a notice) that period, excluding the day when the notice is given or deemed to be given and the day for which it is given or on which it is to take effect
Company	HSBC Holdings plc
Depository	a custodian or other person (or a nominee for such custodian or other person) appointed under contractual arrangements with the Company or other arrangements approved by the Board whereby such custodian or other person or nominee holds or is interested in shares of the Company or rights or interests in shares of the Company and issues securities or other documents of title or otherwise evidencing the entitlement of the holder thereof to or to receive such shares, rights or interests, provided and to the extent that such arrangements have been approved by the Board prior to the date of adoption of these Articles or for the purpose of these Articles and shall include, where approved by the Board, the trustees (acting in their capacity as such) of any employees' share scheme established by the Company or any other scheme or arrangements principally for the benefit of employees of the Company and/or its subsidiaries which have been approved by the Board
Director	a director for the time being of the Company
dividend	a distribution or a bonus
Dollar Preference Share	a non-cumulative preference share of US\$0.01
electronic form	has the meaning given in the Act ¹ , and shall include provision of any information or document on a website, and references to "electronic copy", "electronic communication" and "electronic means" shall be construed accordingly
Euro Preference Share	a non-cumulative preference share of €0.01
execution	includes any mode of execution (and "executed" shall be construed accordingly)

¹ Section 1168 of the Act

hard copy	any document sent or supplied in a paper copy or similar form capable of being read by the recipient
holder	(in relation to any share) the member whose name is entered in the Register as the holder or, where the context permits, the members whose names are entered in the Register as joint holders, of that share
Hong Kong Overseas Branch Register	the register referred to in Article 121
The Hong Kong Stock Exchange	The Stock Exchange of Hong Kong Limited or other principal stock exchange in Hong Kong for the time being
member	a member of the Company
Office	the registered office for the time being of the Company
Operator	means Euroclear UK & Ireland Limited or such other person as may for the time being be approved by HM Treasury as Operator under the Regulations
Ordinary Share	an ordinary share of the Company
paid up	paid up or credited as paid up
Principal Register	the register of members of the Company to be kept pursuant to the Act ²
recognised person	a recognised clearing house or a nominee of a recognised clearing house or of a recognised investment exchange who is designated as mentioned in section 778(2) of the Act
Register	the Principal Register or the Hong Kong Overseas Branch Register or any Overseas Branch Register as is referred to in Article 121, as the case may be
Regulations	The Uncertificated Securities Regulations 2001 (SI 2001 No. 3755) including any modifications thereof and rules made thereunder or any regulations in substitution therefor for the time being in force made under the Act or any predecessor statute
relevant system	means a computer-based system and procedures which enable title to units of a security to be evidenced and transferred without a written instrument pursuant to the Regulations
Seal	any common seal of the Company or any official seal kept by the Company by virtue of the Act ³

² Section 113 of the Act

³ Section 45 of the Act

Secretary	the secretary for the time being of the Company or any other person appointed to perform any of the duties of the secretary of the Company including (subject to the provisions of the Act) a joint, temporary, assistant or deputy secretary
share	a share of the Company
Sterling Preference Share	a non-cumulative preference share of £0.01
The Stock Exchange	London Stock Exchange plc or other principal stock exchange in the United Kingdom for the time being
treasury shares	shares that have been purchased by the Company and are held in treasury in accordance with the Act ⁴
uncertificated share	a unit of a security held in uncertificated form which may, by virtue of the Regulations, be transferred by means of a relevant system
United Kingdom	Great Britain and Northern Ireland
writing or written	includes printing, typewriting, lithography, photography and any other mode or modes of representing or reproducing words in a legible and non-transitory form and, if the Board shall in its absolute discretion determine for any purpose or purposes under these Articles, subject to such terms and conditions as the Board may determine, electronic communications
£ (or sterling) and p or pence	pounds sterling and pence
US\$ or US dollars	United States dollars
€ or euro	the single currency adopted by those states participating in European Monetary Union from time to time

2.2 Unless the context otherwise requires:

- (a) words in the singular include the plural, and vice versa;
- (b) words importing the masculine gender include the feminine gender; and
- (c) a reference to a person includes a body corporate and an unincorporated body of persons.

2.3 A reference to any statute or provision of a statute shall include any orders regulations or other subordinate legislation made under it and shall, unless the context otherwise requires, include any statutory modification or re-enactment of any statute or provision of a statute for the time being in force.

⁴ Sections 724-732 of the Act

- 2.4 Save as aforesaid, and unless the context otherwise requires, words or expressions contained in these Articles shall bear the same meaning as in the Act.
- 2.5 Where for any purpose an ordinary resolution of the Company is required, a special resolution shall also be effective.
- 2.6 The headings are inserted for convenience only and shall not affect the construction of these Articles.
- 2.7 The footnotes (and references thereto) do not form part of these Articles and are included only by way of information.

3 Limited liability

- 3.1 The liability of the members is limited to the amount, if any, unpaid on the shares held by them.

4 Registered office

- 4.1 The Office shall be at such place in England and Wales as the Board shall from time to time appoint.

SHARE CAPITAL

5 Share capital

- 5.1 The Ordinary Shares rank pari passu in all respects.
- 5.2 Fully paid Ordinary Shares confer identical rights in respect of capital, dividends (save where and to the extent that any such share is issued on terms providing that it shall rank for dividend as from a particular date), voting and otherwise.

6 Rights of the Sterling Preference Shares

- 6.1 The following rights and restrictions shall be attached to any Sterling Preference Shares that may, from time to time, be in issue:
- (1) The Sterling Preference Shares shall rank pari passu inter se and with the Dollar Preference Shares and the Euro Preference Shares and with all other shares expressed to rank pari passu therewith. They shall confer the rights and be subject to the limitations set out in this Article 6. They shall also confer such further rights (not being inconsistent with the rights set out in this Article 6) and be subject to such further limitations and restrictions as may be attached by the Board to such shares prior to allotment. Whenever the Board has power under this Article 6 to determine any of the rights attached to any of the Sterling Preference Shares, the rights so determined need not be the same as those attached to the Sterling Preference Shares which have then been allotted or issued. The Sterling Preference Shares may be issued in one or more separate series and each series shall be identified in such manner as the Board may determine without any such determination or identification requiring any alteration to these Articles.

(2) Each Sterling Preference Share shall confer the following rights as to dividend and capital:

Income

(a) the right (subject to the provisions of sub-paragraph (4) of this Article 6, if applicable) in priority to the payment of any dividend to the holders of Ordinary Shares and any other class of shares of the Company in issue (other than (i) the Dollar Preference Shares, the Euro Preference Shares and any other shares expressed to rank pari passu therewith as regards income and (ii) any shares which by their terms rank in priority to the Sterling Preference Shares as regards income) to a non-cumulative preferential dividend in sterling payable at such rate (whether fixed, variable or floating or to be determined by a specified procedure, mechanism or formula) on such dates (each a “Dividend Payment Date”) and on such other terms and conditions as may be determined by the Board prior to allotment thereof;

Capital

(b) the right in a winding up of the Company (but not, unless otherwise provided by the terms of issue of such share, upon a redemption, reduction or purchase by the Company of any of its share capital) to receive in sterling out of the assets of the Company available for distribution to its members in priority to any payment to the holders of the Ordinary Shares and any other class of shares of the Company in issue (other than (i) the Dollar Preference Shares, the Euro Preference Shares and any other shares expressed to rank pari passu therewith as regards repayment of capital and (ii) any shares which by their terms rank in priority to the Sterling Preference Shares as regards repayment of capital):

(i) a sum equal to:

(A) the amount of any dividend which is due for payment after the date of commencement of the winding up but which is payable in respect of a period ending on or before such date; and

(B) if the date of commencement of the winding up falls before the last day of a period in respect of which a dividend would have been payable and which began before such date, any further amount of dividend which would have been payable had the day before such date been the last day of that period,

but only to the extent that any such amount or further amount was, or would have been, payable as a dividend in accordance with or pursuant to this Article 6; and

(ii) subject thereto, a sum equal to the amount paid up or credited as paid up on such share together with such premium (if any) as may be determined by the Board (or by a procedure, mechanism or formula determined by the Board) prior to allotment thereof (and so that the Board may determine that such premium is payable only in specified circumstances).

Limitations

(3) No Sterling Preference Share shall:

- (a) confer any right to participate in the profits or assets of the Company other than that set out in sub-paragraphs (2)(a) and (b) of this Article 6;
- (b) confer any right to participate in any offer or invitation by way of rights or otherwise to subscribe for additional shares or securities in the Company;
- (c) confer any right of conversion; or
- (d) confer any right to participate in any issue of bonus shares or shares issued by way of capitalisation of reserves.

Further provisions as to income

- (4) All or any of the following provisions shall apply in relation to any Sterling Preference Shares of any series (“relevant Sterling Preference Shares”) if so determined by the Board prior to allotment thereof:
 - (a) (i) if, on any Dividend Payment Date (“the relevant date”) on which a dividend (“the relevant dividend”) would otherwise fall to be paid on any relevant Sterling Preference Shares, the profits of the Company available for distribution are, in the opinion of the Board, insufficient to enable payment in full to be made of the relevant dividend, then the Board shall (after payment in full, or the setting aside of a sum required for payment in full, of all dividends payable on or before the relevant date on any shares in the capital of the Company in priority to the relevant Sterling Preference Shares) apply such profits, if any, in paying dividends to the holders of participating shares (as defined below) pro rata to the amounts of dividend on participating shares accrued and payable on or before the relevant date. For the purposes of this sub-paragraph, the expression “participating shares” shall mean the relevant Sterling Preference Shares and any other shares in the capital of the Company which rank pari passu as to participation in profits with the relevant Sterling Preference Shares and on which either (A) a dividend is payable on the relevant date or (B) arrears of cumulative dividend are unpaid at the relevant date;
 - (ii) if it shall subsequently appear that any such dividend which has been paid in whole or in part should not, in accordance with the provisions of this sub-paragraph (4), have been so paid, then provided the Board shall have acted in good faith, they shall not incur any liability for any loss which any member may suffer in consequence of such payment having been made;
 - (b) if the payment of any dividend on any relevant Sterling Preference Shares would breach or cause a breach of the capital adequacy requirements of the Financial Services Authority (or any successor organisation responsible for the supervision of banks in the United Kingdom) from time to time applicable to the Company and/or any of its subsidiaries, then none of such dividend shall be payable;
 - (c) if a dividend or any part thereof on any relevant Sterling Preference Shares is not paid for the reasons specified in sub-paragraphs (4)(a) or (b) above,

the holders of such shares shall have no claim in respect of such non-payment;

- (d) if any dividend on any relevant Sterling Preference Shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, the Company may not thereafter purchase or redeem any other share capital of the Company ranking pari passu with or after the relevant Sterling Preference Shares (and may not contribute any moneys to a sinking fund for any such purchase or redemption) until such time as dividends on the relevant Sterling Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or an amount equivalent thereto shall have been paid or set aside to provide for such payment in full);
- (e) if any dividend on any relevant Sterling Preference Shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, no dividend or other distribution may thereafter be declared or paid on any other share capital of the Company ranking as to dividend after the relevant Sterling Preference Shares until such time as dividends on the relevant Sterling Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or a sum shall have been paid or set aside to provide for such payment in full).

Redemption

- (5) (a) Unless otherwise determined by the Board in relation to Sterling Preference Shares of any series prior to allotment thereof, the Sterling Preference Shares shall, subject to the provisions of the Act⁵, be redeemable at the option of the Company.
- (b) In the case of any series of Sterling Preference Shares which are to be so redeemable:
 - (i) the Company may, subject to the provisions of the Act and sub-paragraph (5)(b)(ii) below, redeem on any Redemption Date (as hereinafter defined) all, but not merely some, of the Sterling Preference Shares of such series by giving to the holders of the Sterling Preference Shares to be redeemed not less than 30 days' nor more than 60 days' prior notice in writing (a "Notice of Redemption") of the relevant Redemption Date.

"Redemption Date" means, in relation to Sterling Preference Shares of a particular series, any date mentioned in any one of (A), (B) or (C) below, as determined by the Board prior to the first allotment of Sterling Preference Shares of that series:

 - (A) any date which falls on or after the First Redemption Date (as hereinafter defined); or
 - (B) the First Redemption Date or any subsequent Dividend Payment Date for Sterling Preference Shares of that series; or
 - (C) the First Redemption Date or any successive fifth anniversary thereof.

⁵ Sections 684-689 of the Act

“First Redemption Date” means:

- (D) in relation to any Sterling Preference Shares designated as “Series 1”, 30 June 2015;
- (E) in relation to any other Sterling Preference Shares of a particular series, one day after such one of the following dates as shall be determined by the Board prior to the first allotment of Sterling Preference Shares of that series:
 - (1) five years after the Relevant Date (as hereinafter defined);
 - (2) ten years after the Relevant Date;
 - (3) fifteen years after the Relevant Date;
 - (4) twenty years after the Relevant Date; or
 - (5) thirty years after the Relevant Date.

“Relevant Date” means, in relation to Sterling Preference Shares of a particular series, such one of the following dates as shall be determined by the Board prior to the first allotment of Sterling Preference Shares of that series:

- (F) the first date of allotment of Sterling Preference Shares of that series; or
- (G) the first Dividend Payment Date for Sterling Preference Shares of that series;
- (ii) if either of the restrictions in sub-paragraphs (4)(a) and (b) of this Article 6 applies to any dividend otherwise payable on any Redemption Date on the Sterling Preference Shares of that series, the Company may not redeem such Sterling Preference Shares on that Redemption Date;
- (iii) there shall be paid on each Sterling Preference Share so redeemed, in sterling, the aggregate of the nominal amount thereof and any premium credited as paid up on such share together with any dividend payable on the Redemption Date;
- (iv) any Notice of Redemption given under sub-paragraph (5)(b)(i) above shall specify the applicable Redemption Date, the particular Sterling Preference Shares to be redeemed and the redemption price, and shall state the place or places at which documents of title or such other evidence as may be accepted by the Board in respect of such Sterling Preference Shares are to be presented and surrendered for redemption and payment of the redemption moneys is to be effected. Upon such Redemption Date, the Company shall redeem the particular Sterling Preference Shares to be redeemed on that date subject to the provisions of this sub-paragraph (5) and of the Act⁶. No defect in the Notice of Redemption or in the giving thereof shall affect the validity of the redemption proceedings;
- (v) payments in respect of the amount due on redemption of a Sterling Preference Share shall be made by sterling cheque drawn on a bank in

⁶ Sections 684-689 of the Act

London or upon the request of the holder or joint holders not later than the date specified for the purpose in the Notice of Redemption by transfer to a sterling account maintained by the payee with a bank in London or by such other method as the Board may determine. Such payment will be made against presentation and surrender of the relative certificate at the place or one of the places specified in the Notice of Redemption or against such other evidence as may be accepted by the Board. All payments in respect of redemption moneys will in all respects be subject to any applicable fiscal or other laws;

- (vi) as from the relevant Redemption Date the dividend on the Sterling Preference Shares due for redemption shall cease to accrue except on any such Sterling Preference Shares in respect of which, upon due surrender of the certificate or other evidence aforesaid, payment of the redemption moneys due on such Redemption Date shall be improperly withheld or refused, in which case such dividend, at the rate then applicable, shall be deemed to have continued and shall accordingly continue to accrue from the relevant Redemption Date to the date of payment of such redemption moneys. Such Sterling Preference Shares shall not be treated as having been redeemed until the redemption moneys in question together with the accrued dividend thereon shall have been paid;
 - (vii) if the due date for the payment of the redemption moneys on any Sterling Preference Share is not a day (other than a Saturday or Sunday) on which commercial banks and foreign exchange markets settle payments in sterling and are open for general business in London (a "Sterling Business Day"), then payment of such moneys will be made on the next succeeding day which is a Sterling Business Day and without any interest or other payment in respect of such delay; and
 - (viii) the receipt of the holder for the time being of any Sterling Preference Shares (or, in the case of joint registered holders, the receipt of any one of them) for the moneys payable on redemption thereof shall constitute an absolute discharge to the Company in respect thereof.
- (c) Any Sterling Preference Shares redeemed pursuant to sub-paragraph (5) of this Article 6 shall be cancelled on redemption.

Purchase

- (6) Subject to the provisions of the Act⁷, the Company may at any time purchase any Sterling Preference Shares (i) in the market, (ii) by tender (available alike to all holders of the same class of Sterling Preference Shares) or (iii) by private treaty, in each case upon such terms as the Board shall determine.

Consolidation and division

- (7) Pursuant to the authority given by the passing of the resolution adopting these Articles the Board may consolidate and divide and/or sub-divide any Sterling Preference Shares into shares of a larger or smaller nominal amount.

⁷ Sections 690-708 of the Act

Attendance and voting at general meetings

- (8) (a) Save as provided by its terms of issue, no Sterling Preference Share shall carry any right to attend or vote at general meetings of the Company.
- (b) If so determined by the Board prior to allotment thereof, holders of Sterling Preference Shares of any series shall have the right to attend and vote at general meetings of the Company in the following circumstances:
- (i) if any dividend on any Sterling Preference Shares of that series in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, the right to attend and vote at general meetings of the Company until such time as dividends on those Sterling Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or a sum shall have been paid or set aside to provide for such payment in full); and
- (ii) in such other circumstances, and upon and subject to such terms, as the Board may determine prior to allotment of such Sterling Preference Shares.
- (c) Whenever holders of Sterling Preference Shares are entitled to vote on a resolution at a general meeting, on a show of hands every such holder who is present, in person or by proxy, shall have one vote and on a poll every such holder who is present, in person or by proxy, shall have one vote per Sterling Preference Share held by him or such number of votes per share as the Board shall determine prior to allotment of such share.
- (d) Holders of Sterling Preference Shares having a registered address or address for correspondence within the United Kingdom, or who have provided the Company with an address to which notices, documents or other information may be sent using electronic means, shall 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, documents and other information sent out by the Company to the holders of Ordinary Shares.

Further preference shares

- (9) The special rights attached to any Sterling Preference Shares of any series allotted or in issue shall not (unless otherwise provided by their terms of issue) be deemed to be varied by the creation or issue of any other preference shares or further shares in any currency ("new shares") ranking as regards participation in the profits and assets of the Company *pari passu* with such Sterling Preference Shares and so that any new shares ranking *pari passu* with such Sterling Preference Shares may either carry rights and restrictions identical in all respects with such Sterling Preference Shares or any of them or rights and restrictions differing therefrom in any respect including but without prejudice to the generality of the foregoing in that:
- (a) the rate of and/or basis of calculation of dividend may differ and the dividend may be cumulative or non-cumulative;
- (b) the new shares or any series thereof may rank for dividend as from such date as may be provided by the terms of issue thereof and the dates of payment of dividend may differ;

- (c) a premium may be payable on return of capital or there may be no such premium;
- (d) the new shares may be redeemable at the option of the holder or of the Company, or may be non-redeemable, and if redeemable at the option of the Company they may be redeemable at different dates and on different terms from those applying to the Sterling Preference Shares; and/or
- (e) the new shares may be convertible into Ordinary Shares or any other class of shares ranking as regards participation in the profits and assets of the Company pari passu with or after such Sterling Preference Shares in each case on such terms and conditions as may be prescribed by the terms of issue thereof.

Variation of class rights

(10) (a) Subject to the provisions of the Act⁸:

- (i) all or any of the rights, preferences, privileges, limitations or restrictions for the time being attached to the Sterling Preference Shares may from time to time (whether or not the Company is being wound up) be varied or abrogated with the consent in writing of the holders of not less than three-quarters in nominal value of the Sterling Preference Shares of all series in issue or with the sanction of a special resolution passed at a separate general meeting of the holders of the Sterling Preference Shares, voting as a single class without regard for series; and
 - (ii) all or any of the rights, preferences, privileges, limitations or restrictions for the time being attached to Sterling Preference Shares of any series may be varied or abrogated so as to affect adversely such rights on a basis different from any other series of Sterling Preference Shares with the consent in writing of the holders of not less than three-quarters in nominal value of the Sterling Preference Shares of such series or with the sanction of a special resolution passed at a separate general meeting of the holders of Sterling Preference Shares of such series.
- (b) All the provisions of these Articles as to general meetings of the Company shall mutatis mutandis apply to any such separate general meeting, but so that the necessary quorum shall be two persons holding or representing by proxy at least one-third in nominal value of the issued shares of the class, that every holder of shares of the class shall be entitled on a poll to one vote for every share of the class held by him, that any holder of shares of the class present in person or by proxy may demand a poll and that at any adjourned meeting of the holders one holder present in person or by proxy (whatever the number of shares held by him) shall be a quorum.
- (c) Unless otherwise provided by its terms of issue, the rights attached to any Sterling Preference Share shall not be deemed to be varied or abrogated by a reduction of any share capital or purchase by the Company or redemption of any share capital in each case ranking as regards participation in the profits and assets of the Company in priority to or pari passu with or after such Sterling Preference Share.

⁸ Sections 630-640 of the Act

7 Rights of the Dollar Preference Shares

7.1 The following rights and restrictions shall be attached to any Dollar Preference Shares that may, from time to time, be in issue:

- (1) The Dollar Preference Shares shall rank *pari passu* inter se and with the Sterling Preference Shares and the Euro Preference Shares and with all other shares expressed to rank *pari passu* therewith. They shall confer the rights and be subject to the limitations set out in this Article 7. They shall also confer such further rights (not being inconsistent with the rights set out in this Article 7) and be subject to such further limitations and restrictions as may be attached by the Board to such shares prior to allotment. Whenever the Board has power under this Article 7 to determine any of the rights attached to any of the Dollar Preference Shares, the rights so determined need not be the same as those attached to the Dollar Preference Shares which have then been allotted or issued. The Dollar Preference Shares may be issued in one or more separate series and each series shall be identified in such manner as the Board may determine without any such determination or identification requiring any alteration to these Articles.
- (2) Each Dollar Preference Share shall confer the following rights as to dividend and capital:

Income

- (a) the right (subject to the provisions of sub-paragraph (4) of this Article 7, if applicable) in priority to the payment of any dividend to the holders of Ordinary Shares and any other class of shares of the Company in issue (other than (i) the Sterling Preference Shares, the Euro Preference Shares and any other shares expressed to rank *pari passu* therewith as regards income and (ii) any shares which by their terms rank in priority to the Dollar Preference Shares as regards income) to a non-cumulative preferential dividend in US dollars payable at such rate (whether fixed, variable or floating or to be determined by a specified procedure, mechanism or formula) on such dates (each a "Dividend Payment Date") and on such other terms and conditions as may be determined by the Board prior to allotment thereof;

Capital

- (b) the right in a winding up of the Company (but not, unless otherwise provided by the terms of issue of such share, upon a redemption, reduction or purchase by the Company of any of its share capital) to receive in US dollars out of the assets of the Company available for distribution to its members in priority to any payment to the holders of the Ordinary Shares and any other class of shares of the Company in issue (other than (i) the Sterling Preference Shares, the Euro Preference Shares and any other shares expressed to rank *pari passu* therewith as regards repayment of capital and (ii) any shares which by their terms rank in priority to the Dollar Preference Shares as regards repayment of capital):
 - (i) a sum equal to:

- (A) the amount of any dividend which is due for payment after the date of commencement of the winding up but which is payable in respect of a period ending on or before such date; and
- (B) if the date of commencement of the winding up falls before the last day of a period in respect of which a dividend would have been payable and which began before such date, any further amount of dividend which would have been payable had the day before such date been the last day of that period

but only to the extent that any such amount or further amount was, or would have been, payable as a dividend in accordance with or pursuant to this Article 7; and

- (ii) subject thereto, a sum equal to the amount paid up or credited as paid up on such share together with such premium (if any) as may be determined by the Board (or by a procedure, mechanism or formula determined by the Board) prior to allotment thereof (and so that the Board may determine that such premium is payable only in specified circumstances).

Limitations

- (3) No Dollar Preference Share shall;
 - (a) confer any right to participate in the profits or assets of the Company other than that set out in sub-paragraphs (2)(a) and (b) of this Article 7;
 - (b) confer any right to participate in any offer or invitation by way of rights or otherwise to subscribe for additional shares or securities in the Company;
 - (c) confer any right of conversion; or
 - (d) confer any right to participate in any issue of bonus shares or shares issued by way of capitalisation of reserves.

Further provisions as to income

- (4) All or any of the following provisions shall apply in relation to any Dollar Preference Shares of any series (“relevant Dollar Preference Shares”) if so determined by the Board prior to allotment thereof:
 - (a) (i) if, on any Dividend Payment Date (“the relevant date”) on which a dividend (“the relevant dividend”) would otherwise fall to be paid on any relevant Dollar Preference Shares, the profits of the Company available for distribution are, in the opinion of the Board, insufficient to enable payment in full to be made of the relevant dividend, then the Board shall (after payment in full, or the setting aside of a sum required for payment in full, of all dividends payable on or before the relevant date on any shares in the capital of the Company in priority to the relevant Dollar Preference Shares) apply such profits, if any, in paying dividends to the holders of participating shares (as defined below) pro rata to the amounts of dividend on participating shares accrued and payable on or before the relevant date. For

the purposes of this sub-paragraph, the expression “participating shares” shall mean the relevant Dollar Preference Shares and any other shares in the capital of the Company which rank pari passu as to participation in profits with the relevant Dollar Preference Shares and on which either (A) a dividend is payable on the relevant date or (B) arrears of cumulative dividend are unpaid at the relevant date;

- (ii) if it shall subsequently appear that any such dividend which has been paid in whole or in part should not, in accordance with the provisions of this sub-paragraph (4), have been so paid, then provided the Board shall have acted in good faith, they shall not incur any liability for any loss which any member may suffer in consequence of such payment having been made;
- (b) if the payment of any dividend on any relevant Dollar Preference Shares would breach or cause a breach of the capital adequacy requirements of the Financial Services Authority (or any successor organisation responsible for the supervision of banks in the United Kingdom) from time to time applicable to the Company and/or any of its subsidiaries, then none of such dividend shall be payable;
- (c) if a dividend or any part thereof on any relevant Dollar Preference Shares is not paid for the reasons specified in sub-paragraphs (4)(a) or (b) above, the holders of such shares shall have no claim in respect of such non-payment;
- (d) if any dividend on any relevant Dollar Preference Shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, the Company may not thereafter purchase or redeem any other share capital of the Company ranking pari passu with or after the relevant Dollar Preference Shares (and may not contribute any moneys to a sinking fund for any such purchase or redemption) until such time as dividends on the relevant Dollar Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or an amount equivalent thereto shall have been paid or set aside to provide for such payment in full);
- (e) if any dividend on any relevant Dollar Preference Shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, no dividend or other distribution may thereafter be declared or paid on any other share capital of the Company ranking as to dividend after the relevant Dollar Preference Shares until such time as dividends on the relevant Dollar Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or a sum shall have been paid or set aside to provide for such payment in full).

Redemption

- (5) (a) Unless otherwise determined by the Board in relation to Dollar Preference Shares of any series prior to allotment thereof, the Dollar

Preference Shares shall, subject to the provisions of the Act⁹, be redeemable at the option of the Company.

- (b) In the case of any series of Dollar Preference Shares which are to be so redeemable:
- (i) the Company may, subject to the provisions of the Act, and sub-paragraph (5)(b)(ii) below, redeem on any Redemption Date (as hereinafter defined) all, but not merely some, of the Dollar Preference Shares of such series by giving to the holders of the Dollar Preference Shares to be redeemed not less than 30 days' nor more than 60 days' prior notice in writing (a "Notice of Redemption") of the relevant Redemption Date.

"Redemption Date" means, in relation to Dollar Preference Shares of a particular series, any date mentioned in any one of (A), (B) or (C) below, as determined by the Board prior to the first allotment of Dollar Preference Shares of that series:

- (A) any date which falls on or after the First Redemption Date (as hereinafter defined); or
- (B) the First Redemption Date or any subsequent Dividend Payment Date for Dollar Preference Shares of that series; or
- (C) the First Redemption Date or any successive fifth anniversary thereof.

"First Redemption Date" means:

- (D) in relation to any relevant Dollar Preference Shares designated as:
- (1) "Series 1", 30 June 2010;
 - (2) "Series 2", 30 June 2030; and
 - (3) "Series 3", 27 June 2013.
- (E) in relation to any other Dollar Preference Shares of a particular series, one day after such one of the following dates as shall be determined by the Board prior to the first allotment of Dollar Preference Shares of that series:
- (1) five years after the Relevant Date (as hereinafter defined);
 - (2) ten years after the Relevant Date;
 - (3) fifteen years after the Relevant Date;
 - (4) twenty years after the Relevant Date; or
 - (5) thirty years after the Relevant Date.

"Relevant Date" means, in relation to Dollar Preference Shares of a particular series, such one of the following dates as shall be

⁹ Sections 684-689 of the Act

determined by the Board prior to the first allotment of Dollar Preference Shares of that series:

- (F) the first date of allotment of Dollar Preference Shares of that series; or
- (G) the first Dividend Payment Date for Dollar Preference Shares of that series;
- (ii) if either of the restrictions in sub-paragraphs (4)(a) and (b) of this Article 7 applies to any dividend otherwise payable on any Redemption Date on the Dollar Preference Shares of that series, the Company may not redeem such Dollar Preference Shares on that Redemption Date;
- (iii) there shall be paid on each Dollar Preference Share so redeemed, in US dollars, the aggregate of the nominal amount thereof and any premium credited as paid up on such share together with any dividend payable on the Redemption Date;
- (iv) any Notice of Redemption given under sub-paragraph (5)(b)(i) above shall specify the applicable Redemption Date, the particular Dollar Preference Shares to be redeemed and the redemption price, and shall state the place or places at which documents of title or such other evidence as may be accepted by the Board in respect of such Dollar Preference Shares are to be presented and surrendered for redemption and payment of the redemption moneys is to be effected. Upon such Redemption Date, the Company shall redeem the particular Dollar Preference Shares to be redeemed on that date subject to the provisions of this sub-paragraph and of the Act¹⁰. No defect in the Notice of Redemption or in the giving thereof shall affect the validity of the redemption proceedings;
- (v) payments in respect of the amount due on redemption of a Dollar Preference Share shall be made by US Dollar cheque drawn on a bank in New York City or upon the request of the holder or joint holders not later than the date specified for the purpose in the Notice of Redemption by transfer to a US dollar account maintained by the payee with a bank in New York City or by such other method as the Board may determine. Such payment will be made against presentation and surrender of the relative certificate at the place or one of the places specified in the Notice of Redemption or against such other evidence as may be accepted by the Board. All payments in respect of redemption moneys will in all respects be subject to any applicable fiscal or other laws;
- (vi) as from the relevant Redemption Date the dividend on the Dollar Preference Shares due for redemption shall cease to accrue except on any such Dollar Preference Shares in respect of which, upon due surrender of the certificate or other evidence aforesaid, payment of the redemption moneys due on such Redemption Date shall be improperly withheld or refused, in

¹⁰ Sections 684-689 of the Act

which case such dividend, at the rate then applicable, shall be deemed to have continued and shall accordingly continue to accrue from the relevant Redemption Date to the date of payment of such redemption moneys. Such Dollar Preference Shares shall not be treated as having been redeemed until the redemption moneys in question together with the accrued dividend thereon shall have been paid;

- (vii) if the due date for the payment of the redemption moneys on any Dollar Preference Share is not a day (other than a Saturday or Sunday) on which commercial banks and foreign exchange markets settle payments in US dollars and are open for general business in London and New York City (a “Dollar Business Day”), then payment of such moneys will be made on the next succeeding day which is a Dollar Business Day and without any interest or other payment in respect of such delay; and
 - (viii) the receipt of the holder for the time being of any Dollar Preference Shares (or, in the case of joint registered holders, the receipt of any one of them) for the moneys payable on redemption thereof shall constitute an absolute discharge to the Company in respect thereof.
- (c) Any Dollar Preference Shares redeemed pursuant to sub-paragraph (5) of this Article 7 shall be cancelled on redemption.

Purchase

- (6) Subject to the provisions of the Act¹¹, the Company may at any time purchase any Dollar Preference Shares (i) in the market, (ii) by tender (available alike to all holders of the same class of Dollar Preference Shares) or (iii) by private treaty, in each case upon such terms as the Board shall determine.

Consolidation and division

- (7) Pursuant to the authority given by the passing of the resolution adopting these Articles the Board may consolidate and divide and/or sub-divide any Dollar Preference Shares into shares of a larger or smaller nominal amount.

Attendance and voting at general meetings

- (8) (a) Save as provided by its terms of issue, no Dollar Preference Share shall carry any right to attend or vote at general meetings of the Company.
- (b) If so determined by the Board prior to allotment thereof, holders of Dollar Preference Shares of any series shall have the right to attend and vote at general meetings of the Company in the following circumstances:
- (i) if any dividend on any Dollar Preference Shares of that series in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, the right to attend and vote

¹¹ Sections 690-708 of the Act

at general meetings of the Company until such time as dividends on those Dollar Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or a sum shall have been paid or set aside to provide for such payment in full); and

- (ii) in such other circumstances, and upon and subject to such terms, as the Board may determine prior to allotment of such Dollar Preference Shares.
- (c) Whenever holders of Dollar Preference Shares are entitled to vote on a resolution at a general meeting, on a show of hands every such holder who is present, in person or by proxy, shall have one vote and on a poll every such holder who is present, in person or by proxy, shall have one vote per Dollar Preference Share held by him or such number of votes per share as the Board shall determine prior to allotment of such share.
- (d) Holders of Dollar Preference Shares having a registered address or address for correspondence within the United Kingdom, or who have provided the Company with an address to which notices, documents or other information may be sent using electronic means, shall 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, documents and other information sent out by the Company to the holders of Ordinary Shares.

Further preference shares

- (9) The special rights attached to any Dollar Preference Shares of any series allotted or in issue shall not (unless otherwise provided by their terms of issue) be deemed to be varied by the creation or issue of any other preference shares or further shares in any currency ("new shares") ranking as regards participation in the profits and assets of the Company *pari passu* with such Dollar Preference Shares and so that any new shares ranking *pari passu* with such Dollar Preference Shares may either carry rights and restrictions identical in all respects with such Dollar Preference Shares or any of them or rights and restrictions differing therefrom in any respect including but without prejudice to the generality of the foregoing in that:
 - (a) the rate of and/or basis of calculation of dividend may differ and the dividend may be cumulative or non-cumulative;
 - (b) the new shares or any series thereof may rank for dividend as from such date as may be provided by the terms of issue thereof and the dates of payment of dividend may differ;
 - (c) a premium may be payable on return of capital or there may be no such premium;
 - (d) the new shares may be redeemable at the option of the holder or of the Company, or may be non-redeemable, and if redeemable at the option of the Company they may be redeemable at different dates and on different terms from those applying to the Dollar Preference Shares; and/or

- (e) the new shares may be convertible into Ordinary Shares or any other class of shares ranking as regards participation in the profits and assets of the Company *pari passu* with or after such Dollar Preference Shares in each case on such terms and conditions as may be prescribed by the terms of issue thereof.

Variation of class rights

- (10) (a) Subject to the provisions of the Act¹²:
 - (i) all or any of the rights, preferences, privileges, limitations or restrictions for the time being attached to the Dollar Preference Shares may from time to time (whether or not the Company is being wound up) be varied or abrogated with the consent in writing of the holders of not less than three-quarters in nominal value of the Dollar Preference Shares of all series in issue or with the sanction of a special resolution passed at a separate general meeting of the holders of the Dollar Preference Shares, voting as a single class without regard for series; and
 - (ii) all or any of the rights, preferences, privileges, limitations or restrictions for the time being attached to Dollar Preference Shares of any series may be varied or abrogated so as to affect adversely such rights on a basis different from any other series of Dollar Preference Shares with the consent in writing of the holders of not less than three-quarters in nominal value of the Dollar Preference Shares of such series or with the sanction of a special resolution passed at a separate general meeting of the holders of Dollar Preference Shares of such series.
- (b) All the provisions of these Articles as to general meetings of the Company shall *mutatis mutandis* apply to any such separate general meeting, but so that the necessary quorum shall be two persons holding or representing by proxy at least one-third in nominal value of the issued shares of the class, that every holder of shares of the class shall be entitled on a poll to one vote for every share of the class held by him, that any holder of shares of the class present in person or by proxy may demand a poll and that at any adjourned meeting of the holders one holder present in person or by proxy (whatever the number of shares held by him) shall be a quorum.
- (c) Unless otherwise provided by its terms of issue, the rights attached to any Dollar Preference Share shall not be deemed to be varied or abrogated by a reduction of any share capital or purchase by the Company or redemption of any share capital in each case ranking as regards participation in the profits and assets of the Company in priority to or *pari passu* with or after such Dollar Preference Share.

8 Rights of the Euro Preference Shares

- 8.1 The following rights and restrictions shall be attached to any Euro Preference Shares that may, from time to time, be in issue:

¹² Sections 630-640 of the Act

(1) The Euro Preference Shares shall rank pari passu inter se and with the Dollar Preference Shares and the Sterling Preference Shares and with all other shares expressed to rank pari passu therewith. They shall confer the rights and be subject to the limitations set out in this Article 8. They shall also confer such further rights (not being inconsistent with the rights set out in this Article 8) and be subject to such further limitations and restrictions as may be attached by the Board to such shares prior to allotment. Whenever the Board has power under this Article 8 to determine any of the rights attached to any of the Euro Preference Shares, the rights so determined need not be the same as those attached to the Euro Preference Shares which have then been allotted or issued. The Euro Preference Shares may be issued in one or more separate series and each series shall be identified in such manner as the Board may determine without any such determination or identification requiring any alteration to these Articles.

(2) Each Euro Preference Share shall confer the following rights as to dividend and capital:

Income

(a) the right (subject to the provisions of sub-paragraph (4) of this Article 8, if applicable) in priority to the payment of any dividend to the holders of Ordinary Shares and any other class of shares of the Company in issue (other than (i) the Dollar Preference Shares, the Sterling Preference Shares and any other shares expressed to rank pari passu therewith as regards income and (ii) any shares which by their terms rank in priority to the Euro Preference Shares as regards income) to a non-cumulative preferential dividend in euro payable at such rate (whether fixed, variable or floating or to be determined by a specified procedure, mechanism or formula) on such dates (each a "Dividend Payment Date") and on such other terms and conditions as may be determined by the Board prior to allotment thereof;

Capital

(b) the right in a winding up of the Company (but not, unless otherwise provided by the terms of issue of such share, upon a redemption, reduction or purchase by the Company of any of its share capital) to receive in euro out of the assets of the Company available for distribution to its members in priority to any payment to the holders of the Ordinary Shares and any other class of shares of the Company in issue (other than (i) the Dollar Preference Shares, the Sterling Preference Shares and any other shares expressed to rank pari passu therewith as regards repayment of capital and (ii) any shares which by their terms rank in priority to the Euro Preference Shares as regards repayment of capital):

(i) a sum equal to:

(A) the amount of any dividend which is due for payment after the date of commencement of the winding up but which is payable in respect of a period ending on or before such date; and

(B) if the date of commencement of the winding up falls before the last day of a period in respect of which a dividend would have been payable and which began before such date, any further amount of dividend which would have been payable had the day before such date been the last day of that period

but only to the extent that any such amount or further amount was, or would have been, payable as a dividend in accordance with or pursuant to this Article 8; and

- (ii) subject thereto, a sum equal to the amount paid up or credited as paid up on such share together with such premium (if any) as may be determined by the Board (or by a procedure, mechanism or formula determined by the Board) prior to allotment thereof (and so that the Board may determine that such premium is payable only in specified circumstances).

Limitations

- (3) No Euro Preference Share shall;
 - (a) confer any right to participate in the profits or assets of the Company other than that set out in sub-paragraphs (2)(a) and (b) of this Article 8;
 - (b) confer any right to participate in any offer or invitation by way of rights or otherwise to subscribe for additional shares or securities in the Company;
 - (c) confer any right of conversion; or
 - (d) confer any right to participate in any issue of bonus shares or shares issued by way of capitalisation of reserves.

Further provisions as to income

- (4) All or any of the following provisions shall apply in relation to any Euro Preference Shares of any series (“relevant Euro Preference Shares”) if so determined by the Board prior to allotment thereof;
 - (a) (i) if, on any Dividend Payment Date (“the relevant date”) on which a dividend (“the relevant dividend”) would otherwise fall to be paid on any relevant Euro Preference Shares, the profits of the Company available for distribution are, in the opinion of the Board, insufficient to enable payment in full to be made of the relevant dividend, then the Board shall (after payment in full, or the setting aside of a sum required for payment in full, of all dividends payable on or before the relevant date on any shares in the capital of the Company in priority to the relevant Euro Preference Shares) apply such profits, if any, in paying dividends to the holders of participating shares (as defined below) pro rata to the amounts of dividend on participating shares accrued and payable on or before the relevant date. For the purposes of this sub-paragraph, the expression “participating shares” shall mean the relevant Euro Preference Shares and any other shares in the capital of the Company which rank *pari passu* as to participation in profits with the relevant Euro Preference Shares and on which either (A) a dividend is payable on the relevant date or (B) arrears of cumulative dividend are unpaid at the relevant date;
 - (ii) if it shall subsequently appear that any such dividend which has been paid in whole or in part should not, in accordance with the provisions of this sub-paragraph (4), have been so paid, then provided the Board shall have acted in good faith, they shall not incur any liability for any loss which any member may suffer in consequence of such payment having been made;

- (b) if the payment of any dividend on any relevant Euro Preference Shares would breach or cause a breach of the capital adequacy requirements of the Financial Services Authority (or any successor organisation responsible for the supervision of banks in the United Kingdom) from time to time applicable to the Company and/or any of its subsidiaries, then none of such dividend shall be payable;
- (c) if a dividend or any part thereof on any relevant Euro Preference Shares is not paid for the reasons specified in sub-paragraphs (4)(a) or (b) above, the holders of such shares shall have no claim in respect of such non-payment;
- (d) if any dividend on any relevant Euro Preference Shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, the Company may not thereafter purchase or redeem any other share capital of the Company ranking *pari passu* with or after the relevant Euro Preference Shares (and may not contribute any moneys to a sinking fund for any such purchase or redemption) until such time as dividends on the relevant Euro Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or an amount equivalent thereto shall have been paid or set aside to provide for such payment in full);
- (e) if any dividend on any relevant Euro Preference Shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, no dividend or other distribution may thereafter be declared or paid on any other share capital of the Company ranking as to dividend after the relevant Euro Preference Shares until such time as dividends on the relevant Euro Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or a sum shall have been paid or set aside to provide for such payment in full).

Redemption

- (5) (a) Unless otherwise determined by the Board in relation to Euro Preference Shares of any series prior to allotment thereof, the Euro Preference Shares shall, subject to the provisions of the Act¹³, be redeemable at the option of the Company.
- (b) In the case of any series of Euro Preference Shares which are to be so redeemable:
 - (i) the Company may, subject to the provisions of the Act and sub-paragraph (5)(b)(ii) below, redeem on any Redemption Date (as hereinafter defined) all, but not merely some, of the Euro Preference Shares of such series by giving to the holders of the Euro Preference Shares to be redeemed not less than 30 days' nor more than 60 days' prior notice in writing (a "Notice of Redemption") of the relevant Redemption Date.

"Redemption Date" means, in relation to Euro Preference Shares of a particular series, any date mentioned in any one of (A), (B) or (C) below, as determined by the Board prior to the first allotment of Euro Preference Shares of that series:

¹³ Sections 684-689 of the Act

- (A) any date which falls on or after the First Redemption Date (as hereinafter defined); or
- (B) the First Redemption Date or any subsequent Dividend Payment Date for Euro Preference Shares of that series; or
- (C) the First Redemption Date or any successive fifth anniversary thereof.

“First Redemption Date” means:

- (D) in relation to any Euro Preference Shares designated as:
 - (1) “Series 1”, 30 June 2012;
 - (2) “Series 2”, 24 March 2014; and
 - (3) “Series 3”, 29 March 2016.
- (E) in relation to any other Euro Preference Shares of a particular series, one day after such one of the following dates as shall be determined by the Board prior to the first allotment of Euro Preference Shares of that series:
 - (1) five years after the Relevant Date (as hereinafter defined);
 - (2) ten years after the Relevant Date;
 - (3) fifteen years after the Relevant Date;
 - (4) twenty years after the Relevant Date; or
 - (5) thirty years after the Relevant Date.

“Relevant Date” means, in relation to Euro Preference Shares of a particular series, such one of the following dates as shall be determined by the Board prior to the first allotment of Euro Preference Shares of that series:

- (F) the first date of allotment of Euro Preference Shares of that series; or
 - (G) the first Dividend Payment Date for Euro Preference Shares of that series;
- (ii) if either of the restrictions in sub-paragraphs (4)(a) and (b) of this Article 8 applies to any dividend otherwise payable on any Redemption Date on the Euro Preference Shares of that series, the Company may not redeem such Euro Preference Shares on that Redemption Date;
 - (iii) there shall be paid on each Euro Preference Share so redeemed, in euro, the aggregate of the nominal amount thereof and any premium credited as paid up on such share together with any dividend payable on the Redemption Date;
 - (iv) any Notice of Redemption given under sub-paragraph (5)(b)(i) above shall specify the applicable Redemption Date, the particular Euro Preference Shares to be redeemed and the redemption price, and shall state the place or places at which documents of title or such other evidence as may be accepted by the Board in respect of such Euro

Preference Shares are to be presented and surrendered for redemption and payment of the redemption moneys is to be effected. Upon such Redemption Date, the Company shall redeem the particular Euro Preference Shares to be redeemed on that date subject to the provisions of this sub-paragraph and of the Act¹⁴. No defect in the Notice of Redemption or in the giving thereof shall affect the validity of the redemption proceedings;

- (v) payments in respect of the amount due on redemption of a Euro Preference Share shall be made by euro cheque drawn on a bank in a member state of the European Union (or such other country participating in European Monetary Union from time to time) or upon the request of the holder or joint holders not later than the date specified for the purpose in the Notice of Redemption by transfer to a euro account maintained by the payee with a bank in a member state of the European Union (or such other country participating in European Monetary Union from time to time) or by such other method as the Board may determine. Such payment will be made against presentation and surrender of the relative certificate at the place or one of the places specified in the Notice of Redemption or against such other evidence as may be accepted by the Board. All payments in respect of redemption moneys will in all respects be subject to any applicable fiscal or other laws;
 - (vi) as from the relevant Redemption Date the dividend on the Euro Preference Shares due for redemption shall cease to accrue except on any such Euro Preference Shares in respect of which, upon due surrender of the certificate or other evidence aforesaid, payment of the redemption moneys due on such Redemption Date shall be improperly withheld or refused, in which case such dividend, at the rate then applicable, shall be deemed to have continued and shall accordingly continue to accrue from the relevant Redemption Date to the date of payment of such redemption moneys. Such Euro Preference Shares shall not be treated as having been redeemed until the redemption moneys in question together with the accrued dividend thereon shall have been paid;
 - (vii) if the due date for the payment of the redemption moneys on any Euro Preference Share is not a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) System (or any successor system) is open (a "Euro Business Day"), then payment of such moneys will be made on the next succeeding day which is a Euro Business Day and without any interest or other payment in respect of such delay; and
 - (viii) the receipt of the holder for the time being of any Euro Preference Shares (or, in the case of joint registered holders, the receipt of any one of them) for the moneys payable on redemption thereof shall constitute an absolute discharge to the Company in respect thereof.
- (c) Any Euro Preference Shares redeemed pursuant to sub-paragraph (5) of this Article 8 shall be cancelled on redemption.

¹⁴ Sections 684-689 of the Act

Purchase

- (6) Subject to the provisions of the Act¹⁵, the Company may at any time purchase any Euro Preference Shares (i) in the market, (ii) by tender (available alike to all holders of the same class of Euro Preference Shares) or (iii) by private treaty, in each case upon such terms as the Board shall determine.

Consolidation and division

- (7) Pursuant to the authority given by the passing of the resolution adopting these Articles the Board may consolidate and divide and/or sub-divide any Euro Preference Shares into shares of a larger or smaller nominal amount.

Attendance and voting at general meetings

- (8) (a) Save as provided by its terms of issue, no Euro Preference Share shall carry any right to attend or vote at general meetings of the Company.
- (b) If so determined by the Board prior to allotment thereof, holders of Euro Preference Shares of any series shall have the right to attend and vote at general meetings of the Company in the following circumstances:
- (i) if any dividend on any Euro Preference Shares of that series in respect of such period as the Board shall determine prior to allotment thereof is not paid in full, the right to attend and vote at general meetings of the Company until such time as dividends on those Euro Preference Shares in respect of such period as the Board shall determine prior to allotment thereof shall have been paid in full (or a sum shall have been paid or set aside to provide for such payment in full); and
- (ii) in such other circumstances, and upon and subject to such terms, as the Board may determine prior to allotment of such Euro Preference Shares.
- (c) Whenever holders of Euro Preference Shares are entitled to vote on a resolution at a general meeting, on a show of hands every such holder who is present, in person or by proxy, shall have one vote and on a poll every such holder who is present, in person or by proxy, shall have one vote per Euro Preference Share held by him or such number of votes per share as the Board shall determine prior to allotment of such share.
- (d) Holders of Euro Preference Shares having a registered address or address for correspondence within the United Kingdom, or who have provided the Company with an address to which notices, documents or other information may be sent using electronic means, shall 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, documents and other information sent out by the Company to the holders of Ordinary Shares.

Further preference shares

- (9) The special rights attached to any Euro Preference Shares of any series allotted or in issue shall not (unless otherwise provided by their terms of issue) be deemed to be varied by the creation or issue of any other preference shares or

¹⁵ Sections 690-708 of the Act

further shares in any currency (“new shares”) ranking as regards participation in the profits and assets of the Company pari passu with such Euro Preference Shares and so that any new shares ranking pari passu with such Euro Preference Shares may either carry rights and restrictions identical in all respects with such Euro Preference Shares or any of them or rights and restrictions differing therefrom in any respect including but without prejudice to the generality of the foregoing in that:

- (a) the rate of and/or basis of calculation of dividend may differ and the dividend may be cumulative or non-cumulative;
- (b) the new shares or any series thereof may rank for dividend as from such date as may be provided by the terms of issue thereof and the dates of payment of dividend may differ;
- (c) a premium may be payable on return of capital or there may be no such premium;
- (d) the new shares may be redeemable at the option of the holder or of the Company, or may be non-redeemable, and if redeemable at the option of the Company they may be redeemable at different dates and on different terms from those applying to the Euro Preference Shares; and/or
- (e) the new shares may be convertible into Ordinary Shares or any other class of shares ranking as regards participation in the profits and assets of the Company pari passu with or after such Euro Preference Shares in each case on such terms and conditions as may be prescribed by the terms of issue thereof.

Variation of class rights

- (10) (a) Subject to the provisions of the Act¹⁶:
 - (i) all or any of the rights, preferences, privileges, limitations or restrictions for the time being attached to the Euro Preference Shares may from time to time (whether or not the Company is being wound up) be varied or abrogated with the consent in writing of the holders of not less than three-quarters in nominal value of the Euro Preference Shares of all series in issue or with the sanction of a special resolution passed at a separate general meeting of the holders of the Euro Preference Shares, voting as a single class without regard for series; and
 - (ii) all or any of the rights, preferences, privileges, limitations or restrictions for the time being attached to Euro Preference Shares of any series may be varied or abrogated so as to affect adversely such rights on a basis different from any other series of Euro Preference Shares with the consent in writing of the holders of not less than three-quarters in nominal value of the Euro Preference Shares of such series or with the sanction of a special resolution passed at a separate general meeting of the holders of Euro Preference Shares of such series.
- (b) All the provisions of these Articles as to general meetings of the Company shall mutatis mutandis apply to any such separate general meeting, but so

¹⁶ Sections 630-640 of the Act

that the necessary quorum shall be two persons holding or representing by proxy at least one-third in nominal value of the issued shares of the class, that every holder of shares of the class shall be entitled on a poll to one vote for every share of the class held by him, that any holder of shares of the class present in person or by proxy may demand a poll and that at any adjourned meeting of the holders one holder present in person or by proxy (whatever the number of shares held by him) shall be a quorum.

- (c) Unless otherwise provided by its terms of issue, the rights attached to any Euro Preference Share shall not be deemed to be varied or abrogated by a reduction of any share capital or purchase by the Company or redemption of any share capital in each case ranking as regards participation in the profits and assets of the Company in priority to or *pari passu* with or after such Euro Preference Share.

9 Rights of the Non-voting Deferred Shares

9.1 The following rights and restrictions shall be attached to any Non-voting Deferred Shares that may, from time to time, be in issue:

- (1) As regards income

The holders of the Non-voting Deferred Shares shall not be entitled to receive any dividend out of the profits of the Company available for distribution and resolved to be distributed in respect of any financial year.

- (2) As regards capital

On a distribution of assets on a winding-up or other return of capital (otherwise than on conversion or redemption or purchase by the Company of any of its shares) the holders of the Non-voting Deferred Shares shall be entitled to receive the amount paid up on their shares after there shall have been distributed (in cash or specie) to the holders of the Ordinary Shares the amount of £10,000,000 in respect of each Ordinary Share held by them respectively. For this purpose distributions in currency other than sterling shall be treated as converted into sterling, and the value of any distribution in specie shall be ascertained in sterling, in each case in such manner as the Board or the Company in general meeting may approve. The Non-voting Deferred Shares shall not entitle the holders thereof to any further or other right of participation in the assets of the Company.

- (3) As regards voting

The holders of Non-voting Deferred Shares shall not be entitled to receive notice of or to attend (either personally or by proxy) any general meeting of the Company or to vote (either personally or by proxy) on any resolution to be proposed thereat.

- (4) Variation

The rights attached to the Non-voting Deferred Shares shall not be deemed to be varied or abrogated by the creation or issue of any new shares ranking in priority to or *pari passu* with or subsequent to such shares.

10 Allotment

- 10.1 Subject to the provisions of the Act¹⁷ and to any relevant authority of the Company in general meeting required by the Act, the Board may allot (with or without conferring rights of renunciation), grant options over, offer or otherwise deal with or dispose of shares or grant rights to subscribe for or convert any security into shares of the Company, to such persons (including the Directors themselves), at such times and generally on such terms and conditions as the Board may decide, provided that no share shall be issued at a discount.
- 10.2 (a) This Article 10.2 applies to any rights issue of any New Securities (as hereinafter defined) or any invitation to subscribe for any such securities which the Company may make in favour of holders of Ordinary Shares.
- (b) Whenever this Article 10.2 applies, the Company shall subject to the following provisions of this Article 10.2 extend the same invitation to all holders of Ordinary Shares at the same price and on the same terms.
- (c) Notwithstanding anything herein contained, whenever this Article 10.2 applies:
- (i) the Board may make such exclusions or other arrangements as the Board may deem necessary or expedient in relation to fractional entitlements or securities represented by depositary receipts or having regard to any restrictions, limits, obligations or legal problems under the laws of or the requirements of any regulatory body or stock exchange in any territory or otherwise howsoever;
 - (ii) the Board may determine that the price per New Security may be converted into such currency or currencies at such rate or rates of exchange as the Board may in its absolute discretion determine;
 - (iii) if the Board determines to exercise the power conferred by sub-paragraph (c)(ii) above, it need not exercise such power in the same manner or to the same extent in relation to all holders of Ordinary Shares but may exercise such power in relation to such holders of Ordinary Shares and in such manner and to such extent as it shall in its absolute discretion think fit.
- (d) In this Article 10.2, "New Securities" means Ordinary Shares or any securities conferring the right to subscribe for or convert into or to exchange such security for Ordinary Shares.
- 10.3 The Board may issue shares which, in its absolute discretion, may be held as certificated shares or uncertificated shares, and these Articles shall be construed accordingly.

11 Redeemable shares

- 11.1 Subject to the provisions of the Act¹⁸ and to any special rights for the time being attached to any existing shares, any share may be issued which is, or at the option of the Company or of the holder of such share is liable, to be redeemed on such terms and conditions and in such manner as these Articles may provide or the Directors may determine.

¹⁷ Sections 549-579 of the Act

¹⁸ Sections 684-689 of the Act

12 Power to attach rights

- 12.1 Subject to the provisions of the Act¹⁹ and to any special rights for the time being attached to any existing shares, any shares may be allotted or issued with or have attached to them such preferred, deferred or other special rights or restrictions, whether in regard to dividend, voting, transfer, return of capital or otherwise, as the Company may from time to time by ordinary resolution determine or, if no such resolution has been passed or so far as the resolution does not make specific provision, as the Board may determine.

13 Share warrants to bearer

- 13.1 The Company may issue, under the Seal, share warrants to bearer in respect of any fully paid shares in the Company, stating that the bearer is entitled to the shares represented thereby, and the Company may provide by coupons or otherwise for the payment of any future dividends on the shares so represented. Such powers shall be vested in the Board which may determine and from time to time vary the conditions upon which warrants shall be issued. Without prejudice to the generality of the foregoing, the Board may determine the conditions upon which any warrant or coupon shall be replaced, but so that, in the case of the loss of a warrant or coupon, no replacement warrant or coupon shall be issued unless the Board is satisfied beyond reasonable doubt that the original has been destroyed, and the Board may also determine the conditions upon which the bearer of a warrant shall be entitled to receive notice of, and to attend and vote and demand a poll at, general meetings of the Company and to join in requisitioning or convening general meetings, and upon which a warrant may be surrendered and the name of the bearer entered in the register in respect of the shares represented thereby. Subject to such conditions and to the provisions of these Articles and of the Act²⁰, the bearer of a warrant shall be deemed to be a member for all purposes. The bearer of a warrant shall hold the same subject to the conditions for the time being in force in regard to warrants for shares of the same class of shares to which the warrant relates and whether such conditions are determined by the Board before or after the issue of such warrant.

14 Commission and brokerage

- 14.1 The Company may in connection with the issue of any shares exercise all powers of paying commission and brokerage conferred or permitted by the Act. Subject to the provisions of the Act²¹, any such commission or brokerage may be satisfied by the payment of cash, the allotment of fully or partly paid shares, the grant of an option to call for an allotment of shares or any combination of such methods.

15 Trusts not to be recognised

- 15.1 Except as otherwise expressly provided by these Articles, as required by law or as ordered by a court of competent jurisdiction, the Company shall not recognise any person as holding any share on any trust, and (except as aforesaid) the Company shall not be bound by or recognise (even if having notice of it) any equitable, contingent, future, partial or other claim to or interest in any share except an absolute right of the holder to the whole of the share.

SHARE CERTIFICATES

¹⁹ Sections 549-609 of the Act

²⁰ Section 122 of the Act

²¹ Sections 552 and 553 of the Act

16 Right to certificates

- 16.1 On becoming the holder of any certificated share every person (except a recognised person in respect of whom the Company is not by law required to complete and have ready for delivery a certificate) shall be entitled, without charge, to receive within two months after allotment or lodgment of a transfer (unless the terms of issue of the shares provide otherwise) one certificate for all the shares of each class registered in his name. Such certificate shall specify the number, class and distinguishing numbers (if any) of the shares in respect of which it is issued and the amount or respective amounts paid up thereon.
- 16.2 If and so long as all the issued shares of the Company or all the issued shares of a particular class are fully paid up and rank pari passu for all purposes, then none of those shares shall bear a distinguishing number. In all other cases each share shall bear a distinguishing number.
- 16.3 The Company shall not be bound to issue more than one certificate in respect of shares held jointly by two or more persons. Delivery of a certificate to the person first named on the Register shall be sufficient delivery to all joint holders.
- 16.4 Where a member (other than a recognised person) has transferred part only of the shares comprised in a certificate, he shall be entitled without charge to a certificate for the balance of such shares.
- 16.5 No certificate shall be issued representing shares of more than one class, or in respect of shares held by a recognised person.

17 Replacement certificates

- 17.1 Any two or more certificates representing shares of any one class held by any member may at his request be cancelled and a single new certificate for such shares issued in lieu thereof, without charge, on surrender of the original certificates for cancellation.
- 17.2 If any member shall surrender for cancellation a share certificate representing shares held by him and request the Company to issue in lieu thereof two or more share certificates representing such shares in such proportions as he may specify, the Board may, if it thinks fit, comply with such request.
- 17.3 If any share certificate shall be defaced, worn out, destroyed or lost, it may be renewed on such terms as to provision of evidence and indemnity (with or without security) and, without prejudice to the provisions of Article 17.5 below, to payment of any exceptional 'out of pocket' expenses, including those incurred by the Company in investigating such evidence and preparing such indemnity and security, as the Board may decide, and on surrender of the original certificate (where it is defaced, damaged or worn out) but without further charge.
- 17.4 In the case of shares held jointly by several persons, any such request as is mentioned in this Article 17 may be made by any one of the joint holders.
- 17.5 If the Board so requires, a fee shall be paid in any jurisdiction in which all or any shares are for the time being listed or traded on a stock exchange in that jurisdiction before the issue of any new certificate, whether the same is issued as a result of a transfer or transmission of the shares to which it relates or the splitting up of an existing certificate

provided always that such fee shall not exceed the maximum such fee prescribed or permitted from time to time by the relevant stock exchange or by a relevant regulatory body in that jurisdiction.

UNCERTIFICATED SHARES

18 Uncertificated shares

- 18.1 Notwithstanding anything in these Articles to the contrary, any shares in the Company may be issued, held, registered, converted to, transferred or otherwise dealt with as certificated shares or uncertificated shares and converted from uncertificated shares to certificated shares in accordance with the Regulations and practices instituted by the Operator of the relevant system. Any provisions of these Articles shall not apply to any uncertificated shares to the extent that such provisions are inconsistent with:
- (a) the holding of uncertificated shares;
 - (b) the transfer of title to shares by means of the relevant system; or
 - (c) any provision of the Regulations.
- 18.2 Without prejudice to the generality and effectiveness of the foregoing:
- (a) Articles 16 and 17 shall not apply to uncertificated shares;
 - (b) references in these Articles to a requirement on any person to execute or deliver an instrument of transfer or certificate or other document shall, in the case of uncertificated shares, be treated as references to a requirement to comply with any relevant requirements of the relevant system relating to the transfer of such shares and any relevant arrangements or regulations which the Board may make from time to time pursuant to sub-paragraph (e) of this Article 18.2;
 - (c) the Company shall enter on the Principal Register the number of certificated shares and uncertificated shares which are held by each member and shall maintain the Principal Register in each case as is required by the Regulations and the relevant system and, unless the Board otherwise determines, holdings of certificated shares and uncertificated shares by the same holder or joint holders may be treated by the Company as separate holdings for such purpose or purposes as the Board may in its absolute discretion determine;
 - (d) a class of share shall not be treated as two classes by virtue only of that class comprising both certificated shares and uncertificated shares or as a result of any provision of these Articles or the Regulations which applies only in respect of certificated shares or uncertificated shares;
 - (e) the Board may make such arrangements or regulations (if any) as it may from time to time in its absolute discretion think fit in relation to the evidencing and transfer of uncertificated shares and otherwise for the purpose of implementing and/or supplementing the provisions of these Articles in relation to uncertificated shares and the Regulations and the facilities and requirements of the relevant system and such arrangements and regulations (as the case may be) shall have the same effect as if set out in these Articles;

- (f) the Board may utilise the relevant system to the fullest extent available from time to time in the exercise of the Company's powers or functions under the Act or these Articles or otherwise in effecting any actions; and
- (g) the Board may resolve that a class of shares is to become a participating security (within the meaning of the Regulations) and may at any time determine that a class of shares shall cease to be a participating security.

18.3 Where any class of shares in the capital of the Company is a participating security and the Company is entitled under any provisions of the Act or the rules made and practices instituted by the Operator of the relevant system or under these Articles to dispose of, forfeit, enforce a lien or sell or otherwise procure the sale of any uncertificated shares, such entitlement (to the extent permitted by the Regulations and the rules made and practices instituted by the Operator of the relevant system) shall include the right to:

- (a) request or require the deletion of any computer-based entries in the relevant system relating to the holding of such uncertificated shares; and/or
- (b) require any holder of any uncertificated shares which are the subject of any exercise by the Company of any such entitlement, by notice in writing to the holder concerned, to change his holding of such uncertificated shares into certificated shares within such period as may be specified in the notice, prior to completion of any disposal, sale or transfer of such shares or direct the holder to take such steps, by instructions given by means of the relevant system or otherwise, as may be necessary to sell or transfer such shares; and/or
- (c) appoint any person to take such other steps, by instruction given by means of the relevant system or otherwise, in the name of the holder of such shares as may be required to effect transfer of such shares and such steps shall be as effective as if they had been taken by the registered holder of the uncertificated shares concerned; and/or
- (d) transfer any uncertificated shares which are the subject of any exercise by the Company of any such entitlement by entering the name of the transferee in the Principal Register in respect of that share as a transferred share; and/or
- (e) otherwise rectify or change the Principal Register in respect of that share in such manner as may be appropriate; and/or
- (f) take such other action as may be necessary to enable those shares to be registered in the name of the person to whom the shares have been sold or disposed of or as directed by him.

LIEN ON SHARES

19 Lien on shares not fully paid

- 19.1 The Company shall have a first and paramount lien on any of its shares which are not fully paid, to the extent and in the circumstances permitted by the Act²². The Board may waive any lien which has arisen and may resolve that any share shall for some limited period be exempt wholly or partially from the provisions of this Article 19.

20 Enforcement of lien by sale

- 20.1 The Board may sell all or any of the shares subject to any lien at such time or times and in such manner as it may determine. However, no sale shall be made until such time as the moneys in respect of which such lien exists or some part thereof are or is presently payable or the liability or engagement in respect of which such lien exists is liable to be presently fulfilled or discharged, and until a demand and notice in writing stating the amount due or specifying the liability or engagement and demanding payment or fulfilment or discharge thereof and giving notice of intention to sell in default shall have been served on the member or the persons (if any) entitled by transmission to the shares (as the case may be), and default in payment, fulfilment or discharge shall have been made by him or them for 14 clear days after service of such notice. For giving effect to any such sale, the Board may authorise some person to execute an instrument of transfer of the shares sold in the name and on behalf of the member or the persons (if any) entitled by transmission to the shares (as the case may be) in favour of the purchaser or as the purchaser may direct. The purchaser shall not be bound to see to the application of the purchase consideration, and the title of the purchaser to the shares shall not be affected by any act, omission, irregularity or invalidity relating to or connected with the proceedings in reference to the sale.

21 Application of proceeds of sale

- 21.1 The net proceeds of any sale of shares subject to any lien, after payment of the expenses of sale, shall be applied in or towards satisfaction of so much of the amount due to the Company, or of the liability or engagement (as the case may be) as is presently payable or is liable to be presently fulfilled or discharged. The balance (if any) shall (on surrender to the Company for cancellation of the certificate for the shares sold, and subject to a like lien for any moneys not presently payable or any liability or engagement not liable to be presently fulfilled or discharged as existed on the shares before the sale) be paid (without interest) to the member or the person (if any) entitled by transmission to the shares so sold (as the case may be).

CALLS ON SHARES

22 Calls

- 22.1 Subject to the terms of allotment of shares, the Board may from time to time make calls on the members in respect of any moneys unpaid on the shares or any class of shares held by them respectively (whether in respect of nominal value or premium) and not payable on a date fixed by or in accordance with the terms of issue. Each member shall (subject to receiving at least 14 clear days' notice specifying when and where payment is to be made and whether or not by instalments) be liable to pay the amount of every call so made on him as required by the notice. A call shall be deemed to have been made at the

²² Section 670 of the Act

time when the resolution of the Board authorising such call was passed or (as the case may require) any person to whom power has been delegated pursuant to these Articles serves notice of exercise of such power. A call may be required to be paid by instalments and may, before receipt by the Company of any sum due thereunder, be either revoked or postponed in whole or part as regards all or any member (s) as the Board may determine. A person on whom a call is made shall remain liable notwithstanding the subsequent transfer of the shares in respect of which the call was made. The joint holders of a share shall be jointly and severally liable for the payment of all calls in respect thereof.

23 Interest on calls

- 23.1 If the whole of the sum payable in respect of any call is not paid on or before the day appointed for payment, the person from whom it is due and payable shall pay all costs, charges and expenses that the Company may have incurred by reason of such non-payment, together with interest on the unpaid amount from the day appointed for payment thereof to the day of actual payment (both days inclusive) at the rate fixed by the terms of the allotment of the share or in the notice of the call or, if no rate is so fixed, at such rate, not exceeding 15 per cent. per annum, as the Board shall determine. The Board may waive payment of such costs, charges, expenses or interest in whole or in part.

24 Rights of member when call unpaid

- 24.1 No member shall, unless the Board otherwise determines, be entitled to receive any dividend or to be present and vote at any general meeting either personally or (save as proxy for another member) by proxy, or be reckoned in a quorum, or to exercise any other privilege as a member unless and until he shall have paid all calls for the time being due and payable on every share held by him, whether alone or jointly with any other person, together with interest and expenses (if any) payable by such member to the Company.

25 Sums due on allotment treated as calls

- 25.1 Any sum payable in respect of a share on allotment or at any fixed date, whether in respect of the nominal value of the share or by way of premium or as an instalment of a call, shall for the purposes of these Articles be deemed to be a call duly made. If it is not paid, the provisions of these Articles shall apply as if such amount had become due and payable by virtue of a call.

26 Power to differentiate

- 26.1 The Board may make arrangements on the allotment or issue of shares for a difference as between the allottees or holders of such shares in the amount and time of payment of calls.

27 Payment in advance of calls

- 27.1 The Board may, if it thinks fit, receive from any member willing to advance the same all or any part of the moneys uncalled and unpaid on the shares held by him. Such payment in advance of calls shall extinguish pro tanto the liability on the shares in respect of which it is made. The Company may pay interest on the money paid in advance, or so much of it as exceeds the amount for the time being called up on the shares in respect of which such advance has been made, at such rate as the Board may decide. The Board may at any time repay the amount so advanced on giving to such member not less than

three months' notice in writing, unless before the expiration of such notice the amount so advanced shall have been called up on the shares in respect of which it was advanced.

28 Delegation of power to make calls

- 28.1 If any uncalled capital of the Company is included in or charged by any mortgage or other security, the Board may delegate to the person in whose favour such mortgage or security is executed, or to any other person in trust for him, the power to make calls on the members in respect of such uncalled capital, to sue in the name of the Company or otherwise for the recovery of moneys becoming due in respect of calls so made and to give valid receipts for such moneys. The power so delegated shall subsist during the continuance of the mortgage or security, notwithstanding any change of Directors, and shall be assignable if expressed so to be.

29 Indemnity against claims in respect of shares

- 29.1 Whenever any law for the time being of any country, state or place imposes or purports to impose any immediate or future or possible liability on the Company to make any payment, or empowers any government or taxing authority or government official to require the Company to make any payment, in respect of any shares held either jointly or solely by any member or in respect of any dividends, bonuses or other monies due or payable or accruing due or which may become due or payable to such member by the Company or in respect of any such shares or for or on account or in respect of any member and whether in consequence of:

- (a) the death of such member;
- (b) the non-payment of any income tax or other tax by such member;
- (c) the non-payment of any estate, probate, succession, death, stamp or other duty by the executor or administrator of such member, or by or out of his estate; or
- (d) any other act or thing;

the Company in every such case:

- (i) shall be fully indemnified by such member or his executor or administrator from all liability arising by virtue of such law; and
 - (ii) may recover as a debt due from such member or his executor or administrator (wherever constituted or residing) any moneys paid by the Company under or in consequence of any such law, together with interest thereon at the rate of 15 per cent. per annum thereon from the date of payment to the date of repayment.
- 29.2 Nothing contained in this Article 29 shall prejudice or affect any right or remedy which any law may confer or purport to confer on the Company and as between the Company and every such member as aforesaid, his executor, administrator and estate wherever constituted or situated, and any right or remedy which such law shall confer or purport to confer on the Company shall be enforceable by the Company.

FORFEITURE OF SHARES**30 Notice if call not paid**

- 30.1 If any member fails to pay the whole of any call or any instalment of any call on or before the day appointed for payment, the Board may at any time serve a notice in writing on such member or on any person entitled to the shares by transmission, requiring payment, on a date not less than 14 clear days from the date of the notice, of the amount unpaid and any interest which may have accrued thereon and any costs, charges and expenses incurred by the Company by reason of such non-payment. The notice shall name the place where the payment is to be made and state that, if the notice is not complied with, the shares in respect of which such call was made will be liable to be forfeited.

31 Forfeiture for non-compliance

- 31.1 If the notice referred to in Article 30 is not fully complied with, any share in respect of which it was given may, at any time before the payment required by the notice has been made, be forfeited by a resolution of the Board to that effect. Such forfeiture shall include all dividends declared or other moneys payable in respect of the forfeited shares and not paid before the forfeiture.
- 31.2 If any person from whom any call or interest thereon or any part thereof is due, and whose share has been declared forfeited for non-payment thereof, shows to the satisfaction of the Board that he is unable to pay the whole amount then remaining due from him in respect of such call or interest, the Board may accept from him such sum by way of composition for and in lieu of the whole amount so then due from him as the Board may determine; and upon the payment of such composition may discharge him from all claims and demands whatsoever then remaining due in respect of such call and interest; but no such composition shall be accepted from any person while he continues to be a member in his own right in respect of any share besides the share so forfeited, or shall give him any claim to or in respect of the share so forfeited.

32 Notice after forfeiture

- 32.1 When any share has been forfeited, notice of the forfeiture shall be served on the person who was before forfeiture the holder of the share or the person (if any) entitled to such share by transmission (as the case may be). An entry of such notice having been given and of the forfeiture with the date thereof shall forthwith be made in the Register in respect of such share. However, no forfeiture shall be invalidated by any omission to give such notice or to make such entry as aforesaid.

33 Forfeiture may be annulled

- 33.1 The Board may, at any time before any share so forfeited has been cancelled or sold, re-allotted or otherwise disposed of, annul the forfeiture, on the terms of payment of all calls and interest due thereon and all expenses incurred in respect of the share and on such further terms (if any) as the Board shall see fit.

34 Surrender

- 34.1 The Board may accept a surrender of any share liable to be forfeited. In such case references in these Articles to forfeiture shall include surrender.

35 Disposal of forfeited shares

35.1 Every share which shall be forfeited shall thereupon become the property of the Company. Subject to the provisions of the Act²³, any such share may be sold, re-allotted or otherwise disposed of, either to the person who was before forfeiture the holder thereof or entitled thereto or to any other person, on such terms and in such manner as the Board shall determine. The Board may for the purposes of the disposal authorise some person to transfer the shares in question and may enter the name of the transferee in respect of the transferred shares in the Register notwithstanding the absence of any share certificate being lodged in respect thereof and may issue a new certificate to the transferee and an instrument of transfer executed by that person shall be as effective as if it had been executed by the holder of, or the person (if any) entitled by transmission to (as the case may be), the shares. The Company may receive the consideration (if any) given for the share on its disposal.

36 Effect of forfeiture

36.1 A member whose shares have been forfeited shall cease to be a member in respect of them and shall surrender to the Company for cancellation the certificate for the shares forfeited. He shall nevertheless be liable to pay to the Company all calls made and not paid on such shares at the time of forfeiture, and interest thereon from the date of the forfeiture to the date of payment (both dates inclusive), in the same manner in all respects as if the shares had not been forfeited, and to satisfy all (if any) claims, demands and liabilities which the Company might have enforced in respect of the shares at the time of forfeiture, without any reduction or allowance for the value of the shares at the time of forfeiture or for any consideration received on their disposal.

37 Extinction of claims

37.1 The forfeiture of a share shall involve the extinction at the time of forfeiture of all interest in and all claims and demands against the Company in respect of the share and all other rights and liabilities incidental to the share as between the member whose share is forfeited (or the person (if any) entitled by transmission to the forfeited share, as the case may be) and the Company, except only such of those rights and liabilities as are by these Articles expressly saved, or as are by the Act given or imposed in the case of past members.

38 Evidence of forfeiture

38.1 A statutory declaration by a Director or the Secretary that a share has been forfeited in pursuance of these Articles, and stating the date on which it was forfeited, shall, as against all persons claiming to be entitled to that share adversely to the forfeiture thereof, be conclusive evidence of the facts therein stated. The declaration, together with the receipt by the Company of the consideration (if any) given for the share on the sale or disposition thereof and a certificate for the share under the Seal delivered to the person to whom the same is sold or disposed of, shall (subject if necessary to the execution of an instrument of transfer) constitute a good title to the share. Subject to the execution of any necessary transfer, such person shall be registered as the holder of the share and shall be discharged from all calls made prior to such sale or disposition and shall not be bound to see to the application of the purchase consideration (if any), nor shall his title to the share be affected by any act, omission, irregularity or invalidity relating to or connected with the proceedings in reference to the forfeiture or disposal of the share. Any such person shall not (unless by express agreement with the Company) become entitled to any of the

²³ Section 662 of the Act

dividends accrued or which might have accrued upon the shares before the completion of the sale or disposition thereof.

TRANSFER OF SHARES

39 Form of transfer

39.1 Subject to such of the restrictions of these Articles as may be applicable, each member may transfer all or any of his shares by instrument of transfer in writing in any usual form or in any form approved by the Board. Such instrument shall be executed by or on behalf of the transferor and (in the case of a transfer of a share which is not fully paid up) by or on behalf of the transferee. The transferor shall be deemed to remain the holder of such share until the name of the transferee is entered in the Register in respect of it.

40 Right to refuse registration

40.1 The Board may, in its absolute discretion, refuse to register any transfer of a share unless:

- (a) it is in respect of a share which is fully paid up;
- (b) it is in respect of a share on which the Company has no lien;
- (c) it is in respect of only one class of shares;
- (d) it is in favour of a single transferee or not more than four joint transferees;
- (e) it is duly stamped (if so required); and
- (f) it is delivered for registration to the Office or such other place as the Board may from time to time determine, accompanied (except in the case of a transfer by a recognised person where a certificate has not been issued or in the case of an uncertificated share) by the certificate for the shares to which it relates and such other evidence as the Board may reasonably require to prove the title of the transferor and the due execution by him of the transfer or, if the transfer is executed by some other person on his behalf, the authority of that person to do so,

provided that the Board shall not refuse to register any transfer of partly paid shares which are listed on The Stock Exchange on the grounds that they are partly paid shares in circumstances where such refusal would prevent dealing in such shares from taking place on an open and proper basis. References herein to a transfer shall be deemed to include renunciation of a renounceable letter of allotment.

40.2 A transfer of shares will not be registered in the circumstances envisaged by Article 85.

40.3 Without prejudice to Article 41, the Board may refuse to register a transfer of uncertificated shares in such other circumstances as may be permitted or required by the Regulations and the relevant system.

41 Notice of refusal

41.1 In the case of certificated shares, if the Board refuses to register a transfer of a share it shall, within two months after the date on which the transfer was lodged with the

Company send notice of the refusal, together with the reasons for the refusal, to the transferee. Any instrument of transfer which the Board refuses to register shall (except in the case of suspected fraud) be returned to the person depositing it. All instruments of transfer which are registered may be retained by the Company.

- 41.2 In the case of uncertificated shares, if the Board refuses to register a transfer of a share it shall, within two months after the date on which the appropriate instruction was received by or on behalf of the Company in accordance with the facilities and requirements of the relevant system, send notice of the refusal, together with the reasons for the refusal, to the transferee.

42 Fees on registration

- 42.1 If the Board so requires, a fee shall be charged in any jurisdiction in which all or any shares are for the time being listed or traded on a stock exchange in that jurisdiction for the registration of a transfer or on the registration of any probate, letters of administration, certificate of death or marriage, power of attorney, notice or other instrument relating to or affecting the title to any shares provided always that such fee shall not exceed the maximum such fee prescribed or permitted from time to time by the relevant stock exchange or by a relevant regulatory body in that jurisdiction.

43 Other powers in relation to transfers

- 43.1 Nothing in these Articles shall preclude the Board:

- (a) from recognising a renunciation of the allotment of any share by the allottee in favour of some other person; or
- (b) if empowered by these Articles to authorise any person to execute an instrument of transfer of a share, from authorising any person to transfer that share.

TRANSMISSION OF SHARES

44 On death

- 44.1 If a member dies, the survivors or survivor, where he was a joint holder, and his executors or administrators, where he was a sole or the only survivor of joint holders, shall be the only persons recognised by the Company as having any title to his shares. Nothing in these Articles shall release the estate of a deceased member from any liability in respect of any share which has been solely or jointly held by him.

45 Election of person entitled by transmission

- 45.1 Any person becoming entitled to a share in consequence of the death or bankruptcy of any member, or of any other event giving rise to a transmission of such entitlement by operation of law, may, on such evidence as to his title being produced as the Board may require, elect either to become registered as a member or to have some person nominated by him registered as a member. If he elects to become registered himself, he shall give notice to the Company to that effect. If he elects to have some other person registered, he shall execute an instrument of transfer of such share to that person. All the provisions of these Articles relating to the transfer of shares shall apply to the notice or instrument of transfer (as the case may be) as if it were an instrument of transfer executed by the member and his death, bankruptcy or other event as aforesaid had not occurred. Where

the entitlement of a person to a share in consequence of the death or bankruptcy of a member or of any other event giving rise to its transmission by operation of law is proved to the satisfaction of the Board, the Board shall within two months after proof cause the entitlement of that person to be noted in the Register.

- 45.2 For the purposes referred to in Article 45.1, a person entitled by transmission to an uncertificated share who elects to have some other person registered shall either:
- (a) procure that instructions are given by means of the relevant system to effect the transfer of such uncertificated share to that person; or
 - (b) change the uncertificated share into a certificated share and execute an instrument of transfer of that certificated share in favour of that person.

46 Rights on transmission

- 46.1 Where a person becomes entitled to a share in consequence of the death or bankruptcy of any member, or of any other event giving rise to a transmission of such entitlement by operation of law, the rights of the holder in relation to such share shall cease. However, the person so entitled may give a good discharge for any dividends and other moneys payable in respect of it and shall have the same rights to which he would be entitled if he were the holder of the share, except that he shall not, before he is registered as the holder of the share, be entitled in respect of it to receive notice of, or to attend or vote at any meeting of the Company or at any separate meeting of the holders of any class of shares of the Company. The Board may at any time give notice requiring any such person to elect either to be registered himself or to transfer the share. If the notice is not complied with within 60 days, the Board may thereafter withhold payment of all dividends and other moneys payable in respect of such share until the requirements of the notice have been complied with.

DESTRUCTION OF DOCUMENTS

47 Destruction of documents

- 47.1 The Company may destroy:
- (a) any instrument of transfer, after six years from the date on which it is registered;
 - (b) any dividend mandate or any variation or cancellation thereof or any notification of change of name or address, after two years from the date on which it is recorded;
 - (c) any share certificate, after one year from the date on which it is cancelled; and
 - (d) any other document on the basis of which any entry in the Register is made, after six years from the date on which an entry was first made in the Register in respect of it,

provided that the Company may destroy any such type of document at a date earlier than that authorised by this Article 47.1 if a copy of such document is made (whether made electronically, by microfilming, by digital imaging or by any other means) and retained until the expiration of the period applicable to the destruction of the original of such document.

- 47.2 It shall be conclusively presumed in favour of the Company that every entry in the Register purporting to have been made on the basis of a document so destroyed was duly and properly made, that every instrument of transfer so destroyed was duly registered, that every share certificate so destroyed was duly cancelled, and that every other document so destroyed was valid and effective in accordance with the particulars in the records of the Company, provided that:
- (a) this Article 47.2 shall apply only to the destruction of a document in good faith and without notice of any claim (regardless of the parties to it) to which the document might be relevant; and
 - (b) nothing in this Article 47.2 shall be construed as imposing on the Company any liability in respect of the destruction of any such document otherwise than as provided for in this Article 47.2 which would not attach to the Company in the absence of this Article 47.2.
- 47.3 References in this Article 47 to instruments of transfer include, in relation to uncertificated shares, instructions and/or notifications made in accordance with the relevant system relating to the transfer of such shares and references in this Article 47 to the destruction of any document include references to the disposal of it in any manner.

ALTERATION OF SHARE CAPITAL

48 Increase, consolidation, sub-division and redenomination

- 48.1 The Company in general meeting may from time to time by ordinary resolution:
- (a) authorise the Directors to increase its share capital by allotting shares pursuant to Article 10;
 - (b) consolidate and divide all or any of its share capital into shares of a larger nominal amount than its existing shares;
 - (c) sub-divide its shares or any of them into shares of a smaller nominal amount, and may by such resolution determine that, as between the shares resulting from such sub-division, one or more of the shares may, as compared with the others, have any such preferred, deferred or other special rights or be subject to any such restrictions as the Company has power to attach to new shares; and
 - (d) redenominate its share capital by converting shares from having a fixed nominal value in one currency to having a fixed nominal value in another currency.

Any resolution for consolidation and division of Ordinary Shares into shares of a larger nominal amount pursuant to sub-paragraph (b) of this Article 48, any resolution for sub-division of Ordinary Shares into shares of a smaller nominal amount pursuant to sub-paragraph (c) of this Article and any resolution for redenomination of Ordinary Shares into shares having a fixed nominal value in another currency pursuant to sub-paragraph (d) of this Article 48 shall constitute a variation of the rights attached to the Ordinary Shares unless such resolution shall affect all the Ordinary Shares in issue in like manner and to like extent.

49 Fractions

- 49.1 Whenever as the result of any consolidation, division or sub-division of shares any difficulty arises, the Board may settle it as it thinks fit and in particular (but without prejudice to the generality of the foregoing):
- (a) whenever as a result of any consolidation of shares any members would become entitled to fractions of shares, the Board may, on behalf of those members, sell the shares incorporating the fractions for the best price reasonably obtainable to any person (including the Company) and distribute the net proceeds of sale after deduction of the expenses of sale in due proportion among those members (except that any amount otherwise due to a member, being less than £5.00 or its equivalent based on such exchange rate as the Board may determine in any other relevant currency or such other sum as the Board may from time to time determine, may be retained for the benefit of the Company);
 - (b) the Board may as between the holders of shares to be consolidated determine which particular shares are to be consolidated into each consolidated share and, in the case of any shares registered in the name of one holder or joint holders being consolidated with shares registered in the name of another holder or joint holders, may make such arrangements as it may think fit for the sale of the consolidated share and for the distribution among the persons entitled thereto of the net proceeds of such sale after deduction of the expenses of sale or for the payment of such net proceeds to the Company (except that any amount otherwise due to a member, being less than £5.00 or its equivalent based on such exchange rate as the Board may determine in any other relevant currency or such other sum as the Board may from time to time determine, may be retained for the benefit of the Company);
 - (c) alternatively, the Board may, in each case where the number of shares held by any holder is not an exact multiple of the number of shares to be consolidated into a single share, issue to each such holder credited as fully paid by way of capitalisation the minimum number of shares required to round up his holding to such a multiple (such issue being deemed to have been effected immediately prior to consolidation); the amount required to pay up such shares shall be appropriated at the Board's discretion from any of the sums standing to the credit of any of the Company's reserve accounts (including any share premium account and capital redemption reserve) or to the credit of the profit and loss account and capitalised by applying the same in paying up such shares; and in relation to such capitalisation the Board may exercise all the powers conferred on it by Article 159 without an ordinary resolution of the Company;
 - (d) the Board may treat certificated shares and uncertificated shares of a holder as separate holdings in giving effect to sub-divisions and/or consolidations and may cause any shares arising on sub-division or consolidation and representing fractional entitlements to be entered in the Register as certificated shares where this is desirable to facilitate the sale thereof; and
 - (e) for the purposes of any sale of consolidated shares pursuant to sub-paragraph (a) of this Article 49, the Board may authorise some person to execute an instrument of transfer of the shares to, or in accordance with, the directions of the purchaser, and the transferee shall not be bound to see to the application of the purchase consideration, nor shall his title to the shares be affected by any act, omission,

irregularity or invalidity relating to or connected with the proceedings in reference to the sale.

VARIATION OF CLASS RIGHTS

50 Sanction to variation

- 50.1 Any of the rights or privileges for the time being attached to any share or class of shares in the Company (and notwithstanding that the Company may be or be about to be in liquidation) may be varied or abrogated in such manner (if any) as may be provided by such rights contained in these Articles or, in the absence of any such provision, either with the consent in writing of the holders of not less than three-quarters in nominal value of the issued shares of the class (excluding any shares of that class held as treasury shares), or with the sanction of a special resolution passed at a separate general meeting of the holders of shares of the class duly convened and held as hereinafter provided (but not otherwise). The foregoing provisions of this Article 50 shall apply also to the variation or abrogation of the special rights attached to some only of the shares of any class as if each group of shares of the class differently treated formed a separate class the separate rights of which are to be varied.
- 50.2 Ordinary Shares whenever issued are subject to the restriction that the rights attached to them may be varied or abrogated by a special resolution of the Company without the separate consent or sanction (given in accordance with Article 50.1 or otherwise) of the holders of any of the Ordinary Shares provided that the rights attached to all the Ordinary Shares are thereby varied or abrogated in like manner and to like extent and accordingly neither the passing nor the implementation of any such resolution constitutes a variation or abrogation of any of the rights attached to any of the Ordinary Shares.

51 Class meetings

- 51.1 All the provisions in these Articles as to general meetings shall mutatis mutandis apply to every meeting of the holders of any class of shares. The quorum at every such meeting shall be two persons holding or representing by proxy at least one-third of the nominal amount paid up on the issued shares of the class (excluding any shares of that class held as treasury shares). Every holder of shares of the class, present in person or by proxy, may demand a poll. Each such holder shall on a poll be entitled to one vote for every share of the class held by him. If at any adjourned meeting of such holders such quorum as aforesaid is not present, one person holding shares of the class who is present in person or by proxy shall be a quorum.

52 Deemed variation

- 52.1 Subject to the terms of issue of or rights attached to any shares, the rights or privileges attached to any class of shares shall be deemed to be varied or abrogated by the reduction of the capital paid up on such shares, but shall not be deemed to be varied or abrogated by the creation or issue of any new shares ranking in priority to or *pari passu* in all respects (save as to the date from which such new shares shall rank for dividend) with or subsequent to those already issued or by the purchase or redemption by the Company of its own shares or the sale of any shares held as treasury shares in accordance with the provisions of the Act²⁴ and these Articles.

²⁴ Part 18 of the Act

GENERAL MEETINGS

53 Annual general meetings

53.1 The Company shall in each year hold a general meeting as its annual general meeting in addition to any other meetings in that year in accordance with the requirements of the Act²⁵. The annual general meeting shall be held at such time and in such place as the Board may determine.

54 Convening of general meetings

54.1 The Board may convene a general meeting, other than an annual general meeting, whenever it thinks fit. A general meeting, other than an annual general meeting, shall also be convened on such requisition, or in default may be convened by such requisitionists, as provided by the Act²⁶. At any meeting convened on such requisition or by such requisitionists no business shall be transacted except that stated by the requisition or proposed by the Board.

55 Notice of general meetings

55.1 An annual general meeting shall be convened by not less than 21 clear days' notice in writing. All other general meetings shall be convened by not less than 14 clear days' notice in writing or such longer period as may be required by law from time to time.

55.2 The notice shall include such statements as are required by the Act²⁷ and shall in any event specify:

- (a) whether the meeting is an annual general meeting or any other general meeting;
- (b) the place, the day and the time of the meeting;
- (c) in the case of special business, the general nature of that business;
- (d) if the meeting is convened to consider a special resolution, the intention to propose the resolution as such; and
- (e) with reasonable prominence, that a member entitled to attend and vote is entitled to appoint one or more proxies to attend and vote instead of him and that a proxy need not also be a member.

55.3 The notice shall be given to the members (other than any who, under the provisions of these Articles or of any restrictions imposed on any shares, are not entitled to receive notice from the Company), to the Directors and to the Auditors and to any other person who may be entitled to receive it.

55.4 For the purposes of the Act²⁸ any amount paid up on any Ordinary Share in any currency other than sterling shall be treated as if it had been converted into sterling at such rate of exchange prevailing at or about the date of the requisition as the Board shall determine.

²⁵ Section 336 of the Act

²⁶ Sections 303-305 of the Act

²⁷ Section 311 of the Act

²⁸ Sections 314(2)(b), 338(3)(b) and 338A(3)(b) of the Act

56 Omission to send notice

- 56.1 The accidental omission to give or send notice of a general meeting or, in cases where it is intended that it be given or sent out with the notice, any other document relating to the meeting (including an appointment of proxy) to, or the non-receipt of either by, any person entitled to receive the same shall not invalidate the proceedings at that meeting.

57 Postponement of general meetings

- 57.1 If the Board, in its absolute discretion, considers that it is impractical or unreasonable for any reason to hold a general meeting on the date or at the time or place specified in the notice calling the general meeting, it may postpone the general meeting to another date, time and/or place. The Board shall take reasonable steps to ensure that notice of the date, time and place of the postponed meeting is provided to any member trying to attend the meeting at the original time and place. When a meeting is so postponed, notice of the date, time and place of the postponed meeting shall be given in such manner as the Board may in its absolute discretion determine. Notice of the business to be transacted at such postponed meeting shall not be required. If a meeting is postponed in accordance with this Article 57, the appointment of a proxy will be valid if it is delivered and received as required by these Articles not less than 48 hours before the time appointed for holding the postponed meeting and, for the purpose of calculating this period, the Directors can decide, in their absolute discretion, not to take account of any part of a day that is not a working day. The Board may (for the avoidance of doubt) also postpone any meeting which has been rearranged under this Article 57.

58 Special business

- 58.1 All business that is transacted at a general meeting shall be deemed special, except the following transactions at an annual general meeting:
- (a) the declaration of dividends;
 - (b) the receipt and consideration of the annual accounts, the Directors' Report, the Directors' Remuneration Report, the Auditors' Report and any other documents required to be annexed to the annual accounts;
 - (c) the election or re-election of Directors; and
 - (d) the re-appointment of the Auditors retiring (unless they were last appointed otherwise than by the Company in general meeting) and the determination of the remuneration of the Auditors or of the manner in which such remuneration is to be determined.

PROCEEDINGS AT GENERAL MEETINGS**59 Quorum**

- 59.1 No business shall be transacted at any general meeting unless a quorum is present when the meeting proceeds to business. For all purposes the quorum shall be not less than three persons entitled to attend and to vote on the business to be transacted, each being a member or a proxy for a member or a duly authorised representative of a corporation which is a member.

- 59.2 In calculating whether a quorum is present for the purposes of Article 59.1, if two or more persons are appointed as proxies for the same member or two or more persons are appointed as corporate representatives of the same corporate member, only one of such proxies or only one of such corporate representatives shall be counted.

60 If quorum not present

- 60.1 If within 15 minutes (or such longer interval as the Chairman in his absolute discretion thinks fit) from the time appointed for the holding of a general meeting a quorum is not present, or if during a meeting such a quorum ceases to be present, the meeting shall stand adjourned to such day (being not less than ten clear days after the original meeting) and at such time and place as the Chairman (or, in default, the Board) may determine. If at such adjourned meeting a quorum is not present within 15 minutes from the time appointed for holding the meeting, one person entitled to attend and to vote on the business to be transacted, being a member or a proxy for a member or a duly authorised representative of a corporation which is a member, shall be a quorum.

61 Chairman

- 61.1 The Chairman (if any) of the Board shall preside at every general meeting of the Company. If there be no such Chairman or if at any meeting he shall not be present within five minutes after the time appointed for holding the meeting, or shall be unwilling to act as Chairman, a Deputy Chairman shall, if present and willing to act, preside at such meeting. In the event of two or more Deputy Chairmen being present, the Deputy Chairman to act as Chairman shall be decided by those Directors present. If no Chairman or Deputy Chairman shall be so present and willing to act, the Directors present shall choose one of their number to act or, if there be only one Director present, he shall be Chairman if willing to act. If there be no Director present and willing to act, the members present (in person or by proxy) and entitled to vote on the business to be transacted at the meeting shall choose one of their number to be Chairman of the meeting.

62 Entitlement to attend and speak

- 62.1 A Director shall, notwithstanding that he is not a member, be entitled to attend and speak at any general meeting and at any separate meeting of the holders of any class of shares of the Company. Any proxy appointed by a member shall also be entitled to speak at any general meeting of the Company. The Chairman may invite any person to attend and speak at a general meeting where he considers this will assist in the deliberations of the meeting.

63 Power to adjourn

- 63.1 The Chairman may, with or without the consent of a meeting at which a quorum is present, and shall, if so directed by the meeting, adjourn any meeting from time to time (or indefinitely) and from place to place as the meeting shall determine. However, without prejudice to any other power which he may have under these Articles or at common law, the Chairman may, without the need for the consent of the meeting, interrupt or adjourn any meeting (whether or not it has commenced or a quorum is present) from time to time and from place to place or for an indefinite period if he is of the opinion that it has become necessary to do so in order to secure the proper and orderly conduct of the meeting, to give all persons entitled to do so a reasonable

opportunity of attending, speaking and voting at the meeting or to ensure that the business of the meeting is properly disposed of.

64 Notice of adjourned meeting

- 64.1 Where a meeting is adjourned indefinitely, the Board shall fix the time and place for the adjourned meeting. Whenever a meeting is adjourned for 14 days or more or indefinitely, at least seven clear days' notice, specifying the place, the day and time of the adjourned meeting and the general nature of the business to be transacted, shall be given in the same manner as in the case of the original meeting. Save as aforesaid, no member shall be entitled to any notice of an adjournment or of the business to be transacted at any adjourned meeting.

65 Business of adjourned meeting

- 65.1 No business shall be transacted at any adjourned meeting other than the business which might properly have been transacted at the meeting from which the adjournment took place.

66 Accommodation of members at meeting and security arrangements

- 66.1 The Board may, for the purpose of controlling the level of attendance or ensuring the safety of those attending at any place specified for the holding of a general meeting, from time to time make such arrangements (whether involving the issue of tickets, on a basis intended to afford to all members otherwise entitled to attend such meeting an equal opportunity of being admitted to the meeting, or the imposition of some random means of selection, or otherwise) as the Board shall in its absolute discretion consider to be appropriate and may from time to time vary any such arrangements or make new arrangements in place therefor. The entitlement of any member or proxy to attend a general meeting at such place shall be subject to any such arrangements as may be for the time being approved by the Board and by the notice of meeting stated to apply to that meeting. In the case of any general meeting to which such arrangements apply the Board shall, and in the case of any other general meeting the Board may, when specifying the place of the general meeting:

- (a) direct that the meeting shall be held at a place specified in the notice at which the Chairman of the meeting shall preside ("the Principal Place"); and
- (b) make arrangements for simultaneous attendance and participation at other places by members otherwise entitled to attend the general meeting but excluded therefrom under the provisions of this Article 66 or who wish to attend at any of such other places, provided that persons attending at the Principal Place and at any of such other places shall be able to see and hear and be seen and heard by persons attending at the Principal Place and at such other places by any means.

Such arrangements for simultaneous attendance may include arrangements for controlling the level of attendance in any manner aforesaid at any of such other places, provided that they shall operate so that any such excluded members as aforesaid are able to attend at one of such other places. For the purposes of all other provisions of these Articles any such meeting shall be treated as being held and taking place at the Principal Place.

- 66.2 The Board may direct that any person wishing to attend any meeting should provide evidence of identity and submit to such searches or other security arrangements or

restrictions as the Board shall consider appropriate in the circumstances and shall be entitled in its absolute discretion to refuse entry to any meeting to any person who fails to provide such evidence of identity or to submit to such searches or to otherwise comply with such security arrangements or restrictions.

67 Orderly conduct

- 67.1 The Chairman shall take such action or give such directions as he thinks fit to promote the orderly conduct of the meeting. The Chairman's decision on matters of procedure or arising incidentally from the business of the meeting shall be final, as shall his determination as to whether any matter is of such a nature.

VOTING

68 Method of voting

- 68.1 At any general meeting a resolution put to a vote of the meeting shall be decided on a show of hands, unless (before or on the declaration of the result of the show of hands) a poll is duly demanded. Subject to the provisions of the Act²⁹, a poll may be demanded by:
- (a) the Chairman of the meeting; or
 - (b) by at least five members present in person or by proxy and entitled to vote on the resolution; or
 - (c) a member or members present in person or by proxy representing not less than one-tenth of the total voting rights of all the members having the right to vote on the resolution (excluding any voting rights attached to any shares in the Company held as treasury shares); or
 - (d) a member or members present in person or by proxy holding shares conferring a right to vote on the resolution, being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all the shares conferring that right (excluding shares in the Company conferring a right to vote on the resolution which are held as treasury shares).

69 Chairman's declaration conclusive on show of hands

- 69.1 Unless a poll is duly demanded and the demand is not withdrawn, a declaration by the Chairman of the meeting that a resolution has on a show of hands been carried, or carried unanimously or by a particular majority, or lost, or not carried by a particular majority, and an entry to that effect in the book containing the minutes of proceedings of the Company, shall be conclusive evidence thereof, without proof of the number or proportion of the votes recorded in favour of or against such resolution.

70 Objection to error in voting

- 70.1 No objection shall be raised to the qualification of any voter or to the counting of, or failure to count, any vote, except at the meeting or adjourned meeting at which the vote objected to is given or tendered or at which the error occurs. Any objection or error shall be referred to the Chairman of the meeting and shall only vitiate the decision of the

²⁹ Section 321 of the Act

meeting on any resolution if the Chairman decides that the same is of sufficient magnitude to vitiate the resolution or may otherwise have affected the decision of the meeting. Any vote which is not disallowed at such meeting or poll shall be valid for all purposes. The decision of the Chairman on such matters shall be final and conclusive.

71 Amendment to resolutions

- 71.1 In the case of a resolution duly proposed as a special resolution, no amendment thereto (other than a mere clerical amendment to correct a patent error) may in any event be considered or voted on.
- 71.2 In the case of a resolution duly proposed as an ordinary resolution, no amendment thereto (other than a mere clerical amendment to correct a patent error) may be considered or voted on unless:
- (a) notice in writing of the terms of the proposed amendment and intention to move the same has been given to the Secretary at the Office by a person entitled to vote at the general meeting at which it is to be proposed not less than 48 hours prior to the time appointed for holding the meeting or adjourned meeting at which such ordinary resolution is to be proposed (or such later time as the Chairman of the meeting in his absolute discretion may determine); and
 - (b) the proposed amendment does not, in the opinion of the Chairman of the meeting, materially alter the scope of the resolution.
- 71.3 If an amendment shall be proposed to any resolution under consideration but shall in good faith be ruled out of order by the Chairman of the meeting, any error in such ruling shall not invalidate the proceedings on the substantive resolution.
- 71.4 The Chairman of the meeting can agree to the withdrawal of any proposed amendment before it is voted on at the meeting.

72 Procedure on a poll

- 72.1 Any poll duly demanded on the election of a Chairman of a meeting or on any question of adjournment shall be taken forthwith. A poll duly demanded on any other matter shall be taken in such manner (including the use of ballot, voting papers, tickets or electronic means, or any combination thereof) and at such time and place, not being more than 30 days from the date of the meeting or adjourned meeting at which the poll was demanded, as the Chairman shall direct. No notice need be given of a poll not taken immediately if the time and place at which it is to be taken are announced at the meeting at which it is demanded. In any other case at least seven clear days' notice shall be given specifying the time and place at which the poll is to be taken. The result of the poll shall be deemed to be the resolution of the meeting at which the poll was demanded.
- 72.2 The demand for a poll (other than on the election of a Chairman or a resolution for adjourning the meeting) shall not prevent the continuance of the meeting for the transaction of any business other than the question on which a poll has been demanded. If a poll is demanded before the declaration of the result on a show of hands and the demand is duly withdrawn, the meeting shall continue as if the demand had not been made.
- 72.3 The demand for a poll may, before the poll is taken, be withdrawn, but only with the consent of the Chairman. A demand so withdrawn shall validate the result of a show of

hands declared before the demand was made and, in the case of a poll demanded but duly withdrawn before the declaration of the result of a show of hands, the meeting shall continue as if the demand had not been made.

- 72.4 On a poll votes may be given in person or by proxy. A member entitled to more than one vote need not, if he votes, use all his votes or cast all the votes he uses in the same way.

73 Votes of members

- 73.1 Subject to the provisions of the Act³⁰ and to any special terms as to voting on which any shares may have been issued or may for the time being be held and to any suspension or abrogation of voting rights pursuant to these Articles, at any general meeting every member who is present in person or by proxy shall on a show of hands have one vote and every member present, in person or by proxy, shall on a poll have one vote for every share of which he is the holder.
- 73.2 If two or more persons are joint holders of a share, then in voting on any question the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of the other joint holders. For this purpose seniority shall be determined by the order in which the names of the holders stand in the Register.
- 73.3 Where in England or elsewhere a receiver or other person (by whatever name called) has been appointed by any court claiming jurisdiction to exercise powers with respect to the property or affairs of any member on the ground (however formulated) of mental disorder, the Board may, subject to the Act³¹, in its absolute discretion, on or subject to production of such evidence of the appointment as the Board may require, permit such receiver or other person to vote in person or by proxy on behalf of such member at any general meeting. Evidence to the satisfaction of the Board of the authority of the person claiming to exercise the right to vote shall be deposited at the Office, or deposited or received at such other place or address as is specified in accordance with these Articles for the deposit or receipt of appointments of proxy, not less than 48 hours before the time appointed for holding the meeting or adjourned meeting at which the right to vote is to be exercised, and in default the right to vote shall not be exercisable. For the purpose of calculating the 48 hour period, the Directors can decide, in their absolute discretion, not to take account of any part of a day that is not a working day.

74 Restriction on voting rights for unpaid calls etc.

- 74.1 No member shall, unless the Board otherwise determines, be entitled to vote at a general meeting or at any separate meeting of the holders of any class of shares, either in person or by proxy, in respect of any share held by him or to exercise any right as a member unless all calls or other sums presently payable by him in respect of that share in the Company have been paid.

75 Votes not counted where abstention required

- 75.1 Where any member is, under the rules governing the listing of securities on any stock exchange on which all or any shares of the Company are for the time being listed or traded, required to abstain from voting on any particular resolution or restricted to voting only for or only against any particular resolution, any votes cast by or on

³⁰ Sections 284-286 of the Act

³¹ Section 327(A1) of the Act

behalf of such member in contravention of such requirement or restriction shall, notwithstanding the provision of any other Article, not be counted.

76 Voting by proxy

- 76.1 Any person (whether a member of the Company or not) may be appointed to act as a proxy. The appointment of a proxy shall not preclude a member from attending and voting in person at the meeting in respect of which the proxy is appointed or at any adjournment thereof. In the event that and to the extent that a member personally votes his shares his proxy shall not be entitled to vote those shares and any vote cast by a proxy in respect of such shares in such circumstances shall be ignored.
- 76.2 Every proxy who has been appointed by one or more members entitled to vote on the resolution shall, on a show of hands, have one vote unless Article 76.3 applies.
- 76.3 Every proxy who has been appointed by more than one member entitled to vote on the resolution shall, on a show of hands, have two votes, one vote for and one against the resolution, if either:
- (a) one or more of the members have instructed the proxy to vote for the resolution and one or more of the members have instructed the proxy to vote against the resolution; or
 - (b) one or more of the members have instructed the proxy to vote for the resolution and one or more of the members have given the proxy discretion as to how to vote in respect of the resolution and the proxy exercises that discretion by voting against the resolution; or
 - (c) one or more of the members have instructed the proxy to vote against the resolution and one or more of the members have given the proxy discretion as to how to vote in respect of the resolution and the proxy exercises that discretion by voting for the resolution.
- 76.4 Every proxy who has been appointed by one or more members entitled to vote on the resolution shall, on a poll, have one vote for each share in respect of which the proxy has been appointed.

77 Validity of votes by proxies and corporate representatives

- 77.1 A vote given by a proxy or by a corporate representative shall be valid notwithstanding that the proxy or corporate representative has failed to vote in accordance with the instructions of the member by whom the proxy or corporate representative was appointed and the Company shall be under no obligation to check any vote so given is in accordance with any such instructions.

78 Form of proxy

- 78.1 An appointment of a proxy shall:
- (a) be in writing and, if the Board in its absolute discretion determines, may be contained in an electronic communication, in any such case in any common form or in such other form as the Board may approve and: (i) if in writing but not contained in an electronic communication, under the hand of the appointor or of his attorney duly authorised in writing or, if the appointor is a corporation, under

its common seal or under the hand of some officer or attorney duly authorised; or (ii) in the case of an appointment contained in an electronic communication, submitted by or on behalf of the appointor, subject to such terms and conditions and authenticated in such manner as the Board may in its absolute discretion determine;

- (b) be deemed (subject to any contrary direction contained in the same) to confer authority to demand or join in demanding a poll and to vote on any resolution or amendment of a resolution put to the meeting for which it is given, as the proxy thinks fit and to speak at the meeting; and
- (c) unless the contrary is stated therein, be valid as well for any adjournment of the meeting as for the meeting to which it relates.

79 Deposit or receipt of proxy

79.1 The appointment of a proxy and the power of attorney or other authority (if any) under which it is signed, or a copy of such authority certified notarially or in some other way approved by the Board may:

- (a) in the case of an instrument in writing (including, whether or not the appointment of proxy is contained in an electronic communication, any such power of attorney or other authority), be deposited at the Office or at such other place or places and in such location or locations as is or are specified in the notice convening the meeting or in any appointment of proxy sent out by the Company in relation to the meeting not less than 48 hours before the time of the holding of the meeting or adjourned meeting at which the person named in the instrument proposes to vote; or
- (b) in the case of an appointment contained in an electronic communication, where an address has been specified for the purpose of receiving communications in electronic form:
 - (i) in the notice convening the meeting; or
 - (ii) in any instrument of proxy sent out by the Company in relation to the meeting; or
 - (iii) in any invitation contained in an electronic communication to appoint a proxy issued by the Company in relation to the meeting,

be received at such address not less than 48 hours before the time for holding the meeting or adjourned meeting at which the person named in the appointment proposes to vote; or

- (c) in the case of a poll taken more than 48 hours after it is demanded, be deposited or received as aforesaid after the poll has been demanded and not less than 24 hours before the time appointed for the taking of the poll; or
- (d) where the poll is not taken forthwith but is taken not more than 48 hours after it was demanded, be delivered at the meeting at which the poll was demanded to the Chairman of the meeting or to any Director, the Secretary or some person authorised for the purpose by the Secretary,

and an appointment of proxy not deposited, delivered or received in a manner so permitted shall be invalid. No appointment of proxy shall be valid after the expiry of 12 months from the date named in it as the date of its execution or the date of its submission, except at an adjourned meeting or on a poll demanded at a meeting or an adjourned meeting in cases where the meeting was originally held within 12 months from such date.

79.2 For the purpose of calculating the relevant periods referred to in Article 79.1, the Directors can decide, in their absolute discretion, not to take account of any part of a day that is not a working day.

80 More than one proxy may be appointed

80.1 A member may appoint more than one proxy to attend on the same occasion. When two or more valid but differing appointments of proxy are delivered or received in respect of the same share for use at the same meeting and in respect of the same matter, the one which is last validly delivered or received (regardless of its date or of the date of its execution or submission) shall be treated as replacing and revoking the other or others as regards that share. If the Company is unable to determine which appointment was last validly delivered or received, none of them shall be treated as valid in respect of that share.

81 Board may supply proxy cards

81.1 The Board may at the expense of the Company send or make available, by post, electronic communication or otherwise, appointments of proxy (reply-paid or otherwise) to members for use at any general meeting(s) or at any separate meeting(s) of the holders of any class of shares, either in blank or nominating in the alternative any one or more of the Directors or any other persons. If for the purpose of any meeting invitations to appoint as proxy a person or one of a number of persons specified in the invitations are issued at the expense of the Company, such invitations shall subject to Article 56 be issued to all (and not some only) of the members entitled to be sent notice of the meeting and to vote thereat by proxy.

82 Revocation of proxy

82.1 A vote given or poll demanded in accordance with the terms of an appointment of proxy shall be valid notwithstanding the death or mental disorder of the principal or the revocation of the appointment of proxy, or of the authority under which the appointment of proxy was executed or submitted, or the transfer of the share in respect of which the appointment of proxy is given, unless notice in writing of such death, mental disorder, revocation or transfer shall have been received by the Company at the Office, or at such other place or places or address as has or have been appointed for the deposit or receipt of appointments of proxy, in the case of a meeting or adjourned meeting at which the appointment of proxy is used, at least 48 hours before the time for holding the meeting or adjourned meeting and, in the case of a poll taken more than 48 hours after it was demanded at which the appointment of proxy is used, at least 24 hours before the time appointed for the taking of the poll.

82.2 For the purpose of calculating the relevant periods referred to in Article 82.1, the Directors can decide, in their absolute discretion, not to take account of any part of a day that is not a working day.

83 Directors' powers to establish verification procedures in connection with proxies

83.1 From time to time the Directors may (consistently with the Act³² and these Articles) make such regulations and establish such procedures as they consider appropriate to receive and verify the appointment or revocation of a proxy. Any such regulations may be general or specific to a particular meeting. Without limitation, any regulations may include provisions that the Directors (or some person or persons appointed by them) may conclusively determine any matter or dispute relating to:

- (a) the appointment or revocation, or purported appointment or revocation, of a proxy; and/or
- (b) any instruction contained or allegedly contained in any such appointment,

and any such regulations may also include rebuttable or conclusive presumptions of any fact concerning those matters. The Directors may from time to time modify or revoke any such regulations as they think fit, provided that no subsisting valid appointment or revocation of a proxy or any voting instruction shall thereby be rendered invalid.

84 Corporate representative

84.1 A corporation (whether or not a company within the meaning of the Act) which is a member may, by resolution of its directors or other governing body, authorise such person or persons as it thinks fit to act as its representative (or, as the case may be, representatives) at any meeting of the Company or at any separate meeting of the holders of any class of shares. Any person so authorised shall be entitled to exercise the same powers on behalf of the corporation (in respect of that part of the corporation's holdings to which the authority relates) as the corporation could exercise if it were an individual member. The corporation shall for the purposes of these Articles be deemed to be present in person at any such meeting if a person so authorised is present at it; and all references to attendance and voting in person shall be construed accordingly. A Director, the Secretary or some person authorised for the purpose by the Secretary may require the representative to produce a certified copy of the resolution so authorising him or such other evidence of his authority reasonably satisfactory to such Director, Secretary or other person before permitting him to exercise his powers.

85 Failure to disclose interests in shares

85.1 If a member, or any other person appearing to be interested in shares held by that member, has been issued with a notice pursuant to the Act³³ requiring such person to provide information about his interests in the Company's shares (a "Section 793 Notice") and has failed in relation to any shares ("the default shares", which expression includes shares issued after the date of such notice in respect of those shares) to give the Company the information thereby required within the prescribed period from the date of the notice, the following sanctions shall apply unless the Board otherwise determines:

- (a) the member shall not be entitled, in respect of the default shares, to be present or to vote (either in person or by representative or proxy) at any general meeting or at any separate meeting of the holders of any class of shares or on any poll, or to exercise any other right conferred by his membership in relation to any such meeting or poll; and

³² Section 327(A1) of the Act

³³ Section 793 of the Act

- (b) where the default shares represent at least 0.25 per cent. in nominal value of the issued shares of their class (excluding any shares of that class held as treasury shares):
 - (i) any dividend or other money payable in respect of the shares shall be withheld by the Company, which shall not have any obligation to pay interest on it, and the member shall not be entitled to elect, pursuant to Article 157, to receive shares instead of that dividend; and
 - (ii) no transfer, other than an excepted transfer, of any shares held by the member shall be registered unless:
 - (A) the member is not himself in default as regards supplying the information required; and
 - (B) the member proves to the satisfaction of the Board that no person in default as regards supplying such information is interested in any of the shares the subject of the transfer.

85.2 For the purposes of Article 85.1, the Board may only exercise its discretion not to register a transfer of uncertificated shares if permitted to do so by the Regulations, and it may determine to treat certificated shares and uncertificated shares of a member as separate holdings and apply the sanctions only to the former or to the latter or make different provisions for the former and the latter.

85.3 Where the sanctions under Article 85.1 apply in relation to any shares, they shall cease to have effect:

- (a) if the shares are transferred by means of an excepted transfer but only in respect of the shares transferred; or
- (b) at the end of the period of one week (or such shorter period as the Board may determine) following receipt by the Company of the information required by the applicable notice or notices mentioned in Article 85.1 and the Board being fully satisfied that such information is full and complete.

85.4 Where, on the basis of information obtained from a member in respect of any share held by him, the Company issues a Section 793 Notice to any other person, it shall at the same time send a copy of such notice to the member, but the accidental omission to do so, or the non-receipt by the member of the copy, shall not invalidate or otherwise affect the application of Article 85.1.

85.5 For the purposes of this Article 85:

- (a) a person, other than the member holding a share, shall be treated as appearing to be interested in any shares (or, if applicable, rights to subscribe for, or convert into, shares) if the member has informed the Company that the person is, or may be, so interested, or if the Company (after taking account of any information obtained from the member or from a Section 793 Notice or from anyone else) knows or has reasonable cause to believe that the person is, or may be, or has been so interested;
- (b) “interested” shall be construed in accordance with sections 820 to 825 of the Act;

- (c) reference to a person having failed to give the Company the information required by a Section 793 Notice, or being in default as regards supplying such information, includes reference to (i) his having failed or refused to give all or any part of it and (ii) his having given information which he knows to be false in a material particular or having recklessly given information which is false in a material particular;
- (d) the “prescribed period” means 14 days; and
- (e) an “excepted transfer” means, in relation to any shares held by a member:
 - (i) a transfer by way of or pursuant to acceptance of a takeover offer for the Company (within the meaning of section 974 of the Act); or
 - (ii) a transfer in consequence of a sale made through a recognised investment exchange (as defined in section 285 of the Financial Services and Markets Act 2000) or any other stock exchange outside the United Kingdom on which the Company’s shares are normally traded; or
 - (iii) a transfer which is shown to the satisfaction of the Board to be made in consequence of a sale of the whole of the beneficial interest in the shares to a person who is unconnected with the member and with any other person appearing to be interested in the shares.

85.6 Where any person appearing to be interested in the default shares has been duly served with a Section 793 Notice and the default shares which are the subject of such notice or notices are held by a Depositary the provisions of this Article 85 shall be treated as applying only to such default shares held by the Depositary and not (in the absence of any other reason why they should be so treated) to any other shares held by the Depositary.

85.7 Where the member on which a Section 793 Notice is served is a Depositary acting in its capacity as such the obligations of the Depositary as a member of the Company shall be limited to disclosing to the Company such information relating to any person appearing to be interested in the shares held by it as has been recorded by it pursuant to the arrangements entered into by the Company or approved by the Board pursuant to which it was appointed as a Depositary or otherwise.

85.8 Nothing contained in this Article 85 shall limit the power of the Board under the Act³⁴.

UNTRACED MEMBERS

86 Power of sale

86.1 The Company shall be entitled to sell any share of a member, or any share to which a person is entitled by transmission, if and provided that:

- (a) during the period of 12 years prior to the date of the publication of the advertisements referred to in sub-paragraph (b) below (or, if published on different dates, the earlier or earliest thereof) no cheque, order or warrant in respect of such share sent by the Company through the post in a pre-paid

³⁴ Section 794 of the Act

envelope addressed to the member or to the person entitled by transmission to the share, at his address on the Register or other last known address given by the member or person to which cheques, orders or warrants in respect of such share are to be sent has been cashed and the Company has received no communications in respect of such share from such member or person, provided that during such period of 12 years the Company has paid at least three dividends (whether interim or final) and no such dividend has been claimed by the person entitled to it;

- (b) on expiry of the said period of 12 years the Company has given notice of its intention to sell such share by advertisements appearing in one national newspaper published in the United Kingdom and one newspaper circulating in the area of the address on the Register or other last known address of the member or the person entitled by transmission to the share or the address for the service of notices notified under Article 167.3 (unless any such address shall be in Hong Kong), and in one leading English language daily newspaper and one leading Chinese language daily newspaper printed and circulating in Hong Kong;
- (c) the said advertisements, if not published on the same day, shall have been published within 30 days of each other;
- (d) during the further period of three months following the date of publication of the said advertisements (or, if published on different dates, the later or latest thereof) and prior to the exercise of the power of sale the Company has not received any communication in respect of such share from the member or person entitled by transmission; and
- (e) if shares of the class concerned are listed or dealt in on any stock exchange, the Company has given notice to that exchange of its intention to make such sale.

86.2 The manner, timing and terms of any sale of shares pursuant to this Article 86 (including but not limited to the price or prices at which the same is made) shall be such as the Board determines, based upon advice from such bankers, brokers or other persons as the Board considers appropriate consulted by it for the purposes, to be reasonably practicable having regard to all the circumstances including the number of shares to be disposed of and the requirement that the disposal be made without delay; and the Board shall not be liable to any person for any of the consequences of reliance on such advice.

86.3 To give effect to any sale of shares pursuant to this Article 86 the Board may authorise some person to transfer the shares in question and may enter the name of the transferee in respect of the transferred shares in the Register notwithstanding the absence of any share certificate being lodged in respect thereof and may issue a new certificate to the transferee and an instrument of transfer executed by that person shall be as effective as if it had been executed by the holder of, or person (if any) entitled by transmission to (as the case may be), the shares. The purchaser shall not be bound to see to the application of the purchase consideration nor shall his title to the shares be affected by any act, omission, irregularity or invalidity relating to or connected with the proceedings in reference to the sale.

86.4 If during the period of 12 years referred to in Article 86.1 above, or during any period ending on the date when all the requirements of sub-paragraphs (a) to (d) of Article 86.1 above have been satisfied, any additional shares have been issued in respect of those held at the beginning of, or previously so issued during, any such period and all the requirements of sub-paragraphs (b) to (d) of Article 86.1 above have been satisfied in

regard to such additional shares, the Company shall also be entitled to sell the additional shares.

87 Application of proceeds of sale

- 87.1 The Company shall account to the member or other person entitled to such share for the net proceeds of such sale by carrying all moneys in respect thereof to a separate account. The Company shall be deemed to be a debtor to, and not a trustee for, such member or other person in respect of such moneys. Moneys carried to such separate account may either be employed in the business of the Company or invested in such investments as the Board may from time to time think fit. No interest shall be payable to such member or other person in respect of such moneys and the Company shall not be required to account for any money earned on them.

**APPOINTMENT, RETIREMENT AND
REMOVAL OF DIRECTORS**

88 Number of Directors

- 88.1 Unless and until otherwise determined by the Company by ordinary resolution, the number of Directors (other than any alternate Directors) shall be not less than five not more than twenty five.

89 Power of Company to appoint Directors

- 89.1 Subject to the provisions of these Articles, the Company may by ordinary resolution appoint a person who is willing to act to be a Director, either to fill a vacancy or as an addition to the existing Board, but the total number of Directors shall not exceed any maximum number fixed in accordance with these Articles.

90 Power of Board to appoint Directors

- 90.1 Without prejudice to the power of the Company to appoint any person to be a Director pursuant to these Articles, the Board shall have power at any time to appoint any person who is willing to act as a Director, either to fill a vacancy or as an addition to the existing Board, but the total number of Directors shall not exceed any maximum number fixed in accordance with these Articles. Any Director so appointed shall retire at the annual general meeting of the Company next following such appointment and shall then be eligible for re-election but shall not be taken into account in determining the number of Directors who are to retire by rotation at such meeting.

91 Appointment of executive Directors

- 91.1 Subject to the provisions of the Act³⁵, the Board may from time to time appoint one or more of its body to hold any employment or executive office for such term and subject to such other conditions as the Board thinks fit. The Board may revoke or terminate any such appointment without prejudice to any claim for damages for breach of contract between the Director and the Company.

92 Eligibility of new Directors

³⁵ Sections 188 and 227-330

92.1 No person, other than a Director retiring (by rotation or otherwise), shall be appointed or re-appointed a Director at any general meeting unless:

- (a) he is recommended by the Board; or
- (b) during the period commencing on the day after despatch of the notice of the meeting and ending no later than seven clear days prior to the date of such meeting, notice duly executed by a member (other than the person to be proposed) qualified to vote at the meeting has been given to the Company of the intention to propose that person for appointment or re-appointment, stating the particulars which would, if he were so appointed or re-appointed, be required to be included in the Company's register of Directors, together with notice executed by that person of his willingness to be appointed or re-appointed, is given to the Secretary at the Office.

93 Share qualification

93.1 A Director shall not be required to hold any shares of the Company.

94 Resolution for appointment

94.1 A resolution for the appointment of two or more persons as Directors by a single resolution shall be void unless an ordinary resolution that it shall be so proposed has first been agreed to by the meeting without any vote being given against it.

95 Retirement by rotation

95.1 At each annual general meeting of the Company one-third of the Directors who are subject to retirement by rotation or, if their number is not three or a multiple of three, the number nearest to but not exceeding one-third shall retire from office.

95.2 In addition to the Directors required to retire by rotation under Article 95.1, there shall also be required to retire by rotation:

- (a) any Director who at an annual general meeting of the Company shall have been a Director at each of the preceding two annual general meetings of the Company and who was not elected or re-elected at either such annual general meeting and who has not otherwise ceased to be a Director (either by resignation, retirement, removal or otherwise) and been re-elected by general meeting of the Company at or since either such annual general meeting; and
- (b) any Director who has held office with the Company, other than employment or executive office, for a continuous period of nine years or more at the date of the annual general meeting.

96 Directors subject to retirement by rotation

96.1 Subject to the provisions of the Act³⁶ and of these Articles, the Directors to retire by rotation at each annual general meeting shall include, so far as necessary to obtain the number required, first, any Director who wishes to retire and not offer himself for re-election and secondly, those Directors who have been longest in office since their last appointment or re-appointment. As between two or more Directors who have been in

³⁶ Section 168 of the Act

office an equal length of time, the Director to retire shall, in default of agreement between them, be determined by lot.

97 Position of retiring Director

97.1 A Director who retires at an annual general meeting (whether by rotation or otherwise) may, if willing to act, be re-elected. If he is not re-elected or deemed to have been re-appointed, he shall retain office until the meeting appoints someone in his place or, if it does not do so, until the end of the meeting.

98 Deemed re-appointment

98.1 At any general meeting at which a Director retires by rotation the Company may fill the vacancy and, if it does not do so, the retiring Director shall, if willing, be deemed to have been re-appointed unless it is expressly resolved not to fill the vacancy or a resolution for the re-appointment of the Director is put to the meeting and lost.

99 Removal by ordinary resolution

99.1 The Company may by ordinary resolution remove any Director before the expiration of his period of office in accordance with the Act³⁷, but without prejudice to any claim for damages which he may have for breach of any contract of service between him and the Company, and may (subject to these Articles) by ordinary resolution appoint another person who is willing to act to be a Director in his place. Any person so appointed shall be treated, for the purposes of determining the time at which he or any other Director is to retire, as if he had become a Director on the day on which the person in whose place he is appointed was last appointed or re-appointed a Director.

100 Vacation of office by Director

100.1 Without prejudice to the provisions for retirement (by rotation or otherwise) contained in these Articles, the office of a Director shall be vacated if:

- (a) he resigns by notice in writing delivered to, or, if in electronic form, received by, the Secretary at the Office or tendered at a Board meeting;
- (b) he ceases to be a Director by virtue of any provision of the Act, is removed from office pursuant to these Articles or becomes prohibited by law from being a Director;
- (c) he becomes bankrupt, has an interim receiving order made against him, makes any arrangement or compounds with his creditors generally or applies to the court for an interim order under section 253 of the Insolvency Act 1986 in connection with a voluntary arrangement under that Act or enters into any analogous or similar procedure in any jurisdiction;
- (d) an order is made by any court of competent jurisdiction on the ground (howsoever formulated) of mental disorder for his detention or for the appointment of a guardian or receiver or other person to exercise powers with respect to his affairs or he is admitted to hospital in pursuance of an application for admission for treatment under the Mental Health Act 1983 or equivalent legislation in any jurisdiction and the Board resolves that his office be vacated;

³⁷ Sections 168 and 169 of the Act

- (e) both he and his alternate Director appointed pursuant to the provisions of these Articles (if any) are absent, without the permission of the Board, from Board meetings for six consecutive months and the Board resolves that his office be vacated; or
- (f) he is requested to resign by notice in writing addressed to him at his last known address and signed by all his co-Directors (without prejudice to any claim for damages which he may have for breach of any contract of service between him and the Company).

101 Resolution as to vacancy conclusive

- 101.1 A resolution of the Board declaring a Director to have vacated office under the terms of Article 100 shall be conclusive as to the fact and grounds of vacation stated in the resolution.

ALTERNATE DIRECTORS

102 Appointments

- 102.1 Each Director (other than an alternate Director) may, by notice in writing delivered to, or, if in electronic form, received by, the Secretary at the Office, or in any other manner approved by the Board, appoint any other Director or any person approved for that purpose by the Board and willing to act, to be his alternate and remove from office an alternate Director so appointed by him.
- 102.2 No appointment of an alternate Director shall be effective until his consent to act as a Director in the form prescribed by the Act³⁸ has been received at the Office.
- 102.3 An alternate Director need not hold a share qualification and shall not be counted in reckoning any maximum number of Directors allowed by these Articles.

103 Participation in Board meetings

- 103.1 Every alternate Director shall (subject to his giving to the Company an address within the United Kingdom or Hong Kong (or such other country or territory as the Board may from time to time determine) at which notices may be served on him or an address to which notices may be sent using electronic means) be entitled to receive notice of all meetings of the Board and all committees of the Board of which his appointor is a member and, in the absence from such meetings of his appointor, to attend and vote at such meetings and to exercise all the powers, rights, duties and authorities of his appointor. A Director acting as alternate Director shall have a separate vote at Board meetings for each Director for whom he acts as alternate Director, but he shall count as only one for the purpose of determining whether a quorum is present.

104 Alternate Director responsible for own acts

- 104.1 Every person acting as an alternate Director shall be an officer of the Company, shall alone be responsible to the Company for his own acts and defaults and shall not be deemed to be the agent of the Director appointing him.

³⁸ Section 167 of the Act

105 Interests of alternate Director

105.1 The provisions of Articles 133 to 143 shall apply to an alternate Director to the same extent as if he was a Director and for the purposes of those provisions an alternate Director shall be deemed to have an interest which conflicts, or possibly may conflict, with the interest of the Company if either he or his appointor has such an interest. The provisions of Articles 173 and 174 shall also apply to an alternate Director to the same extent as if he was a Director. However, he shall not be entitled to receive from the Company any fees for his services as alternate, except only such part (if any) of the fee payable to his appointor as such appointor may by notice in writing to the Company direct. Subject to this Article 105, the Company shall pay to an alternate Director such expenses as might properly have been paid to him if he had been a Director.

106 Revocation of appointment

106.1 An alternate Director shall cease to be an alternate Director:

- (a) if his appointor ceases for any reason to be a Director, provided that if any Director retires but is re-appointed or deemed to be re-appointed at the same meeting, any valid appointment of an alternate Director which was in force immediately before his retirement shall remain in force; or
- (b) if any event happens in relation to him which, if he were a Director otherwise appointed, would cause him to vacate office; or
- (c) if his appointor revokes the appointment by notice in writing delivered to, or, if in electronic form, received by, the Secretary at the Office; or
- (d) if he resigns his office by notice in writing delivered to, or, if in electronic form, received by, the Secretary at the Office.

**DIRECTORS' REMUNERATION,
EXPENSES AND PENSIONS**

107 Directors' fees

107.1 The Directors (other than alternate Directors) shall be entitled to receive by way of fees for their services as Directors such sum (or its equivalent in any other currency at such rate of exchange as the Board shall determine) and on such terms as the Company in general meeting may from time to time determine. Any sum so determined may be an aggregate sum in respect of the fees for all Directors or a sum in respect of the fees for each individual Director provided that, in the case of an aggregate sum, such sum shall, subject to any special directions of the Company in general meeting, be divided among the Directors in such proportions and in such manner as the Board may from time to time decide. Any fees payable pursuant to this Article 107 shall be distinct from any salary, remuneration or other amounts payable to a Director pursuant to any other provisions of these Articles and shall accrue from day to day.

108 Expenses

108.1 Each Director shall be entitled to be repaid all reasonable travelling, hotel and other expenses properly incurred by him in or about the performance of his duties as Director, including any expenses incurred in attending meetings of the Board or any committee of

the Board or general meetings or separate meetings of the holders of any class of shares or of debentures of the Company.

109 Additional remuneration

109.1 If by arrangement with the Board any Director shall perform or render any special duties or services outside his ordinary duties as a Director, he may be paid such reasonable additional remuneration (whether by way of salary, commission, participation in profits or otherwise) as the Board may from time to time determine.

110 Remuneration of executive Directors

110.1 The salary or remuneration of any Director appointed to hold any employment or executive office in accordance with the provisions of these Articles may be either a fixed sum of money, or may altogether or in part be governed by business done or profits made or otherwise determined by the Board, and may be in addition to or in lieu of any fee payable to him for his services as Director pursuant to these Articles.

111 Pensions and other benefits

111.1 The Board may exercise all the powers of the Company to provide pensions or other retirement or superannuation benefits and to provide death or disability benefits or other allowances or gratuities (whether by insurance or otherwise) for any person who is or has at any time been a Director of the Company or any company which is a subsidiary company of or allied to or associated with the Company or any such subsidiary or any predecessor in business of the Company or of any such subsidiary, and for any member of his family (including a spouse or former spouse) and any person who is or was dependent on him. For such purpose the Board may establish, maintain, subscribe and contribute to any scheme, trust or fund and pay premiums. The Board may procure any of such matters to be done by the Company either alone or in conjunction with any other person. Any Director or former Director shall be entitled to receive and retain for his own benefit any pension or other benefit provided under this Article 111 and shall not be obliged to account for it to the Company.

POWERS AND DUTIES OF THE BOARD

112 Powers of the Board

112.1 Subject to the provisions of the Act and these Articles and to any directions given by special resolution of the Company, the business of the Company shall be managed by the Board, which may exercise all the powers of the Company, whether relating to the management of the business or not. No alteration of these Articles and no such direction given by the Company shall invalidate any prior act of the Board which would have been valid if such alteration had not been made or such direction had not been given. Provisions contained elsewhere in these Articles as to any specific power of the Board shall not be deemed to limit the general powers given by this Article 112.

113 Powers of Directors being less than minimum number

113.1 If the number of Directors is less than the minimum for the time being prescribed by these Articles, the remaining Director or Directors shall act only for the purposes of appointing an additional Director or Directors to make up such minimum or of convening a general meeting of the Company for the purpose of making such appointment. If there

are no Director or Directors able or willing to act, any two members may summon a general meeting for the purpose of appointing Directors. Subject to the provisions of these Articles, any additional Director so appointed shall hold office only until the dissolution of the annual general meeting of the Company next following such appointment unless he is re-elected during such meeting.

114 Powers of executive Directors

114.1 The Board may from time to time:

- (a) delegate or entrust to and confer on any Director holding executive office (including the Chairman or a Deputy Chairman or a Chief Executive or a Managing Director) such of its powers, authorities and discretions (with power to sub-delegate), including, without prejudice to the generality of the foregoing, all powers, authorities and discretions the exercise of which involves or may involve the payment of remuneration to or conferring any other benefit on all or any of the Directors, for such time, on such terms and subject to such conditions as it thinks fit; and
- (b) revoke, withdraw, alter or vary all or any of such powers.

115 Delegation to committees

115.1 The Board may delegate any of its powers, authorities and discretions (with power to sub-delegate) for such time on such terms and subject to such conditions as it thinks fit to any committee consisting of one or more Directors and (if thought fit) one or more other persons, provided that:

- (a) where any committee constituted by the Board pursuant to this Article 115.1 consists of more than one member, not less than two members of such committee shall be Directors or alternate Directors; and
- (b) no resolution of a committee shall be effective unless one of those present when it is passed is a Director (or his alternate).

115.2 The Board may confer such powers, authorities and discretions either collaterally with, or to the exclusion of and in substitution for, all or any of the powers of the Board in that respect and may from time to time revoke, withdraw, alter or vary any of such powers, authorities and discretions and discharge any such committee in whole or in part. Insofar as any power, authority or discretion is so delegated, any reference in these Articles to the exercise by the Board of such power, authority or discretion shall be construed as if it were a reference to the exercise of such power, authority or discretion by such committee.

116 Local management

116.1 The Board may establish any local or divisional boards or agencies for managing any of the affairs of the Company in any specified locality, either in the United Kingdom or Hong Kong or elsewhere, and may appoint any persons to be members of such local or divisional board, or any managers or agents, and may fix their remuneration. The Board may delegate to any local or divisional board, manager or agent so appointed any of its powers, authorities and discretions (with power to sub-delegate) and may authorise the members for the time being of any such local or divisional board, or any of them, to fill any vacancies and to act notwithstanding vacancies; and any such appointment or

delegation may be made for such time, on such terms and subject to such conditions as the Board may think fit. The Board may confer such powers, authorities and discretions either collaterally with, or to the exclusion of and in substitution for, all or any of the powers of the Board in that respect and may from time to time revoke, withdraw, alter or vary all or any of such powers, authorities and discretions. Subject to any terms and conditions expressly imposed by the Board, the proceedings of any local or divisional board or agency with two or more members shall be governed by such of these Articles as regulate the proceedings of the Board, so far as they are capable of applying.

117 Power of attorney

117.1 The Board may by power of attorney or otherwise appoint any person or persons to be the agent of the Company and may delegate to any such person or persons any of its powers, authorities and discretions (with power to sub-delegate), in each case for such purposes and for such time, on such terms (including as to remuneration) and subject to such conditions as it thinks fit. The Board may confer such powers, authorities and discretions either collaterally with, or to the exclusion of and in substitution for, all or any of the powers of the Board in that respect and may from time to time revoke, withdraw, alter or vary any of such powers, authorities and discretions.

118 Associate directors

118.1 The Board may appoint any person (not being a Director) to any office or employment having a designation or title including the word “director” or attach to any existing office or employment with the Company such designation or title and may terminate any such appointment or the use of such designation or title. The inclusion of the word “director” in the designation or title of any such office or employment shall not imply that such person is, or is deemed to be, or is empowered in any respect to act as, a Director for any of the purposes of the Act or these Articles.

119 Exercise of voting power

119.1 The Board may exercise or cause to be exercised the voting power conferred by the shares in any other company held or owned by the Company, or any power of appointment to be exercised by the Company, in such manner in all respects as it thinks fit (including the exercise of the voting power or power of appointment in favour of the appointment of any Director as a director or other officer or employee of such company or in favour of the payment of remuneration to the directors, officers or employees of such company).

120 Provision for employees

120.1 The Board may exercise any power conferred on the Company by the Act³⁹ to make provision for the benefit of persons (other than directors, former directors or shadow directors) employed or formerly employed by the Company or any of its subsidiaries in connection with the cessation or the transfer to any person of the whole or part of the undertaking of the Company or that subsidiary.

³⁹ Section 247 of the Act

121 Registers of members

121.1 Subject to the provisions of the Act⁴⁰, the Board shall keep the following registers of its members and shall enter therein the particulars specified in Article 121.2:

- (a) in the United Kingdom, the Principal Register;
- (b) in Hong Kong, a register of members resident in Hong Kong which shall be called “the Hong Kong Overseas Branch Register”; and
- (c) in any such countries or territories as the Board may from time to time in its sole discretion determine, a register of members resident in such country or territory, each such register being hereinafter referred to as an “Overseas Branch Register”.

121.2 The following particulars shall be entered or stored in the registers referred to in Article 121.1:

- (a) the names and addresses of the members respectively entitled and requiring to be registered in one of such registers, and a statement of the shares held by each member distinguishing each share by its number so long as the share has a number, and where the Company has more than one class of share, by its class and a statement of the amount paid or agreed to be considered as paid on the shares of each member; provided that no member shall be entitled to be entered in more than one register at the same time in respect of the same shares;
- (b) the date at which each member was entered in the register as a member in respect of any share or shares; and
- (c) the date at which each member ceased to be a member in respect of any share or shares.

121.3 Subject to the Act⁴¹, the Board may make and vary such regulations as it thinks fit with respect to the keeping of any of the registers referred to in Article 121.1.

121.4 The Board may at any time serve a written notice on a member who is registered in the Hong Kong Overseas Branch Register or in any Overseas Branch Register requiring him to provide to the Board any information, supported by a declaration and by such other evidence as the Board may require, for the purpose of determining whether that member is resident in Hong Kong or in the country or territory in which an Overseas Branch Register is situated. If such information and evidence is not provided within 21 days of the date of such written notice or the information and evidence provided shows that the member is not so resident or is, in the opinion of the Board, unsatisfactory for the purpose of determining whether the member is so resident the Board may remove the shares registered in the name of that member from the Hong Kong Overseas Branch Register or, as the case may be, from the relevant Overseas Branch Register and register such shares in the name of that member on the Principal Register and shall serve a written notice of such removal and registration on the member.

⁴⁰ Sections 113-121 of the Act

⁴¹ Sections 129-135 of the Act

122 Borrowing powers

- 122.1 The Board may exercise all the powers of the Company to borrow money and to mortgage or charge all or any part of the undertaking, property and assets (present or future) and uncalled capital of the Company and, subject to the provisions of the Act⁴², to issue debentures and other securities, whether outright or as collateral security for any debt, liability or obligation of the Company or of any third party.

PROCEEDINGS OF DIRECTORS AND COMMITTEES**123 Board meetings**

- 123.1 Subject to the provisions of these Articles, the Board may meet for the despatch of business, adjourn and otherwise regulate its proceedings as it thinks fit.

124 Notice of Board meetings

- 124.1 Board meetings shall be convened at any time by the Chairman or by two Directors or the Secretary at the request of two Directors. A Director may waive the requirement that notice be given to him of any Board meeting, either prospectively or retrospectively. It shall not be necessary to give notice of a Board meeting to a Director who is absent from the United Kingdom or Hong Kong (or from such other country or territory as the Board may from time to time determine) unless he has requested the Board in writing that notices of Board meetings shall during his absence be given to him at any address in the United Kingdom or Hong Kong (or in such other country or territory as the Board may from time to time determine) or be sent to any address to which notices and documents can be sent using electronic means, in each case notified to the Company for this purpose, but he shall not, in such event, be entitled to a longer period of notice than if he had been present in the United Kingdom or Hong Kong (or in such other country or territory as the Board may from time to time determine) at that address.

125 Quorum

- 125.1 The quorum necessary for the transaction of business may be determined by the Board and, until otherwise so determined, shall be three persons, each being a Director or an alternate Director. A duly convened meeting of the Board at which a quorum is present shall be competent to exercise all or any of the authorities, powers, and discretions for the time being vested in or exercisable by the Board.

⁴² Sections 738-754 of the Act

126 Chairman of Board

126.1 The Board may appoint one of its body as Chairman to preside at every Board meeting at which he is present and no more than two other members as Deputy Chairmen, may determine the period for which he is or they are to hold office and may at any time remove him or them from office. If no such Chairman or Deputy Chairman is elected, or if at any meeting neither the Chairman nor a Deputy Chairman is present within five minutes of the time appointed for holding the same, the Directors present shall choose one of their number to be Chairman of such meeting. In the event of two or more Deputy Chairmen being present, the Deputy Chairman to act as Chairman shall be decided by those Directors present. Any Chairman or Deputy Chairman may also hold executive office under the Company.

127 Voting

127.1 Questions arising at any meeting shall be determined by a majority of votes. In the case of an equality of votes the Chairman shall have a second or casting vote.

128 Electronic participation in meetings

128.1 Any Director or his alternate may validly participate in a meeting of the Board or a committee of the Board by means of conference telephone or any other form of communication equipment, provided that all persons participating in the meeting are able to hear and speak to each other throughout such meeting, by a series of telephone calls from the Chairman or by exchange of communication in electronic form addressed to the Chairman.

128.2 A person so participating by being present or being in telephone communication with or by exchanging communication in electronic form with those in the meeting or with the Chairman shall be deemed to be present in person at the meeting and shall accordingly be counted in a quorum and be entitled to vote. Such a meeting shall be deemed to take place where the largest group of those participating is assembled or, if there is no group which is larger than any other group, where the Chairman then is.

128.3 A resolution passed at any meeting held in the above manner, and authenticated by the Chairman or the Secretary, shall be as valid and effectual as if it had been passed at a meeting of the Board (or committee, as the case may be) duly convened and held.

129 Resolution in writing

129.1 A resolution in writing executed by all the Directors for the time being entitled to receive notice of a Board meeting, and not being less than a quorum, or by all the members of a committee of the Board, shall be as valid and effective for all purposes as a resolution duly passed at a meeting of the Board (or committee, as the case may be). Such a resolution:

- (a) may consist of several documents in the same form each executed by one or more of the Directors or members of the relevant committee, including by means of facsimile transmission;
- (b) need not be signed by an alternate Director if it is signed by the Director who appointed him;
- (c) if signed by an alternate Director need not also be signed by his appointor; and

(d) to be effective, need not be signed by a Director who is prohibited by these Articles from voting thereon, or by his alternate.

130 Proceedings of committees

130.1 All committees of the Board shall, in the exercise of the powers delegated to them and in the transaction of business, conform to any mode of proceedings and regulations which the Board may prescribe and subject thereto shall be governed by such of these Articles as regulate the proceedings of the Board as are capable of applying.

131 Minutes of proceedings

131.1 The Board shall cause minutes to be made in books kept for the purpose of recording:

- (a) all appointments of officers and committees made by the Board; and
- (b) all orders, resolutions and proceedings at every meeting of the Company, of the Board and of any committee of the Board.

Any such minutes, if purporting to be signed by the Chairman of the meeting at which the proceedings were held or by the Chairman of the next succeeding meeting or the Secretary, shall be prima facie evidence of the matters stated in such minutes without any further proof.

132 Validity of proceedings

132.1 All acts done by a meeting of the Board, or of a committee of the Board, or by any person acting as a Director, alternate Director or member of a committee shall, notwithstanding that it is afterwards discovered that there was some defect in the appointment of any person or persons acting as aforesaid, or that they or any of them were or was disqualified from holding office or not entitled to vote, or had in any way vacated their or his office, be as valid as if every such person had been duly appointed, was duly qualified and had continued to be a Director, alternate Director or member of a committee, and was entitled to vote.

DIRECTORS' INTERESTS

133 Director may have interests

133.1 Subject to the provisions of the Act⁴³ and provided that Article 135 is complied with, a Director, notwithstanding his office:

- (a) may enter into or otherwise be interested in any contract, arrangement, transaction or proposal with the Company or in which the Company is otherwise interested, either in regard to his tenure of any office or place of profit or as vendor, purchaser or otherwise;
- (b) may hold any other office or place of profit under the Company (except that of Auditor or auditor of a subsidiary of the Company) in conjunction with the office of Director and may act by himself or through his firm in a professional capacity for the Company, and in any such case on such terms as to remuneration and

⁴³ Sections 175-177 and 182-187 of the Act

otherwise as the Board may arrange, either in addition to or in lieu of any remuneration provided for by any other Article;

- (c) may be a director or other officer, or employed by, or a party to any transaction or arrangement with or otherwise interested in, any company promoted by the Company or in which the Company is otherwise interested or as regards which the Company has any powers of appointment; and
- (d) shall not be liable to account to the Company for any profit, remuneration or other benefit realised by any such office, employment, contract, arrangement, transaction or proposal or from any interest in any body corporate and no such contract, arrangement, transaction, proposal or interest shall be avoided on the grounds of any such interest or benefit nor shall the receipt of any such profit, remuneration or any other benefit constitute a breach of his duty under the Act⁴⁴ not to accept benefits from third parties.

134 Power of the Board to authorise conflicts of interest

134.1 The Board may authorise any matter proposed to it which would, if not so authorised, involve a breach by a Director of his duty to avoid conflicts of interest under the Act⁴⁵, including, without limitation, any matter which relates to a situation in which a Director has, or can have, an interest which conflicts, or possibly may conflict, with the interest of the Company (including the exploitation of any property, information or opportunity, whether or not the Company could take advantage of it, but excluding any situation which cannot reasonably be regarded as likely to give rise to a conflict of interest). The provisions of this Article 134 do not apply to a conflict of interest arising in relation to a transaction or arrangement with the Company.

134.2 Any such authorisation will be effective only if:

- (a) any requirement as to quorum at the meeting at which the matter is considered is met without counting the Director in question or any other interested Director; and
- (b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

134.3 The Board may (whether at the time of the giving of the authorisation or subsequently) make any such authorisation subject to any limits or conditions it expressly imposes but such authorisation is otherwise given to the fullest extent permitted.

134.4 The Board may vary or terminate any such authorisation at any time.

135 Declaration of interests

135.1 A Director shall declare the nature and extent of his interest in a matter within Article 134 to the other Directors.

135.2 A Director who is aware that he is in any way interested in a proposed transaction or arrangement with the Company must declare the nature and extent of his interest to the other Directors.

⁴⁴ Section 176 of the Act

⁴⁵ Section 175 of the Act

- 135.3 A Director who is aware that he is in any way interested in a transaction or arrangement that has been entered into by the Company must declare the nature and extent of his interest to the other Directors, unless the interest has already been declared under Article 135.2.
- 135.4 The declaration of interest must (in the case of Article 135.3) and may, but need not (in the case of Article 135.1 or 135.2), be made:
- (a) at a meeting of the Directors; or
 - (b) by general or specific notice to the Directors in accordance with the Act⁴⁶.
- 135.5 If a declaration of interest, or deemed declaration of interest, proves to be, or becomes, inaccurate or incomplete, a further disclosure must be made.
- 135.6 Any declaration of interest required by Article 135.1 above must be made as soon as reasonably practicable.
- 135.7 Any declaration of interest required by Article 135.2 above must be made before the Company enters into the transaction or arrangement.
- 135.8 Any declaration of interest under Article 135.3 above must be made as soon as reasonably practicable. Failure to comply with this requirement does not affect the underlying duty to make the declaration of interest.
- 135.9 For the purposes of Articles 135.1, 135.2 and 135.3, a Director need not declare an interest:
- (a) if it cannot reasonably be regarded as likely to give rise to a conflict of interest;
 - (b) if, or to the extent that, the other Directors are already aware of it; or
 - (c) if, or to the extent that, it concerns terms of his service contract that have been or are to be considered:
 - (i) by a meeting of the Directors; or
 - (ii) by a committee of the Directors appointed for the purpose under these Articles.

136 Entitlement to keep information confidential

- 136.1 Subject to Article 136.2, a Director shall be under no duty to the Company with respect to any information which he obtains or has obtained otherwise than as a Director of the Company and in respect of which he has a duty of confidentiality to another person. In particular, the Director shall not be in breach of the general duties he owes to the Company under the Act⁴⁷ because he fails to:
- (a) disclose any such information to the Board or to any Director or other officer or employee of the Company; and/or

⁴⁶ Sections 184 and 185 of the Act

⁴⁷ Sections 171-177 of the Act

(b) use or apply any such information in performing his duties as a Director of the Company.

136.2 To the extent that the relationship between a Director and a person to whom he owes a duty of confidentiality gives rise to a conflict of interest or possible conflict of interest, Article 136.1 applies only if the existence of that relationship has been authorised by the Board pursuant to Article 134 or if Article 133 applies to the relationship.

137 Avoiding conflicts of interest

137.1 Where the existence of a Director's relationship with another person has been authorised by the Board pursuant to Article 134 (and subject to any limits or conditions imposed pursuant to Article 134.3), or if Article 133 applies to the relationship, and his relationship with that person gives rise to a conflict of interest or possible conflict of interest, the Director shall not be in breach of the general duties he owes to the Company under the Act⁴⁸ because he:

- (a) absents himself from meetings of the Board at which any matter relating to the conflict of interest or possible conflict of interest will or may be discussed or from the discussion of any such matter at a meeting or otherwise; and/or
- (b) makes arrangements not to receive documents and information relating to any matter which gives rise to the conflict of interest or possible conflict of interest sent or supplied by the Company and/or makes arrangements for such documents and information to be received and read by a professional adviser,

for so long as he reasonably believes such conflict of interest or possible conflict of interest subsists.

138 Overriding principles

138.1 The provisions of Articles 136 and 137 are without prejudice to any equitable principle or rule of law which may excuse the Director from:

- (a) disclosing information in circumstances where disclosure would otherwise be required under these Articles; or
- (b) attending meetings or discussions or receiving documents and information as referred to in Article 137, in circumstances where such attendance or receiving such documents and information would otherwise be required under these Articles.

139 Interested Director not to vote or count for quorum

139.1 Save as provided in this Article 139, a Director shall not vote on, or be counted in the quorum in relation to, any resolution of the Board or of a committee of the Board concerning any contract, arrangement, transaction or any proposal whatsoever to which the Company is or is to be a party and in which he or any of his associates has a material interest otherwise than by virtue of his interest or the interests of his associate(s) in shares or debentures or other securities of or otherwise in or through the Company unless the resolution concerns any of the following matters:

⁴⁸ Sections 171-177 of the Act

- (a) the giving to him or his associate(s) of any guarantee, security or indemnity in respect of money lent or obligations incurred by him or any of them at the request of or for the benefit of the Company or any of its subsidiary undertakings;
- (b) the giving to a third party of any guarantee, security or indemnity in respect of a debt or obligation of the Company or any of its subsidiary undertakings for which he or his associate(s) has himself/themselves assumed responsibility in whole or in part, either alone or jointly with others, under a guarantee or indemnity or by the giving of security;
- (c) any proposal concerning an offer of shares or debentures or other securities of or by the Company or any of its subsidiary undertakings in which offer he or his associate(s) is/are or may be entitled to participate as a holder of securities or in the underwriting or sub-underwriting of which he is to participate;
- (d) any proposal concerning any other body corporate in which he (together with his associates) does not to his knowledge have an interest (as the term is used in Part 22 of the Act) in five per cent. or more of the issued equity share capital of any class of such body corporate or of the voting rights available to members of such body corporate;
- (e) any proposal relating to an arrangement for the benefit of the employees of the Company or any of its subsidiary undertakings which does not award him any privilege or benefit not generally awarded to the employees to whom such arrangement relates;
- (f) any proposal concerning insurance which the Company proposes to maintain or purchase for the benefit of the Directors or for the benefit of persons who include Directors; or
- (g) the giving of any other indemnity or any proposal concerning the funding of expenditure by one or more Directors on defending proceedings against him or them, or doing anything to enable such Director or Directors to avoid incurring such expenditure, where all other Directors are also being offered indemnities or funding on substantially the same terms.

140 Director's interest in own appointment

- 140.1 A Director shall not vote or be counted in the quorum on any resolution of the Board or committee of the Board concerning his own appointment (including fixing or varying the terms of his appointment or its termination) as the holder of any office or place of profit with the Company or any company in which the Company is interested. Where proposals are under consideration concerning the appointment (including fixing or varying the terms of appointment or its termination) of two or more Directors to offices or places of profit with the Company or any company in which the Company is interested, such proposals may be divided and a separate resolution considered in relation to each Director. In such case each of the Directors concerned (if not otherwise debarred from voting under these Articles) shall be entitled to vote (and be counted in the quorum) in respect of each resolution except that concerning his own appointment.

141 Chairman's ruling conclusive on Director's interest

- 141.1 If any question arises at any meeting as to the materiality of a Director's interest or the interests of his associate(s) (other than the Chairman's interest) or as to the entitlement of

any Director (other than the Chairman) to vote or be counted in a quorum for the purposes of Article 139, and such question is not resolved by his voluntarily agreeing to abstain from voting or being counted in the quorum, such question shall be referred to the Chairman. The Chairman's ruling in relation to the Director concerned shall be final and conclusive.

142 Directors' resolution conclusive on Chairman's interest

142.1 If any question arises at any meeting as to the materiality of the Chairman's interest or the interests of his associate(s) or as to the entitlement of the Chairman to vote or be counted in a quorum for the purposes of Article 139, and such question is not resolved by his voluntarily agreeing to abstain from voting or being counted in the quorum, such question shall be decided by resolution of the Directors or committee members present at the meeting (excluding the Chairman), whose majority vote shall be final and conclusive.

143 Definitions

143.1 For the purposes of Articles 133 to 143:

- (a) a conflict of interest includes a conflict of interest and duty and a conflict of duties;
- (b) an interest means a direct or an indirect interest, and for these purposes an interest of a person who is for the purposes of the Act⁴⁹ connected with a Director shall be treated as an interest of the Director and "interested" shall be construed accordingly;
- (c) an interest, transaction, arrangement or proposal of which a Director is aware includes an interest, transaction, arrangement or proposal of which that Director ought reasonably to be aware;
- (d) in relation to an alternate Director, an interest of his appointor shall be treated as an interest of the alternate Director in addition to any interest which the alternate Director otherwise has; and
- (e) an "associate" of a Director shall mean any person who is for the purposes of the Act⁵⁰ connected with a Director and any person who is an associate of a Director within the meaning of rule 1.01 of the rules governing the listing of securities on The Hong Kong Stock Exchange.

THE SEAL

144 Application of Seal

144.1 The Seal shall be used only by the authority of a resolution of the Board or of a committee of the Board. The Board may determine whether any instrument to which the Seal is affixed shall be signed and, if it is to be signed, who shall sign it. Unless otherwise so determined:

- (a) share certificates and, subject to the provisions of any instrument constituting the same, certificates issued under the Seal in respect of any debentures or other

⁴⁹ Sections 252-256 of the Act

⁵⁰ Sections 252-256 of the Act

securities need not be signed and any signature may be affixed to or printed on any such certificate by any means approved by the Board; and

- (b) every other instrument to which the Seal is affixed shall be signed by one Director and by the Secretary, by two Directors or by one Director in the presence of a witness who attests his signature.

144.2 Every certificate or share warrant to bearer shall be issued under the Seal or in such other manner as the Board, having regard to the terms of issue, the Act, and the regulations of The Hong Kong Stock Exchange and The Stock Exchange, may authorise; all references in these Articles to the Seal shall be construed accordingly.

145 Deed without sealing

145.1 A document signed by a Director and by the Secretary, by two Directors or by a Director in the presence of a witness who attests the signature, and expressed (in whatever form of words) to be executed by the Company shall have the same effect as if it were executed under the Seal, provided that no instrument shall be so signed which makes it clear on its face that it is intended by the person or persons making it to have effect as a deed without the authority of a resolution of the Board or of a committee of the Board duly authorised. An instrument or document which is executed by the Company as a deed shall not be deemed to be delivered by the Company solely as a result of it having been executed by the Company.

146 Official seal for use abroad

146.1 Subject to the provisions of the Act⁵¹, the Company may have an official seal for use in any place outside the United Kingdom.

THE SECRETARY

147 The Secretary

147.1 Subject to the provisions of the Act⁵², the Board shall appoint a Secretary or joint secretaries and shall have power to appoint one or more persons to be an assistant or deputy secretary at such remuneration and on such conditions as it thinks fit.

147.2 Any provision of the Act or of these Articles requiring or authorising a thing to be done by or to a Director and the Secretary shall not be satisfied by its being done by or to the same person acting both as Director and as, or in place of, the Secretary.

DIVIDENDS AND OTHER PAYMENTS

148 Declaration of dividends

148.1 Subject to the provisions of the Act⁵³ and of these Articles, the Company may by ordinary resolution declare dividends to be paid to members according to their respective rights and interests in the profits of the Company. However, no dividend shall exceed the

⁵¹ Section 49 of the Act

⁵² Sections 271-279 of the Act

⁵³ Sections 829-853 of the Act

amount recommended by the Board. If and whenever the shares on which any such dividend is declared are denominated in different currencies, the dividend shall be declared in a single currency (which may be any currency).

149 Interim dividends

149.1 Subject to the provisions of the Act⁵⁴, the Board may declare and pay such interim dividends (including any dividend payable at a fixed rate) as appears to the Board to be justified by the profits of the Company available for distribution. The Board shall declare such dividend on all shares ranking pari passu in a single currency (which may be any currency) even if such shares are denominated in different currencies. If at any time the share capital of the Company is divided into different classes, the Board may pay such interim dividends on shares which rank after shares conferring preferential rights with regard to dividend as well as on shares conferring preferential rights, unless at the time of payment any preferential dividend is in arrear. Provided that the Board acts in good faith, it shall not incur any liability to the holders of shares conferring preferential rights for any loss that they may suffer by the lawful payment of any interim dividend on any shares ranking after those with preferential rights.

150 Entitlement to dividends

150.1 Except as otherwise provided by the terms of issue of or rights attached to any shares, all dividends shall be declared and paid according to the amounts paid up (otherwise than in advance of calls) on the shares on which the dividend is paid. . Subject as aforesaid, all dividends shall be apportioned and paid proportionately to the percentage of the nominal amount (which shall in the case of Ordinary Shares be treated as the same amount as is hereby treated as paid up on all fully paid Ordinary Shares) paid up on the shares during any portion or portions of the period in respect of which the dividend is paid, but if any share is issued on terms providing that it shall rank for dividend as from a particular date, it shall rank for dividend accordingly.

151 Calls or debts may be deducted from dividends

151.1 The Board may deduct from any dividend or other money payable to any person on or in respect of a share all such sums as may be due from him to the Company on account of calls or otherwise in relation to the shares of the Company.

152 Distribution in specie

152.1 The Board may direct that payment of any dividend declared may be satisfied wholly or partly by the distribution of assets of any kind, and in particular of paid up shares or securities or debentures of any other company, or in any one or more of such ways. Where any difficulty arises in regard to such distribution, the Board may settle it as it thinks fit. In particular, the Board may:

- (a) issue fractional certificates (or ignore fractions);
- (b) fix the value for distribution of such assets or any part thereof and determine that cash payments may be made to any members on the footing of the value so fixed, in order to adjust the rights of members; and
- (c) vest any such assets in trustees on trust for the persons entitled to the dividend.

⁵⁴ Sections 829-853 of the Act

153 Dividends not to bear interest

- 153.1 Unless otherwise provided by the rights attached to the share, no dividend or other moneys payable by the Company or in respect of a share shall bear interest as against the Company.

154 Method of payment

- 154.1 The Company may pay any dividend, interest or other sum payable in respect of a share by cheque, dividend warrant, or money order and may send the same by post to the registered address (or in the case of a Depositary, subject to the approval of the Board, such persons and addresses as the Depositary may require) of the member or person entitled to it or, if two or more persons are holders of the share or are jointly entitled to it by reason of the death or bankruptcy of the member or otherwise by operation of law, to the registered address of such of those persons as is first named in the Register or to such person and to such address as such member or person or persons may direct in writing. Every cheque, warrant or order is sent at the risk of the person entitled to the money represented by it, shall be crossed in accordance with the Cheques Act 1992 or in such other manner as the Board may from time to time approve and shall be made payable to the person or persons entitled, or to such other person as the person or persons entitled may direct in writing. Payment of the cheque, warrant or order shall be a good discharge to the Company. If any such cheque, warrant or order has or shall be alleged to have been lost, stolen or destroyed, on request of the person entitled thereto a replacement cheque or warrant or order may be issued subject to compliance with such conditions as to evidence and indemnity and the payment of out of pocket expenses of the Company in connection with the request as the Board may think fit. Any joint holder or other person jointly entitled to a share may give an effective receipt for any dividend or other money payable in respect of such share. Any such dividend, interest or other sum may also be paid by any other method (including direct debit or autopay or bank transfer) as the Board considers appropriate.
- 154.2 The Board may at its discretion make provisions to enable a Depositary and/or any other member as they shall from time to time determine to receive dividends duly declared in such currency or currencies and at such rate or rates of exchange and on such terms and conditions as the Board may in its absolute discretion determine.
- 154.3 For the purposes of Article 154.1, any payment in the case of uncertificated shares may be made by means of the relevant system (subject to the facilities and requirements of the relevant system) and without prejudice to the generality of the foregoing such payment may be made by the sending by the Company or any person on its behalf of an instruction to the Operator of the relevant system to credit the cash memorandum account of the holder or joint holders of such shares or, if permitted by the Company, of such person as the holder or joint holders may in writing direct and, for the purposes of Article 154.1, the making of a payment in accordance with the facilities and requirements of the relevant system concerned shall be a good discharge to the Company.

155 Uncashed dividends

- 155.1 If cheques, warrants or orders for dividends or other moneys payable in respect of a share sent by the Company to the person entitled thereto are returned to the Company or left uncashed on two consecutive occasions, the Company shall not be obliged to send any dividend or other money payable in respect of that share due to that person until he notifies the Company of an address to be used for the purpose.

156 Unclaimed dividends

156.1 All dividends unclaimed for 12 months after having become payable may be invested or otherwise made use of by the Board for the benefit of the Company until claimed and the Company shall not be constituted a trustee in respect thereof. All dividends unclaimed for a period of 12 years after having become due for payment shall (if the Board so resolves) be forfeited and shall cease to remain owing by the Company.

157 Payment of scrip dividends

157.1 The Board may, with the prior authority of an ordinary resolution of the Company and subject to such terms and conditions as the Board may determine, offer to any holders of Ordinary Shares the right to elect to receive, in accordance with the provisions of this Article 157, Ordinary Shares, credited as fully paid, instead of cash in any currency in respect of the whole (or some part, to be determined by the Board) of any dividend specified by the ordinary resolution. The following provisions shall apply:

- (a) the said resolution may specify a particular dividend, or may specify all or any dividends declared within a specified period or periods;
- (b) the entitlement of each holder of Ordinary Shares to new Ordinary Shares shall be such that the relevant value of the entitlement shall be as nearly as possible equal to (but not greater than) the cash amount (disregarding any tax credit) of the dividend that such holder would have received by way of dividend in the currency in which such dividend was declared or as converted into the equivalent amount in another currency if and in such manner as the Board shall so determine. For this purpose "relevant value" shall be calculated by reference to the average of the middle market quotations for the Ordinary Shares on The Stock Exchange, as derived from the Daily Official List, for the day on which the Ordinary Shares are first quoted "ex" the relevant dividend and the four subsequent dealing days, or in such other manner as the Board may determine on such basis as it considers to be fair and reasonable and the cash amount of the relevant dividend in a particular currency shall be converted into the equivalent amount in another currency if and in such manner as the Board shall so determine. A certificate or report by the Auditors as to the amount of the relevant value in respect of any dividend shall be conclusive evidence of that amount;
- (c) no fractions of a share shall be allotted. The Board may make such provisions as it thinks fit for the application of any residual dividend entitlement remaining following the calculation of the entitlement of a holder of Ordinary Shares to new Ordinary Shares pursuant to sub-paragraph (b) of this Article 157.1 including provisions whereby, in whole or in part, the benefit thereof accrues to the Company and/or under which such entitlements are accrued and/or retained and in each case accumulated on behalf of any holder of Ordinary Shares and such accruals or retentions are applied to the allotment by way of bonus to or cash subscription on behalf of such holder of fully paid Ordinary Shares and/or provisions whereby cash payments may be made to holders of Ordinary Shares in respect of such entitlements;
- (d) the Board shall, after determining the basis of allotment, notify the holders of Ordinary Shares in writing of the right of election offered to them, and specify the procedure to be followed and place at which, and the latest time by which, elections must be lodged in order to be effective;

- (e) the Board may exclude from any offer any holders of Ordinary Shares or any Ordinary Shares held by a Depositary where the Board considers that the making of the offer to them or in respect of such shares would or might involve the contravention of the laws of any territory or that for any other reason the offer should not be made to them or in respect of such shares;
- (f) the Board may determine that every duly effected election in respect of any Ordinary Shares shall be binding on every successor in title to the holder thereof;
- (g) the dividend (or that part of the dividend in respect of which a right of election has been offered) shall not be payable on Ordinary Shares in respect of which an election has been duly made (“the elected Ordinary Shares”) and instead additional Ordinary Shares shall be allotted, credited as fully paid, to the holders of the elected Ordinary Shares on the basis of their entitlement pursuant to sub-paragraph (b) of this Article 157.1. For such purpose the Board may capitalise, out of any amount for the time being standing to the credit of any reserve or fund (including any share premium account or capital redemption reserve) or of any of the profits which could otherwise have been applied in paying dividends in cash as the Board may determine, a sum equal to the aggregate nominal amount or amounts of the additional Ordinary Shares to be allotted on that basis and apply it in paying up in full the appropriate number of unissued Ordinary Shares for allotment and distribution to the holders of the elected Ordinary Shares on that basis. A Board resolution capitalising any part of such reserve or fund or profits shall have the same effect as if such capitalisation had been declared by ordinary resolution of the Company in accordance with Article 159 and in relation to any such capitalisation the Board may exercise all the powers conferred on them by Article 159 without need of such ordinary resolution;
- (h) the additional Ordinary Shares so allotted shall rank *pari passu* in all respects with each other and with the fully paid Ordinary Shares in issue on the record date for the dividend in respect of which the right of election has been offered, except that they will not rank for any dividend or other distribution or other entitlement which has been declared, paid or made by reference to such record date;
- (i) the Board may establish or vary from time to time a procedure for election mandates in respect of future rights of election;
- (j) the Board may terminate, suspend or amend any offer of the right to elect to receive Ordinary Shares in lieu of any cash dividend at any time; and
- (k) the Board generally may implement an offer of the right to elect to receive Ordinary Shares in lieu of any cash dividend on such terms and conditions as the Board may from time to time determine and take such other action as the Board may deem necessary or desirable from time to time in respect of any such offer.

158 Reserves

- 158.1 The Board may, before recommending any dividend (whether preferential or otherwise), carry to reserve out of the profits of the Company such sums as it thinks fit. All sums standing to reserve may be applied from time to time, at the discretion of the Board, for any other purpose to which the profits of the Company may properly be applied, and pending such application may, at the like discretion, either be employed in the business

of the Company or be invested in such investments as the Board thinks fit. The Board may divide the reserve into such special funds as it thinks fit, and may consolidate into one fund any special funds or any parts of any special funds into which the reserve may have been divided as it thinks fit. Any sum which the Board may carry to reserve out of the unrealised profits of the Company shall not be mixed with any reserve to which profits available for distribution have been carried. The Board may also, without placing the same to reserve, carry forward any profits which it may think prudent not to distribute.

159 Capitalisation of reserves

159.1 The Board may, with the authority of an ordinary resolution of the Company:

- (a) subject as provided in this Article 159, resolve to capitalise any undivided profits of the Company not required for paying any preferential dividend (whether or not they are available for distribution) or any sum standing to the credit of any reserve or fund of the Company which is available for distribution or standing to the credit of any share premium account or capital redemption reserve or other undistributable reserve;
- (b) appropriate the sum resolved to be capitalised to the holders of Ordinary Shares (whether or not fully paid) in proportion to the number of such Ordinary Shares held by them respectively and apply such sum on their behalf either in or towards paying up the amounts, if any, for the time being unpaid on any Ordinary Shares held by them respectively, or in paying up in full unissued shares or debentures of the Company of a nominal amount equal to that sum, and allot the shares or debentures credited as fully paid to those holders of Ordinary Shares or as they may direct, in those proportions, or partly in one way and partly in the other, provided that:
 - (i) the share premium account, the capital redemption reserve, any other undistributable reserve and any profits which are not available for distribution may, for the purposes of this Article 159, only be applied in paying up new shares to be allotted to holders of Ordinary Shares credited as fully paid;
 - (ii) where the amount capitalised is applied in paying up in full new shares, the Company will also be entitled to participate in the relevant distribution in relation to any Ordinary Shares held by it as treasury shares and the proportionate entitlement of the holders of Ordinary Shares to the distribution will be calculated accordingly; and
 - (iii) the sum appropriated as hereinbefore mentioned need not be in the same currency as the securities which it is to be used to pay up but in that event and for the purpose of determining the extent to which such securities are paid up by such sum the Board shall select such rate of exchange as it shall consider appropriate;
- (c) resolve that any shares so allotted to any holder of Ordinary Shares in respect of a holding by him of any partly paid Ordinary Shares shall, so long as such Ordinary Shares remain partly paid, rank for dividends only to the extent that such partly paid Ordinary Shares rank for dividends;

- (d) make such provision by the issue of fractional certificates (or by ignoring fractions or by accruing the benefit thereof to the Company rather than to the holders of Ordinary Shares concerned) or by payment in cash or otherwise as it thinks fit in the case of shares or debentures becoming distributable in fractions;
- (e) authorise any person to enter on behalf of all the holders of Ordinary Shares concerned into an agreement with the Company providing for either (i) the allotment to them respectively, credited as fully paid up, of any shares or debentures to which they may be entitled on such capitalisation or (ii) the payment up by the Company on behalf of such holders by the application thereto of their respective proportions of the reserves or profits resolved to be capitalised, of the amounts or any part of the amounts remaining unpaid on their existing Ordinary Shares (any agreement made under such authority being effective and binding on all such holders); and
- (f) generally do all acts and things required to give effect to such resolution.

160 Record dates

- 160.1 Notwithstanding any other provision of these Articles but without prejudice to the rights attached to any shares and subject always to the Act, the Company or the Board may by resolution specify any date (the “record date”) as the date at the close of business (or such other time as the Board may determine) on which persons registered as the holders of shares or other securities shall be entitled to receipt of any dividend, distribution, interest, allotment, issue, notice, information, document or circular and such record date may be on or at any time before the date on which the same is paid or made or (in the case of any dividend, distribution, interest, allotment or issue) at any time before or after the same is recommended, resolved, declared or announced but without prejudice to the rights inter se in respect of the same of transferors and transferees of any such shares or other securities. Different dates may be fixed as record dates in respect of shares registered on different Registers.

ACCOUNTS

161 Accounting records

- 161.1 The Board shall cause accounting records to be kept in accordance with the Act⁵⁵.

162 Inspection of records

- 162.1 No member (other than a Director) shall have any right to inspect any accounting record or other document of the Company unless he is authorised to do so by statute, by order of the court, by the Board or by ordinary resolution of the Company.

163 Accounts to be sent to members

- 163.1 Except as provided in Article 164, the annual accounts and reports shall, not less than 21 clear days before the annual general meeting before which they are to be laid, be delivered, sent by post or made available on the Company’s website to every member, holder of debentures of the Company and any other person who is entitled to receive notice of general meetings. However, this Article 163 shall not require a copy of those

⁵⁵ Parts 15 and 16 of the Act

documents to be sent to any person who under the provisions of these Articles is not entitled to receive notices from the Company or of whose address the Company is unaware or to more than one of the joint holders of any shares or debentures. If all or any of the shares in or debentures of the Company are listed or dealt in on any stock exchange, there shall at the same time be forwarded to the secretary of that stock exchange such number of copies of each of those documents as the regulations of that stock exchange may require.

164 Summary financial statements

164.1 The Company may, in accordance with the Act⁵⁶ and any regulations made under the Act send a summary financial statement to any member, holder of debentures of the Company or any other person who is entitled to receive notice of general meetings instead of or in addition to the documents referred to in Article 163. Where it does so, the statement shall be delivered, sent by post or made available on the Company's website to the member, holder of debentures of the Company or any other person entitled to receive notice of general meetings not less than 21 clear days before the annual general meeting before which those documents are to be laid.

NOTICES

165 Form of notices

165.1 Notwithstanding anything to the contrary in these Articles, any notice, document or information to be given, sent, issued, deposited, served or delivered (or the equivalent) to or by any person pursuant to these Articles (other than a notice calling a meeting of the Directors) shall be in writing and, if the Board in its absolute discretion considers appropriate for any purpose or purposes under these Articles, any such notice, document or information shall be deemed given, sent, issued, deposited, served or delivered (or the equivalent) where it is sent in electronic form to an address for the time being notified for that purpose to the person giving such notice, document or information, but subject always to the provisions of Article 169. In the case of notices or other documents or information sent in electronic form the Board may make this subject to such terms and conditions as it shall in its absolute discretion consider appropriate, subject to and in accordance with the provisions of the Act⁵⁷. Nothing in these Articles shall affect any requirement of the Act that any particular offer, notice or other document or information be served in any particular manner.

165.2 For the purposes of these Articles, notices, documents or information may be sent in electronic form by the Company to a person where:

- (a) such person has agreed (generally or specifically) that the notice, document or information may be sent or supplied in that form (and has not revoked that agreement), including on a website;
- (b) the notice, document or information (as the case may be) is a notice, document or information to which that agreement applies; and

⁵⁶ Sections 426-429 and sections 434-435 of the Act

⁵⁷ Parts 3 and 4 of Schedule 5 to the Act

- (c) in the case of a notice, document or information being made available on a website, a notice is sent to the person, in a manner for the time being agreed for that purpose between that person and the Company notifying such person, of:
- (i) the publication of that notice, document or information on the website;
 - (ii) the address of the website; and
 - (iii) the place on that website where the notice, document or information may be accessed, and how it may be accessed,

and in any such case the notification referred to above shall be treated as the relevant notice for the purposes of these Articles.

165.3 Subject to the Act⁵⁸, any notice, document or information is validly sent or supplied by the Company if it is made available on a website.

165.4 Subject to the members having resolved that the Company may send or supply notices, documents or information to members by making them available on a website, where the Company requests the agreement of a person to receive specified notices, documents or information by means of a website and the Company does not receive a response within the period of 28 days (or such shorter period as may be required by statute) from the date the Company's request was sent, such person shall be deemed to have agreed to receive such notices, documents or information by the means specified in the request.

165.5 The Company shall, at the request of a member, also provide such member, within 21 days of the receipt by the Company of the request, with a hard copy of any document sent in electronic form in accordance with these Articles.

165.6 Any amendment or revocation of a notification given to the Company under this Article 165 shall only take effect if it is delivered to the Company in writing, signed by the member and on actual receipt by the Company thereof.

166 Authentication

166.1 For the purposes of these Articles, the Company shall treat any document received by it as sufficiently authenticated if:

- (a) where the document is sent in hard copy form, it is signed by the person who sent it; or
- (b) where the document is sent in electronic form, it has been authenticated in such manner as the Board may, in its absolute discretion, from time to time, determine,

provided that, where a document is sent or supplied to the Company by a person on behalf of another, the Board may, in its absolute discretion, request that the sender also provide such reasonable evidence of their authority to act on such other's behalf as the Board may specify before the document may be treated as sufficiently authenticated.

⁵⁸ Part 4 of Schedule 5 to the Act

167 Service of notice on members

- 167.1 The Company may give any notice, document or information (including a share certificate) to a member either personally or by sending it by post in a prepaid envelope addressed to the member at his registered address or by leaving it at that address or, in the circumstances referred to in Article 165, by sending it using electronic means to an address for the time being notified to the Company by the member or by making it available on a website. In the case of a member registered on the Principal Register or the Hong Kong Overseas Branch Register or an Overseas Branch Register any such notice, document or information may be posted either in the United Kingdom or in any territory in which any such Register is maintained.
- 167.2 In the case of joint holders of a share, all notices, documents or information shall be given to the joint holder whose name stands first in the Register in respect of the joint holding. Notice so given shall be sufficient notice to all the joint holders.
- 167.3 Where a member (or, in the case of joint holders, the person first named in the Register) has a registered address outside Hong Kong or the United Kingdom but has notified the Company of an address within Hong Kong or the United Kingdom at which notices, documents or other information may be given to him or, if the Board in its absolute discretion permits, an address to which notices, documents or information may be sent using electronic means, he shall be entitled to have notices, documents or information given or sent to him at that address but otherwise no such member shall be entitled to receive any notice, document or information from the Company. If on at least two consecutive occasions the Company has attempted to send notices, documents or information using electronic means to an address for the time being notified to the Company by a member for that purpose but the Company is aware that there has been a failure of delivery of such notice, document or information in the manner described in Article 169.3, then the Company shall thereafter send notices, documents or information through the post to such member at his registered address or his address for the service of notices by post, in which case the provisions of the remainder of this Article 167.3 shall apply. If on three consecutive occasions notices, documents or information have been sent through the post to any member at his registered address or his address for the service of notices but have been returned undelivered, such member shall not thereafter be entitled to receive notices, documents or information from the Company until he shall have communicated with the Company and supplied in writing a new registered address, address within Hong Kong or the United Kingdom for the service of notices, documents or information or an address to which notices, documents or information may be sent using electronic means.

168 Notice in case of death, bankruptcy or mental disorder

- 168.1 The Company may give any notice, document or information to the person entitled to a share in consequence of the death or bankruptcy of a member or otherwise by operation of law, by sending or delivering it in any manner authorised by these Articles for the giving of any notice, document or information to a member, addressed to that person by name, or by the title of representative of the deceased or trustee of the bankrupt or by any like description, at an address (if any) within Hong Kong or the United Kingdom or an address to which notices may be sent using electronic means supplied for the purpose by the person claiming to be so entitled. Until such an address has been so supplied, a notice, document or other information may be given in any manner in which it might have been given if the death or bankruptcy or operation of law had not occurred.

169 Evidence of service

- 169.1 Any member present, in person or by proxy, at any meeting of the Company or of the holders of any class of shares of the Company shall be deemed to have received due notice of such meeting, and, where requisite, of the purposes for which such meeting was called.
- 169.2 Any notice, document or other information, addressed to a member at his registered address or address for service in Hong Kong or the United Kingdom shall, if sent by post, be deemed to have been served or delivered on the day after the day when it was put in the post (or, where second-class mail is employed, on the second day after the day when it was put in the post). In proving such service or delivery it shall be conclusive to prove that the envelope containing the notice, document or information was properly addressed and put into the post as a prepaid letter. Any notice, document or other information not sent by post but delivered or left at a registered address or address for service in Hong Kong or the United Kingdom shall be deemed to have been served or delivered on the day on which it was so delivered or left.
- 169.3 Any notice, document or other information addressed to a member shall, if sent using electronic means, be deemed to have been served or delivered at the expiration of 24 hours after the time it was first sent. In proving such service or delivery it shall be conclusive to prove that the address used for the electronic communication was the address supplied for that purpose and the electronic communication was properly dispatched, unless the Company is aware that there has been a failure of delivery of such notice, document or information following at least two attempts in which case such notice, document or information shall be sent to the member at his registered address or address for service in Hong Kong or the United Kingdom provided that the date of deemed service or delivery shall be 24 hours from the dispatch of the original electronic communication in accordance with this Article 169.3.
- 169.4 Any notice, document or other information sent or supplied to a member by means of the Company's website, in accordance with Article 165, shall be deemed to have been received by the intended recipient when the material was first made available on the website or, if later, at the time the intended recipient received (or is deemed to have received) notice of the fact the material was available on the Company's website.
- 169.5 Any notice, document or other information sent by a relevant system shall be deemed to have been served or delivered when the Company, or a sponsoring system—participant (within the meaning of the Regulations) acting on its behalf, sends the issuer-instructions (within the meaning of the Regulations) relating to the notice, document or information.

170 Notice binding on transferees

- 170.1 Every person who, by operation of law, transfer or by any other means becomes entitled to a share shall be bound by any notice in respect of that share (other than a notice given by the Company under section 793 of the Act) which, before his name is entered in the Register, has been duly given to a person from whom he derives his title.

171 Notice by advertisement

- 171.1 Any notice to be given by the Company to the members or any of them, and not otherwise provided for by these Articles, shall be sufficiently given if given by advertisement appearing in one leading English language daily newspaper and one leading Chinese language daily newspaper printed and circulating in Hong Kong and in

at least one leading daily newspaper published in the United Kingdom. Any notice given by advertisement shall be deemed to have been served at noon on the day on which the advertisement first appears.

171.2 The production in any court or tribunal of any such newspaper containing any such advertisement shall be sufficient proof of the giving of any such notice as regards all persons and for all purposes.

172 Suspension of postal services

172.1 If at any time by reason of the suspension or curtailment of postal services within Hong Kong or the United Kingdom the Company is unable effectively to convene a general meeting by notices sent through the post, a general meeting may be convened by a notice advertised in accordance with Article 171.1. Such notice shall be deemed to have been duly served on all members entitled thereto at noon on the day on which the advertisement first appears. In any such case the Company shall send confirmatory copies of the notice by post if, at least seven days prior to the meeting, the posting of notices to addresses throughout Hong Kong and the United Kingdom again becomes practicable.

INDEMNITY

173 Right to indemnity

173.1 Subject to the provisions of the Act⁵⁹, but without prejudice to any indemnity to which he may be otherwise entitled, every person who is or was at any time a Director, alternate Director, Secretary or other officer of the Company shall be entitled to be indemnified out of the assets of the Company against all costs, charges, losses, damages and liabilities incurred by him for negligence, default, breach of duty, breach of trust or otherwise in relation to the affairs of the Company or an associated company, or in connection with the activities of the Company, or of an associated company, as a trustee of an occupational pension scheme, provided that this Article 173.1 shall be deemed not to provide for, or entitle any such person to, indemnification to the extent that it would cause this Article 173.1, or any element of it, to be treated as void under the Act.

173.2 Subject to the provisions of the Act⁶⁰, the Company may at the discretion of the Board provide any person who is or was at any time a Director, alternate Director, Secretary or other officer of the Company with funds to meet expenditure incurred or to be incurred by him (or to enable such person to avoid incurring such expenditure) in defending any criminal or civil proceedings or defending himself in any investigation by, or against action proposed to be taken by, a regulatory authority in each case in connection with any alleged negligence, default, breach of duty or breach of trust by that person in relation to the Company or an associated company or in connection with any application under the provisions referred to in section 205(5) of the Act.

174 Power to insure

174.1 Subject to the provisions of the Act⁶¹, the Board may purchase and maintain insurance at the expense of the Company for the benefit of any person who is or was at any time a Director or other officer or employee of the Company against any liability which may

⁵⁹ Sections 232-238 of the Act

⁶⁰ Sections 205 and 206 of the Act

⁶¹ Section 233 of the Act

attach to him or loss or expenditure which he may incur in relation to anything done or alleged to have been done or omitted to be done as a Director, officer or employee of the Company or of an associated company or of any company in which the Company has an interest whether direct or indirect or who is or was at any time a trustee of any pension fund or employee benefits trust in which any employee of the Company or of any such other company or subsidiary is or has been interested. The Board may authorise directors of subsidiaries of the Company to purchase and maintain insurance at the expense of the Company for the benefit of any present or former director, other officer or employee of such company in respect of such liability, loss or expenditure.

Private & Confidential

Dated _____ 2010

HSBC HOLDINGS PLC (1)
and
DOUGLAS JARDINE FLINT (2)

SERVICE AGREEMENT

Contents

Clause	Page
1 Appointment	3
2 Remuneration	3
3 Benefits	4
4 Duration of the Employment	5
5 Scope and Duties of the Employment	5
6 Hours and place of work	7
7 Deductions	8
8 Expenses	8
9 Holidays	8
10 Sickness benefits	9
11 Restrictions during the Employment	10
12 Confidential Information and Company documents	11
13 Inventions and other intellectual property	12
14 Termination	13
15 Restrictive covenants	16
16 Grievance, dismissal and disciplinary procedures	21
17 Disclosure of information	21
18 General	21
19 Other Agreements	22
20 Counterparts	23
21 Choice of law and submission to jurisdiction	23
22 Definitions	23

THIS AGREEMENT is dated _____ 2010 and is made **BETWEEN**:

- (1) **HSBC HOLDINGS PLC** (No. 617987), whose registered office is at 8 Canada Square, London E14 5HQ (the “**Company**”);
and
- (2) **DOUGLAS FLINT** of 8 Canada Square, London E14 5HQ (the “**Appointee**”).

NOW IT IS HEREBY AGREED as follows:

1 Appointment

The Company shall continue to employ the Appointee and the Appointee agrees to act as Group Chairman, reporting to the Board, on and subject to the following terms, conditions and provisions of this Agreement.

2 Remuneration

- 2.1 The Company shall pay to the Appointee a salary, currently at the rate of GBP1,500,000 per annum (the “**Salary**”) less Statutory Deductions, which shall accrue day to day and be payable by equal monthly instalments in arrears on or about the 20th of each calendar month. The Board will review the Appointee’s salary annually in March, the first such review to take place in March 2011. There is no obligation on the Company to increase the Appointee’s Salary pursuant to any such review or otherwise provided always that such reviews are conducted reasonably and in good faith having regard to the Appointee, the treatment of other executives of comparable status and all other relevant circumstances. There will be no review of the Salary after notice has been given by either party to terminate the Employment.
- 2.2 The Appointee will not be considered for any bonus payment or award or any other variable pay whatsoever during the period of the Employment.
- 2.3 The remuneration specified in clause 2.1 shall be inclusive of any fees to which the Appointee may be entitled as a director of the Company or any Group Company or of any other company or any unincorporated body in which the Appointee holds the office as nominee or representative of the Company or any Group Company.
- 2.4 Payment of Salary to the Appointee shall be made either by the Company or by a Group Company and, if by more than one company, in such proportions as the Board may from time to time think fit, subject always to the Company’s reasonable consideration of any detrimental net employment tax consequences on the Appointee by doing so.
- 2.5 The Appointee may be eligible to participate in any employee share plan established by the Company from time to time. Eligibility to participate is subject to the rules of the relevant plan in force from time to time and is at the discretion of the Board. The Company will use reasonable endeavours to procure that any discretion relating to the grant of additional awards to the Appointee is exercised reasonably and in good faith having regard to the Appointee, the treatment of other executives of comparable status and all other relevant circumstances.

- 2.6 If the Appointee is eligible to participate in such a plan as referenced at clause 2.5, his rights under such plan will be subject to and in accordance with the rules of that plan in force from time to time. Subject to such rules, the rights and obligations of the Appointee under the terms and conditions of his office or employment shall not be affected by his participation in the plan or any right he may have to participate in the plan.
- 2.7 Subject to the rules of the relevant plan as referenced at clause 2.5, in participating in such a plan, the Appointee waives all and any rights to compensation or damages from the Company arising from the loss or failure to receive any rights or benefits under the plan (or the diminution in value of such rights or benefits) as a result of:
- (a) the termination of his office or employment and/or giving notice of termination of employment with any Group Company for any reason whatsoever (whether lawful or unlawful); and/or
 - (b) the exercise or failure to exercise any discretion (whether lawful or unlawful) conferred by the rules of the plan.

3 Benefits

3.1 Chauffeur Services

The Appointee shall have access to the chauffeur driven services operated by the Company in London from the chauffeur pool.

3.2 Pension Allowance

Subject to clause 3.4.4, the Appointee is eligible to receive an annual allowance of 50 per cent. of annual Salary (less Statutory Deductions) payable monthly in arrears, in order to fund personal pension arrangements.

3.3 Clubs

The Company shall make payments on the Appointee's behalf in respect of the annual membership subscription of two clubs or such similar two clubs as the Appointee shall nominate each year, to be approved by the Company through the Group Managing Director, Human Resources.

3.4 Medical Benefits

The Appointee shall participate in the schemes set out under clauses 3.4.1 to 3.4.5 subject always to the relevant schemes' terms and conditions from time to time in force and subject to the Appointee meeting the requirements of the relevant scheme and being deemed eligible by the relevant insurance provider. The Company shall not be liable to provide any benefits or any compensation in lieu thereof or take any action to enforce the provision of such benefits in circumstances where the scheme provider refuses for any reason whatsoever, to provide any benefits to the Appointee.

3.4.1 Health Checks

The Appointee is eligible for an annual voluntary health check with a medical adviser appointed and paid for by the Company.

3.4.2 Medical Cover

The Appointee and his spouse/partner and eligible dependants are entitled to participate in the Group's International Medical Scheme.

3.4.3 Personal Accident Insurance Cover

The Appointee is entitled to non-contributory membership of the Company's personal accident insurance scheme.

3.4.4 Group Income Protection

If the Appointee is unable by reason of illness or injury, to perform the material or substantial parts of his duties hereunder, following a period of absence from work in excess of 26 consecutive weeks, the Appointee will be eligible to be considered for a monthly payment equivalent to 50 per cent. of monthly Salary. In the event of such payment, the Appointee's pension allowance at clause 3.2 will continue to be payable, at a rate of 35 per cent. of the Appointee's annual Salary.

3.4.5 Life Assurance Cover

Under the Group Life Assurance Scheme, in the event of the Appointee's death, a sum equivalent to four times annual Salary will be paid to the Appointee's nominated beneficiaries, subject to approval by the trustees of the Group Life Assurance Scheme.

3.4.6 Directors and Officers Liability

The Appointee shall benefit from cover under the Company's policy on Directors' and Officers' Liability (including Outside Directors' and Officers' Liability) subject always to the policy and the rules of the policy from time to time in force.

4 Duration of the Employment

4.1 The Employment pursuant to this Agreement shall commence on the Commencement Date and, subject to clauses 5.4 and 14, shall continue until terminated by either party giving to the other not less than twelve months' notice in writing.

4.2 Notwithstanding clause 4.1 and any retirement date specified in any applicable pension scheme, the Employment shall automatically terminate when the Appointee reaches the normal retiring age from time to time applicable to senior executives of the Company which, for the avoidance of doubt, is currently 65.

4.3 The Appointee's period of continuous employment commenced on 30 September 1995.

5 Scope and Duties of the Employment

5.1 In the Appointee's position as Group Chairman he shall:

5.1.1 devote the whole of his time, attention and skill to his duties;

- 5.1.2 faithfully and diligently perform such duties and exercise such powers consistent with his position as may from time to time be assigned to or vested in him by the Board;
 - 5.1.3 obey the reasonable and lawful directions of the Board;
 - 5.1.4 at all times act in the way he considers in good faith, most likely to promote the success of the Company (and applicable Group Companies) for the benefit of the members as a whole in accordance with Section 172 Companies Act 2006;
 - 5.1.5 perform his services in a professional and competent manner and in cooperation with others;
 - 5.1.6 keep the Board at all times promptly and fully informed (in writing if so requested) of his conduct of and activities in relation to the business of the Company and any Group Company and provide such explanations in connection therewith as the Board may require from time to time including for the avoidance of doubt, any misconduct of other employees or directors or his own; and
 - 5.1.7 comply with the duties set out in the Companies Act 2006.
- 5.2 The Appointee shall comply with:
- 5.2.1 all the Company's and Group Companies codes, rules, regulations, policies and procedures (including without limitation the Company's Compliance Guidelines),
 - 5.2.2 the codes, practices, rules, principles and regulations of the UK Listing Authority (including the Model Code on directors' dealings in securities as set out in Annex 1 to Chapter 9 of the Listing Rules), the FSA, all stock exchanges and/or regulatory authorities relevant to the Company or any Group Company from time to time and of any association or professional body to which the Company and/or any Group Company and/or the Appointee belong from time to time,
 - 5.2.3 such laws as may be relevant to the Group and to the Appointee's duties under this Agreement; and
 - 5.2.4 the Code for Dealing in Group Securities and every regulation of the Group for the time being in force in relation to dealings in shares or other securities of the Company or any Group Company
insofar as they may affect him, the Company, any Group Company or its or their directors, officers or employees.
- 5.3 The Appointee shall comply with any rules, policies and procedures set out in the Company's Employee Handbook, a copy of which is available on the Company's intranet. The Employee Handbook does not form part of this Agreement and the Company may amend it at any time.
- 5.4 The Appointee's continued employment will be subject to him continuing to hold approved status for any position he may hold that requires FSA approval. In the event of approval being withdrawn (under current FSA regulations this includes instances such as insider dealing and market manipulation) in respect

of this position or any subsequent position, the Company reserves the right to summarily terminate the Appointee's employment without being further liable to him (other than in respect of amounts accrued due at the Termination Date). The Company shall provide the Appointee with all reasonable co-operation in relation to him obtaining and/or retaining FSA approved status and such other regulatory registrations as may be required from time to time.

5.5 The Appointee shall do such things as are necessary to ensure compliance by himself with the Corporate Governance Code and, so far as it lies within his power to do so, by the Company and any applicable Group Company.

5.6 The Company reserves the right to appoint any other person or persons to act jointly with the Appointee including in the event that the Appointee is not assigned any duties in accordance with clause 14.4 (or in place of the Appointee if he is suspended in accordance with the provisions of this Agreement).

5.7 The Appointee shall if and so long as the Company requires and without any further remuneration therefore (except as otherwise agreed):

5.7.1 carry out duties on behalf of any Group Company; and

5.7.2 act as a director or officer of any Group Company

Provided always that such duties or offices are consistent with his role as Group Chairman.

5.8 The Company may at its sole discretion transfer the Appointee's employment and assign the provisions of this Agreement to any Group Company at any time subject always, to the Appointee enjoying no less favourable terms and conditions of employment.

5.9 The Appointee agrees that a copy of clauses 5, 11, 12 and 15 of this Agreement will be provided by him to any person, firm, company or other entity making an offer of employment, appointment as a director or officer, agency, consultancy, partnership or joint venture to him during the Employment immediately upon receiving any such offer, and if any such offer is received after the Termination Date but whilst any restrictions in clause 15 remain in force a copy of clauses 12 and 15 will be provided by him immediately upon receiving any such offer.

6 Hours and place of work

6.1 The Company's standard working week is 35 hours (excluding unpaid lunch breaks). The Appointee shall be required to work such hours, including additional hours (without further remuneration) as are necessary for the proper performance of the duties hereunder.

6.2 Notwithstanding clause 6.1 the Appointee acknowledges that because of the autonomous nature of his role the duration of the Appointee's working time is not measured or monitored or determined by the Company so that the limit on weekly working time set out in Regulation 4 of the Working Time Regulations 1998 (or such other regulations as may from time to time come into force) does not apply to the Appointee's Employment.

6.3 The Appointee's place of work will initially be the Company's offices at 8 Canada Square, London E14 5HQ but the Company may reasonably require the Appointee to work at any place of business of the Company or the Group within London, or by mutual agreement, overseas, on either a temporary or an indefinite basis. The Appointee will be given reasonable notice of any permanent change in his place of work. In the performance of the duties hereunder, the Appointee may be required to travel and undertake his duties both throughout and outside the United Kingdom and in other global locations as the Group sees fit from time to time.

7 Deductions

For the purposes of the Employment Rights Act 1996, the Appointee hereby authorises the Company to deduct from the remuneration hereunder any sums due from the Appointee to the Company including, without limitation, any overpayments, loans or advances made to him by the Company, the cost of repairing any damage or loss to the Company's property caused by the Appointee (and of recovering such costs) and any losses suffered by the Company as a result of any negligence or breach of duty by the Appointee or sums in respect of sub-clause 10.6 of this Agreement.

8 Expenses

The Company shall reimburse the Appointee in respect of all expenses reasonably incurred by the Appointee in the proper performance of the duties hereunder subject to the Appointee providing such receipts or other evidence as the Company may require and subject to the Company's rules and policies from time to time relating to expenses.

9 Holidays

- 9.1 The Appointee shall be entitled to receive his normal remuneration for all bank and public holidays normally observed in the United Kingdom and a further 30 working days' paid holiday in each holiday year (being the period from 1 January to 31 December) including one period of 10 consecutive working days which must be taken as Core Leave.
- 9.2 In the holiday year in which the Employment terminates, the Appointee's entitlement to holiday shall accrue on a pro rata basis for each complete month of service during the relevant year. If, on the termination of the Employment, the Appointee has exceeded his accrued holiday entitlement, the excess may be deducted from any sums due to the Appointee and the Appointee hereby authorises the Company to make such deduction. If the Appointee has any unused holiday entitlement, the Company may either require the Appointee to take such unused holiday during any notice period (whether or not the Appointee is on garden leave in accordance with clause 14.4) or make payment in lieu thereof.
- 9.3 Holiday entitlement for one holiday year may not be taken in subsequent holiday years unless otherwise agreed by the Group Managing Director, Human Resources. Failure to take holiday entitlement in the appropriate holiday year will lead to forfeiture of any accrued holiday not taken, without any right to payment in lieu thereof unless otherwise agreed by the Group Managing Director, Human Resources in accordance with the holiday policy applicable to Executive Directors from time to time.

10 Sickness benefits

- 10.1 The Company shall continue to pay the Salary during any period of absence on medical grounds in accordance with the sick pay policy set out in the Company's Employee Handbook ("**Company Sick Pay**") provided that the Appointee complies in full with any of the requirements set out in the Company's Employee Handbook and clause 10.2 below. Thereafter the Appointee will only be entitled to such salary and benefits, if any, as the Board shall in its absolute discretion from time to time allow. Upon the Appointee's return to work from such absence to perform his duties hereunder, he shall be entitled to receive the Salary and the benefits set out at clause 3, pursuant to the terms of this Agreement and subject to any relevant scheme rules.
- 10.2 At any time during the Employment, the Appointee shall, if so required by the Board:
- 10.2.1 supply the Company with medical certificates covering any period of sickness or incapacity exceeding seven days (including weekends); and
- 10.2.2 undergo, at the expense of the Company, an examination by a registered medical practitioner or practitioners to be nominated by the Company (including but not limited to the Appointee's general practitioner or any other physician responsible for the Appointee's care). The Appointee authorises the medical practitioner to disclose and discuss with the Company any report prepared as a result of any such examination pursuant to the Access to Medical Reports Act 1988. The Company has the right to postpone the Appointee's return to work (and the continuance or reinstatement of his normal pay, if appropriate) until the medical practitioner has confirmed that the Appointee is fit to perform his duties.
- 10.3 Payment of the Appointee's Salary pursuant to clause 10.1 shall be inclusive of any Statutory Sick Pay to which the Appointee may be entitled by law. The Company will also deduct from it any other statutory benefits if applicable due to the Appointee, together with any Statutory Deductions.
- 10.4 Subject to the applicable scheme rules in force from time to time, during the Appointee's absence from work on medical grounds, the Appointee will continue to be covered by the Company's life assurance arrangements, private medical insurance and personal accident insurance and whilst he is entitled to receive Company Sick Pay he shall be entitled to receive the pension allowance as set out at clause 3.2. The Appointee's accrual of holiday entitlement above the minimum statutory entitlement shall cease on the expiry of the payment of Company Sick Pay until such time as the Appointee is able to perform his duties hereunder.
- 10.5 The Company reserves the right to terminate the Employment in accordance with the terms of this Agreement for reasons unrelated to the Appointee's illness or sickness absence when the Appointee is absent through sickness or injury at any time, notwithstanding any outstanding or prospective entitlement to pay in accordance with clause 10.1, private medical insurance, permanent health insurance or long term disability benefits. The Company shall not be liable for any loss arising from such termination.

- 10.6 If the Appointee's absence shall be occasioned by the actionable negligence of a third party in respect of which damages are recoverable in respect of the period of the Appointee's incapacity, then the Appointee shall:
- 10.6.1 forthwith notify the Company of all the relevant circumstances and of any claim, compromise, settlement or judgment made or awarded in connection therewith;
- 10.6.2 if the Company so requires, refund to the Company such sum as the Company may determine, not exceeding the lesser of:
- (a) the amount of damages recovered by the Appointee under such compromise, settlement or judgment; and
 - (b) the sums advanced to the Appointee in respect of the period of incapacity

subject to any deductions made by any court or tribunal that takes into account the payments made to the Appointee in this clause 10 when awarding any such damages or compensation.

11 Restrictions during the Employment

- 11.1 The Appointee shall not during the Employment directly or indirectly either on his own account or on behalf of any other person, company, business entity or other organisation be employed, engaged, concerned or interested in any other business or undertaking, provided that this shall not prohibit the holding (directly or through nominees) of investments listed on the London Stock Exchange plc or in respect of which dealing takes place on the Alternative Investment Market of the London Stock Exchange plc or on The Stock Exchange of Hong Kong Limited or on any Recognised Investment Exchange as long as not more than 5 per cent of the issued shares or other securities of any class of any one company shall be so held without the prior sanction of a resolution of the Board.
- 11.2 The Appointee shall obtain the Board's prior written approval (such approval not to be unreasonably withheld) before accepting appointment as a non-executive director of any company outside the Group. Approval is currently limited to one FTSE100 constituent company or other significant company in the UK or elsewhere.
- 11.3 The Appointee shall not (and shall procure so far as the Appointee is able that any person connected with the Appointee within the meaning of section 252 Companies Act 2006 (**Connected Person**) shall not) deal or become or cease to be interested (within the meaning set out in Schedule 1 Companies Act 2006) in any securities of the Company, except in accordance with the Company's code for securities transactions by directors.
- 11.4 Subject to any regulations issued by the Company, the Appointee and any Connected Person shall not be entitled to receive or obtain directly or indirectly any discount, rebate or commission in respect of any sale or purchase of goods effected or other business transacted (whether or not by the Appointee) by or on behalf of the Company or any Group Company and if he or any Connected Person (or any firm or company in which he or any Connected Person is interested) shall obtain any such discount, rebate or commission the Appointee shall account to the Company or the relevant Group Company for the amount received by the Appointee or any Connected Person (or a due proportion of the

amount received by such company or firm having regard to the extent of the Appointee's or the Connected Person's interest therein).

- 11.5 The Appointee agrees to disclose to the Board any matters relating to any Connected Person which may, in the reasonable opinion of the Board, be considered to interfere, conflict or compete with the proper performance of the Appointee's obligations under this Agreement.
- 11.6 During the Employment, the Appointee agrees that he will not in competition with the Company or any Group Company:
- 11.6.1 deal with, canvass, solicit or endeavour to take away from the Company or any Group Company, whether directly or indirectly and whether on his own behalf or on behalf of any other person, firm, company or other entity any customers or prospective customers; or
- 11.6.2 directly or indirectly solicit or entice away from or endeavour to entice away from the Company or any Group Company any individual employed or engaged by the Company or any Group Company; or
- 11.6.3 directly or indirectly make preparations to compete with any business carried on by the Company or any Group Company.
- 11.7 During the Employment the Appointee shall inform the appropriate member of the Board without delay if he becomes aware that any director, officer, or senior employee of the Company or any Group Company is planning to materially breach any of the provisions of their contract of employment or implied duties of loyalty, good faith and fidelity.

12 Confidential Information and Company documents

- 12.1 The Appointee recognises that, whilst performing the duties hereunder for the Company the Appointee will have access to and come into contact with trade secrets and confidential information belonging to the Company and/or any Group Company and will obtain personal knowledge of and influence over its or their customers, suppliers and/or employees. The Appointee therefore agrees that the restrictions set out in this clause 12 are reasonable and necessary to protect the legitimate business interests of the Company and the Group both during and after the termination of the Employment. The Appointee shall neither during the Employment (except in the proper performance of the duties) nor at any time (without limit) after the termination of the Employment directly or indirectly:
- 12.1.1 divulge or communicate to any person, company, business entity or other organisation; or
- 12.1.2 use for his own purposes or for any purposes other than those of the Company or any Group Company; or
- 12.1.3 through any failure to exercise due care and diligence, cause any unauthorised disclosure of any trade secrets or Confidential Information relating to the Company or any Group Company, but so that these restrictions shall cease to apply to any information which shall become available to the public generally otherwise than

through the default of the Appointee and to any use or disclosure authorised by the Board or required by law.

- 12.2 Nothing in this Agreement shall prevent the Appointee from making a protected disclosure in accordance with section 43A Employment Rights Act 1996 and the Public Interest Disclosure Act 1998.
- 12.3 **“Confidential Information”** shall include details of suppliers and their terms of business, details of customers, clients and prospective customers/clients and their requirements, the prices charged to and terms of business with customers, marketing plans and sales forecasts, financial information, results and forecasts (save to the extent that these are included in published audited accounts), any proposals relating to the acquisition or disposal of a company or business or any part thereof or to any proposed expansion or contraction of activities, or any other business strategy or tender, details of employees and officers and of the remuneration and other benefits paid to them, information relating to research activities, inventions, secret processes, designs, software, formulae and product lines, any information which the Appointee either is aware or reasonably ought to know is confidential and any information which has been given to the Company or any Group Company in confidence by customers, suppliers or other persons.
- 12.4 All notes, memoranda, records, lists of customers and suppliers and employees, correspondence, documents, computer and other discs and tapes, data listings, codes, designs and drawings and other documents and material whatsoever (whether made or created by the Appointee or otherwise) relating to the business of the Company or any Group Company (and any copies of the same):
- 12.4.1 shall be and remain the property of the Company or the relevant Group Company; and
- 12.4.2 shall be handed over by the Appointee to the Company or to the relevant Group Company or irrevocably deleted from any computer and/or word processing system in the Appointee’s possession or under the Appointee’s control, on demand and in any event on the termination of the Employment. Provided always that at the reasonable request of the Appointee, he shall be provided, subject always to the provisions of clause 12.1, with copies of all Board Minutes (and documents referred to therein) of Group Companies of which he was a director, in respect of any period during which he was a director of such Group Company, which are reasonably required by the Appointee for the purposes of defending himself in any regulatory or legal proceedings relating to his duties as a director of such Group Company.
- 13 Inventions and other intellectual property**
- 13.1 The Appointee may make inventions or create other intellectual property during the Employment. In this respect the Appointee has a special responsibility to further the interests of the Company and the Group given the Appointee’s position at the Company and the remuneration paid to the Appointee under this Agreement.
- 13.2 In recognition of the Appointee’s position, remuneration and responsibility, the Appointee acknowledges and agrees that any invention, improvement, design, process, information, copyright work, trade mark, trade name or get-up or any

other intellectual property (together the “**Intellectual Property**”) made, created or discovered by him during the Employment (whether capable of being patented or registered or not) in conjunction with or in any way affecting or relating to the business of the Company or any Group Company or capable of being used or adapted for use in the Company or any such Group Company or in connection therewith shall be immediately disclosed to the Company and shall belong to and be the absolute property of the Company or such Group Company as the Company may direct.

- 13.3 However clause 13.2 shall only apply to the extent that any invention was made by the Appointee in the course of his duties or in the course of duties falling outside the Appointee’s normal duties but which have been specifically assigned to him (together “**Duties**”) and (i) such invention was reasonably expected to result therefrom; and/or (ii) at the time of making the invention, because of the nature of his Duties and the particular responsibilities arising therefrom, the Appointee had a special obligation to further the interests of the Company.
- 13.4 The Appointee acknowledges that he has no rights, interest or claims, either during the Employment or after the termination of the Employment, in or to any such Intellectual Property and he shall not use such Intellectual Property other than during the period of the Employment and for the purpose of the Company or the Group.
- 13.5 If and whenever required to do so by the Company, (whether during the Employment or after its termination), the Appointee shall at the expense of the Company or such Group Company as the Company may direct:
- 13.5.1 apply or join with the Company or such Group Company in applying for letters patent or other protection or registration in the United Kingdom and in any other part of the world for any such Intellectual Property; and
- 13.5.2 execute and do all instruments and things necessary for vesting the said letters patent or other protection or registration when obtained and all right title and interest to and in the same absolutely and as sole beneficial owner in the Company or such Group Company or in such other person as the Company may specify.
- 13.6 The Appointee agrees that he irrevocably and unconditionally waives all rights (including all moral rights) under Chapter IV of the Copyrights, Designs and Patents Act 1988 in connection with his authorship of any existing or future copyright work, in whatever part of the world such rights may be enforceable
- 13.7 Nothing in this clause shall be construed as restricting the Appointee’s rights or those of the Company under the Patents Act 1977 and in particular, sections 39 to 43 Patents Act 1977.

14 Termination

- 14.1 Notwithstanding clause 4.1 the Employment shall be subject to termination by the Company:
- 14.1.1 notwithstanding the actual or expected provision of any permanent health insurance benefits or any other benefit, by not less than six months’ notice in writing given at any time while the Appointee shall have been incapacitated by

reason of ill health or accident from performing the duties hereunder for a period of or periods aggregating the total period during which the Appointee is entitled to receive Company Sick Pay provided always that, subject to clause 10.5, the Company shall not terminate the Employment in these circumstances if the effect of such termination would be to deprive the Appointee of the benefit of payments under any permanent health insurance scheme. If at any time during the currency of such a notice the Appointee shall provide a medical certificate satisfactory to the Board to the effect that he has fully recovered physical and/or mental health and that no recurrence of illness or incapacity can reasonably be anticipated, the Company shall withdraw the notice;

14.1.2 by summary notice in writing and with no liability to make any further payment to the Appointee (other than in respect of amounts accrued due at the date of termination) if the Appointee shall have:

- (a) committed by any act or omission any serious breach or repeated or continued (after warning) a material breach of the Appointee's obligations hereunder; or
- (b) been guilty of conduct by act or omission (whether in the course of the duties hereunder or otherwise) which (i) in the reasonable opinion of the Board tends to bring the Appointee and/or the Company and/or any Group Company into disrepute on account of material economic or reputational consequences for all of any of them or (ii) causes the Company or any Group Company substantial economic harm, provided in either case that if such conduct is capable of remedy, he has first been given the reasonable opportunity to remedy the contract and has failed to do so; or
- (c) been convicted of a criminal offence under any statutory enactment or regulation (other than an offence under any road traffic legislation in the United Kingdom or elsewhere for which a fine or non custodial penalty is imposed and which does not render him unable to discharge his duties under this Agreement); or
- (d) become bankrupt or had an interim order made against the Appointee under the Insolvency Act 1986 or compounded with his creditors generally; or
- (e) in the reasonable opinion of the Board, failed to perform the duties hereunder to a satisfactory standard, after having received a written warning from the Company relating to the same; or
- (f) been disqualified from being a director by reason of any order made under the Company Directors Disqualification Act 1986 or any other enactment; or
- (g) resigned of his own choice as a director of the Company, not being at the request of or with the prior written agreement of the Board (save with reasonable and proper cause and where remaining as a director would substantially disadvantage him in his capacity as an officeholder of the Company); or
- (h) become prevented by an applicable law or regulation from performing any material part of his duties; or

- (i) been guilty of a material breach of the rules or regulations as amended from time to time of the UK Listing Authority (including the Model Code for transactions in securities by directors of listed companies), The London Stock Exchange plc, the FSA or any other stock exchanges or regulatory authorities relevant to the Company or any Group Company or any Code of Practice issued by the Company (as amended from time to time); or
- (j) been expelled or subject to any serious disciplinary action by a relevant professional body or failed or ceased to meet the requirements of any regulatory body or statutory authority as a result of which the Appointee is no longer able to perform all or any of the duties under this Agreement or;
- (k) ceased to be eligible to work in the United Kingdom in accordance with Sections 15-25 of the Immigration, Asylum and Nationality Act 2006.

Any delay by the Company in exercising such right of termination shall not constitute a waiver thereof.

- 14.2 If the Company becomes entitled to terminate the Employment pursuant to clauses 5.4 or 14.1.2, or whilst the Company or any external body investigates any allegation which would or may entitle the Company to terminate the Employment pursuant to clauses 5.4 or 14.1.2 it shall be entitled (but without prejudice to its right subsequently to terminate such appointment on the same or any other ground) to suspend the Appointee on full pay for so long as it may think fit or, for such period as is reasonable in the circumstances. During the period of any suspension the Appointee will continue to be bound by the provisions of this Agreement and must continue at all times to conduct himself with good faith towards the Company and all Group Companies.
- 14.3 The Company reserves the right in its absolute discretion to give the Appointee pay in lieu of all or any part of the notice of termination (whether notice is given by the Company or by the Appointee). A dismissal without notice per se shall not constitute or imply an election under this clause 14.3. For this purpose, the Appointee agrees that pay in lieu will consist of the Salary and other contractual benefits (or cash equivalent) as set out at clause 3 of this Agreement for the relevant period of notice (subject to Statutory Deductions in the normal way), but excluding any other emolument referable to the Employment.
- 14.4 During any period of notice of termination or part thereof (whether given by the Company or the Appointee), the Company shall (but only for a period or periods in aggregate not exceeding six months) be under no obligation to assign any duties to the Appointee and shall be entitled to exclude him from its premises and to direct that the Appointee refrains from contacting (other than purely social contact with persons with whom the Appointee has established social relationships) any customers, clients, suppliers, agents, professional advisers or employees of the Company or any Group Company and refrains from accessing the computer or other data or similar system of the Company or any Group Company (whether directly or indirectly) and remove him from office as a director of the Company and from all or any offices held by him in the Company or any Group Company, provided that this shall not affect the Appointee's entitlement during this period to receive Salary and other contractual benefits. For the avoidance of doubt, during such period the Appointee shall continue to

be bound by the same obligations to the Company as were owed prior to the commencement of the period including the duty of good faith and fidelity.

- 14.5 The Appointee agrees that during any period of notice of termination whether given by the Company or by the Appointee he will give such assistance in effecting an orderly and comprehensive handover as the Company may reasonably require and with regard to any claim made by or against any Group Company. For the avoidance of doubt such assistance may include attending meetings, reviewing documents, giving and signing statements/affidavits and attending hearings and giving evidence.
- 14.6 Without prejudice to the constitution (including for the avoidance of doubt the articles of association) of the Company or any Group Company, on the termination of the Employment (howsoever arising) or on either the Company or the Appointee having served notice of such termination and the Company having exercised its right to place the Appointee on garden leave pursuant to clause 14.4, the Appointee shall at the request of the Company:
- 14.6.1 resign from office as a Director of the Company and all offices held by the Appointee in any Group Company provided however that such resignation shall be without prejudice to any claims which the Appointee may have against the Company or any Group Company arising out of the termination of the Employment; and
- 14.6.2 transfer without payment to the Company or as the Company may direct to any third party, any shares or other securities held by the Appointee in the Company or any Group Company as a nominee or trustee for the Company or any Group Company and deliver to the Company the related certificates; and
- 14.6.3 forthwith deliver to the Company all Confidential Information and all materials within the scope of clause 12.4 including any copies of any such materials and all credit cards and other property of or relating to the business of the Company or of any Group Company which may be in the Appointee's possession or under the Appointee's power or control and, if requested, provide a signed statement that he has fully complied with the obligations under this clause 14.6.3.
- 14.7 If the Appointee shall have been offered but shall unreasonably have refused to agree to the transfer of this Agreement by way of novation to a company which has acquired or agreed to acquire the whole or substantially the whole of the undertaking and assets of or of the equity share capital of the Company, the Appointee shall have no claim against the Company in respect of the termination of his employment hereunder by reason of the subsequent voluntary winding-up of the Company or of the disclaimer of this Agreement by the Company within one month after such acquisition.

15 Restrictive covenants

- 15.1 For the purposes of this clause 15 the following words have the following meanings:
- 15.1.1 **"Company Products"** means any banking or financial products researched into, developed, supplied, distributed or sold by the Company with which the duties of the Appointee were materially concerned or for which he was directly or ultimately responsible during the Restricted Period;

- 15.1.2 “**Company Services**” means any banking or financial services (including but not limited to technical and product support, technical advice and customer services) developed or supplied by the Company with which the duties of the Appointee were materially concerned or for which he was directly or ultimately responsible during the Restricted Period;
- 15.1.3 “**Comparator Group**” means the following companies and entities, subject always to amendment from time to time by the Remuneration Committee of the Board of the Company and as notified to the Appointee by no later than 30 days after any such amendment: Banco Bradesco, Banco Itau, Banco Santander, Bank of America, Bank of China, Barclays, BBVA, BNP Paribas, Citigroup, Credit Suisse Group, DBS Group, Deutsche Bank, Fortis, ICBC, JP Morgan Chase, Lloyds Banking Group, National Australia Bank, Royal Bank of Canada, Royal Bank of Scotland, Societe Generale, Standard Chartered, UBS, Unicredito Italiano and Wells Fargo (and all group companies of the companies and entities set out in this clause 15.1.3) and, where any companies or entities set out in this clause 15.1.3 are the subject of a takeover or undergo any form of reconstruction, the entities to which the relevant business assets of such companies or entities are transferred from time to time,
- 15.1.4 “**Confidential Information**” has the meaning ascribed thereto in clause 12.2;
- 15.1.5 “**Customer**” means any person or firm or company or other organisation whatsoever to whom or which the Company supplied Company Products and/or Company Services during the Restricted Period and with whom or which, during the Restricted Period:
- (a) the Appointee had material personal dealings pursuant to the Employment; or
 - (b) any employee who was under the direct or indirect supervision of the Appointee had material personal dealings pursuant to their employment,
- provided that in the case of a firm, company or other organisation “Customer” shall not include any division, branch or office of such firm or company or other organisation with which the Appointee and/or any such employee as defined in sub-clause (b) above had no dealings during the Restricted Period save that where a restructuring of the firm or company or organisation has occurred following such personal dealings “Customer” shall include the part of the business with which the Appointee or any employee as defined in sub-clause (b) above had dealings during the Restricted Period;
- 15.1.6 “**Prospective Customer**” means any person or firm or company or other organisation whatsoever with whom or which the Company shall have had negotiations or material discussions regarding the possible distribution, sale or supply of Company Products and/or Company Services during the Restricted Period and which were ongoing and not finally concluded at the Termination Date and with whom or which during such period:
- (a) the Appointee shall have had material personal dealings pursuant to the Employment; or

(b) any employee who was under the direct or indirect supervision of the Appointee shall have had material personal dealings pursuant to their employment; or

(c) the Appointee was directly responsible in a client management capacity on behalf of the Company,

provided that in the case of a firm, company or other organisation "Prospective Customer" shall not include any division, branch or office of such firm, company or other organisation with which the Appointee and/or any such employee had no dealings during the Restricted Period save that where a restructuring of the firm or company or organisation has occurred following such personal dealings, "Prospective Customer" shall include the part of the business with which the Appointee or any employee as defined in sub-clause (b) had dealings during the Restricted Period;

- 15.1.7 **"Restricted Employee"** means any person who is on the Termination Date, or was during the Restricted Period, employed or engaged by the Company or any Group Company and is by reason of such employment or engagement in possession of, or is reasonably likely to be in possession of, any trade secret or Confidential Information relating to the business of the Company or any Group Company or has acquired influence over its Customers or Prospective Customers (as defined in this clause 15 but so that references to "the Appointee" shall be replaced by references to the relevant employee and so that references to "Employment" shall mean the relevant employee's employment with the Company or Group Company, being in either case a person with whom the Appointee had material dealings during the Restricted Period);
- 15.1.8 **"Restricted Period"** means the period of 12 months ending on the Termination Date or, in the event that no duties were assigned to the Appointee for any part of the duration of the notice period, the 12 months immediately preceding the last day on which the Appointee carried out any duties for the Company;
- 15.1.9 **"Restricted Products"** means Company Products or any products of the same or of a similar kind;
- 15.1.10 **"Restricted Services"** means Company Services or any services of the same or of a similar kind;
- 15.1.11 **"Restricted Supplier"** means any person, company, business entity or other organisation whatsoever who has supplied goods or services to the Company or any Group Company (other than utilities and goods or services supplied for administrative purposes) during any part of the Restricted Period or who has agreed prior to the Termination Date to supply goods or services to the Company to commence at any time in the twelve months following the Termination Date;
- 15.2 The Appointee recognises that, whilst performing his duties for the Company, he will have access to and come into contact with trade secrets and Confidential Information belonging to the Company and certain Group Companies and will obtain personal knowledge of and influence over its or their customers and/or employees. The Appointee therefore agrees that the restrictions set out in this clause 15 are reasonable and necessary to protect

the legitimate business interests of the Company and any applicable Group Company both during and after the termination of the Employment.

- 15.3 The Appointee hereby undertakes with the Company that he will not for the period of six months after the Termination Date without the prior written consent of the Company (such consent not to be unreasonably withheld) whether by himself, through his employees or agents or otherwise howsoever and whether on his own behalf or on behalf of any other person, firm, company or other organisation, directly or indirectly:
- 15.3.1 in competition with the Company anywhere in the world in a senior capacity, be employed by or engaged or otherwise interested in any of the companies (or other entities) in the Comparator Group in the business of researching into, developing, distributing, selling, supplying or otherwise dealing with Restricted Products or Restricted Services; or
 - 15.3.2 in competition with the Company, accept orders or facilitate the acceptance of any orders or have any business dealings for Restricted Products or Restricted Services from any Customer or Prospective Customer; or
 - 15.3.3 employ or otherwise engage in the business of or be personally involved to a material extent in employing or otherwise engaging in the business of researching into, developing, manufacturing, distributing, selling, supplying or otherwise dealing with Restricted Products or Restricted Services any Restricted Employee; or
 - 15.3.4 interfere with, or endeavour to interfere with, the supply or provision of goods or services (other than utilities, or goods or services supplied for an administrative purpose) to the Company or to induce the cessation of the supply or provision of such goods or services from any Restricted Supplier; or
 - 15.3.5 In competition with the Company, solicit business from, or solicit the supply of goods or services (other than utilities, or goods or services supplied for an administrative purpose) from any Restricted Supplier for the purposes of the provision of Restricted Products or Restricted Services.
- 15.4 The Appointee hereby undertakes with the Company that he shall not for the period of twelve months after the Termination Date without the prior written consent of the Company (such consent not to be unreasonably withheld) whether by himself through his employees or agents or otherwise howsoever and whether on his own behalf or on behalf of any other person, firm, company or other organisation, directly or indirectly:
- 15.4.1 in competition with the Company, solicit business from or endeavour to entice away or canvass any Customer or Prospective Customer if such solicitation or canvassing is in respect of Restricted Products or Restricted Services; or
 - 15.4.2 solicit or induce or endeavour to solicit or induce any Restricted Employee to cease working for or providing services to the Company, whether or not any such person would thereby commit a breach of contract.
- 15.5 If the restrictions in clauses 15.3 and/or 15.4 are for any reason held to be unenforceable in any jurisdiction in the world the Appointee shall agree to such amended or lesser restriction as would enable that restriction to be enforced so far as possible in such jurisdiction.

- 15.6 The benefit of clauses 15.3 and/or 15.4 shall be held on trust by the Company for each Group Company and the Company reserves the right to assign the benefit of such provisions to any Group Company, in addition such provisions also apply as though there were substituted for references to “the Company” references to each Group Company in relation to which the Appointee has in the course of his duties for the Company or by reason of rendering services to or holding office in such Group Company:
- 15.6.1 acquired knowledge of its trade secrets or Confidential Information; or
- 15.6.2 had material personal dealings with its Customers or Prospective Customers; or
- 15.6.3 supervised directly or indirectly employees having material personal dealings with its Customers or Prospective Customers but so that references in clause 15 to “the Company” shall for this purpose be deemed to be replaced by references to the relevant Group Company. The obligations undertaken by the Appointee pursuant to this clause 15.6 shall, with respect to each such Group Company, constitute a separate and distinct covenant and the invalidity or unenforceability of any such covenant shall not affect the validity or enforceability of the covenants in favour of any other Group Company or the Company. In addition, at the request of the Company the Appointee shall enter into a direct agreement or undertaking with any Group Company whereby he will accept restrictions corresponding to the restrictions in this clause 15 (or such of them as may be appropriate).
- 15.7 In the event of the transfer (within the meaning of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (“the Transfer Regulations”) of the undertaking or the part of the undertaking in which the Appointee shall at the time be employed as the result of which (by virtue of the Transfer Regulations) the Employment is automatically transferred to another (“the Transferee”), the provisions of this clause 15 shall have effect as though references in it (and in all associated terms defined in this Agreement) to “the Group” are construed as references to “any other company within the Transferee’s Group” (which for these purposes shall comprise the Transferee and any holding company of the Transferee and the subsidiaries of the Transferee and of any such holding companies for the time being).
- 15.8 The Appointee hereby undertakes with the Company that he will not at any time without the consent of the Company after the Termination Date:
- 15.8.1 engage other than as a private consumer in any trade or business or be associated with any person, firm or company engaged in any trade or business using the name(s) “HSBC” or “Hongkong and Shanghai Banking Corporation” or incorporating the word(s) “Hongkong Shanghai Banking Corporation”;
- 15.8.2 in the course of carrying on any trade or business, claim, represent or otherwise indicate any present association with the Company or any Group Company or for the purpose of carrying on or retaining any business or custom, claim, represent or otherwise indicate any past association with the Company or any Group Company to its detriment other than simple and factual statements regarding the Appointee’s period of employment, job title, responsibilities and role.

- 15.9 The parties agree that the periods referred to in clauses 15.3 and 15.4 above will be reduced by one day for every day, during which, at the Company's direction, the Appointee is on garden leave in accordance with clause 14.4.
- 15.10 While the restrictions in this clause 15 (on which the Appointee has had the opportunity to take independent legal advice, as the Appointee hereby acknowledges) are considered by the parties to be reasonable in all the circumstances, it is agreed that if any such restrictions, by themselves, or taken together, shall be adjudged to go beyond what is reasonable in all the circumstances for the protection of the legitimate interests of the Company or a Group Company but would be adjudged reasonable if part or parts of the wording thereof were deleted, the relevant restriction or restrictions shall apply with such deletion(s) as may be necessary to make it or them valid and effective.

16 Grievance, dismissal and disciplinary procedures

- 16.1 If the Appointee wishes to obtain redress of any grievance relating to the Employment or is dissatisfied with any reprimand, suspension or other disciplinary step taken by the Company, he shall apply in writing to the Board setting out the nature and details of any such grievance or dissatisfaction. If the Appointee is not satisfied with the decision of the Board he may within seven days of the decision appeal in writing to a non-executive director of the Company nominated by the Board.
- 16.2 The disciplinary rules applicable to the Appointee are set out in the Company's Employee Handbook. The disciplinary procedure is not contractually binding on the Company.

17 Disclosure of information

- 17.1 For the purposes of the Data Protection Act 1998 the Appointee hereby consents to the processing by the Company of personal data including sensitive data of which the Appointee is the subject. The Appointee agrees that the data may be collected and held by the Company, or be disclosed or transferred to other employees of the Company or to any other member of a Group Company (including if necessary to other offices of the Company or any Group Company outside the European Economic Area) or to any other person as may be reasonably necessary or as otherwise permitted by law. In this event, the Appointee's personal information/data and sensitive personal data will be protected by the strictest code of secrecy and security, and only used in accordance with the Company's strict instructions.
- 17.2 The Appointee agrees that the Company and any Group Company may intercept, process and monitor communications transmitted by or to the Appointee via any private telecommunication systems (including e-mail) or services of the Company or any Group Company.

18 General

- 18.1 The provisions of this Agreement are severable and, if any one or more provision may be determined to be illegal or otherwise unenforceable in whole or in part under the laws of any jurisdiction, the remaining provisions of this Agreement in that jurisdiction shall not be affected and the legality and enforceability of this Agreement in any other jurisdiction shall not be affected.

- 18.2 Any notice or other document to be given under this Agreement shall be in writing and may be given personally to the Appointee or to the Secretary of the Company (as the case may be) or may be sent by first class post or other fast postal service or by facsimile transmission to, in the case of the Company, its registered office for the time being and in the case of the Appointee either to his address shown on the face hereof or to his last known place of residence.
- 18.3 Any such notice at clause 18.2 shall be deemed served when in the ordinary course of the means of transmission it would first be received by the addressee in normal business hours.
- 18.4 The Appointee hereby irrevocably appoints any other director of the Company from time to time, jointly and severally, to be his attorney in his name and on his benefit to sign any documents and do things necessary or requisite to give effect to those matters which he is obliged to do pursuant to this Agreement (including but not limited to clauses 13 and 14.6.1). In favour of any third party a certificate in writing signed by any director or by the Secretary of the Company that any instrument or act falls within the authority hereby conferred shall be conclusive evidence that such is the case.
- 18.5 Any Group Company may enforce the terms of this Agreement. No other person who is not a party to this Agreement may enforce any of its terms under the Contracts (Rights of Third Parties) Act 1999.
- 18.6 This Agreement contains the statement of initial employment particulars of the Appointee as required under the Employment Rights Act 1996.
- 18.7 There are no collective agreements that affect the terms and conditions of the Appointee's employment.

19 Other Agreements

- 19.1 This Agreement together with the Company's Employee Handbook (as amended from time to time) constitutes the entire agreement of the parties and shall be in substitution for and shall replace any previous letters of appointment, agreements or arrangements (including without limitation the Appointee's service agreement with the Company dated 14 October 2008), whether written, oral or implied, relating to the employment of the Appointee by the Company or any Group Company.
- 19.2 Without prejudice to clause 19.1, in the event of any conflict between the terms of this Agreement and any other document purporting to relate to the employment of the Appointee (including the Company's Employee Handbook from time to time in force) the terms of this Agreement prevail.
- 19.3 The Appointee hereby acknowledges that he has no outstanding claims of any kind against the Company/any Group Company (otherwise than in respect of remuneration and expenses accrued due and existing rights with respect to deferred bonuses and/or under and in accordance with any Group share plan, as at the date of this Agreement but not yet paid).

20 Counterparts

This Agreement may be executed in any number of counterparts and by the parties on separate counterparts, but in that case shall not be effective until each party has executed at least one counterpart. Each counterpart shall constitute the original of this Agreement, but all counterparts together constitute one and the same instrument.

21 Choice of law and submission to jurisdiction

21.1 This Agreement shall be governed by and interpreted in accordance with the laws of England and Wales.

21.2 The Appointee hereby submits to the jurisdiction of the High Court of Justice in England but this Agreement may be enforced by the Company in any court of competent jurisdiction.

22 Definitions

22.1 In this Agreement unless the context otherwise requires the following expressions have the following meanings:

“Board” means the Board of Directors for the time being of the Company or any committee of the Board (including the Group Management Board) to which powers have been properly delegated or such person or persons designated by the Board from time to time as its representative for the purposes of this Agreement;

“Corporate Governance Code” means the UK Corporate Governance Code published by the Financial Reporting Council (as amended from time to time);

“Commencement Date” means 3 December 2010;

“Employment” means the Appointee’s employment under this Agreement;

“FSA” means the Financial Services Authority;

“Group” means (1) HSBC Holdings plc and any entity which from time to time is a holding company of HSBC Holdings plc or a subsidiary of HSBC Holdings plc or of any such holding company; and (2) any entity over which from time to time any of the entities defined in paragraph (1) of this definition either directly or indirectly exercises management control, even though it may own less than fifty per cent (50%) of the shares and is prevented by law from owning a greater shareholding and **“Group Company”** and **“Group Companies”** shall be construed accordingly;

“Recognised Investment Exchange” means an investment exchange granted recognition under section 285 (1) Financial Services and Markets Act 2000 including a recognised overseas investment exchange;

“Statutory Deductions” means appropriate tax, national insurance contributions and any other applicable statutory deductions;

“Termination Date” means the date on which the Appointee’s Employment terminated;

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

- 22.2 references to clauses, sub-clauses and schedules are unless otherwise stated to clauses and sub-clauses of and schedules to this Agreement;
- 22.3 the headings to the clauses are for convenience only and shall not affect the construction or interpretation of this Agreement;
- 22.4 the words “subsidiary” and “holding company” have the meanings set out in section 1159 of the UK Companies Act 2006 and “management control” shall be demonstrated by the ability to exercise significant influence over an entity or its management; and
- 22.5 a reference to any statute or statutory provision (whether of the United Kingdom or elsewhere) includes any subordinate provision (as defined by section 21(1) Interpretation Act 1978) made under it and provision which has superseded it or re-enacted it (with or without modification) before or after the date of this Agreement except where it is after the date of this Agreement to the extent that the liability of any party is thereby increased or extended.

IN WITNESS whereof this Agreement has been executed the day and year first above written.

Executed as a Deed by _____)

the Company in the presence of: _____)

Dated: _____

Director

Dated: _____

Director/Secretary

Executed as a Deed by _____)

the Appointee _____)

Dated: _____

in the presence of: _____)

Dated: _____

Signature of Witness

Witness Name: _____

Witness Address: _____

Witness occupation: _____

Private & Confidential

Dated 2010

HSBC HOLDINGS PLC (1)

and

IAIN MACKAY (2)

SERVICE AGREEMENT

Contents

Clause	Page
1 Appointment	3
2 Remuneration	3
3 Benefits	5
4 Duration of the Employment	6
5 Scope and Duties of the Employment	6
6 Hours and place of work	8
7 Deductions	9
8 Expenses	9
9 Holidays	9
10 Sickness benefits	9
11 Restrictions during the Employment	11
12 Confidential Information and Company documents	12
13 Inventions and other intellectual property	13
14 Termination	14
15 Restrictive covenants	17
16 Grievance, dismissal and disciplinary procedures	22
17 Disclosure of information	22
18 General	22
19 Other Agreements	23
20 Counterparts	23
21 Choice of law and submission to jurisdiction	24
22 Definitions	24

THIS AGREEMENT is dated _____ 2010 and is made **BETWEEN**:

- (1) **HSBC HOLDINGS PLC** (No. 617987) whose registered office is at 8 Canada Square, London E14 5HQ (the “**Company**”); and
- (2) **IAIN MACKAY** of 8 Canada Square, London E14 5HQ (the “**Executive**”).

NOW IT IS HEREBY AGREED as follows:

1 Appointment

- 1.1 Subject to the granting and maintaining of appropriate work/residence permits and any regulatory issues, the provisions of this Agreement will commence with effect from the Commencement Date.
- 1.2 The Company shall employ the Executive and the Executive agrees to act as a senior executive of the Company at Band 0. The Executive will act as Group Finance Director of the Group and agrees to do so on and subject to the following terms, conditions and provisions of this Agreement.
- 1.3 The Executive will report to the Group Chairman and the Group Chief Executive of the Group although the Company has the right in its absolute discretion to change the person or persons to whom the Executive reports at any time subject always to such reporting line being appropriate to the Executive’s seniority within the Group and status as an executive director of the Company.

2 Remuneration

- 2.1 The Company shall pay to the Executive, a gross salary currently at the rate of GBP700,000 per annum (the “**Salary**”) less Statutory Deductions, which shall accrue day to day and be payable by equal monthly instalments in arrears on or about the 20th of each calendar month. The Board will review the Executive’s salary annually in March, the first such review to take place in March 2011. There is no obligation on the Company to increase the Executive’s Salary pursuant to any such review or otherwise provided always that such reviews are conducted reasonably and in good faith having regard to the Executive, the treatment of other executives of comparable status and all other relevant circumstances. There will be no review of the Salary after notice has been given by either party to terminate the Employment.
- 2.2 The Company may at its sole discretion (acting reasonably and in good faith) both as to whether to pay or award any Variable Pay (as defined at clause 2.3) and if so, how much, pay or award the Executive Variable Pay of such amount as the Board may determine in respect of each complete financial year of the Company during which the Employment subsists.
- 2.3 For the purposes of this Agreement “**Variable Pay**” means any non-pensionable incentive compensation including any bonus or deferred bonus in the form of (i) cash or (ii) equity awarded under any share plan in force from time to time (in relation to which performance conditions may or may not be attached) and subject to clauses 2.9 and 2.10.

- 2.4 The operation of and all arrangements relating to any such Variable Pay, (including without limitation the payment or award date for any Variable Pay from time to time), will be at the absolute discretion of the Board which may in its absolute discretion terminate, replace or amend any such plan at any time provided that the Executive is treated no less favourably than other executives of comparable status and in similar circumstances.
- 2.5 The Executive shall not be entitled to be considered for and/or to receive any Variable Pay if on the date that any such Variable Pay is due to be declared he is:
- 2.5.1 no longer employed by the Company or any Group Company; or
- 2.5.2 is under notice of termination of employment (including if the Executive is not assigned any duties in accordance with the garden leave provisions at clause 14.4),
due to the termination of the Employment by either the Executive (other than in response to the Company's repudiatory breach of contract) or by the Company pursuant to clause 14.1.2 of this Agreement.
- 2.6 The remuneration specified in clauses 2.1 and 2.2 (if any), shall be inclusive of any fees to which the Executive may be entitled as a director of the Company or any Group Company or of any other company or any unincorporated body in which the Executive holds the office as nominee or representative of the Company or any Group Company.
- 2.7 Payment of Salary and any Variable Pay to the Executive shall be made either by the Company or by a Group Company and, if by more than one company, in such proportions as the Board may from time to time think fit, subject always to the Company's reasonable consideration of any detrimental net employment tax consequences on the Executive, by doing so.
- 2.8 The Executive may be eligible to participate in any employee share plan established by the Company from time to time. Eligibility to participate is subject to the rules of the relevant plan in force from time to time and is at the discretion of the Board. The Company will use reasonable endeavours to procure that any discretion relating to the grant of additional awards to the Executive is exercised reasonably and in good faith having regard to the Executive, the treatment of other executives of comparable status and all other relevant circumstances.
- 2.9 If the Executive is eligible to participate in an employee share plan pursuant to clauses 2.2 and/or 2.8, his rights under such plan will be subject to and in accordance with the rules of that plan in force from time to time. To the extent that the rules of such plans impose legally enforceable limitations on the Executive's legal rights, the Executive hereby acknowledges he shall be bound by such limitations.
- 2.10 Subject to the rules of the relevant plan as referenced at clauses 2.3 and 2.8, in participating in such a plan, the Executive waives all and any rights to compensation or damages arising from the loss or failure to receive any rights or benefits under the plan (or the diminution in value of such rights or benefits) as a result of:

- (a) the termination of his office or employment and/or giving notice of termination of employment with any Group Company for any reason whatsoever (whether lawful or unlawful); and/or
- (b) the exercise or failure to exercise any discretion (whether lawful or unlawful) conferred by the rules of the plan.

3 Benefits

3.1 Chauffeur Services

The Executive shall have access to the chauffeur driven services operated by the Company in London from the chauffeur pool.

3.2 Pension

Subject to clause 3.5.3, the Company shall pay to the Executive an annual pension allowance of 50 per cent. of the Executive's annual Salary, payable monthly in arrears, less Statutory Deductions.

3.3 Personal Accident Insurance Cover

The Executive is entitled to non-contributory membership of the Group's personal accident insurance scheme.

3.4 Clubs

The Company shall make payments on the Executive's behalf in respect of the annual membership subscription of two clubs or such similar two clubs as the Executive shall nominate each year, to be approved by the Company through the Company's Group Managing Director, Human Resources.

3.5 Medical Benefits

The Executive shall participate in the schemes set out under clauses 3.5.1 to 3.5.4 subject always to the relevant schemes' terms and conditions from time to time in force and subject to the Executive meeting the requirements of the relevant scheme and being deemed eligible by the relevant insurance provider. The Company shall not be liable to provide any benefits or any compensation in lieu thereof or take any action to enforce the provision of such benefits in circumstances where the scheme provider refuses for any reason whatsoever, to provide any benefits to the Executive.

3.5.1 Health Checks

The Executive is eligible for an annual voluntary health check with a medical adviser appointed and paid for by the Company.

3.5.2 Medical Cover

The Executive and his spouse/partner and eligible dependants are entitled to participate in the Group's International Medical Scheme.

3.5.3 Group Income Protection

If the Executive is unable by reason of illness or injury, to perform the material or substantial parts of his duties hereunder, following a period of absence from work in excess of 26 consecutive weeks, the Executive will be eligible to be considered for a monthly payment equivalent to 50 per cent. of monthly Basic Salary. In the event of such payment, the pension allowance will continue to be payable, subject to a cap of 35 per cent. of the Executive's annual Salary.

3.5.4 Life Assurance Cover

Under the Group Life Assurance Scheme, in the event of the Executive's death, a sum equivalent to four times annual Salary will be paid to the Executive's nominated beneficiaries, subject to approval by the trustees of the Group Life Assurance Scheme.

3.6 Directors and Officers Liability

The Executive shall benefit from cover under the Company's policy on Directors' and Officers' Liability (including Outside Directors' and Officers' Liability) subject always to the policy and the rules of the policy from time to time in force.

4 Duration of the Employment

4.1 The Employment pursuant to this Agreement shall commence on the Commencement Date and, subject to clauses 5.4 and 14, shall continue until terminated by either party giving to the other not less than twelve months' notice in writing.

4.2 Notwithstanding clause 4.1 and any retirement date specified in any applicable pension scheme, the Employment shall automatically terminate when the Executive reaches the normal retiring age from time to time applicable to senior executives of the Company which, for the avoidance of doubt, is currently 65.

4.3 The Executive's period of continuous employment commenced on 16 July 2007.

5 Scope and Duties of the Employment

5.1 In the Executive's position as Group Finance Director, he shall:

5.1.1 devote the whole of his time, attention and skill to his duties;

5.1.2 faithfully and diligently perform such duties and exercise such powers consistent with his position as may from time to time be assigned to or vested in him by the Board;

5.1.3 obey the reasonable and lawful directions of the Board;

5.1.4 at all times act in the way he considers in good faith, most likely to promote the success of the Company (and applicable Group Companies) for the benefit of the members as a whole in accordance with Section 172 Companies Act 2006;

5.1.5 perform his services in a professional and competent manner and in cooperation with others;

- 5.1.6 keep the Board at all times promptly and fully informed (in writing if so requested) of his conduct of and activities in relation to the business of the Company and any Group Company and provide such explanations in connection therewith as the Board may require from time to time including for the avoidance of doubt, any misconduct of other employees or directors or his own; and
- 5.1.7 comply with the duties set out in the Companies Act 2006.
- 5.2 The Executive shall comply with:
 - 5.2.1 all of the Company's and Group Company's codes, rules, regulations, policies and procedures (including without limitation the Compliance Manual),
 - 5.2.2 the codes, practices, rules, principles and regulations of the UK Listing Authority (including the Model Code on directors' dealings in securities as set out in Annex 1 to Chapter 9 of the Listing Rules), the FSA, any other stock exchange and/or regulatory authorities relevant to the Company or any Group Company and of any association or professional body to which the Company and/or any Group Company and/or the Executive belong to from time to time,
 - 5.2.3 such laws as may be relevant to the Group and to the Executive's duties under this Agreement; and
 - 5.2.4 the Code for Dealing in Group Securities and every regulation of the Group for the time being in force in relation to dealings in shares or other securities of the Company or any Group Company
insofar as they may affect him, the Company, any Group Company or its or their directors, officers or employees.
- 5.3 The Executive shall comply with any rules, policies and procedures set out in the the Company's Employee Handbook, a copy of which is available on the Company's intranet. The Employee Handbook does not form part of this Agreement and the Company may amend it at any time.
- 5.4 The Executive's continued employment will be subject to him continuing to hold approved status for any position he may hold that requires FSA approval. In the event of approval being withdrawn (under current FSA regulations this includes instances such as insider dealing and market manipulation) in respect of this position or any subsequent position, the Company reserves the right to summarily terminate the Executive's employment without being further liable to him (other than in respect of amounts accrued due at the Termination Date). If the Executive's current role does not require registration with the FSA, his role in the future may require him to pass regulatory exams and/or obtain regulatory registrations. It is therefore a condition of the Executive's continuing employment that he passes any such exams and obtains such registrations. The Company shall provide the Executive with all reasonable co-operation in relation to him obtaining and/or retaining FSA approved status and such other regulatory registrations as may be required from time to time.
- 5.5 The Executive shall do such things as are necessary to ensure compliance by himself with the Corporate Governance Code and, so far as it lies within his power to do so, by the Company and any applicable Group Company.

- 5.6 The Company reserves the right to appoint any other person or persons to act jointly with the Executive in the event that the Executive is not assigned any duties in accordance with the garden leave provisions at clause 14.4 (or in place of the Executive if he is suspended in accordance with the provisions of this Agreement) in any position to which he may be assigned from time to time.
- 5.7 The Executive shall if and so long as the Company requires and without any further remuneration therefore (except as otherwise agreed):
- 5.7.1 carry out duties on behalf of any Group Company; and
- 5.7.2 act as a director or officer of any Group Company.
- Provided always that such duties or offices are consistent with his role as Group Finance Director.
- 5.8 The Company may at its sole discretion transfer the Executive's employment and assign the provisions of this Agreement to any Group Company at any time, subject always to the Executive enjoying no less favourable terms and conditions of employment.
- 5.9 The Executive agrees that a copy of clauses 5, 11, 12 and 15 of this Agreement will be provided by him to any person, firm, company or other entity making an offer of employment, appointment as a director or officer, agency, consultancy, partnership or joint venture to him during the Employment or thereafter whilst any restrictions in clause 15 remain in force immediately upon receiving any such offer.

6 Hours and place of work

- 6.1 The Company's standard working week is 35 hours (excluding unpaid lunch breaks). The Executive shall be required to work such hours, including additional hours (without further remuneration) as are necessary for the proper performance of the duties hereunder.
- 6.2 Notwithstanding clause 6.1 the Executive acknowledges that because of the autonomous nature of his role the duration of the Executive's working time is not measured or monitored or determined by the Company so that the limit on weekly working time set out in Regulation 4 of the Working Time Regulations 1998 (or such other regulations as may from time to time come into force) does not apply to the Executive's Employment.
- 6.3 The Executive's place of work will initially be the Company's offices at 8 Canada Square, London E14 5HQ but the Company may reasonably require the Executive to work at any place of business of the Company or the Group within London, or by mutual agreement, overseas, on either a temporary or an indefinite basis. The Executive will be given reasonable notice of any permanent change in his place of work. In the performance of the duties hereunder, the Executive may be required to travel and undertake his duties both throughout and outside the United Kingdom and in other global locations as the Group sees fit from time to time.

7 Deductions

For the purposes of the Employment Rights Act 1996, the Executive hereby authorises the Company to deduct from the remuneration hereunder any sums due from the Executive to the Company including, without limitation, any overpayments, loans or advances made to him by the Company, the cost of repairing any damage or loss to the Group's property caused by the Executive (and of recovering such costs) and any losses suffered by the Group as a result of any negligence or breach of duty by the Executive or sums in respect of sub-clause 10.6 of this Agreement.

8 Expenses

The Company shall reimburse the Executive in respect of all expenses reasonably incurred by the Executive in the proper performance of the duties hereunder subject to the Executive providing such receipts or other evidence as the Company may require and subject to the Company's rules and policies from time to time relating to expenses.

9 Holidays

- 9.1 The Executive shall be entitled to receive his normal remuneration for all bank and public holidays normally observed in the United Kingdom and a further 30 working days' paid holiday in each holiday year (being the period from 1 January to 31 December) including one period of 10 consecutive working days which must be taken as core leave. The Executive's holiday shall be taken at such times as are agreed with the Group Chief Executive.
- 9.2 In the holiday year in which the Employment terminates, the Executive's entitlement to holiday shall accrue on a pro rata basis for each complete month of service during the relevant year. If, on the termination of the Employment, the Executive has exceeded his accrued holiday entitlement, the excess may be deducted from any sums due to the Executive and the Executive hereby authorises the Company to make such deduction. If the Executive has any unused holiday entitlement, the Company may either require the Executive to take such unused holiday during any notice period (whether or not the Executive is on garden leave in accordance with clause 14.4) or make payment in lieu thereof.
- 9.3 Holiday entitlement for one holiday year may not be taken in subsequent holiday years unless otherwise agreed by the Group Chief Executive. Failure to take holiday entitlement in the appropriate holiday year will lead to forfeiture of any accrued holiday not taken, without any right to payment in lieu thereof unless otherwise agreed by the Company's Group Managing Director, Human Resources in accordance with the holiday policy applicable to Executive Directors from time to time.

10 Sickness benefits

- 10.1 The Company shall continue to pay the Salary during any period of absence on medical grounds up to a maximum of 120 working days in any period of 12 months ("**Company Sick Pay**") provided that the Executive complies in full with any of the requirements set out in the Company's Employee Handbook and clause 10.2 below. Thereafter the Executive will only be entitled to such salary and benefits, if any, as the Board shall in its absolute discretion from time to time

allow. Upon the Executive's return to work from such absence to perform his duties hereunder, he shall be entitled to receive the Salary and the benefits set out at clause 3, pursuant to the terms of this Agreement and subject to any relevant scheme rules.

10.1.1 At any time during the Employment, the Executive shall, if so required by the Board,

- (a) supply the Company with medical certificates covering any period of sickness or incapacity exceeding seven days (including weekends); and
- (b) undergo, at the expense of the Company, an examination by a registered medical practitioner or practitioners to be nominated by the Company (including but not limited to the Executive's general practitioner or any other physician responsible for the Executive's care). The Executive authorises the medical practitioner to disclose and discuss with the Company any report prepared as a result of any such examination pursuant to the Access to Medical Reports Act 1988. The Company has the right to postpone the Executive's return to work (and the continuance or reinstatement of his normal pay, if appropriate) until the medical practitioner has confirmed that the Executive is fit to perform his duties.

10.2 Payment of the Executive's Salary pursuant to clause 10.1 shall be inclusive of any Statutory Sick Pay to which the Executive may be entitled by law. The Company will also deduct from it any other statutory benefits if applicable due to the Executive, together with any Statutory Deductions.

10.3 Subject to the applicable scheme rules in force from time to time, during the Executive's absence from work on medical grounds, the Executive will continue to be covered by the Company's life assurance arrangements, private medical insurance and personal accident insurance and whilst he is entitled to receive Company Sick Pay he shall be entitled to receive the pension allowance as set out at clause 3.2. The Executive's entitlement to participation in any Variable Pay plan and the accrual of holiday entitlement above the minimum statutory entitlement shall cease on the expiry of the payment of Company Sick Pay until such time as the Executive is able to perform his duties hereunder.

10.4 The Company reserves the right to terminate the Employment in accordance with the terms of this Agreement for reasons unrelated to the Executive's illness or sickness absence when the Executive is absent through sickness or injury at any time, notwithstanding any outstanding or prospective entitlement to pay in accordance with clause 10.1, private medical insurance, permanent health insurance or long term disability benefits. The Company shall not be liable for any loss arising from such termination.

10.5 If the Executive's absence shall be occasioned by the actionable negligence of a third party in respect of which damages are recoverable in respect of the period of the Executive's incapacity, then the Executive shall:

10.5.1 forthwith notify the Company of all the relevant circumstances and of any claim, compromise, settlement or judgment made or awarded in connection therewith;

10.5.2 if the Company so requires, refund to the Company such sum as the Company may determine, not exceeding the lesser of:

- (a) the amount of damages recovered by the Executive under such compromise, settlement or judgment; and
- (b) the sums advanced to the Executive by the Company in respect of the period of incapacity

subject to any deductions made by any court or tribunal that takes into account the payments made to the Executive in this clause 10 when awarding any such damages or compensation.

11 Restrictions during the Employment

- 11.1 The Executive shall not during the Employment directly or indirectly either on his own account or on behalf of any other person, company, business entity or other organisation be employed, engaged, concerned or interested in any other business or undertaking, provided that this shall not prohibit the holding (directly or through nominees) of investments listed on the London Stock Exchange plc or in respect of which dealing takes place on the Alternative Investment Market of the London Stock Exchange plc or on The Stock Exchange of Hong Kong Limited or on any Recognised Investment Exchange as long as not more than 5 per cent of the issued shares or other securities of any class of any one company shall be so held without the prior sanction of a resolution of the Board.
- 11.2 The Executive shall obtain the Chairman's prior written approval (such approval not to be unreasonably withheld) before accepting appointment as a non-executive director of any company outside the Group. Approval is currently limited to one FTSE100 constituent company or other significant company in the UK or elsewhere.
- 11.3 The Executive shall not (and shall procure so far as the Executive is able that any person connected with the Executive within the meaning of section 252 Companies Act 2006 (**Connected Person**) shall not) deal or become or cease to be interested (within the meaning set out in Schedule 1 Companies Act 2006) in any securities of the Company, except in accordance with the Company's code for securities transactions by directors.
- 11.4 Subject to any regulations issued by the Company, the Executive and any Connected Person shall not be entitled to receive or obtain directly or indirectly any discount, rebate or commission in respect of any sale or purchase of goods effected or other business transacted (whether or not by the Executive) by or on behalf of the Company or any Group Company and if he or any Connected Person (or any firm or company in which he or any Connected Person is interested) shall obtain any such discount, rebate or commission the Executive shall account to the Company or the relevant Group Company for the amount received by the Executive or any Connected Person (or a due proportion of the amount received by such company or firm having regard to the extent of the Executive's or the Connected Person's interest therein).
- 11.5 The Executive agrees to disclose to the Board any matters relating to any Connected Person which may, in the reasonable opinion of the Board, be considered to interfere, conflict or compete with the proper performance of the Executive's obligations under this Agreement.

- 11.6 During the Employment, the Executive agrees that he will not in competition with the Company or any Group Company:
- 11.6.1 deal with, canvass, solicit or endeavour to take away from the Company or any Group Company, whether directly or indirectly and whether on his own behalf or on behalf of any other person, firm, company or other entity any customers or prospective customers; or
 - 11.6.2 directly or indirectly solicit or entice away from or endeavour to entice away from the Company or any Group Company any individual employed or engaged by the Company or any Group Company; or
 - 11.6.3 directly or indirectly make preparations to compete with any business carried on by the Company or any Group Company.
- 11.7 During the Employment the Executive shall inform the appropriate member of the Board without delay if he becomes aware that any director, officer, or senior employee of the Company or any Group Company is planning to materially breach any of the provisions of their contract of employment or implied duties of loyalty, good faith and fidelity.

12 Confidential Information and Company documents

- 12.1 The Executive recognises that, whilst performing the duties hereunder for the Company and the Group the Executive will have access to and come into contact with trade secrets and Confidential Information belonging to the Company and/or any Group Company and will obtain personal knowledge of and influence over its or their customers, suppliers and/or employees. The Executive therefore agrees that the restrictions set out in this clause 12 are reasonable and necessary to protect the legitimate business interests of the Company and the Group both during and after the termination of the Employment. The Executive shall neither during the Employment (except in the proper performance of the duties) nor at any time (without limit) after the termination of the Employment directly or indirectly:
- 12.1.1 divulge or communicate to any person, company, business entity or other organisation; or
 - 12.1.2 use for his own purposes or for any purposes other than those of the Company or any Group Company; or
 - 12.1.3 through any failure to exercise due care and diligence, cause any unauthorised disclosure of any trade secrets or Confidential Information relating to the Company or any Group Company, but so that these restrictions shall cease to apply to any information which shall become available to the public generally otherwise than through the default of the Executive and to any use or disclosure authorised by the Board or required by law.
- 12.2 Nothing in this Agreement shall prevent the Executive from making a protected disclosure in accordance with section 43A Employment Rights Act 1996 and the Public Interest Disclosure Act 1998.

- 12.3 **“Confidential Information”** shall include details of suppliers and their terms of business, details of customers, clients and prospective customers/clients and their requirements, the prices charged to and terms of business with customers, marketing plans and sales forecasts, financial information, results and forecasts (save to the extent that these are included in published audited accounts), any proposals relating to the acquisition or disposal of a company or business or any part thereof or to any proposed expansion or contraction of activities, or any other business strategy or tender, details of employees and officers and of the remuneration and other benefits paid to them, information relating to research activities, inventions, secret processes, designs, software, formulae and product lines, any information which the Executive either is aware or reasonably ought to know is confidential and any information which has been given to the Company or any Group Company in confidence by customers, suppliers or other persons.
- 12.4 All notes, memoranda, records, lists of customers and suppliers and employees, correspondence, documents, computer and other discs and tapes, data listings, codes, designs and drawings and other documents and material whatsoever (whether made or created by the Executive or otherwise) relating to the business of the Company or any Group Company (and any copies of the same):
- 12.4.1 shall be and remain the property of the Company or the relevant Group Company; and
- 12.4.2 shall be handed over by the Executive to the Company or to the relevant Group Company or irrevocably deleted from any computer and/or word processing system in the Executive’s possession or under the Executive’s control, on demand and in any event on the termination of the Employment. Provided always that, at the reasonable request of the Executive, he shall be provided, subject always to the provisions of clause 12.1, with copies of all Board Minutes (and documents referred to therein) of Group Companies of which he was a director, in respect of any period during which he was a director of such Group Company, which are reasonably required by the Executive for the purposes of defending himself in any regulatory or legal proceedings relating to his duties as a director of such Group Company.
- 13 Inventions and other intellectual property**
- 13.1 The Executive may make inventions or create other intellectual property during the Employment. In this respect the Executive has a special responsibility to further the interests of the Company and the Group given the Executive’s position at the Company and the remuneration paid to the Executive under this Agreement.
- 13.2 In recognition of the Executive’s position, remuneration and responsibility, the Executive acknowledges and agrees that any invention, improvement, design, process, information, copyright work, trade mark, trade name or get-up or any other intellectual property (together the **“Intellectual Property”**) made, created or discovered by him during the Employment (whether capable of being patented or registered or not) in conjunction with or in any way affecting or relating to the business of the Company or any Group Company or capable of being used or adapted for use in the Company or any such Group Company or in connection therewith shall be immediately disclosed to the Company and shall belong to and be the absolute property of the Company or such Group Company as the Company may direct.

- 13.3 However clause 13.2 shall only apply to the extent that any invention was made by the Executive in the course of his duties or in the course of duties falling outside the Executive's normal duties but which have been specifically assigned to him (together "**Duties**") and (i) such invention was reasonably expected to result therefrom; and/or (ii) at the time of making the invention, because of the nature of his Duties and the particular responsibilities arising therefrom, the Executive had a special obligation to further the interests of the Company and the Group.
- 13.4 The Executive acknowledges that he has no rights, interest or claims, either during the Employment or after the termination of the Employment, in or to any such Intellectual Property and he shall not use such Intellectual Property other than during the period of the Employment and for the purpose of the Company or the Group.
- 13.5 If and whenever required to do so by the Company, (whether during the Employment or after its termination), the Executive shall at the expense of the Company or such Group Company as the Company may direct:
- 13.5.1 apply or join with the Company or such Group Company in applying for letters patent or other protection or registration in the United Kingdom and in any other part of the world for any such Intellectual Property; and
- 13.5.2 execute and do all instruments and things necessary for vesting the said letters patent or other protection or registration when obtained and all right title and interest to and in the same absolutely and as sole beneficial owner in the Company or such Group Company or in such other person as the Company may specify.
- 13.6 The Executive agrees that he irrevocably and unconditionally waives all rights (including all moral rights) under Chapter IV of the Copyrights, Designs and Patents Act 1988 in connection with his authorship of any existing or future copyright work, in whatever part of the world such rights may be enforceable
- 13.7 Nothing in this clause shall be construed as restricting the Executive's rights or those of the Company under the Patents Act 1977 and in particular, sections 39 to 43 Patents Act 1977.

14 Termination

- 14.1 Notwithstanding clause 4.1 the Employment shall be subject to termination by the Company:
- 14.1.1 by not less than six months' notice in writing given at any time while the Executive shall have been incapacitated by reason of ill health or accident from performing the duties hereunder for a period of or periods aggregating the total period during which the Executive is entitled to receive Company Sick Pay provided always that, subject to clause 10.5, the Company shall not terminate the Employment in these circumstances if the effect of such termination would be to deprive the Executive of the benefit of payments under any permanent health insurance scheme. If at any time during the currency of such a notice the Executive shall provide a medical certificate satisfactory to the Board to the effect that he has fully recovered physical and/or mental health and that no recurrence of illness or incapacity can reasonably be anticipated, the Company shall withdraw the notice;

14.1.2 by summary notice in writing and with no liability to make any further payment to the Executive (other than in respect of amounts accrued due at the Termination Date) if the Executive shall have:

- (a) committed by any act or omission any serious breach or repeated or continued (after warning) a material breach of the Executive's obligations hereunder; or
- (b) been guilty of conduct by act or omission (whether in the course of the duties hereunder or otherwise) which (i) in the reasonable opinion of the Board, tends to bring the Executive and/or the Company and/or any Group Company into disrepute on account of material economic or reputational consequences for all or any of them; or (ii) causes the Company or any Group Company substantial economic harm, provided in either case that if such conduct is capable of remedy, he has first been given a reasonable opportunity to remedy the contract and has failed to do so; or
- (c) been convicted of a criminal offence under any statutory enactment or regulation (other than an offence under any road traffic legislation in the United Kingdom or elsewhere for which a fine or non custodial penalty is imposed and which does not render him unable to discharge his duties under this Agreement); or
- (d) become bankrupt or had an interim order made against the Executive under the Insolvency Act 1986 or compounded with his creditors generally; or
- (e) in the reasonable opinion of the Board, failed to perform the duties hereunder to a satisfactory standard, after having received a written warning from the Company relating to the same; or
- (f) been disqualified from being a director by reason of any order made under the Company Directors Disqualification Act 1986 or any other enactment; or
- (g) resigned of his own choice as a director of the Company or any Group Company, not being at the request of or with the prior written agreement of the Board (save with reasonable and proper cause and where remaining as a director would substantially disadvantage him in his capacity as an officeholder of the Company); or
- (h) become prevented by an applicable law or regulation from performing any material part of his duties; or
- (i) been guilty of a material breach of the rules or regulations as amended from time to time of the UK Listing Authority (including the Model Code for transactions in securities by directors of listed companies), The London Stock Exchange plc, the FSA or any other stock exchanges or regulatory authorities relevant to the Company or any Group Company or any Code of Practice issued by the Company or any Group Company (as amended from time to time); or
- (j) been expelled, or subject to any serious disciplinary action by a relevant professional body or failed or ceased to meet the requirements of any

regulatory body or statutory authority as a result of which the Executive is no longer able to perform all or any of the duties under this Agreement or;

- (k) ceased to be eligible to work in the United Kingdom in accordance with Sections 15-25 of the Immigration, Asylum and Nationality Act 2006.

Any delay by the Company in exercising such right of termination shall not constitute a waiver thereof.

- 14.2 If the Company becomes entitled to terminate the Employment pursuant to clauses 5.4 or 14.1.2, or whilst the Company or any external body investigates any allegation which would or may entitle the Company to terminate the Employment pursuant to clauses 5.4 or 14.1.2 it shall be entitled (but without prejudice to its right subsequently to terminate such appointment on the same or any other ground) to suspend the Executive on full pay for such period as is reasonable in the circumstances. During the period of any suspension the Executive will continue to be bound by the provisions of this Agreement and must continue at all times to conduct himself with good faith towards the Company and all Group Companies.
- 14.3 The Company reserves the right in its absolute discretion to give the Executive pay in lieu of all or any part of the notice of termination (whether notice is given by the Company or by the Executive). A dismissal without notice per se shall not constitute or imply an election under this clause 14.3. For this purpose, the Executive agrees that pay in lieu will consist of the Salary, pension allowance and other contractual benefits (or cash equivalent) as set out at clause 3 of this Agreement only, for the relevant period of notice (subject to Statutory Deductions in the normal way), excluding any Variable Pay and any other emolument referable to the Employment.
- 14.4 During any period of notice of termination or part thereof (whether given by the Company or the Executive), the Company shall (but only for a period or periods in aggregate not exceeding six months) be under no obligation to assign any duties to the Executive and shall be entitled to exclude him from the Group's premises and to direct that the Executive refrains from contacting (other than purely social contact with persons with whom the Executive has established social relationships) any customers, clients, suppliers, agents, professional advisers or employees of the Company or any Group Company and refrains from accessing the computer or other data or similar system of the Company or any Group Company (whether directly or indirectly) and remove him from office as a director of the Company and any Group Company and from all or any offices held by him in the Company or any Group Company, provided that this shall not affect the Executive's entitlement to receive Salary and other contractual benefits (excluding Variable Pay if the circumstances in clause 2.5 apply). For the avoidance of doubt, during such period the Executive shall continue to be bound by the same obligations to the Company and the Group as were owed prior to the commencement of the period including the duty of good faith and fidelity.
- 14.5 The Executive agrees that during any period of notice of termination whether given by the Company or by the Executive he will give such assistance in effecting an orderly and comprehensive handover as the Company may reasonably require and with regard to any claim made by or against any Group Company. For the avoidance of doubt such assistance may include attending

meetings, reviewing documents, giving and signing statements/affidavits and attending hearings and giving evidence.

- 14.6 Without prejudice to the constitution (including for the avoidance of doubt the articles of association) of the Company or any Group Company, on the termination of the Employment (howsoever arising) or on either the Company or the Executive having served notice of such termination and the Company having exercised its right to place the Executive on garden leave pursuant to clause 14.4, the Executive shall at the request of the Company:
- 14.6.1 resign from office as a Director of the Company and of any Group Company and all other offices held by the Executive in the Company and/or any Group Company provided however that such resignation shall be without prejudice to any claims which the Executive may have against the Company or any Group Company arising out of the termination of the Employment; and
- 14.6.2 transfer without payment to the Company or as the Company may direct to the Company or to any third party, any shares or other securities held by the Executive in the Company or any Group Company as a nominee or trustee for the Company or any Group Company and deliver to the Company the related certificates; and
- 14.6.3 forthwith deliver to the Company all Confidential Information and all materials within the scope of clause 12.4 including any copies of any such materials and all credit cards and other property of or relating to the business of the Company or of any Group Company which may be in the Executive's possession or under the Executive's power or control and, if requested, provide a signed statement that he has fully complied with the obligations under this clause 14.6.3.
- 14.7 If the Executive shall have been offered but shall unreasonably have refused to agree to the transfer of this Agreement by way of novation to a company which has acquired or agreed to acquire the whole or substantially the whole of the undertaking and assets of or of the equity share capital of the Company, the Executive shall have no claim against the Company in respect of the termination of his employment hereunder by reason of the subsequent voluntary winding-up of the Company or of the disclaimer of this Agreement by the Company within one month after such acquisition.

15 Restrictive covenants

- 15.1 For the purposes of this clause 15 the following words have the following meanings:
- 15.1.1 **"Company Products"** means any banking or financial products researched into, developed, supplied, distributed or sold by the Company with which the duties of the Executive were materially concerned or for which he was directly or ultimately responsible during the Restricted Period;
- 15.1.2 **"Company Services"** means any banking or financial services (including but not limited to technical and product support, technical advice and customer services) developed or supplied by the Company with which the duties of the Executive were materially concerned or for which he was directly or ultimately responsible during the Restricted Period;

15.1.3 **“Comparator Group”** means the following companies and entities, subject always to amendment from time to time by the Remuneration Committee of the Board of the Company and as notified to the Executive by no later than 30 days after any such amendment: Banco Bradesco, Banco Itau, Banco Santander, Bank of America, Bank of China, Barclays, BBVA, BNP Paribas, Citigroup, Credit Suisse Group, DBS Group, Deutsche Bank, Fortis, ICBC, JP Morgan Chase, Lloyds Banking Group, National Australia Bank, Royal Bank of Canada, Royal Bank of Scotland, Societe Generale, Standard Chartered, UBS, Unicredito Italiano and Wells Fargo (and all group companies of the companies and entities set out in this clause 15.1.3) and, where any companies or entities set out in this clause 15.1.3 are the subject of a takeover or undergo any form of reconstruction, the entities to which the relevant business assets of such companies or entities are transferred from time to time;

15.1.4 **“Confidential Information”** has the meaning ascribed thereto in clause 12.2;

15.1.5 **“Customer”** means any person or firm or company or other organisation whatsoever to whom or which the Company supplied Company Products and/or Company Services during the Restricted Period and with whom or which, during the Restricted Period:

- (a) the Executive had material personal dealings pursuant to the Employment; or
- (b) any employee who was under the direct or indirect supervision of the Executive had material personal dealings pursuant to their employment,

provided that in the case of a firm, company or other organisation “Customer” shall not include any division, branch or office of such firm or company or other organisation with which the Executive and/or any such employee as defined in sub-clause (b) above had no dealings during the Restricted Period save that where a restructuring of the firm or company or organisation has occurred following such personal dealings “Customer” shall include the part of the business with which the Executive or any employee as defined in sub-clause (b) above had dealings during the Restricted Period;

15.1.6 **“Prospective Customer”** means any person or firm or company or other organisation whatsoever with whom or which the Company shall have had negotiations or material discussions regarding the possible distribution, sale or supply of Company Products and/or Company Services during the Restricted Period and which were ongoing and not finally concluded at the Termination Date and with whom or which during such period:

- (a) the Executive shall have had material personal dealings pursuant to the Employment; or
- (b) any employee who was under the direct or indirect supervision of the Executive shall have had material personal dealings pursuant to their employment; or
- (c) the Executive was directly responsible in a client management capacity on behalf of the Company,

provided that in the case of a firm, company or other organisation "Prospective Customer" shall not include any division, branch or office of such firm, company or other organisation with which the Executive and/or any such employee had no dealings during the Restricted Period save that where a restructuring of the firm or company or organisation has occurred following such personal dealings, "Prospective Customer" shall include the part of the business with which the Executive or any employee as defined in sub-clause (b) had dealings during the Restricted Period;

- 15.1.7 **"Restricted Employee"** means any person who is on the Termination Date, or was during the Restricted Period, employed or engaged by the Company or any Group Company and is by reason of such employment or engagement in possession of, or is reasonably likely to be in possession of, any trade secret or Confidential Information relating to the business of the Company or any Group Company or has acquired influence over its Customers or Prospective Customers (as defined in this clause 15 but so that references to "the Executive" shall be replaced by references to the relevant employee and so that references to "Employment" shall mean the relevant employee's employment with the Company or Group Company, being in either case a person with whom the Executive had material dealings during the Restricted Period);
- 15.1.8 **"Restricted Period"** means the period of 12 months ending on the Termination Date or, in the event that no duties were assigned to the Executive for any part of the duration of the notice period, the 12 months immediately preceding the last day on which the Executive carried out any duties for the Company;
- 15.1.9 **"Restricted Products"** means Company Products or any products of the same or of a similar kind;
- 15.1.10 **"Restricted Services"** means Company Services or any services of the same or of a similar kind;
- 15.1.11 **"Restricted Supplier"** means any person, company, business entity or other organisation whatsoever who has supplied goods or services to the Company or any Group Company (other than utilities and goods or services supplied for administrative purposes) during any part of the Restricted Period or who has agreed prior to the Termination Date to supply goods or services to the Company to commence at any time in the twelve months following the Termination Date.
- 15.2 The Executive recognises that, whilst performing his duties for the Company, he will have access to and come into contact with trade secrets and Confidential Information belonging to the Company and certain Group Companies and will obtain personal knowledge of and influence over its or their customers and/or employees. The Executive therefore agrees that the restrictions set out in this clause 15 are reasonable and necessary to protect the legitimate business interests of the Company and any applicable Group Company both during and after the termination of the Employment.
- 15.3 The Executive hereby undertakes with the Company that he will not for the period of six months after the Termination Date without the prior written consent of the Company (such consent not to be unreasonably withheld) whether by himself, through his employees or agents or otherwise howsoever and whether on his own behalf or on behalf of any other person, firm, company or other organisation, directly or indirectly:

- 15.3.1 in competition with the Company anywhere in the world in a senior capacity, be employed by or engaged or otherwise interested in any of the companies (or other entities) in the Comparator Group in the business of researching into, developing, distributing, selling, supplying or otherwise dealing with Restricted Products or Restricted Services; or
- 15.3.2 in competition with the Company, accept orders or facilitate the acceptance of any orders or have any business dealings for Restricted Products or Restricted Services from any Customer or Prospective Customer; or
- 15.3.3 employ or otherwise engage in the business of or be personally involved to a material extent in employing or otherwise engaging in the business of researching into, developing, manufacturing, distributing, selling, supplying or otherwise dealing with Restricted Products or Restricted Services any Restricted Employee; or
- 15.3.4 interfere with, or endeavour to interfere with, the supply or provision of goods or services (other than utilities, or goods or services supplied for an administrative purpose) to the Company or to induce the cessation of the supply or provision of such goods or services from any Restricted Supplier; or
- 15.3.5 in competition with the Company, solicit business from, or solicit the supply of goods or services (other than utilities, or goods or services supplied for an administrative purpose) from any Restricted Supplier for the purposes of the provision of Restricted Products or Restricted Services.
- 15.4 The Executive hereby undertakes with the Company that he will not for the period of twelve months after the Termination Date without the prior written consent of the Company (such consent not to be unreasonably withheld) whether by himself, through his employees or agents or otherwise howsoever and whether on his own behalf or on behalf of any other person, firm, company or other organisation, directly or indirectly:
 - 15.4.1 in competition with the Company, solicit business from or endeavour to entice away or canvass any Customer or Prospective Customer if such solicitation or canvassing is in respect of Restricted Products or Restricted Services; or
 - 15.4.2 solicit or induce or endeavour to solicit or induce any Restricted Employee to cease working for or providing services to the Company, whether or not any such person would thereby commit a breach of contract.
- 15.5 If the restrictions in clauses 15.3 and 15.4 are for any reason held to be unenforceable in any jurisdiction in the world the Executive shall agree to such amended or lesser restriction as would enable that restriction to be enforced so far as possible in such jurisdiction.
- 15.6 The benefit of clauses 15.3 and 15.4 shall be held on trust by the Company for each Group Company and the Company reserves the right to assign the benefit of such provisions to to any Group Company, in addition such provisions also apply as though there were substituted for references to "the Company" references to each Group Company in relation to which the Executive has in the course of his duties for the Company or by reason of rendering services to or holding office in such Group Company:
 - 15.6.1 acquired knowledge of its trade secrets or Confidential Information; or

- 15.6.2 had material personal dealings with its Customers or Prospective Customers; or
- 15.6.3 supervised directly or indirectly employees having material personal dealings with its Customers or Prospective Customers,
- but so that references in clause 15 to “the Company” shall for this purpose be deemed to be replaced by references to the relevant Group Company. The obligations undertaken by the Executive pursuant to this clause 15.6 shall, with respect to each such Group Company, constitute a separate and distinct covenant and the invalidity or unenforceability of any such covenant shall not affect the validity or enforceability of the covenants in favour of any other Group Company or the Company. In addition, at the request of the Company the Executive shall enter into a direct agreement or undertaking with any Group Company whereby he will accept restrictions corresponding to the restrictions in this clause 15 (or such of them as may be appropriate).
- 15.7 In the event of the transfer (within the meaning of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (the “**Transfer Regulations**”) of the undertaking or the part of the undertaking in which the Executive shall at the time be employed as the result of which (by virtue of the Transfer Regulations) the Employment is automatically transferred to another (“the Transferee”), the provisions of this clause 15 shall have effect as though references in it (and in all associated terms defined in this Agreement) to “the Group” are construed as references to “any other company within the Transferee’s Group” (which for these purposes shall comprise the Transferee and any holding company of the Transferee and the subsidiaries of the Transferee and of any such holding companies for the time being).
- 15.8 The Executive hereby undertakes with the Company that he will not at any time without the consent of the Company after the Termination Date:
- 15.8.1 engage other than as a private consumer in any trade or business or be associated with any person, firm or company engaged in any trade or business using the name(s) “HSBC” or “The Hongkong and Shanghai Banking Corporation” or incorporating the word(s) “Hongkong Shanghai Banking Corporation”;
- 15.8.2 in the course of carrying on any trade or business, claim, represent or otherwise indicate any present association with the Company or any Group Company or for the purpose of carrying on or retaining any business or custom, claim, represent or otherwise indicate any past association with the Company or any Group Company to its detriment other than simple and factual statements regarding the Executive’s period of employment, job title, responsibilities and role.
- 15.9 The parties agree that the periods referred to in clauses 15.3 and 15.4 above will be reduced by one day for every day, during which, at the Company’s direction, the Executive is on garden leave in accordance with clause 14.4.
- 15.10 While the restrictions in this clause 15 (on which the Executive has had the opportunity to take independent legal advice, as the Executive hereby acknowledges) are considered by the parties to be reasonable in all the circumstances, it is agreed that if any such restrictions, by themselves, or taken together, shall be adjudged to go beyond what is reasonable in all the circumstances for the protection of the legitimate interests of the Company or a

Group Company but would be adjudged reasonable if part or parts of the wording thereof were deleted, the relevant restriction or restrictions shall apply with such deletion(s) as may be necessary to make it or them valid and effective.

16 Grievance, dismissal and disciplinary procedures

- 16.1 If the Executive wishes to obtain redress of any grievance relating to the Employment or is dissatisfied with any reprimand, suspension or other disciplinary step taken by the Company, he shall apply in writing to the Chairman of the Group from time to time setting out the nature and details of any such grievance or dissatisfaction. If the Executive is not satisfied with the decision of the Chairman he may within seven days of the decision appeal in writing to a non-executive director of the Company nominated by the Board.
- 16.2 The disciplinary rules applicable to the Executive are set out in the Company's Employee Handbook. The disciplinary procedure is not contractually binding on the Company.

17 Disclosure of information

- 17.1 For the purposes of the Data Protection Act 1998 the Executive hereby consents to the processing by the Company of personal data including sensitive data of which the Executive is the subject. The Executive agrees that the data may be collected and held by the Company, or be disclosed or transferred to other employees of the Company or to any other member of a Group Company (including if necessary to other offices of the Company or any Group Company outside the European Economic Area) or to any other person as may be reasonably necessary or as otherwise permitted by law. In this event, the Executive's personal information/data and sensitive personal data will be protected by the strictest code of secrecy and security, and only used in accordance with the Company's strict instructions.
- 17.2 The Executive agrees that the Company and any Group Company may intercept, process and monitor communications transmitted by or to the Executive via any private telecommunication systems (including e-mail) or services of the Company or any Group Company.

18 General

- 18.1 The provisions of this Agreement are severable and, if any one or more provision may be determined to be illegal or otherwise unenforceable in whole or in part under the laws of any jurisdiction, the remaining provisions of this Agreement in that jurisdiction shall not be affected and the legality and enforceability of this Agreement in any other jurisdiction shall not be affected.
- 18.2 Any notice or other document to be given under this Agreement shall be in writing and may be given personally to the Executive or to the Secretary of the Company (as the case may be) or may be sent by first class post or other fast postal service or by facsimile transmission to, in the case of the Company, its registered office for the time being and in the case of the Executive either to his address shown on the face hereof or to his last known place of residence.
- 18.3 Any such notice shall be deemed served when in the ordinary course of the means of transmission it would first be received by the addressee in normal business hours.

- 18.4 The Executive hereby irrevocably appoints any other director of the Company from time to time, jointly and severally, to be his attorney in his name and on his benefit to sign any documents and do things necessary or requisite to give effect to those matters which he is obliged to do pursuant to this Agreement (including but not limited to clauses 13 and 14.6.1). In favour of any third party a certificate in writing signed by any director or by the Secretary of the Company that any instrument or act falls within the authority hereby conferred shall be conclusive evidence that such is the case.
- 18.5 Any Group Company may enforce the terms of this Agreement. No other person who is not a party to this Agreement may enforce any of its terms under the Contracts (Rights of Third Parties) Act 1999.
- 18.6 This Agreement contains the statement of initial employment particulars of the Executive as required under the Employment Rights Act 1996.
- 18.7 There are no collective agreements that affect the terms and conditions of the Executive's employment.

19 Other Agreements

- 19.1 This Agreement together with the Company's Employee Handbook (as amended from time to time) and the letter from the Company to the Executive related to his relocation to the United Kingdom of even date constitutes the entire agreement of the parties and shall be in substitution for and shall replace any previous letters of appointment, agreements or arrangements (including without limitation the Executive's service agreement with HSBC Asia Holdings B.V dated 2 July 2009), whether written, oral or implied, relating to the employment of the Executive by the Company or any Group Company.
- 19.2 Without prejudice to clause 19.1, in the event of any conflict between the terms of this Agreement and any other document purporting to relate to the employment of the Executive (including the Company's Employee Handbook from time to time in force) the terms of this Agreement prevail.
- 19.3 The Executive hereby acknowledges that he has no outstanding claims of any kind against the Company and/or any Group Company (otherwise than in respect of remuneration and expenses accrued due and existing rights with respect to deferred bonuses and/or under and in accordance with any Group share plan to the date of this Agreement but not yet paid).

20 Counterparts

This Agreement may be executed in any number of counterparts and by the parties on separate counterparts, but in that case shall not be effective until each party has executed at least one counterpart. Each counterpart shall constitute the original of this Agreement, but all counterparts together constitute one and the same instrument.

21 Choice of law and submission to jurisdiction

21.1 This Agreement shall be governed by and interpreted in accordance with the laws of England and Wales.

21.2 The Executive hereby submits to the jurisdiction of the High Court of Justice in England but this Agreement may be enforced by the Company in any court of competent jurisdiction.

22 Definitions

22.1 In this Agreement unless the context otherwise requires the following expressions have the following meanings:

“Board” means the Board of Directors for the time being of the Company or any committee of the Board (including the Group Management Board) to which powers have been properly delegated or such person or persons designated by the Board from time to time as its representative for the purposes of this Agreement;

“Corporate Governance Code” means the UK Corporate Governance Code published by the Financial Reporting Council (as amended from time to time);

“Commencement Date” means 3 December 2010;

“Employment” means the Executive’s employment under this Agreement;

“FSA” means the Financial Services Authority;

“Group” means (1) the Company and any entity which from time to time is a holding company of the Company or a subsidiary of the Company or of any such holding company; and (2) any entity over which from time to time any of the entities defined in paragraph (1) of this definition either directly or indirectly exercises management control, even though it may own less than fifty per cent (50%) of the shares and is prevented by law from owning a greater shareholding and **“Group Company”** and **“Group Companies”** shall be construed accordingly;

“Group Chief Executive” means the Group Chief Executive of the Group from time to time;

“Recognised Investment Exchange” means an investment exchange granted recognition under section 285 (1) Financial Services and Markets Act 2000 including a recognised overseas investment exchange;

“Statutory Deductions” means appropriate tax, national insurance contributions and any other applicable statutory deductions;

“Termination Date” means the date on which the Executive’s Employment terminated;

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

- 22.2 references to clauses, sub-clauses and schedules are unless otherwise stated to clauses and sub-clauses of and schedules to this Agreement;
- 22.3 the headings to the clauses are for convenience only and shall not affect the construction or interpretation of this Agreement;
- 22.4 the words “subsidiary” and “holding company” have the meanings set out in section 1159 of the UK Companies Act 2006 and “management control” shall be demonstrated by the ability to exercise significant influence over an entity or its management; and
- 22.5 a reference to any statute or statutory provision (whether of the United Kingdom or elsewhere) includes any subordinate provision (as defined by section 21(1) Interpretation Act 1978) made under it and provision which has superseded it or re-enacted it (with or without modification) before or after the date of this Agreement except where it is after the date of this Agreement to the extent that the liability of any party is thereby increased or extended.

IN WITNESS whereof this Agreement has been executed the day and year first above written.

Executed as a Deed by _____)

HSBC HOLDINGS PLC in the presence of: _____)

Dated: _____

Director

Dated: _____

Director/Secretary

Executed as a Deed by _____)

the EXECUTIVE _____) Dated: _____

in the presence of: _____)

Dated: _____

Signature of Witness

Witness Name: _____

Witness Address: _____

Witness occupation: _____

Private & Confidential

Dated 14 February 2011

HSBC HOLDINGS PLC

(1)

and

ALEXANDER FLOCKHART

(2)

SERVICE AGREEMENT

Contents

Clause	Page
1 Appointment	3
2 Remuneration	3
3 Benefits	5
4 Duration of the Employment	6
5 Scope and Duties of the Employment	6
6 Hours and place of work	8
7 Deductions	9
8 Expenses	9
9 Holidays	9
10 Sickness benefits	9
11 Restrictions during the Employment	11
12 Confidential Information and Company documents	12
13 Inventions and other intellectual property	13
14 Termination	14
15 Restrictive covenants	17
16 Grievance, dismissal and disciplinary procedures	22
17 Disclosure of information	22
18 General	22
19 Other Agreements	23
20 Counterparts	23
21 Choice of law and submission to jurisdiction	23
22 Definitions	24

THIS AGREEMENT is dated 14 February 2011 and is made **BETWEEN**:

- (1) **HSBC HOLDINGS PLC** (No. 00617987), whose registered office is at 8 Canada Square, London, E14 5HQ (the "**Company**"); and
- (2) **ALEXANDER FLOCKHART** of 8 Canada Square, London E14 5HQ (the "**Executive**").

NOW IT IS HEREBY AGREED as follows:

1 Appointment

- 1.1 The Company shall employ the Executive and the Executive agrees to act as a senior executive of the Company at Band 0. The Executive will be Chairman, Europe, Middle East, Africa, Latin America and Commercial Banking, and Chairman of HSBC Bank plc and agrees to do so on and subject to the following terms, conditions and provisions of this Agreement.
- 1.2 The Executive will report to the Group Chief Executive of the Group although the Company has the right in its absolute discretion to change the person or persons to whom the Executive reports at any time subject always to such reporting line being appropriate to the Executive's seniority within the Group and status as an executive director of the Company.

2 Remuneration

- 2.1 The Company shall pay to the Executive a gross salary currently at the rate of GBP 975,000 per annum (the "**Salary**") less Statutory Deductions, which shall accrue day to day and be payable by equal monthly instalments in arrears on or about the 20th of each calendar month. The Board will review the Executive's salary annually in March, the first such review to take place in March 2011. There is no obligation on the Company to increase the Executive's Salary pursuant to any such review or otherwise provided always that such reviews are conducted reasonably and in good faith having regard to the Executive, the treatment of other executives of comparable status and all other relevant circumstances. There will be no review of the Salary after notice has been given by either party to terminate the Employment.
- 2.2 The Company may at its sole discretion (acting reasonably and in good faith) both as to whether to pay or award any Variable Pay (as defined at clause 2.3) and if so, how much, pay or award the Executive Variable Pay of such amount as the Board may determine in respect of each complete financial year of the Company during which the Employment subsists.
- 2.3 For the purposes of this Agreement "**Variable Pay**" means any non-pensionable incentive compensation including any bonus or deferred bonus in the form of (i) cash or (ii) equity awarded under any share plan in force from time to time (in relation to which performance conditions may or may not be attached) and subject to clauses 2.9 and 2.10.
- 2.4 The operation of and all arrangements relating to any such Variable Pay, (including without limitation the payment or award date for any Variable Pay from time to time), will be at the absolute discretion of the Board which may in its absolute discretion, terminate, replace or amend any such plan at any time

provided that the Executive is treated no less favourably than other executives of comparable status and in similar circumstances.

- 2.5 The Executive shall not be entitled to be considered for and/or to receive any Variable Pay if on the date that any such Variable Pay is due to be declared he is no longer employed by the Company or any Group Company or is under notice of termination of employment (including if the Executive is not assigned any duties in accordance with the garden leave provisions at clause 14.4), due to the termination of the Employment by either the Executive (other than in response to the Company's repudiatory breach of contract) or by the Company pursuant to clause 14.1.2 of this Agreement.
- 2.6 The remuneration specified in clauses 2.1 and 2.2 (if any), shall be inclusive of any fees to which the Executive may be entitled as a director of the Company or any Group Company or of any other company or any unincorporated body in which the Executive holds the office as nominee or representative of the Company or any Group Company.
- 2.7 Payment of Salary and any Variable Pay to the Executive shall be made either by the Company or by a Group Company and, if by more than one company, in such proportions as the Board may from time to time think fit, subject always to the Company's reasonable consideration of any detrimental net employment tax consequences on the Executive, by doing so.
- 2.8 The Executive may be eligible to participate in any employee share plan established by the Company from time to time. Eligibility to participate is subject to the rules of the relevant plan in force from time to time and is at the discretion of the Board. The Company will use reasonable endeavours to procure that any discretion relating to the grant of additional awards to the Executive is exercised reasonably and in good faith having regard to the Executive, the treatment of other executives of comparable status and all other relevant circumstances.
- 2.9 If the Executive is eligible to participate in an employee share plan pursuant to clauses 2.2 and/or 2.8, his rights under such plan will be subject to and in accordance with the rules of that plan in force from time to time. Subject to such rules, the rights and obligations of the Executive under the terms and conditions of his office or employment shall not be affected by his participation in the plan or any right he may have to participate in the plan.
- 2.10 Subject to the rules of the relevant plan as referenced at clauses 2.2 and 2.9, in participating in such a plan, the Executive waives all and any rights to compensation or damages arising from the loss or failure to receive any rights or benefits under the plan (or the diminution in value of such rights or benefits) as a result of:
 - (a) the termination of his office or employment and/or giving notice of termination of employment with any Group Company for any reason whatsoever (whether lawful or unlawful); and/or
 - (b) the exercise or failure to exercise any discretion (whether lawful or unlawful) conferred by the rules of the plan.

3 Benefits

3.1 Chauffeur Services

The Executive shall have access to the chauffeur driven services operated by the Company in London from the chauffeur pool.

3.2 Pension

3.2.1 Subject to clause 3.5.3, the Executive is eligible to receive a total annual allowance of 50 per cent. of annual Salary in order to fund pension arrangements which will be provided to him in the following way:

- (a) Subject to clause 3.2.1(c), with effect from the Commencement Date to 31 March 2011:
 - (i) the Executive will receive an annual cash allowance of 50 per cent. of the Executive's annual Salary (less Statutory Deductions) payable monthly in installments, in order to fund personal pension arrangements.
- (b) Subject to clause 3.2.1(c) and the executive's review at the relevant time of the way in which he wishes pension entitlement to be delivered to him, with effect from 1 April 2011:
 - (i) the Executive will be a member of the HSBC Bank (UK) Pension Scheme - Defined Contribution Section (the "**Scheme**") subject to its rules from time to time in force, to which the Company will make an employer contribution of £50,000 per annum, payable by monthly installments. Details of the Scheme are set out in the Company's Employee Handbook. The Company reserves the right in its absolute discretion to terminate or substitute another pension scheme for the Scheme at any time. Any such termination or substitution will not constitute a breach of contract; and
 - (ii) the balance of the Executive's annual pension allowance of 50 per cent. of annual Salary less £50,000, will be paid to him as an annual cash allowance payable monthly in installments, less Statutory Deductions in order to fund personal pension arrangements.
- (c) Subject to relevant legislation in force from time to time, upon the Executive reaching the Lifetime Allowance as specified in relevant legislation and/or the Scheme rules, employer contributions to the Scheme will cease in full and instead the Executive will receive the annual allowance of 50 per cent. of annual Salary in cash only (less Statutory Deductions), payable in monthly installments.

3.3 Personal Accident Insurance Cover

The Executive is entitled to non-contributory membership of the Group's personal accident insurance scheme.

3.4 Clubs

The Company shall make payments on the Executive's behalf in respect of the annual membership subscription of two clubs or such similar two clubs as the Executive shall nominate each year, to be approved by the Company through the Group Managing Director, Human Resources.

3.5 Medical Benefits

The Executive shall participate in the schemes set out under clauses 3.5.1 to 3.5.4 subject always to the relevant schemes' terms and conditions from time to time in force and subject to the Executive meeting the requirements of the relevant scheme and being deemed eligible by the relevant insurance provider. The Company shall not be liable to provide any benefits or any compensation in lieu thereof or take any action to enforce the provision of such benefits in circumstances where the scheme provider refuses for any reason whatsoever, to provide any benefits to the Executive.

3.5.1 Health Checks

The Executive is eligible for an annual voluntary health check with a medical adviser appointed and paid for by the Company.

3.5.2 Medical Cover

The Executive and his spouse/partner and eligible dependants are entitled to participate in the Group's International Medical Scheme.

3.5.3 Group Income Protection

If the Executive is unable by reason of illness or injury, to perform the material or substantial parts of his duties hereunder, following a period of absence from work in excess of 26 consecutive weeks, the Executive will be eligible to be considered for a monthly payment equivalent to 50 per cent of monthly Basic Salary. In the event of such payment, the pension allowance will continue to be payable, subject to a cap of 35 per cent. of the Executive's annual Salary.

3.5.4 Life Assurance Cover

Under the Group Life Assurance Scheme, in the event of the Executive's death, a sum equivalent to four times annual Salary will be paid to the Executive's nominated beneficiaries, subject to approval by the trustees of the Group Life Assurance Scheme.

3.6 Directors and Officers Liability

The Executive shall benefit from cover under the Company's policy on Directors' and Officers' Liability (including Outside Directors' and Officers' Liability) subject always to the policy and the rules of the policy from time to time in force.

3.7 Housing Loan/Mortgage Subsidy Arrangements

The Executive will continue to be entitled to his existing International Manager Housing Loan (IMHL) under the rules of that scheme in force from time to time.

3.8 Severance Arrangements

On the termination of his employment with the Group, the Executive will remain entitled to benefit from the arrangements contained in a letter dated 23 February 2009 from Willem J de Graaf to the Executive and countersigned by the Executive on that day.

4 Duration of the Employment

4.1 The Employment pursuant to this Agreement shall commence on the Commencement Date and, subject to clauses 5.4 and 14, shall continue until terminated by either party giving to the other not less than twelve months' notice in writing.

4.2 Notwithstanding clause 4.1 and any retirement date specified in any applicable pension scheme, the Employment shall automatically terminate when the Executive reaches the normal retiring age from time to time applicable to senior executives of the Company which, for the avoidance of doubt, is currently 65.

4.3 The Executive's period of continuous employment commenced on 6 July 1974.

5 Scope and Duties of the Employment

5.1 In the Executive's position as Chairman, Europe, Middle East, Africa, Latin America and Commercial Banking, and Chairman of HSBC Bank plc, he shall:

5.1.1 devote the whole of his time, attention and skill to his duties;

5.1.2 faithfully and diligently perform such duties and exercise such powers consistent with his position as may from time to time be assigned to or vested in him by the Board;

5.1.3 obey the reasonable and lawful directions of the Board;

5.1.4 at all times act in the way he considers in good faith, most likely to promote the success of the Company (and applicable Group Companies) for the benefit of the members as a whole in accordance with Section 172 Companies Act 2006;

- 5.1.5 perform his services in a professional and competent manner and in cooperation with others;
- 5.1.6 keep the Board at all times promptly and fully informed (in writing if so requested) of his conduct of and activities in relation to the business of the Company and any Group Company and provide such explanations in connection therewith as the Board may require from time to time including for the avoidance of doubt, any misconduct of other employees or directors or his own; and
- 5.1.7 comply with the duties set out in the Companies Act 2006.
- 5.2 The Executive shall comply with:
 - 5.2.1 all of the Company's and Group Company's codes, rules, regulations, policies and procedures (including without limitation the Company's Compliance Guidelines),
 - 5.2.2 the codes, practices, rules, principles and regulations of the UK Listing Authority (including the Model Code on directors' dealings in securities as set out in Annex 1 to Chapter 9 of the Listing Rules), the FSA, any other stock exchange and/or regulatory authorities relevant to the Company or any Group Company and of any association or professional body to which the Company and/or any Group Company and/or the Executive belong to from time to time,
 - 5.2.3 such laws as may be relevant to the Group and to the Executive's duties under this Agreement; and
 - 5.2.4 the Code for Dealing in Group Securities and every regulation of the Group for the time being in force in relation to dealings in shares or other securities of the Company or any Group Company
insofar as they may affect him, the Company, any Group Company or its or their directors, officers or employees.
- 5.3 The Executive shall comply with any rules, policies and procedures set out in the Company's Employee Handbook, a copy of which is available on the Company's intranet. The Employee Handbook does not form part of this agreement and the Company may amend it at any time.
- 5.4 The Executive's continued employment will be subject to him continuing to hold approved status for any position he may hold that requires FSA approval. In the event of approval being withdrawn (under current FSA regulations this includes instances such as insider dealing and market manipulation) in respect of this position or any subsequent position, the Company reserves the right to summarily terminate the Executive's employment without being further liable to him (other than in respect of amounts accrued due at the Termination Date). The Company shall provide the Executive with all reasonable co-operation in relation to him obtaining and/or retaining FSA approved status and such other regulatory registrations as may be required from time to time.
- 5.5 The Executive shall do such things as are necessary to ensure compliance by himself with the Corporate Governance Code and, so far as it lies within his power to do so, by the Company and any applicable Group Company.

- 5.6 The Company reserves the right to appoint any other person or persons to act jointly with the Executive in the event that the Executive is not assigned any duties in accordance with the garden leave provisions at clause 14.4 (or in place of the Executive if he is suspended in accordance with the provisions of this Agreement) in any position to which he may be assigned from time to time.
- 5.7 The Executive shall if and so long as the Company requires and without any further remuneration therefore (except as otherwise agreed):
- 5.7.1 carry out duties on behalf of any Group Company; and
- 5.7.2 act as a director or officer of any Group Company
- Provided always that such duties or offices are consistent with his role(s) as described in clause 1.1 above.
- 5.8 The Company may at its sole discretion transfer the Executive's employment and assign the provisions of this Agreement to any Group Company at any time, subject always to the Executive enjoying no less favourable terms and conditions of employment.
- 5.9 The Executive agrees that a copy of clauses 5, 11, 12 and 15 of this Agreement will be provided by him to any person, firm, company or other entity making an offer of employment, appointment as a director or officer, agency, consultancy, partnership or joint venture to him during the Employment or thereafter whilst any restrictions in clause 15 remain in force immediately upon receiving any such offer.

6 Hours and place of work

- 6.1 The Company's standard working week is 35 hours (excluding unpaid lunch breaks). The Executive shall be required to work such hours, including additional hours (without further remuneration) as are necessary for the proper performance of the duties hereunder.
- 6.2 Notwithstanding clause 6.1 the Executive acknowledges that because of the autonomous nature of his role the duration of the Executive's working time is not measured or monitored or determined by the Company so that the limit on weekly working time set out in Regulation 4 of the Working Time Regulations 1998 (or such other regulations as may from time to time come into force) does not apply to the Executive's Employment.
- 6.3 The Executive's place of work will initially be the Company's offices at 8 Canada Square, London E14 5HQ but the Company may reasonably require the Executive to work at any place of business of the Company or the Group within the United Kingdom, or by mutual agreement, overseas, on either a temporary or an indefinite basis. The Executive will be given reasonable notice of any permanent change in his place of work. In the performance of the duties hereunder, the Executive may be required to travel and undertake his duties both throughout and outside the United Kingdom and in other global locations as the Group sees fit from time to time.

7 Deductions

For the purposes of the Employment Rights Act 1996, the Executive hereby authorises the Company to deduct from the remuneration hereunder any sums due from the Executive to the Company including, without limitation, any overpayments, loans or advances made to him by the Company, the cost of repairing any damage or loss to the Group's property caused by the Executive (and of recovering such costs) and any losses suffered by the Group as a result of any negligence or breach of duty by the Executive or sums in respect of sub-clause 10.6 of this Agreement.

8 Expenses

The Company shall reimburse the Executive in respect of all expenses reasonably incurred by the Executive in the proper performance of the duties hereunder subject to the Executive providing such receipts or other evidence as the Company may require and subject to the Company's rules and policies from time to time relating to expenses.

9 Holidays

- 9.1 The Executive shall be entitled to receive his normal remuneration for all bank and public holidays normally observed in the United Kingdom and a further 30 working days' paid holiday in each holiday year (being the period from 1 January to 31 December) including one period of 10 consecutive working days which must be taken as core leave. The Executive's holiday shall be taken at such times as are agreed with the Group Chief Executive.
- 9.2 In the holiday year in which the Employment terminates, the Executive's entitlement to holiday shall accrue on a pro rata basis for each complete month of service during the relevant year. If, on the termination of the Employment, the Executive has exceeded his accrued holiday entitlement, the excess may be deducted from any sums due to the Executive and the Executive hereby authorises the Company to make such deduction. If the Executive has any unused holiday entitlement, the Company may either require the Executive to take such unused holiday during any notice period (whether or not the Executive is on garden leave in accordance with clause 14.4) or make payment in lieu thereof.
- 9.3 Holiday entitlement for one holiday year may not be taken in subsequent holiday years unless otherwise agreed by the Group Chief Executive. Failure to take holiday entitlement in the appropriate holiday year will lead to forfeiture of any accrued holiday not taken, without any right to payment in lieu thereof unless otherwise agreed by the Company's Group Managing Director, Human Resources in accordance with the holiday policy applicable to Executive Directors from time to time.

10 Sickness benefits

- 10.1 The Company shall continue to pay the Salary during any period of absence on medical grounds in accordance with the sick pay policy set out in the Company's Employee Handbook (the "**Company Sick Pay**") provided that the Executive complies in full with any of the requirements set out in the Company's Employee Handbook and clause 10.2 below. Thereafter the Executive will only be entitled to such salary and benefits, if any, as the Board shall in its absolute discretion

from time to time allow. Upon the Executive's return to work from such absence to perform his duties hereunder, he shall be entitled to receive the Salary and the benefits set out at clause 3, pursuant to the terms of this Agreement and subject to any relevant scheme rules.

- 10.2 At any time during the Employment, the Executive shall, if so required by the Board, undergo, at the expense of the Company, an examination by a registered medical practitioner or practitioners to be nominated by the Company (including but not limited to the Executive's general practitioner or any other physician responsible for the Executive's care). The Executive authorises the medical practitioner to disclose and discuss with the Company any report prepared as a result of any such examination pursuant to the Access to Medical Reports Act 1988. The Company has the right to postpone the Executive's return to work (and the continuance or reinstatement of his normal pay, if appropriate) until the medical practitioner has confirmed that the Executive is fit to perform his duties.
- 10.3 Payment of the Executive's Salary pursuant to clause 10.1 shall be inclusive of any Statutory Sick Pay to which the Executive may be entitled by law. The Company will also deduct from it any other statutory benefits if applicable due to the Executive, together with any Statutory Deductions.
- 10.4 Subject to the applicable scheme rules in force from time to time, during the Executive's absence from work on medical grounds, the Executive will continue to be covered by the Company's life assurance arrangements, private medical insurance and personal accident insurance and whilst he is entitled to receive Company Sick Pay he shall be entitled to receive the pension allowance as set out at clause 3.2. The Executive's entitlement to participation in any Variable Pay plan and the accrual of holiday entitlement shall cease on the expiry of the payment of the Company Sick Pay until such time as the Executive is able to perform his duties hereunder.
- 10.5 The Company reserves the right to terminate the Employment in accordance with the terms of this Agreement for reasons unrelated to the Executive's illness or sickness absence when the Executive is absent through sickness or injury at any time, notwithstanding any outstanding or prospective entitlement to pay in accordance with clause 10.1, private medical insurance, permanent health insurance or long term disability benefits, provided that the Company shall not terminate the Executive's employment under this clause 10.5 where the sole or main reason for doing so is to deprive the Executive of any right under the Company's Group Income Protection Scheme. The Company shall not be liable for any loss arising from such termination.
- 10.6 If the Executive's absence shall be occasioned by the actionable negligence of a third party in respect of which damages are recoverable in respect of the period of the Executive's incapacity, then the Executive shall:
- 10.6.1 forthwith notify the Company of all the relevant circumstances and of any claim, compromise, settlement or judgment made or awarded in connection therewith;
- 10.6.2 if the Company so requires, refund to the Company such sum as the Company may determine, not exceeding the lesser of:
- (a) the amount of damages recovered by the Executive under such compromise, settlement or judgment; and

(b) the sums advanced to the Executive by the Company in respect of the period of incapacity

subject to any deductions made by any court or tribunal that takes into account the payments made to the Executive in this clause 10 when awarding any such damages or compensation.

11 Restrictions during the Employment

- 11.1 The Executive shall not during the Employment directly or indirectly either on his own account or on behalf of any other person, company, business entity or other organisation be employed, engaged, concerned or interested in any other business or undertaking, provided that this shall not prohibit the holding (directly or through nominees) of investments listed on the London Stock Exchange plc or in respect of which dealing takes place on the Alternative Investment Market of the London Stock Exchange plc or on The Stock Exchange of Hong Kong Limited or on any Recognised Investment Exchange as long as not more than 5 per cent of the issued shares or other securities of any class of any one company shall be so held without the prior sanction of a resolution of the Board.
- 11.2 The Executive shall obtain the Chairman's prior written approval (such approval not to be unreasonably withheld) before accepting appointment as a non-executive director of any company outside the Group. Approval is currently limited to one FTSE100 constituent company or other significant company in the UK or elsewhere.
- 11.3 The Executive shall not (and shall procure so far as the Executive is able that any person connected with the Executive within the meaning of section 252 Companies Act 2006 (**Connected Person**) shall not) deal or become or cease to be interested (within the meaning set out in Schedule 1 Companies Act 2006) in any securities of the Company, except in accordance with the Company's code for securities transactions by directors.
- 11.4 Subject to any regulations issued by the Company, the Executive and any Connected Person shall not be entitled to receive or obtain directly or indirectly any discount, rebate or commission in respect of any sale or purchase of goods effected or other business transacted (whether or not by the Executive) by or on behalf of the Company or any Group Company and if he or any Connected Person (or any firm or company in which he or any Connected Person is interested) shall obtain any such discount, rebate or commission the Executive shall account to the Company or the relevant Group Company for the amount received by the Executive or any Connected Person (or a due proportion of the amount received by such company or firm having regard to the extent of the Executive's or the Connected Person's interest therein).
- 11.5 The Executive agrees to disclose to the Board any matters relating to any Connected Person of which he is aware and which may, in the reasonable opinion of the Board, be considered to interfere, conflict or compete with the proper performance of the Executive's obligations under this Agreement.

- 11.6 During the Employment, the Executive agrees that he will not in competition with the Company or any Group Company:
- 11.6.1 deal with, canvass, solicit or endeavour to take away from the Company or any Group Company, whether directly or indirectly and whether on his own behalf or on behalf of any other person, firm, company or other entity any customers or prospective customers; or
 - 11.6.2 directly or indirectly solicit or entice away from or endeavour to entice away from the Company or any Group Company any individual employed or engaged by the Company or any Group Company; or
 - 11.6.3 without prior notification to the Board, directly or indirectly make preparations to compete with any business carried on by the Company or any Group Company.
- 11.7 During the Employment the Executive shall inform the appropriate member of the Board without delay if he becomes aware that any director, officer, or senior employee of the Company or any Group Company is planning to materially breach any of the provisions of their contract of employment or implied duties of loyalty, good faith and fidelity.

12 Confidential Information and Company documents

- 12.1 The Executive recognises that, whilst performing the duties hereunder for the Company and the Group the Executive will have access to and come into contact with trade secrets and Confidential Information belonging to the Company and/or any Group Company and will obtain personal knowledge of and influence over its or their customers, suppliers and/or employees. The Executive therefore agrees that the restrictions set out in this clause 12 are reasonable and necessary to protect the legitimate business interests of the Company and the Group both during and after the termination of the Employment. The Executive shall neither during the Employment (except in the proper performance of the duties) nor at any time (without limit) after the termination of the Employment directly or indirectly:
- 12.1.1 divulge or communicate to any person, company, business entity or other organisation; or
 - 12.1.2 use for his own purposes or for any purposes other than those of the Company or any Group Company; or
 - 12.1.3 through any failure to exercise due care and diligence, cause any unauthorised disclosure of any trade secrets or Confidential Information relating to the Company or any Group Company, but so that these restrictions shall cease to apply to any information which shall become available to the public generally otherwise than through the default of the Executive and to any use or disclosure authorised by the Board or required by law.
- 12.2 Nothing in this Agreement shall prevent the Executive from making a protected disclosure in accordance with section 43A Employment Rights Act 1996 and the Public Interest Disclosure Act 1998.

12.3 “**Confidential Information**” shall include details of suppliers and their terms of business, details of customers, clients and prospective customers/clients and their requirements, the prices charged to and terms of business with customers, marketing plans and sales forecasts, financial information, results and forecasts (save to the extent that these are included in published audited accounts), any proposals relating to the acquisition or disposal of a company or business or any part thereof or to any proposed expansion or contraction of activities, or any other business strategy or tender, details of employees and officers and of the remuneration and other benefits paid to them, information relating to research activities, inventions, secret processes, designs, software, formulae and product lines, any information which the Executive either is aware or reasonably ought to know is confidential and any information which has been given to the Company or any Group Company in confidence by customers, suppliers or other persons.

12.4 All notes, memoranda, records, lists of customers and suppliers and employees, correspondence, documents, computer and other discs and tapes, data listings, codes, designs and drawings and other documents and material whatsoever (whether made or created by the Executive or otherwise) relating to the business of the Company or any Group Company (and any copies of the same):

12.4.1 shall be and remain the property of the Company or the relevant Group Company; and

12.4.2 shall be handed over by the Executive to the Company or to the relevant Group Company or irrevocably deleted from any computer and/or word processing system in the Executive’s possession or under the Executive’s control, on demand and in any event on the termination of the Employment. Provided always that, at the reasonable request of the Executive, he shall be provided, subject always to the provisions of clause 12.1, with copies of all Board Minutes (and documents referred to therein) of Group Companies of which he was a director, in respect of any period during which he was a director of such Group Company, which are reasonably required by the Executive for the purposes of defending himself in any regulatory or legal proceedings relating to his duties as a director of such Group Company.

13 Inventions and other intellectual property

13.1 The Executive may make inventions or create other intellectual property during the Employment. In this respect the Executive has a special responsibility to further the interests of the Company and the Group given the Executive’s position at the Company and the remuneration paid to the Executive under this Agreement.

13.2 In recognition of the Executive’s position, remuneration and responsibility, the Executive acknowledges and agrees that any invention, improvement, design, process, information, copyright work, trade mark, trade name or get-up or any other intellectual property (together the “**Intellectual Property**”) made, created or discovered by him during the Employment (whether capable of being patented or registered or not) in conjunction with or in any way affecting or relating to the business of the Company or any Group Company or capable of being used or adapted for use in the Company or any such Group Company or in connection therewith shall be immediately disclosed to the Company and shall belong to and be the absolute property of the Company or such Group Company as the Company may direct.

- 13.3 However clause 13.2 shall only apply to the extent that any invention was made by the Executive in the course of his duties or in the course of duties falling outside the Executive's normal duties but which have been specifically assigned to him (together "**Duties**") and (i) such invention was reasonably expected to result therefrom; and/or (ii) at the time of making the invention, because of the nature of his Duties and the particular responsibilities arising therefrom, the Executive had a special obligation to further the interests of the Company and the Group.
- 13.4 The Executive acknowledges that he has no rights, interest or claims, either during the Employment or after the termination of the Employment, in or to any such Intellectual Property and he shall not use such Intellectual Property other than during the period of the Employment and for the purpose of the Company or the Group.
- 13.5 If and whenever required to do so by the Company, (whether during the Employment or after its termination), the Executive shall at the expense of the Company or such Group Company as the Company may direct:
- 13.5.1 apply or join with the Company or such Group Company in applying for letters patent or other protection or registration in the United Kingdom and in any other part of the world for any such Intellectual Property; and
- 13.5.2 execute and do all instruments and things necessary for vesting the said letters patent or other protection or registration when obtained and all right title and interest to and in the same absolutely and as sole beneficial owner in the Company or such Group Company or in such other person as the Company may specify.
- 13.6 The Executive agrees that he irrevocably and unconditionally waives all rights (including all moral rights) under Chapter IV of the Copyrights, Designs and Patents Act 1988 in connection with his authorship of any existing or future copyright work, in whatever part of the world such rights may be enforceable
- 13.7 Nothing in this clause shall be construed as restricting the Executive's rights or those of the Company under the Patents Act 1977 and in particular, sections 39 to 43 Patents Act 1977.

14 Termination

- 14.1 Notwithstanding clause 4.1 the Employment shall be subject to termination by the Company:
- 14.1.1 by not less than six months' notice in writing given at any time while the Executive shall have been incapacitated by reason of ill health or accident from performing the duties hereunder for a period of or periods aggregating the total period during which the Executive is entitled to receive the Company Sick Pay provided always that, subject to clause 10.5, the Company shall not terminate the Employment in these circumstances if the effect of such termination would be to deprive the Executive of the benefit of payments under any permanent health insurance scheme. If at any time during the currency of such a notice the Executive shall provide a medical certificate satisfactory to the Board to the effect that he has fully recovered physical and/or mental health and that no recurrence of illness or incapacity can reasonably be anticipated, the Company shall withdraw the notice;

14.1.2 by summary notice in writing and with no liability to make any further payment to the Executive (other than in respect of amounts accrued due at the Termination Date) if the Executive shall have:

- (a) committed by any act or omission any serious breach or repeated or continued (after warning) a material breach of the Executive's obligations hereunder; or
- (b) been guilty of conduct by act or omission (whether in the course of the duties hereunder or otherwise) which (i) in the reasonable opinion of the Board, tends to bring the Executive and/or the Company and/or any Group Company into disrepute on account of material economic or reputational consequences for all or any of them; or (ii) causes the Company or any Group Company substantial economic harm, provided in either case that if such conduct is capable of remedy, he has first been given a reasonable opportunity to remedy the contract and has failed to do so; or
- (c) been convicted of a criminal offence under any statutory enactment or regulation (other than an offence under any road traffic legislation in the United Kingdom or elsewhere for which a fine or non custodial penalty is imposed and which does not render him unable to discharge his duties under this Agreement); or
- (d) become bankrupt or had an interim order made against the Executive under the Insolvency Act 1986 or compounded with his creditors generally; or
- (e) in the reasonable opinion of the Board, failed to perform the duties hereunder to a satisfactory standard, after having received a written warning from the Company relating to the same; or
- (f) been disqualified from being a director by reason of any order made under the Company Directors Disqualification Act 1986 or any other enactment; or
- (g) resigned of his own choice as a director of the Company or any Group Company, not being at the request of or with the prior written agreement of the Board (save with reasonable and proper cause and where remaining as a director would substantially disadvantage him in his capacity as an officeholder of the Company); or
- (h) become prevented by an applicable law or regulation from performing any material part of his duties; or
- (i) been guilty of a breach of the rules or regulations as amended from time to time of the UK Listing Authority (including the Model Code for transactions in securities by directors of listed companies), The London Stock Exchange plc, the FSA or any other stock exchanges or regulatory authorities relevant to the Company or any Group Company or any Code of Practice issued by the Company or any Group Company (as amended from time to time); or
- (j) been expelled or subject to any serious disciplinary action by a relevant professional body or failed or ceased to meet the requirements of any

regulatory body or statutory authority as a result of which the Executive is no longer able to perform all or any of the duties under this Agreement or;

- (k) ceased to be eligible to work in the United Kingdom in accordance with Sections 15-25 of the Immigration, Asylum and Nationality Act 2006.

Any delay by the Company in exercising such right of termination shall not constitute a waiver thereof.

- 14.2 If the Company becomes entitled to terminate the Employment pursuant to clauses 5.4 or 14.1.2, or whilst the Company or any external body investigates any allegation which would or may entitle the Company to terminate the Employment pursuant to clauses 5.4 or 14.1.2 it shall be entitled (but without prejudice to its right subsequently to terminate such appointment on the same or any other ground) to suspend the Executive on full pay for such period as is reasonable in the circumstances. During the period of any suspension the Executive will continue to be bound by the provisions of this Agreement and must continue at all times to conduct himself with good faith towards the Company and all Group Companies.
- 14.3 The Company reserves the right in its absolute discretion to give the Executive pay in lieu of all or any part of the notice of termination (whether notice is given by the Company or by the Executive). A dismissal without notice per se shall not constitute or imply an election under this clause 14.3. For this purpose, the Executive agrees that pay in lieu will consist of the Salary, pension allowance and other contractual benefits (or cash equivalent) as set out at clause 3 of this Agreement only, for the relevant period of notice (subject to Statutory Deductions in the normal way), excluding any Variable Pay and any other emolument referable to the Employment.
- 14.4 During any period of notice of termination or part thereof (whether given by the Company or the Executive), the Company shall (but only for a period or periods in aggregate not exceeding six months) be under no obligation to assign any duties to the Executive and shall be entitled to exclude him from the Group's premises and to direct that the Executive refrains from contacting (other than purely social contact with persons with whom the Executive has established social relationships) any customers, clients, suppliers, agents, professional advisers or employees of the Company or any Group Company and refrains from accessing the computer or other data or similar system of the Company or any Group Company (whether directly or indirectly) and remove him from office as a director of the Company and any Group Company and from all or any offices held by him in the Company or any Group Company, provided that this shall not affect the Executive's entitlement to receive Salary and other contractual benefits (excluding Variable Pay). For the avoidance of doubt, during such period the Executive shall continue to be bound by the same obligations to the Company and the Group as were owed prior to the commencement of the period including the duty of good faith and fidelity.
- 14.5 The Executive agrees that during any period of notice of termination whether given by the Company or by the Executive he will give such assistance in effecting an orderly and comprehensive handover as the Company may reasonably require and with regard to any claim made by or against any Group Company. For the avoidance of doubt such assistance may include attending

meetings, reviewing documents, giving and signing statements/affidavits and attending hearings and giving evidence.

- 14.6 Without prejudice to the constitution (including for the avoidance of doubt the articles of association) of the Company or any Group Company, on the termination of the Employment (howsoever arising) or on either the Company or the Executive having served notice of such termination and the Company having exercised its right to place the Executive on garden leave pursuant to clause 14.4, the Executive shall at the request of the Company:
- 14.6.1 resign from office as a Director of the Company and of any Group Company and all other offices held by the Executive in the Company and/or any Group Company provided however that such resignation shall be without prejudice to any claims which the Executive may have against the Company or any Group Company arising out of the termination of the Employment; and
- 14.6.2 transfer without payment to the Company or as the Company may direct to any third party, any shares or other securities held by the Executive in the Company or any Group Company as a nominee or trustee for the Company or any Group Company and deliver to the Company the related certificates; and
- 14.6.3 forthwith deliver to the Company all Confidential Information and all materials within the scope of clause 12.4 including any copies of any such materials and all credit cards and other property of or relating to the business of the Company or of any Group Company which may be in the Executive's possession or under the Executive's power or control and, if requested, provide a signed statement that he has fully complied with the obligations under this clause 14.6.3.
- 14.7 If the Executive shall have been offered but shall unreasonably have refused to agree to the transfer of this Agreement by way of novation to a company which has acquired or agreed to acquire the whole or substantially the whole of the undertaking and assets of or of the equity share capital of the Company the Executive shall have no claim against the Company in respect of the termination of his employment hereunder by reason of the subsequent voluntary winding-up of the Company or of the disclaimer of this Agreement by the Company within one month after such acquisition.

15 Restrictive covenants

- 15.1 For the purposes of this clause 15 the following words have the following meanings:
- 15.1.1 **"Company Products"** means any banking or financial products researched into, developed, supplied, distributed or sold by the Company with which the duties of the Executive were materially concerned or for which he was directly or ultimately responsible during the Restricted Period;
- 15.1.2 **"Company Services"** means any banking or financial services (including but not limited to technical and product support, technical advice and customer services) developed or supplied by the Company with which the duties of the Executive were materially concerned or for which he was directly or ultimately responsible during the Restricted Period;

15.1.3 “Comparator Group” means the following companies and entities, subject always to amendment from time to time by the Remuneration Committee of the Board of the Company and as notified to the Executive by no later than 30 days after any such amendment: Banco Bradesco, Banco Itau, Banco Santander, Bank of America, Bank of China, Barclays, BBVA, BNP Paribas, Citigroup, Credit Suisse Group, DBS Group, Deutsche Bank, Fortis, ICBC, JP Morgan Chase, Lloyds Banking Group, National Australia Bank, Royal Bank of Canada, Royal Bank of Scotland, Societe Generale, Standard Chartered, UBS, Unicredito Italiano and Wells Fargo (and all group companies of the companies and entities set out in this clause 15.1.3) and, where any companies or entities set out in this clause 15.1.3 are the subject of a takeover or undergo any form of reconstruction, the entities to which the relevant business assets of such companies or entities are transferred from time to time;

15.1.4 **“Confidential Information”** has the meaning ascribed thereto in clause 12.2;

15.1.5 **“Customer”** means any person or firm or company or other organisation whatsoever to whom or which the Company supplied Company Products and/or Company Services during the Restricted Period and with whom or which, during the Restricted Period:

- (a) the Executive had material personal dealings pursuant to the Employment; or
- (b) any employee who was under the direct or indirect supervision of the Executive had material personal dealings pursuant to their employment,

provided that in the case of a firm, company or other organisation “Customer” shall not include any division, branch or office of such firm or company or other organisation with which the Executive and/or any such employee as defined in sub-clause (b) above had no dealings during the Restricted Period save that where a restructuring of the firm or company or organisation has occurred following such personal dealings “Customer” shall include the part of the business with which the Executive or any employee as defined in sub-clause (b) above had dealings during the Restricted Period;

15.1.6 **“Prospective Customer”** means any person or firm or company or other organisation whatsoever with whom or which the Company shall have had negotiations or material discussions regarding the possible distribution, sale or supply of Company Products and/or Company Services during the Restricted Period and which were ongoing and not finally concluded at the Termination Date and with whom or which during such period:

- (a) the Executive shall have had material personal dealings pursuant to the Employment; or
- (b) any employee who was under the direct or indirect supervision of the Executive shall have had material personal dealings pursuant to their employment; or
- (c) the Executive was directly responsible in a client management capacity on behalf of the Company,

provided that in the case of a firm, company or other organisation "Prospective Customer" shall not include any division, branch or office of such firm, company or other organisation with which the Executive and/or any such employee had no dealings during the Restricted Period save that where a restructuring of the firm or company or organisation has occurred following such personal dealings, "Prospective Customer" shall include the part of the business with which the Executive or any employee as defined in sub-clause (b) had dealings during the Restricted Period;

- 15.1.7 **"Restricted Employee"** means any person who is on the Termination Date, or was during the Restricted Period, employed or engaged by the Company or any Group Company and is by reason of such employment or engagement in possession of, or is reasonably likely to be in possession of, any trade secret or Confidential Information relating to the business of the Company or any Group Company or has acquired influence over its Customers or Prospective Customers (as defined in this clause 15 but so that references to "the Executive" shall be replaced by references to the relevant employee and so that references to "Employment" shall mean the relevant employee's employment with the Company or Group Company, being in either case a person with whom the Executive had material dealings during the Restricted Period);
- 15.1.8 **"Restricted Period"** means the period of 12 months ending on the Termination Date or, in the event that no duties were assigned to the Executive for any part of the duration of the notice period, the 12 months immediately preceding the last day on which the Executive carried out any duties for the Company;
- 15.1.9 **"Restricted Products"** means Company Products or any products of the same or of a similar kind;
- 15.1.10 **"Restricted Services"** means Company Services or any services of the same or of a similar kind;
- 15.1.11 **"Restricted Supplier"** means any person, company, business entity or other organisation whatsoever who has supplied goods or services to the Company or any Group Company (other than utilities and goods or services supplied for administrative purposes) during any part of the Restricted Period or who has agreed prior to the Termination Date to supply goods or services to the Company to commence at any time in the twelve months following the Termination Date.
- 15.2 The Executive recognises that, whilst performing his duties for the Company, he will have access to and come into contact with trade secrets and Confidential Information belonging to the Company and certain Group Companies and will obtain personal knowledge of and influence over its or their customers and/or employees. The Executive therefore agrees that the restrictions set out in this clause 15 are reasonable and necessary to protect the legitimate business interests of the Company and any applicable Group Company both during and after the termination of the Employment.
- 15.3 The Executive hereby undertakes with the Company that he will not for the period of six months after the Termination Date without the prior written consent of the Company (such consent not to be unreasonably withheld) whether by himself, through his employees or agents or otherwise howsoever and whether on his own behalf or on behalf of any other person, firm, company or other organisation, directly or indirectly:

- 15.3.1 in competition with the Company anywhere in the world in a senior capacity, be employed by or engaged or otherwise interested in any of the companies (or other entities) in the Comparator Group in the business of researching into, developing, distributing, selling, supplying or otherwise dealing with Restricted Products or Restricted Services; or
- 15.3.2 in competition with the Company, accept orders or facilitate the acceptance of any orders or have any business dealings for Restricted Products or Restricted Services from any Customer or Prospective Customer; or
- 15.3.3 knowingly employ or otherwise engage in the business of or be personally involved to a material extent in employing or otherwise engaging in the business of researching into, developing, manufacturing, distributing, selling, supplying or otherwise dealing with Restricted Products or Restricted Services any Restricted Employee; or
- 15.3.4 interfere with, or endeavour to interfere with, the supply or provision of goods or services (other than utilities, or goods or services supplied for an administrative purpose) to the Company or to induce the cessation of the supply or provision of such goods or services from any Restricted Supplier; or
- 15.3.5 in competition with the Company, solicit business from, or solicit the supply of goods or services (other than utilities, or goods or services supplied for an administrative purpose) from any Restricted Supplier for the purposes of the provision of Restricted Products or Restricted Services.
- 15.4 The Executive hereby undertakes with the Company that he will not for the period of twelve months after the Termination Date without the prior written consent of the Company (such consent not to be unreasonably withheld) whether by himself, through his employees or agents or otherwise howsoever and whether on his own behalf or on behalf of any other person, firm, company or other organisation, directly or indirectly:
 - 15.4.1 in competition with the Company, solicit business from or endeavour to entice away or canvass any Customer or Prospective Customer if such solicitation or canvassing is in respect of Restricted Products or Restricted Services; or
 - 15.4.2 solicit or induce or endeavour to solicit or induce any Restricted Employee to cease working for or providing services to the Company, whether or not any such person would thereby commit a breach of contract.
- 15.5 If the restrictions in clauses 15.3 and 15.4 are for any reason held to be unenforceable in any jurisdiction in the world the Executive shall agree to such amended or lesser restriction as would enable that restriction to be enforced so far as possible in such jurisdiction.
- 15.6 The benefit of clauses 15.3 and 15.4 shall be held on trust by the Company for each Group Company and the Company reserves the right to assign the benefit of such provisions to any Group Company, in addition such provisions also apply as though there were substituted for references to "the Company" references to each Group Company in relation to which the Executive has in the course of his duties for the Company or by reason of rendering services to or holding office in such Group Company:
 - 15.6.1 acquired knowledge of its trade secrets or Confidential Information; or

15.6.2 had material personal dealings with its Customers or Prospective Customers; or

15.6.3 supervised directly or indirectly employees having material personal dealings with its Customers or Prospective Customers,

but so that references in clause 15 to “the Company” shall for this purpose be deemed to be replaced by references to the relevant Group Company. The obligations undertaken by the Executive pursuant to this clause 15.6 shall, with respect to each such Group Company, constitute a separate and distinct covenant and the invalidity or unenforceability of any such covenant shall not affect the validity or enforceability of the covenants in favour of any Group Company or the Company. In addition, at the request of the Company the Executive shall enter into a direct agreement or undertaking with any Group Company whereby he will accept restrictions corresponding to the restrictions in this clause 15 (or such of them as may be appropriate).

15.7 In the event of the transfer (within the meaning of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (the “**Transfer Regulations**”) of the undertaking or the part of the undertaking in which the Executive shall at the time be employed as the result of which (by virtue of the Transfer Regulations) the Employment is automatically transferred to another (“the Transferee”), the provisions of this clause 15 shall have effect as though references in it (and in all associated terms defined in this Agreement) to “the Group” are construed as references to “any other company within the Transferee’s Group” (which for these purposes shall comprise the Transferee and any holding company of the Transferee and the subsidiaries of the Transferee and of any such holding companies for the time being).

15.8 The Executive hereby undertakes with the Company that he will not at any time without the consent of the Company after the Termination Date:

15.8.1 engage other than as a private consumer in any trade or business or be associated with any person, firm or company engaged in any trade or business using the name(s) “HSBC” or “The Hongkong and Shanghai Banking Corporation” or incorporating the word(s) “Hongkong Shanghai Banking Corporation”;

15.8.2 in the course of carrying on any trade or business, claim, represent or otherwise indicate any present association with the Company or any Group Company or for the purpose of carrying on or retaining any business or custom, claim, represent or otherwise indicate any past association with the Company or any Group Company to its detriment other than simple and factual statements regarding the Executive’s period of employment, job title, responsibilities and role.

15.9 The parties agree that the periods referred to in clauses 15.3 and 15.4 above will be reduced by one day for every day, during which, at the Company’s direction, the Executive is on garden leave in accordance with clause 14.4.

15.10 While the restrictions in this clause 15 (on which the Executive has had the opportunity to take independent legal advice, as the Executive hereby acknowledges) are considered by the parties to be reasonable in all the circumstances, it is agreed that if any such restrictions, by themselves, or taken together, shall be adjudged to go beyond what is reasonable in all the circumstances for the protection of the legitimate interests of the Company or a

Group Company but would be adjudged reasonable if part or parts of the wording thereof were deleted, the relevant restriction or restrictions shall apply with such deletion(s) as may be necessary to make it or them valid and effective.

16 Grievance, dismissal and disciplinary procedures

- 16.1 If the Executive wishes to obtain redress of any grievance relating to the Employment or is dissatisfied with any reprimand, suspension or other disciplinary step taken by the Company, he shall apply in writing to the Chairman of the Board setting out the nature and details of any such grievance or dissatisfaction. If the Executive is not satisfied with the decision of the Chairman of the Board he may within seven days of the decision appeal in writing to a non-executive director of the Company nominated by the Board.
- 16.2 The disciplinary rules applicable to the Executive are set out in the Company's Employee Handbook. The disciplinary procedure is not contractually binding on the Company.

17 Disclosure of information

- 17.1 For the purposes of the Data Protection Act 1998 the Executive hereby consents to the processing by the Company of personal data including sensitive data of which the Executive is the subject. The Executive agrees that the data may be collected and held by the Company or be disclosed or transferred to other employees of the Company or to any other member of a Group Company (including if necessary to other offices of the Company or any Group Company outside the European Economic Area) or to any other person as may be reasonably necessary or as otherwise permitted by law. In this event, the Executive's personal information/data and sensitive personal data will be protected by the strictest code of secrecy and security, and only used in accordance with the Company's strict instructions.
- 17.2 The Executive agrees that the Company and any Group Company may intercept, process and monitor communications transmitted by or to the Executive via any private telecommunication systems (including e-mail) or services of the Company or any Group Company.

18 General

- 18.1 The provisions of this Agreement are severable and, if any one or more provision may be determined to be illegal or otherwise unenforceable in whole or in part under the laws of any jurisdiction, the remaining provisions of this Agreement in that jurisdiction shall not be affected and the legality and enforceability of this Agreement in any other jurisdiction shall not be affected.
- 18.2 Any notice or other document to be given under this Agreement shall be in writing and may be given personally to the Executive or to the Secretary of the Company (as the case may be) or may be sent by first class post or other fast postal service or by facsimile transmission to, in the case of the Company, its registered office for the time being and in the case of the Executive either to his address shown on the face hereof or to his last known place of residence.
- 18.3 Any such notice at clause 18.2 shall be deemed served when in the ordinary course of the means of transmission it would first be received by the addressee in normal business hours.

- 18.4 The Executive hereby irrevocably appoints any other director of the Company from time to time, jointly and severally, to be his attorney in his name and on his benefit to sign any documents and do things necessary or requisite to give effect to those matters which he is obliged to do pursuant to this Agreement (including but not limited to clauses 13 and 14.6.1). In favour of any third party a certificate in writing signed by any director or by the Secretary of the Company that any instrument or act falls within the authority hereby conferred shall be conclusive evidence that such is the case.
- 18.5 The Company and any Group Company may enforce the terms of this Agreement. No other person who is not a party to this Agreement may enforce any of its terms under the Contracts (Rights of Third Parties) Act 1999.
- 18.6 This Agreement contains the statement of initial employment particulars of the Executive as required under the Employment Rights Act 1996.
- 18.7 There are no collective agreements that affect the terms and conditions of the Executive's employment.

19 Other Agreements

- 19.1 This Agreement together with the Company's Employee Handbook (as amended from time to time) and the letter to the Executive from Willem J de Graaf referenced at clause 3.7 above constitutes the entire agreement of the parties and shall be in substitution for and shall replace any previous letters of appointment, agreements or arrangements (including without limitation the Executive's service agreement with HSBC Asia Holdings B.V. dated 2 December 2008), whether written, oral or implied, relating to the employment of the Executive by the Company or any Group Company.
- 19.2 Without prejudice to clause 19.1, in the event of any conflict between the terms of this Agreement and any other document purporting to relate to the employment of the Executive (including the Company's Employee Handbook from time to time in force) the terms of this Agreement prevail.
- 19.3 The Executive hereby acknowledges that he has no outstanding claims of any kind against HSBC, the Company and/or any Group Company (otherwise than in respect of remuneration and expenses including relocation expenses) accrued due and existing rights with respect to deferred bonuses and/or under and in accordance with any the Company share plan to the date of this Agreement but not yet paid)

20 Counterparts

This Agreement may be executed in any number of counterparts and by the parties on separate counterparts, but in that case shall not be effective until each party has executed at least one counterpart. Each counterpart shall constitute the original of this Agreement, but all counterparts together constitute one and the same instrument.

21 Choice of law and submission to jurisdiction

- 21.1 This Agreement shall be governed by and interpreted in accordance with the laws of England and Wales.

21.2 The Executive hereby submits to the jurisdiction of the High Court of Justice in England but this Agreement may be enforced by the Company in any court of competent jurisdiction.

22 Definitions

22.1 In this Agreement unless the context otherwise requires the following expressions have the following meanings:

“**Board**” means the Board of Directors for the time being of the Company or any committee of the Board (including the Group Management Board) to which powers have been properly delegated or such person or persons designated by the Board from time to time as its representative for the purposes of this Agreement;

“**Corporate Governance Code**” means the UK Corporate Governance Code published by the Financial Reporting Council (as amended from time to time);

“**Commencement Date**” means 1 January 2011;

“**Employment**” means the Executive’s employment under this Agreement;

“**FSA**” means the Financial Services Authority;

“**Group**” means (1) HSBC Holdings plc and any entity which from time to time is a holding company of HSBC Holdings plc or a subsidiary of HSBC Holdings plc or of any such holding company; and (2) any entity over which from time to time any of the entities defined in paragraph (1) of this definition either directly or indirectly exercises management control, even though it may own less than fifty per cent (50%) of the shares and is prevented by law from owning a greater shareholding and “**Group Company**” and “**Group Companies**” shall be construed accordingly;

“**Group Chief Executive**” means the Group Chief Executive of the Group from time to time;

“**Recognised Investment Exchange**” means an investment exchange granted recognition under section 285 (1) Financial Services and Markets Act 2000 including a recognised overseas investment exchange;

“**Statutory Deductions**” means appropriate tax, national insurance contributions and any other applicable statutory deductions;

“**Termination Date**” means the date on which the Executive’s Employment shall terminate;

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

22.2 references to clauses, sub-clauses and schedules are unless otherwise stated to clauses and sub-clauses of and schedules to this Agreement;

22.3 the headings to the clauses are for convenience only and shall not affect the construction or interpretation of this Agreement;

22.4 the words “subsidiary” and “holding company” have the meanings set out in section 1159 of the UK Companies Act 2006 and “management control” shall be demonstrated by the ability to exercise significant influence over an entity or its management; and

22.5 a reference to any statute or statutory provision (whether of the United Kingdom or elsewhere) includes any subordinate provision (as defined by section 21(1) Interpretation Act 1978) made under it and provision which has superseded it or re-enacted it (with or without modification) before or after the date of this Agreement except where it is after the date of this Agreement to the extent that the liability of any party is thereby increased or extended.

IN WITNESS whereof this Agreement has been executed the day and year first above written.

Executed as a Deed by _____)

the Company in the presence of: _____)

Dated: _____

Director

Dated: _____

Director/Secretary

Executed as a Deed by _____)

the Executive _____)

Dated: _____

in the presence of: _____)

Dated: _____

Signature of Witness

Witness Name: _____

Witness Address: _____

Witness occupation: _____

Private & Confidential
Draft: 25.11.10

Dated 10 February 2011

HSBC ASIA HOLDINGS B.V.

(1)

and

STUART GULLIVER

(2)

SERVICE AGREEMENT

Contents

Clause	Page
1 Appointment	3
2 Remuneration	3
3 Benefits	5
4 Duration of the Employment	7
5 Scope and Duties of the Employment	8
6 Hours and place of work	10
7 Deductions	10
8 Expenses	10
9 Holidays	10
10 Sickness benefits	11
11 Restrictions during the Employment	12
12 Confidential Information and Company documents	13
13 Inventions and other intellectual property	15
14 Termination	16
15 Restrictive covenants	19
16 Grievance, dismissal and disciplinary procedures	23
17 Disclosure of information	24
18 General	24
19 Other Agreements	25
20 Choice of law and submission to jurisdiction	25
21 Counterparts	25
22 Definitions	26

THIS AGREEMENT is dated 10/02 2011 and is made **BETWEEN**:

- (1) **HSBC ASIA HOLDINGS B.V.** (No. 33296181), whose registered office is at De entrée 242, 1101 EE Amsterdam, The Netherlands (the "**Company**"); and
- (2) **STUART GULLIVER** of 1 Queen's Road Central, Hong Kong SAR (the "**Executive**").

NOW IT IS HEREBY AGREED as follows:

1 Appointment

- 1.1 The provisions of this Agreement will commence with effect from the Commencement Date.
- 1.2 The Company shall continue to employ the Executive and the Executive agrees to act as a senior executive of the Company at Band 0. The Executive will be seconded to HSBC Holdings plc ("**HSBC**") as Group Chief Executive of the Group and on the basis that his principal office will be located in Hong Kong (as set out at clause 6.3), and agrees to do so on and subject to the following terms, conditions and provisions of this Agreement.
- 1.3 The Executive will report to the Chairman of the Group although HSBC or the Company has the right in its absolute discretion to change the person or persons to whom the Executive reports at any time subject always to such reporting line being appropriate to the Executive's seniority within the Group and status as an executive director of HSBC.

2 Remuneration

- 2.1 HSBC shall pay to the Executive on behalf of the Company, a gross salary currently at the rate of GBP1,250,000 per annum (the "**Salary**") less Statutory Deductions, which shall accrue day to day and be payable by equal monthly instalments in arrears on or about the 20th of each calendar month. The Board will review the Executive's salary annually in March, the first such review to take place in March 2011. There is no obligation on HSBC or the Company to increase the Executive's Salary pursuant to any such review or otherwise provided always that such reviews are conducted reasonably and in good faith having regard to the Executive, the treatment of other executives of comparable status and all other relevant circumstances. There will be no review of the Salary after notice has been given by either party to terminate the Employment.
- 2.2 HSBC on behalf of the Company may at its sole discretion (acting reasonably and in good faith) both as to whether to pay or award any Variable Pay (as defined at clause 2.3) and if so, how much, pay or award the Executive Variable Pay of such amount as the Board may determine in respect of each complete financial year of HSBC during which the Employment subsists.
- 2.3 For the purposes of this Agreement "**Variable Pay**" means any non-pensionable incentive compensation including any bonus or deferred bonus in the form of (i) cash or (ii) equity awarded under any share plan in force from time to time (in relation to which performance conditions may or may not be attached) and subject to clauses 2.10 and 2.11.

- 2.4 The operation of and all arrangements relating to any such Variable Pay, (including without limitation the payment or award date for any Variable Pay from time to time), will be at the absolute discretion of the Board which may in its absolute discretion, terminate, replace or amend any such plan at any time provided that the Executive is treated no less favourably than other executives of comparable status and in similar circumstances.
- 2.5 The Executive shall not be entitled to be considered for and/or to receive any Variable Pay if on the date that any such Variable Pay is due to be declared he:
- 2.5.1 is no longer employed by the Company or any Group Company; or
- 2.5.2 is under notice of termination of employment (including if the Executive is not assigned any duties in accordance with the garden leave provisions at clause 14.4),
due to the termination of the Employment by either the Executive (other than in response to the Company's repudiatory breach of contract) or by the Company pursuant to clause 14.1.2 of this Agreement.
- 2.6 The remuneration specified in clauses 2.1 and 2.2 (if any), shall be inclusive of any fees to which the Executive may be entitled as a director of HSBC or any Group Company or of any other company or any unincorporated body in which the Executive holds the office as nominee or representative of HSBC or any Group Company.
- 2.7 Payment of Salary and any Variable Pay to the Executive shall be made either by HSBC or by a Group Company and, if by more than one company, in such proportions as the Board may from time to time think fit, subject always to the Company's reasonable consideration of any detrimental net employment tax consequences on the Executive, by doing so.
- 2.8 Payments made to the Executive by HSBC (or such other Group Company to which the Executive is seconded from time to time) are made for and on behalf of the Company.
- 2.9 The Executive may be eligible to participate in any employee share plan established by HSBC from time to time. Eligibility to participate is subject to the rules of the relevant plan in force from time to time and is at the discretion of the Board. The Company will use reasonable endeavours to procure that any discretion relating to the grant of additional awards to the Executive is exercised reasonably and in good faith having regard to the Executive, the treatment of other executives of comparable status and all other relevant circumstances.
- 2.10 If the Executive is eligible to participate in an employee share plan pursuant to clauses 2.2 and/or 2.9, his rights under such plan will be subject to and in accordance with the rules of that plan in force from time to time. Subject to such rules, the rights and obligations of the Executive under the terms and conditions of his office or employment shall not be affected by his participation in the plan or any right he may have to participate in the plan.
- 2.11 Subject to the rules of the relevant plan as referenced at clauses 2.2 and 2.9, in participating in such a plan, the Executive waives all and any rights to

compensation or damages arising from the loss or failure to receive any rights or benefits under the plan (or the diminution in value of such rights or benefits) as a result of:

- (a) the termination of his office or employment and/or giving notice of termination of employment with any Group Company for any reason whatsoever (whether lawful or unlawful); and/or
- (b) the exercise or failure to exercise any discretion (whether lawful or unlawful) conferred by the rules of the plan.

3 Benefits

3.1 Hong Kong

To enable the Executive to carry out his duties at the Group's request from a principal office in Hong Kong, he shall be provided with the following benefits at no cost to himself (including with regard to any tax that may be assessable on the provision of such benefits), so that they are available to him during such time as he shall spend in Hong Kong:

- 3.1.1 an appropriate level of accommodation in Hong Kong which is convenient for the proper performance of his duties and is commensurate with his position and in accordance with local policy. The Company shall procure that telephone rental, authorised business calls and reasonable utility costs will be met by the Group which shall also pay the taxes in respect of the property and the cost of insuring and maintaining it; and
- 3.1.2 a car and/or chauffeur driven services appropriate to his position in Hong Kong, subject to the rules of the relevant scheme from time to time in force.

3.2 Car

The Executive shall have access to the chauffeur driven services operated by HSBC in London from the chauffeur pool.

3.3 Pension

3.3.1 Subject to clause 3.6.3, the Executive is eligible to receive a total annual allowance of 50 per cent. of annual Salary in order to fund pension arrangements which will be provided to him in the following way:

- (a) Subject to clause 3.3.1(c), with effect from the Commencement Date to 31 March 2011:
 - (i) the Executive will continue to be a member of an offshore defined contribution pension plan called Trailblazer (the "**Scheme**") subject to its rules from time to time in force, to which HSBC will make an employer contribution of 30 per cent. of Salary per annum, payable by monthly instalments. Details of the Scheme are set out in the Explanatory Booklet, a copy of which is available from Deloitte. The Scheme is not a contracted-out scheme for the purposes of the Pension Schemes Act 1993. The Company and HSBC reserve the right

in its absolute discretion to terminate or substitute another pension scheme for the Scheme at any time. Any such termination or substitution will not constitute a breach of contract; and

- (ii) the Executive will receive an annual cash allowance of 20 per cent. of annual Salary (less Statutory Deductions) in order to fund personal pension arrangements.
- (b) Subject to clause 3.3.1(c) and the Executive's review at the relevant time of the way in which he wishes pension entitlement to be delivered to him, with effect from 1 April 2011:
- (i) the annual employer contribution as set out at clause 3.3.1(a)(i) will be reduced to £50,000 per annum; and
 - (ii) the balance of the Executive's annual pension allowance of 50 per cent. of annual Salary less £50,000, will be paid to him as an annual cash allowance less Statutory Deductions.
- (c) Subject to relevant legislation in force from time to time, upon the Executive reaching the Lifetime Allowance as specified in relevant legislation and/or the Scheme rules, employer contributions to the Scheme will cease in full and instead the Executive will receive the annual allowance of 50 per cent. of annual Salary in cash only (less Statutory Deductions) payable in monthly installments.

3.4 Personal Accident Insurance Cover

The Executive is entitled to non-contributory membership of HSBC's personal accident insurance scheme.

3.5 Clubs

HSBC on behalf of the Company shall make payments on the Executive's behalf in respect of the annual membership subscription of two clubs or such similar two clubs as the Executive shall nominate each year, to be approved by HSBC through HSBC's Group Managing Director, Human Resources.

3.6 Medical Benefits

The Executive shall participate in the schemes set out under clauses 3.6.1 to 3.6.4 subject always to the relevant schemes' terms and conditions from time to time in force and subject to the Executive meeting the requirements of the relevant scheme and being deemed eligible by the relevant insurance provider. Neither the Company nor HSBC shall be liable to provide any benefits or any compensation in lieu thereof or take any action to enforce the provision of such benefits in circumstances where the scheme provider refuses for any reason whatsoever, to provide any benefits to the Executive.

3.6.1 Health Checks

The Executive and his spouse/partner are eligible for an annual voluntary health check with a medical adviser appointed and paid for by HSBC on behalf of the Company.

3.6.2 Medical Cover

The Executive and his spouse/partner and eligible dependants are entitled to participate in the Group's International Medical Scheme.

3.6.3 Group Income Protection

If the Executive is unable by reason of illness or injury, to perform the material or substantial parts of his duties hereunder, following a period of absence from work in excess of 26 consecutive weeks, the Executive will be eligible to be considered for a monthly payment equivalent to 50 per cent. of monthly Salary. In the event of such payment, the Executive's total annual pension allowance as set out at clause 3.3 will continue to be payable, subject to an overall cap of 35 per cent. of the Executive's annual Salary.

3.6.4 Life Assurance Cover

Under the Group Life Assurance Scheme, in the event of the Executive's death, a sum equivalent to four times annual Salary will be paid to the Executive's nominated beneficiaries, subject to approval by the trustees of the Group Life Assurance Scheme.

3.7 Tax Advice

The Group shall pay the reasonable costs incurred by the Executive in seeking tax advice from an appropriate adviser selected by him, for the purposes of UK and Hong Kong Tax Return preparation and associated tax compliance services and limited financial planning in relation to remuneration received by the Executive by reason of his employment with the HSBC Group. The Group will not pay for tax services to be provided to the Executive's spouse.

3.8 Directors and Officers Liability

The Executive shall benefit from cover under HSBC's policy on Directors' and Officers' Liability (including Outside Directors' and Officers' Liability) subject always to the policy and the rules of the policy from time to time in force.

4 Duration of the Employment

- 4.1 The Employment pursuant to this Agreement shall commence on the Commencement Date and, subject to clauses 5.4 and 14, shall continue until terminated by either party giving to the other not less than twelve months' notice in writing.
- 4.2 Notwithstanding clause 4.1 and any retirement date specified in any applicable pension scheme, the Employment shall automatically terminate when the Executive reaches the normal retiring age from time to time applicable to senior executives of HSBC which, for the avoidance of doubt, is currently 65.
- 4.3 The Executive's period of continuous employment commenced on 1 October 1980.

5 Scope and Duties of the Employment

5.1 In the Executive's position as Group Chief Executive, he shall:

5.1.1 devote the whole of his time, attention and skill to his duties;

5.1.2 faithfully and diligently perform such duties and exercise such powers consistent with his position as may from time to time be assigned to or vested in him by the Board;

5.1.3 obey the reasonable and lawful directions of the Board;

5.1.4 at all times act in the way he considers in good faith, most likely to promote the success of HSBC (and applicable Group Companies) for the benefit of the members as a whole in accordance with Section 172 Companies Act 2006;

5.1.5 perform his services in a professional and competent manner and in cooperation with others;

5.1.6 keep the Board at all times promptly and fully informed (in writing if so requested) of his conduct of and activities in relation to the business of HSBC and any Group Company and provide such explanations in connection therewith as the Board may require from time to time including for the avoidance of doubt, any misconduct of other employees or directors or his own; and

5.1.7 comply with the duties set out in the Companies Act 2006.

5.2 The Executive shall comply with:

5.2.1 all of HSBC's, the Company's and Group Company's codes, rules, regulations, policies and procedures (including without limitation HSBC's Compliance Guidelines),

5.2.2 the codes, practices, rules, principles and regulations of the UK Listing Authority (including the Model Code on directors' dealings in securities as set out in Annex 1 to Chapter 9 of the Listing Rules), the FSA, any other stock exchange and/or regulatory authorities relevant to HSBC, the Company or any Group Company from time to time and of any association or professional body to which HSBC, the Company and/or any Group Company and/or the Executive belong to from time to time,

5.2.3 such laws as may be relevant to the Group and to the Executive's duties under this Agreement; and

5.2.4 the Code for Dealing in HSBC Group Securities and every regulation of the Group for the time being in force in relation to dealings in shares or other securities of HSBC or any Group Company

insofar as they may affect him, HSBC, the Company, any Group Company or its or their directors, officers or employees.

5.3 The Executive shall comply with any rules, policies and procedures set out in HSBC's Employee Handbook, a copy of which is available on HSBC's

intranet. The Employee Handbook does not form part of this agreement and HSBC may amend it at any time.

- 5.4 The Executive's continued employment will be subject to him continuing to hold approved status for any position he may hold that requires FSA approval. In the event of approval being withdrawn (under current FSA regulations this includes instances such as insider dealing and market manipulation) in respect of this position or any subsequent position, the Company reserves the right to summarily terminate the Executive's employment without being further liable to him (other than in respect of amounts accrued due at the Termination Date). If the Executive's current role does not require registration with the FSA, his role in the future may require him to pass regulatory exams and/or obtain regulatory registrations. It is therefore a condition of the Executive's continuing employment that he passes any such exams and obtains such registrations. The Company shall provide the Executive with all reasonable co-operation in relation to him obtaining and/or retaining FSA approved status and such other regulatory registrations as may be required from time to time.
- 5.5 The Executive shall do such things as are necessary to ensure compliance by himself with the Corporate Governance Code and, so far as it lies within his power to do so, by HSBC and any applicable Group Company.
- 5.6 The Company and HSBC reserve the right to appoint any other person or persons to act jointly with the Executive in the event that the Executive is not assigned any duties in accordance with the garden leave provisions at clause 14.4 (or in place of the Executive if he is suspended in accordance with the provisions of this Agreement) in any position to which he may be assigned from time to time.
- 5.7 The Executive shall if and so long as the Company requires and without any further remuneration therefore (except as otherwise agreed):
 - 5.7.1 carry out duties on behalf of any Group Company; and
 - 5.7.2 act as a director or officer of any Group CompanyProvided always that such duties or offices are consistent with his role as Group Chief Executive.
- 5.8 The Company may at its sole discretion transfer the Executive's employment and assign the provisions of this Agreement to any Group Company at any time, subject always to the Executive enjoying no less favourable terms and conditions of employment.
- 5.9 The Executive agrees that a copy of clauses 5, 11, 12 and 15 of this Agreement will be provided by him to any person, firm, company or other entity making an offer of employment, appointment as a director or officer, agency, consultancy, partnership or joint venture to him during the Employment or thereafter whilst any restrictions in clause 15 remain in force immediately upon receiving any such offer.

6 Hours and place of work

- 6.1 HSBC's standard working week is 35 hours (excluding unpaid lunch breaks). The Executive shall be required to work such hours, including additional hours (without further remuneration) as are necessary for the proper performance of the duties hereunder.
- 6.2 Notwithstanding clause 6.1 the Executive acknowledges that because of the autonomous nature of his role the duration of the Executive's working time is not measured or monitored or determined by the Company or HSBC so that the limit on weekly working time set out in Regulation 4 of the Working Time Regulations 1998 (or such other regulations as may from time to time come into force) does not apply to the Executive's Employment.
- 6.3 The Executive's principal place of work will be HSBC's offices at 1 Queen's Road Central, Hong Kong SAR, but the Company may reasonably require the Executive to work at any place of business of the Group within Hong Kong or by mutual agreement, in any other global location, on either a temporary or an indefinite basis. The Executive will be given reasonable notice of any permanent change in his place of work. In the performance of the duties hereunder, the Executive will be required to travel and undertake his duties both from Hong Kong and from London and in other global locations as the Group sees fit from time to time.

7 Deductions

For the purposes of the Employment Rights Act 1996, the Executive hereby authorises HSBC on behalf of the Company to deduct from the remuneration hereunder any sums due from the Executive to the Company or to HSBC including, without limitation, any overpayments, loans or advances made to him by the Company or by HSBC, the cost of repairing any damage or loss to the Group's property caused by the Executive (and of recovering such costs) and any losses suffered by the Group as a result of any negligence or breach of duty by the Executive or sums in respect of sub-clause 10.6 of this Agreement.

8 Expenses

HSBC on behalf of the Company shall reimburse the Executive in respect of all expenses reasonably incurred by the Executive in the proper performance of the duties hereunder subject to the Executive providing such receipts or other evidence as HSBC may require and subject to HSBC's rules and policies from time to time relating to expenses.

9 Holidays

- 9.1 The Executive shall be entitled to receive his normal remuneration for all bank and public holidays normally observed in the United Kingdom and a further 30 working days' paid holiday in each holiday year (being the period from 1 January to 31 December) including one period of 10 consecutive working days which must be taken as core leave. The Executive's holiday shall be taken at such times as are agreed with the Chairman.
- 9.2 In the holiday year in which the Employment terminates, the Executive's entitlement to holiday shall accrue on a pro rata basis for each complete

month of service during the relevant year. If, on the termination of the Employment, the Executive has exceeded his accrued holiday entitlement, the excess may be deducted from any sums due to the Executive and the Executive hereby authorises HSBC on behalf of the Company to make such deduction. If the Executive has any unused holiday entitlement, the Company or HSBC may either require the Executive to take such unused holiday during any notice period (whether or not the Executive is on garden leave in accordance with clause 14.4) or make payment in lieu thereof.

- 9.3 Holiday entitlement for one holiday year may not be taken in subsequent holiday years unless otherwise agreed by the Chairman. Failure to take holiday entitlement in the appropriate holiday year will lead to forfeiture of any accrued holiday not taken, without any right to payment in lieu thereof unless otherwise agreed by HSBC's Group Managing Director, Human Resources in accordance with the holiday policy applicable to Executive Directors from time to time.

10 Sickness benefits

- 10.1 HSBC on behalf of the Company shall continue to pay the Salary during any period of absence on medical grounds in accordance with the sick pay policy set out in HSBC's Employee Handbook ("**HSBC Sick Pay**") provided that the Executive complies in full with any of the requirements set out in HSBC's Employee Handbook and clause 10.2 below. Thereafter the Executive will only be entitled to such salary and benefits, if any, as the Board shall in its absolute discretion from time to time allow. Upon the Executive's return to work from such absence to perform his duties hereunder, he shall be entitled to receive the Salary and the benefits set out at clause 3, pursuant to the terms of this Agreement and subject to any relevant scheme rules.
- 10.2 At any time during the Employment, the Executive shall, if so required by the Board:
- 10.2.1 supply the Company with medical certificates covering any period of sickness or incapacity exceeding seven days (including weekends); and
- 10.2.2 undergo, at the expense of HSBC, an examination by a registered medical practitioner or practitioners to be nominated by HSBC (including but not limited to the Executive's general practitioner or any other physician responsible for the Executive's care). The Executive authorises the medical practitioner to disclose and discuss with the Company and HSBC any report prepared as a result of any such examination pursuant to the Access to Medical Reports Act 1988. The Company has the right to postpone the Executive's return to work (and the continuance or reinstatement of his normal pay, if appropriate) until the medical practitioner has confirmed that the Executive is fit to perform his duties.
- 10.3 Payment of the Executive's Salary pursuant to clause 10.1 shall be inclusive of any Statutory Sick Pay to which the Executive may be entitled by law. HSBC on behalf of the Company will also deduct from it any other statutory benefits if applicable due to the Executive, together with any Statutory Deductions.
- 10.4 Subject to the applicable scheme rules in force from time to time, during the Executive's absence from work on medical grounds, the Executive will

continue to be covered by HSBC's life assurance arrangements, private medical insurance and personal accident insurance and whilst he is entitled to receive HSBC Sick Pay he shall be entitled to receive the pension allowance as set out at clause 3.3. The Executive's entitlement to participation in any Variable Pay plan and the accrual of holiday entitlement above the minimum statutory entitlement shall cease on the expiry of the payment of HSBC Sick Pay until such time as the Executive is able to perform his duties hereunder.

10.5 The Company reserves the right to terminate the Employment in accordance with the terms of this Agreement for reasons unrelated to the Executive's illness or sickness absence when the Executive is absent through sickness or injury at any time, notwithstanding any outstanding or prospective entitlement to pay in accordance with clause 10.1, private medical insurance, permanent health insurance or long term disability benefits. Neither HSBC nor the Company shall be liable for any loss arising from such termination.

10.6 If the Executive's absence shall be occasioned by the actionable negligence of a third party in respect of which damages are recoverable in respect of the period of the Executive's incapacity, then the Executive shall:

10.6.1 forthwith notify HSBC and the Company of all the relevant circumstances and of any claim, compromise, settlement or judgment made or awarded in connection therewith;

10.6.2 if HSBC so requires, refund to HSBC such sum as HSBC may determine, not exceeding the lesser of:

- (a) the amount of damages recovered by the Executive under such compromise, settlement or judgment; and
- (b) the sums advanced to the Executive by HSBC in respect of the period of incapacity

subject to any deductions made by any court or tribunal that takes into account the payments made to the Executive in this clause 10 when awarding any such damages or compensation.

11 Restrictions during the Employment

11.1 The Executive shall not during the Employment directly or indirectly either on his own account or on behalf of any other person, company, business entity or other organisation be employed, engaged, concerned or interested in any other business or undertaking, provided that this shall not prohibit the holding (directly or through nominees) of investments listed on the London Stock Exchange plc or in respect of which dealing takes place on the Alternative Investment Market of the London Stock Exchange plc or on The Stock Exchange of Hong Kong Limited or on any Recognised Investment Exchange as long as not more than 5 per cent of the issued shares or other securities of any class of any one company shall be so held without the prior sanction of a resolution of the Board.

11.2 The Executive shall obtain the Chairman's prior written approval (such approval not to be unreasonably withheld) before accepting appointment as a non-executive director of any company outside the Group. Approval is

currently limited to one FTSE100 constituent company or other significant company in the UK or elsewhere.

- 11.3 The Executive shall not (and shall procure so far as the Executive is able that any person connected with the Executive within the meaning of section 252 Companies Act 2006 (**Connected Person**) shall not) deal or become or cease to be interested (within the meaning set out in Schedule 1 Companies Act 2006) in any securities of HSBC, except in accordance with HSBC's code for securities transactions by directors.
- 11.4 Subject to any regulations issued by HSBC, the Executive and any Connected Person shall not be entitled to receive or obtain directly or indirectly any discount, rebate or commission in respect of any sale or purchase of goods effected or other business transacted (whether or not by the Executive) by or on behalf of HSBC or any Group Company and if he or any Connected Person (or any firm or company in which he or any Connected Person is interested) shall obtain any such discount, rebate or commission the Executive shall account to HSBC or the relevant Group Company for the amount received by the Executive or any Connected Person (or a due proportion of the amount received by such company or firm having regard to the extent of the Executive's or the Connected Person's interest therein).
- 11.5 The Executive agrees to disclose to the Board any matters relating to any Connected Person which may, in the reasonable opinion of the Board, be considered to interfere, conflict or compete with the proper performance of the Executive's obligations under this Agreement.
- 11.6 During the Employment, the Executive agrees that he will not in competition with HSBC or any Group Company:
- 11.6.1 deal with, canvass, solicit or endeavour to take away from HSBC or any Group Company, whether directly or indirectly and whether on his own behalf or on behalf of any other person, firm, company or other entity any customers or prospective customers; or
- 11.6.2 directly or indirectly solicit or entice away from or endeavour to entice away from HSBC or any Group Company any individual employed or engaged by HSBC or any Group Company; or
- 11.6.3 directly or indirectly make preparations to compete with any business carried on by HSBC or any Group Company.
- 11.6.4 During the Employment the Executive shall inform the appropriate member of the Board without delay if he becomes aware that any director, officer, or senior employee of the Company, HSBC or any Group Company is planning to materially breach any of the provisions of their contract of employment or implied duties of loyalty, good faith and fidelity.

12 Confidential Information and Company documents

- 12.1 The Executive recognises that, whilst performing the duties hereunder for HSBC and the Group the Executive will have access to and come into contact with trade secrets and confidential information belonging to the Company, HSBC and/or any Group Company and will obtain personal knowledge of and influence over its or their customers, suppliers and/or employees. The

Executive therefore agrees that the restrictions set out in this clause 12 are reasonable and necessary to protect the legitimate business interests of the Company, HSBC and the Group both during and after the termination of the Employment. The Executive shall neither during the Employment (except in the proper performance of the duties) nor at any time (without limit) after the termination of the Employment directly or indirectly:

- 12.1.1 divulge or communicate to any person, company, business entity or other organisation; or
 - 12.1.2 use for his own purposes or for any purposes other than those of HSBC, the Company or any Group Company; or
 - 12.1.3 through any failure to exercise due care and diligence, cause any unauthorised disclosure of any trade secrets or Confidential Information relating to HSBC, the Company or any Group Company, but so that these restrictions shall cease to apply to any information which shall become available to the public generally otherwise than through the default of the Executive and to any use or disclosure authorised by the Board or required by law.
- 12.2 Nothing in this Agreement shall prevent the Executive from making a protected disclosure in accordance with section 43A Employment Rights Act 1996 and the Public Interest Disclosure Act 1998.
- 12.3 **“Confidential Information”** shall include details of suppliers and their terms of business, details of customers, clients and prospective customers/clients and their requirements, the prices charged to and terms of business with customers, marketing plans and sales forecasts, financial information, results and forecasts (save to the extent that these are included in published audited accounts), any proposals relating to the acquisition or disposal of a company or business or any part thereof or to any proposed expansion or contraction of activities, or any other business strategy or tender, details of employees and officers and of the remuneration and other benefits paid to them, information relating to research activities, inventions, secret processes, designs, software, formulae and product lines, any information which the Executive either is aware or reasonably ought to know is confidential and any information which has been given to HSBC, the Company or any Group Company in confidence by customers, suppliers or other persons.
- 12.4 All notes, memoranda, records, lists of customers and suppliers and employees, correspondence, documents, computer and other discs and tapes, data listings, codes, designs and drawings and other documents and material whatsoever (whether made or created by the Executive or otherwise) relating to the business of HSBC, the Company or any Group Company (and any copies of the same):
- 12.4.1 shall be and remain the property of HSBC, the Company or the relevant Group Company; and
 - 12.4.2 shall be handed over by the Executive to HSBC, the Company or to the relevant Group Company or irrevocably deleted from any computer and/or word processing system in the Executive’s possession or under the Executive’s control, on demand and in any event on the termination of the

Employment. Provided always that, at the reasonable request of the Executive, he shall be provided, subject always to the provisions of clause 12.1, with copies of all Board Minutes (and documents referred to therein) of Group Companies of which he was a director, in respect of any period during which he was a director of such Group Company, which are reasonably required by the Executive for the purposes of defending himself in any regulatory or legal proceedings relating to his duties as a director of such Group Company.

13 Inventions and other intellectual property

- 13.1 The Executive may make inventions or create other intellectual property during the Employment. In this respect the Executive has a special responsibility to further the interests of the Company, HSBC and the Group given the Executive's position at HSBC and the remuneration paid to the Executive under this Agreement.
- 13.2 In recognition of the Executive's position, remuneration and responsibility, the Executive acknowledges and agrees that any invention, improvement, design, process, information, copyright work, trade mark, trade name or get-up or any other intellectual property (together the "**Intellectual Property**") made, created or discovered by him during the Employment (whether capable of being patented or registered or not) in conjunction with or in any way affecting or relating to the business of HSBC, the Company or any Group Company or capable of being used or adapted for use in HSBC, the Company or any such Group Company or in connection therewith shall be immediately disclosed to the Company and shall belong to and be the absolute property of HSBC or such Group Company as the Company may direct.
- 13.3 However clause 13.2 shall only apply to the extent that any invention was made by the Executive in the course of his duties or in the course of duties falling outside the Executive's normal duties but which have been specifically assigned to him (together "**Duties**") and (i) such invention was reasonably expected to result therefrom; and/or (ii) at the time of making the invention, because of the nature of his Duties and the particular responsibilities arising therefrom, the Executive had a special obligation to further the interests of HSBC, the Company and the Group.
- 13.4 The Executive acknowledges that he has no rights, interest or claims, either during the Employment or after the termination of the Employment, in or to any such Intellectual Property and he shall not use such Intellectual Property other than during the period of the Employment and for the purpose of HSBC, the Company or the Group.
- 13.5 If and whenever required to do so by the Company, (whether during the Employment or after its termination), the Executive shall at the expense of the Company or such Group Company as the Company may direct:
- 13.5.1 apply or join with the Company or such Group Company in applying for letters patent or other protection or registration in the United Kingdom and in any other part of the world for any such Intellectual Property; and
- 13.5.2 execute and do all instruments and things necessary for vesting the said letters patent or other protection or registration when obtained and all right title and interest to and in the same absolutely and as sole beneficial owner in

the Company or such Group Company or in such other person as the Company may specify.

- 13.6 The Executive agrees that he irrevocably and unconditionally waives all rights (including all moral rights) under Chapter IV of the Copyrights, Designs and Patents Act 1988 in connection with his authorship of any existing or future copyright work, in whatever part of the world such rights may be enforceable
- 13.7 Nothing in this clause shall be construed as restricting the Executive's rights or those of HSBC or the Company under the Patents Act 1977 and in particular, sections 39 to 43 Patents Act 1977.

14 Termination

- 14.1 Notwithstanding clause 4.1 the Employment shall be subject to termination by the Company:
- 14.1.1 notwithstanding the actual or expected provision of any permanent health insurance benefits or any other benefit, by not less than six months' notice in writing given at any time while the Executive shall have been incapacitated by reason of ill health or accident from performing the duties hereunder for a period of or periods aggregating the total period during which the Executive is entitled to receive HSBC Sick Pay provided always that, subject to clause 10.5, the Company shall not terminate the Employment in these circumstances if the effect of such termination would be to deprive the Executive of the benefit of payments under any permanent health insurance scheme. If at any time during the currency of such a notice the Executive shall provide a medical certificate satisfactory to the Board to the effect that he has fully recovered physical and/or mental health and that no recurrence of illness or incapacity can reasonably be anticipated, the Company shall withdraw the notice;
- 14.1.2 by summary notice in writing and with no liability to make any further payment to the Executive (other than in respect of amounts accrued due at the Termination Date) if the Executive shall have:
- (a) committed by any act or omission any serious breach or repeated or continued (after warning) a material breach of the Executive's obligations hereunder; or
 - (b) been guilty of conduct by act or omission (whether in the course of the duties hereunder or otherwise) which (i) in the reasonable opinion of the Board, tends to bring the Executive and/or the Company and/or any Group Company into disrepute on account of material economic or reputational consequences for all or any of them or (ii) causes HSBC, the Company or any Group Company substantial economic harm, provided in either case, that if such conduct is capable of remedy, he has first been given the reasonable opportunity to remedy the contract and has failed to do so; or
 - (c) been convicted of a criminal offence under any statutory enactment or regulation (other than an offence under any road traffic legislation in the United Kingdom or elsewhere for which a fine or non custodial penalty is imposed and which does not render him unable to discharge his duties under this Agreement); or

- (d) become bankrupt or had an interim order made against the Executive under the Insolvency Act 1986 or compounded with his creditors generally; or
- (e) in the reasonable opinion of the Board, failed to perform the duties hereunder to a satisfactory standard, after having received a written warning from HSBC or the Company relating to the same; or
- (f) been disqualified from being a director by reason of any order made under the Company Directors Disqualification Act 1986 or any other enactment; or
- (g) resigned of his own choice as a director of HSBC or any Group Company, not being at the request of or with the prior written agreement of the Board (save with reasonable and proper cause and where remaining as a director would substantially disadvantage him in his capacity as an officeholder of HSBC); or
- (h) become prevented by an applicable law or regulation from performing any material part of his duties; or
- (i) been guilty of a material breach of the rules or regulations as amended from time to time of the UK Listing Authority (including the Model Code for transactions in securities by directors of listed companies), The London Stock Exchange plc, the FSA or any other stock exchanges or regulatory authorities relevant to HSBC or any Group Company or any Code of Practice issued by HSBC or any Group Company (as amended from time to time); or
- (j) been expelled or subject to any serious disciplinary action by a relevant professional body or failed or ceased to meet the requirements of any regulatory body or statutory authority as a result of which the Executive is no longer able to perform all or any of the duties under this Agreement or;
- (k) ceased to be eligible to work in the United Kingdom in accordance with Sections 15-25 of the Immigration, Asylum and Nationality Act 2006.

Any delay by the Company in exercising such right of termination shall not constitute a waiver thereof.

14.2 If the Company becomes entitled to terminate the Employment pursuant to clauses 5.4 or 14.1.2, or whilst the Company, HSBC or any external body investigates any allegation which would or may entitle the Company to terminate the Employment pursuant to clauses 5.4 or 14.1.2 it shall be entitled (but without prejudice to its right subsequently to terminate such appointment on the same or any other ground) to suspend the Executive on full pay for so long as it may think fit or, for such period as is reasonable in the circumstances. During the period of any suspension the Executive will continue to be bound by the provisions of this Agreement and must continue at all times to conduct himself with good faith towards HSBC, the Company and all Group Companies.

- 14.3 The Company reserves the right in its absolute discretion to give the Executive pay in lieu of all or any part of the notice of termination (whether notice is given by the Company or by the Executive). A dismissal without notice per se shall not constitute or imply an election under this clause 14.3. For this purpose, the Executive agrees that pay in lieu will consist of the Salary and other contractual benefits (or cash equivalent) as set out at clause 3 of this Agreement for the relevant period of notice (subject to Statutory Deductions in the normal way) but excluding accommodation and car and chauffeur driven services as referenced at clauses 3.1.1 and 3.1.2 respectively, any Variable Pay and any other emolument referable to the Employment.
- 14.4 During any period of notice of termination or part thereof (whether given by the Company or the Executive), the Company shall (but only for a period or periods in aggregate not exceeding six months) be under no obligation to assign any duties to the Executive and shall be entitled to exclude him from the Group's premises and to direct that the Executive refrains from contacting (other than purely social contact with persons with whom the Executive has established social relationships) any customers, clients, suppliers, agents, professional advisers or employees of HSBC, the Company or any Group Company and refrains from accessing the computer or other data or similar system of HSBC, the Company or any Group Company (whether directly or indirectly) and remove him from office as a director of HSBC and any Group Company and from all or any offices held by him in HSBC or any Group Company, provided that this shall not affect the Executive's entitlement to receive Salary and other contractual benefits (excluding Variable Pay if the circumstances in clause 2.5 apply). For the avoidance of doubt, during such period the Executive shall continue to be bound by the same obligations to the Company and the Group as were owed prior to the commencement of the period including the duty of good faith and fidelity.
- 14.5 The Executive agrees that during any period of notice of termination whether given by the Company or by the Executive he will give such assistance in effecting an orderly and comprehensive handover as HSBC and the Company may reasonably require and with regard to any claim made by or against any Group Company. For the avoidance of doubt such assistance may include attending meetings, reviewing documents, giving and signing statements/affidavits and attending hearings and giving evidence.
- 14.6 Without prejudice to the constitution (including for the avoidance of doubt the articles of association) of HSBC or any Group Company, on the termination of the Employment (howsoever arising) or on either the Company or the Executive having served notice of such termination and the Company having exercised its right to place the Executive on garden leave pursuant to clause 14.4, the Executive shall at the request of the Company or HSBC:
- 14.6.1 resign from office as a Director of HSBC and of any Group Company and all other offices held by the Executive in HSBC and/or any Group Company provided however that such resignation shall be without prejudice to any claims which the Executive may have against the Company or any Group Company arising out of the termination of the Employment; and
- 14.6.2 transfer without payment to the Company or as the Company may direct to HSBC or to any third party, any shares or other securities held by the Executive in HSBC or any Group Company as a nominee or trustee for

HSBC, the Company or any Group Company and deliver to HSBC or the Company (as directed) the related certificates; and

14.6.3 forthwith deliver to HSBC all Confidential Information and all materials within the scope of clause 12.3 including any copies of any such materials and all credit cards and other property of or relating to the business of HSBC, the Company or of any Group Company which may be in the Executive's possession or under the Executive's power or control and, if requested, provide a signed statement that he has fully complied with the obligations under this clause 14.6.3.

14.7 If the Executive shall have been offered but shall unreasonably have refused to agree to the transfer of this Agreement by way of novation to a company which has acquired or agreed to acquire the whole or substantially the whole of the undertaking and assets of or of the equity share capital of HSBC, the Executive shall have no claim against the Company or HSBC in respect of the termination of his employment hereunder by reason of the subsequent voluntary winding-up of HSBC or of the disclaimer of this Agreement by the Company within one month after such acquisition.

15 Restrictive covenants

15.1 For the purposes of this clause 15 the following words have the following meanings:

15.1.1 **"Company Products"** means any banking or financial products researched into, developed, supplied, distributed or sold by the Company with which the duties of the Executive were materially concerned or for which he was directly or ultimately responsible during the Restricted Period;

15.1.2 **"Company Services"** means any banking or financial services (including but not limited to technical and product support, technical advice and customer services) developed or supplied by the Company with which the duties of the Executive were materially concerned or for which he was directly or ultimately responsible during the Restricted Period;

15.1.3 **"Comparator Group"** means the following companies and entities, subject always to amendment from time to time by the Remuneration Committee of the Board of HSBC and as notified to the Executive by no later than 30 days after any such amendment: Banco Bradesco, Banco Itau, Banco Santander, Bank of America, Bank of China, Barclays, BBVA, BNP Paribas, Citigroup, Credit Suisse Group, DBS Group, Deutsche Bank, Fortis, ICBC, JP Morgan Chase, Lloyds Banking Group, National Australia Bank, Royal Bank of Canada, Royal Bank of Scotland, Societe Generale, Standard Chartered, UBS, Unicredito Italiano and Wells Fargo (and all group companies of the companies and entities set out in this clause 15.1.3) and, where any companies or entities set out in this clause 15.1.3 are the subject of a takeover or undergo any form of reconstruction, the entities to which the relevant business assets of such companies or entities are transferred from time to time;

15.1.4 **"Confidential Information"** has the meaning ascribed thereto in clause 12.2;

15.1.5 **"Customer"** means any person or firm or company or other organisation whatsoever to whom or which the Company supplied Company Products

and/or Company Services during the Restricted Period and with whom or which, during the Restricted Period:

- (a) the Executive had material personal dealings pursuant to the Employment; or
- (b) any employee who was under the direct or indirect supervision of the Executive had material personal dealings pursuant to their employment,

provided that in the case of a firm, company or other organisation "Customer" shall not include any division, branch or office of such firm or company or other organisation with which the Executive and/or any such employee as defined in sub-clause (b) above had no dealings during the Restricted Period save that where a restructuring of the firm or company or organisation has occurred following such personal dealings "Customer" shall include the part of the business with which the Executive or any employee as defined in sub-clause (b) above had dealings during the Restricted Period;

15.1.6 "**Prospective Customer**" means any person or firm or company or other organisation whatsoever with whom or which the Company shall have had negotiations or material discussions regarding the possible distribution, sale or supply of Company Products and/or Company Services during the Restricted Period and which were ongoing and not finally concluded at the Termination Date and with whom or which during such period:

- (a) the Executive shall have had material personal dealings pursuant to the Employment; or
- (b) any employee who was under the direct or indirect supervision of the Executive shall have had material personal dealings pursuant to their employment; or
- (c) the Executive was directly responsible in a client management capacity on behalf of the Company,

provided that in the case of a firm, company or other organisation "Prospective Customer" shall not include any division, branch or office of such firm, company or other organisation with which the Executive and/or any such employee had no dealings during the Restricted Period save that where a restructuring of the firm or company or organisation has occurred following such personal dealings, "Prospective Customer" shall include the part of the business with which the Executive or any employee as defined in sub-clause (b) had dealings during the Restricted Period;

15.1.7 "**Restricted Employee**" means any person who is on the Termination Date, or was during the Restricted Period, employed or engaged by the Company or any Group Company and is by reason of such employment or engagement in possession of, or is reasonably likely to be in possession of, any trade secret or Confidential Information relating to the business of the Company or any Group Company or has acquired influence over its Customers or Prospective Customers (as defined in this clause 15 but so that references to "the Executive" shall be replaced by references to the relevant employee and so that references to "Employment" shall mean the relevant employee's employment with the Company or Group Company, being in either case a

person with whom the Executive had material dealings during the Restricted Period);

- 15.1.8 **“Restricted Period”** means the period of 12 months ending on the Termination Date or, in the event that no duties were assigned to the Executive for any part of the duration of the notice period, the 12 months immediately preceding the last day on which the Executive carried out any duties for the Company;
- 15.1.9 **“Restricted Products”** means Company Products or any products of the same or of a similar kind;
- 15.1.10 **“Restricted Services”** means Company Services or any services of the same or of a similar kind;
- 15.1.11 **“Restricted Supplier”** means any person, company, business entity or other organisation whatsoever who has supplied goods or services to the Company or any Group Company (other than utilities and goods or services supplied for administrative purposes) during any part of the Restricted Period or who has agreed prior to the Termination Date to supply goods or services to the Company to commence at any time in the twelve months following the Termination Date.
- 15.2 The Executive recognises that, whilst performing his duties for the Company, he will have access to and come into contact with trade secrets and Confidential Information belonging to the Company and certain Group Companies and will obtain personal knowledge of and influence over its or their customers and/or employees. The Executive therefore agrees that the restrictions set out in this clause 15 are reasonable and necessary to protect the legitimate business interests of the Company and any applicable Group Company both during and after the termination of the Employment.
- 15.3 The Executive hereby undertakes with the Company that he will not for the period of six months after the Termination Date without the prior written consent of the Company (such consent not to be unreasonably withheld) whether by himself, through his employees or agents or otherwise howsoever and whether on his own behalf or on behalf of any other person, firm, company or other organisation, directly or indirectly:
 - 15.3.1 in competition with the Company anywhere in the world in a senior capacity, be employed by or engaged or otherwise interested in any of the companies (or other entities) in the Comparator Group in the business of researching into, developing, distributing, selling, supplying or otherwise dealing with Restricted Products or Restricted Services; or
 - 15.3.2 in competition with the Company, accept orders or facilitate the acceptance of any orders or have any business dealings for Restricted Products or Restricted Services from any Customer or Prospective Customer; or
 - 15.3.3 employ or otherwise engage in the business of or be personally involved to a material extent in employing or otherwise engaging in the business of researching into, developing, manufacturing, distributing, selling, supplying or otherwise dealing with Restricted Products or Restricted Services any Restricted Employee; or

- 15.3.4 interfere with, or endeavour to interfere with, the supply or provision of goods or services (other than utilities, or goods or services supplied for an administrative purpose) to the Company or to induce the cessation of the supply or provision of such goods or services from any Restricted Supplier; or
- 15.3.5 in competition with the Company, solicit business from, or solicit the supply of goods or services (other than utilities, or goods or services supplied for an administrative purpose) from any Restricted Supplier for the purposes of the provision of Restricted Products or Restricted Services.
- 15.4 The Executive hereby undertakes with the Company that he will not for the period of twelve months after the Termination Date without the prior written consent of the Company (such consent not to be unreasonably withheld) whether by himself, through his employees or agents or otherwise howsoever and whether on his own behalf or on behalf of any other person, firm, company or other organisation, directly or indirectly:
- 15.4.1 in competition with the Company, solicit business from or endeavour to entice away or canvass any Customer or Prospective Customer if such solicitation or canvassing is in respect of Restricted Products or Restricted Services; or
- 15.4.2 solicit or induce or endeavour to solicit or induce any Restricted Employee to cease working for or providing services to the Company, whether or not any such person would thereby commit a breach of contract.
- 15.5 If the restrictions in clauses 15.3 and/or 15.4 are for any reason held to be unenforceable in any jurisdiction in the world the Executive shall agree to such amended or lesser restriction as would enable that restriction to be enforced so far as possible in such jurisdiction.
- 15.6 The benefit of clauses 15.3 and 15.4 shall be held on trust by the Company for HSBC and for each Group Company and the Company reserves the right to assign the benefit of such provisions to HSBC and to any Group Company, in addition such provisions also apply as though there were substituted for references to "the Company" references to HSBC or to each Group Company in relation to which the Executive has in the course of his duties for the Company or by reason of rendering services to or holding office in such Group Company:
- 15.6.1 acquired knowledge of its trade secrets or Confidential Information; or
- 15.6.2 had material personal dealings with its Customers or Prospective Customers; or
- 15.6.3 supervised directly or indirectly employees having material personal dealings with its Customers or Prospective Customers,

but so that references in clause 15 to "the Company" shall for this purpose be deemed to be replaced by references to HSBC or to the relevant Group Company. The obligations undertaken by the Executive pursuant to this clause 15.6 shall, with respect to each such Group Company, constitute a separate and distinct covenant and the invalidity or unenforceability of any such covenant shall not affect the validity or enforceability of the covenants in favour of HSBC or any other Group Company or the Company. In addition, at the request of the Company the Executive shall enter into a direct agreement

or undertaking with HSBC or any other Group Company whereby he will accept restrictions corresponding to the restrictions in this clause 15 (or such of them as may be appropriate).

- 15.7 In the event of the transfer (within the meaning of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (the “**Transfer Regulations**”) of the undertaking or the part of the undertaking in which the Executive shall at the time be employed as the result of which (by virtue of the Transfer Regulations) the Employment is automatically transferred to another (“the Transferee”), the provisions of this clause 15 shall have effect as though references in it (and in all associated terms defined in this Agreement) to “the Group” are construed as references to “any other company within the Transferee’s Group” (which for these purposes shall comprise the Transferee and any holding company of the Transferee and the subsidiaries of the Transferee and of any such holding companies for the time being).
- 15.8 The Executive hereby undertakes with the Company that he will not at any time without the consent of the Company after the Termination Date:
- 15.8.1 engage other than as a private consumer in any trade or business or be associated with any person, firm or company engaged in any trade or business using the name(s) “HSBC” or “The Hongkong and Shanghai Banking Corporation” or incorporating the word(s) “Hongkong Shanghai Banking Corporation”;
- 15.8.2 in the course of carrying on any trade or business, claim, represent or otherwise indicate any present association with the Company or any Group Company or for the purpose of carrying on or retaining any business or custom, claim, represent or otherwise indicate any past association with the Company or any Group Company to its detriment other than simple and factual statements regarding the Executive’s period of employment, job title, responsibilities and role.
- 15.9 The parties agree that the periods referred to in clauses 15.3 and 15.4 above will be reduced by one day for every day, during which, at the Company’s direction, the Executive is on garden leave in accordance with clause 14.4.
- 15.10 While the restrictions in this clause 15 (on which the Executive has had the opportunity to take independent legal advice, as the Executive hereby acknowledges) are considered by the parties to be reasonable in all the circumstances, it is agreed that if any such restrictions, by themselves, or taken together, shall be adjudged to go beyond what is reasonable in all the circumstances for the protection of the legitimate interests of HSBC, the Company or a Group Company but would be adjudged reasonable if part or parts of the wording thereof were deleted, the relevant restriction or restrictions shall apply with such deletion(s) as may be necessary to make it or them valid and effective.

16 Grievance, dismissal and disciplinary procedures

- 16.1 If the Executive wishes to obtain redress of any grievance relating to the Employment or is dissatisfied with any reprimand, suspension or other disciplinary step taken by the Company, he shall apply in writing to the Chairman setting out the nature and details of any such grievance or dissatisfaction. If the Executive is not satisfied with the decision of the

Chairman he may within seven days of the decision appeal in writing to a non-executive director of HSBC nominated by the Board.

16.2 The disciplinary rules applicable to the Executive are set out in HSBC's Employee Handbook. The disciplinary procedure is not contractually binding on HSBC or the Company.

17 Disclosure of information

17.1 For the purposes of the Data Protection Act 1998 the Executive hereby consents to the processing by the Company or HSBC of personal data including sensitive data of which the Executive is the subject. The Executive agrees that the data may be collected and held by the Company or by HSBC, or be disclosed or transferred to other employees of the Company or HSBC or to any other member of a Group Company (including if necessary to other offices of HSBC, the Company or any Group Company outside the European Economic Area) or to any other person as may be reasonably necessary or as otherwise permitted by law. In this event, the Executive's personal information/data and sensitive personal data will be protected by the strictest code of secrecy and security, and only used in accordance with the Company's or HSBC's strict instructions.

17.2 The Executive agrees that HSBC, the Company and any Group Company may intercept, process and monitor communications transmitted by or to the Executive via any private telecommunication systems (including e-mail) or services of HSBC, the Company or any Group Company.

18 General

18.1 The provisions of this Agreement are severable and, if any one or more provision may be determined to be illegal or otherwise unenforceable in whole or in part under the laws of any jurisdiction, the remaining provisions of this Agreement in that jurisdiction shall not be affected and the legality and enforceability of this Agreement in any other jurisdiction shall not be affected.

18.2 Any notice or other document to be given under this Agreement shall be in writing and may be given personally to the Executive or to the Secretary of the Company (as the case may be) or may be sent by first class post or other fast postal service or by facsimile transmission to, in the case of the Company, its registered office for the time being and in the case of the Executive either to his address shown on the face hereof or to his last known place of residence.

18.3 Any such notice shall be deemed served when in the ordinary course of the means of transmission it would first be received by the addressee in normal business hours.

18.4 The Executive hereby irrevocably appoints any other director of HSBC or of the Company from time to time, jointly and severally, to be his attorney in his name and on his benefit to sign any documents and do things necessary or requisite to give effect to those matters which he is obliged to do pursuant to this Agreement (including but not limited to clauses 13 and 14.6.1). In favour of any third party a certificate in writing signed by any director or by the Secretary of HSBC or of the Company that any instrument or act falls within

the authority hereby conferred shall be conclusive evidence that such is the case.

- 18.5 HSBC and any other Group Company may enforce the terms of this Agreement. No other person who is not a party to this Agreement may enforce any of its terms under the Contracts (Rights of Third Parties) Act 1999.
- 18.6 This Agreement contains the statement of initial employment particulars of the Executive as required under the Employment Rights Act 1996.
- 18.7 There are no collective agreements that affect the terms and conditions of the Executive's employment.

19 Other Agreements

- 19.1 This Agreement together with HSBC's Employee Handbook (as amended from time to time) constitutes the entire agreement of the parties and shall be in substitution for and shall replace any previous letters of appointment, agreements or arrangements (including without limitation the Executive's service agreement with the Company dated 5 September 2008), whether written, oral or implied, relating to the employment of the Executive by HSBC, the Company or any Group Company.
- 19.2 Without prejudice to clause 19.1, in the event of any conflict between the terms of this Agreement and any other document purporting to relate to the employment of the Executive (including HSBC's Employee Handbook from time to time in force) the terms of this Agreement prevail.
- 19.3 The Executive hereby acknowledges that he has no outstanding claims of any kind against HSBC, the Company and/or any Group Company (otherwise than in respect of remuneration and expenses accrued due and existing rights with respect to deferred bonuses and/or under and in accordance with any HSBC share plan, as at the date of this Agreement but not yet paid).

20 Choice of law and submission to jurisdiction

- 20.1 This Agreement shall be governed by and interpreted in accordance with the laws of England and Wales.
- 20.2 The Executive hereby submits to the jurisdiction of the High Court of Justice in England but this Agreement may be enforced by the Company or by HSBC in any court of competent jurisdiction.

21 Counterparts

This Agreement may be executed in any number of counterparts and by the parties on separate counterparts, but in that case shall not be effective until each party has executed at least one counterpart. Each counterpart shall constitute the original of this Agreement, but all counterparts together constitute one and the same instrument.

22 Definitions

22.1 In this Agreement unless the context otherwise requires the following expressions have the following meanings:

“Board” means the Board of Directors for the time being of HSBC or any committee of the Board (including the Group Management Board) to which powers have been properly delegated or such person or persons designated by the Board from time to time as its representative for the purposes of this Agreement;

“Chairman” means the Chairman of the Group from time to time;

“Corporate Governance Code” means the UK Corporate Governance Code published by the Financial Reporting Council (as amended from time to time);

“Commencement Date” means 1 January 2011;

“Employment” means the Executive’s employment under this Agreement;

“FSA” means the Financial Services Authority;

“Group” means (1) HSBC Holdings plc and any entity which from time to time is a holding company of HSBC Holdings plc or a subsidiary of HSBC Holdings plc or of any such holding company; and (2) any entity over which from time to time any of the entities defined in paragraph (1) of this definition either directly or indirectly exercises management control, even though it may own less than fifty per cent (50%) of the shares and is prevented by law from owning a greater shareholding and **“Group Company”** and **“Group Companies”** shall be construed accordingly;

“Recognised Investment Exchange” means an investment exchange granted recognition under section 285 (1) Financial Services and Markets Act 2000 including a recognised overseas investment exchange;

“Statutory Deductions” means appropriate tax, national insurance contributions and any other applicable statutory deductions;

“Termination Date” means the date on which the Executive’s Employment terminated;

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

22.2 references to clauses, sub-clauses and schedules are unless otherwise stated to clauses and sub-clauses of and schedules to this Agreement;

22.3 the headings to the clauses are for convenience only and shall not affect the construction or interpretation of this Agreement;

22.4 the words “subsidiary” and “holding company” have the meanings set out in section 1159 of the UK Companies Act 2006 and “management control” shall be demonstrated by the ability to exercise significant influence over an entity or its management; and

22.5 a reference to any statute or statutory provision (whether of the United Kingdom or elsewhere) includes any subordinate provision (as defined by section 21(1) Interpretation Act 1978) made under it and provision which has superseded it or re-enacted it (with or without modification) before or after the date of this Agreement except where it is after the date of this Agreement to the extent that the liability of any party is thereby increased or extended.

IN WITNESS whereof this Agreement has been executed the day and year first above written.

Executed as a Deed by _____)

the Company in the presence of: _____)

Dated: _____

Director

Dated: _____

Director/Secretary

Executed as a Deed by _____)

the Executive _____)

Dated: _____

in the presence of: _____)

Dated: _____

Signature of Witness

Witness Name: _____

Witness Address: _____

Witness occupation: _____

Computation of ratios of earnings to combined fixed charges (and preference share dividends)

For the purpose of calculating the ratios, earnings consist of income from continuing operations before taxation and minority interests, plus fixed charges, and after deduction of the unremitted pre-tax income of associated undertakings. Fixed charges consist of total interest expense, including or excluding interest on deposits, as appropriate, dividends on preference shares and other equity instruments, as applicable, and the proportion of rental expense deemed representative of the interest factor.

Section 302 Certification for Group Chief Executive

I, Stuart T Gulliver, certify that:

1. I have reviewed this annual report on Form 20-F of HSBC Holdings plc;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this annual report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the

audit committee of the company's board of directors (or persons performing the equivalent functions):

- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

6. Dated: 28 February 2011

/s/ Stuart T Gulliver
Stuart T Gulliver, Group Chief Executive

Section 302 Certification for Group Finance Director

I, Iain J Mackay, certify that:

1. I have reviewed this annual report on Form 20-F of HSBC Holdings plc;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this annual report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the

audit committee of the company's board of directors (or persons performing the equivalent functions):

- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Dated: 28 February 2011

/s/ Iain J Mackay

Iain J Mackay, Group Finance Director

Annual Certification
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), each of the undersigned officers of HSBC Holdings plc (the “Company”), does hereby certify, to such officer’s knowledge, that:

The Annual Report on Form 20-F for the year ended 31 December 2010 of the Company fully complies with the requirements of section 13 (a) and 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 20-F fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: 28 February 2011 /s/ Stuart T Gulliver
Stuart T Gulliver, Group Chief Executive

Dated: 28 February 2011 /s/ Iain J Mackay
Iain J Mackay, Group Finance Director

Consent of Independent Registered Public Accounting Firm

The Board of Directors
HSBC Holdings plc

We consent to the incorporation by reference in the registration statements (nos 333-10474, 333-92024, 222-102027, 333-103887, 333-104203, 333-109288, 333-113427, 333-127327, 333-126531, 333-135007, 333-143639, 333-145859, 333-155338, 333-158054, 333-158065, 333-162565 and 333-170525) of our report dated 28 February 2011, which comprise the consolidated balance sheets as at 31 December 2010 and 2009, and related consolidated income statements, consolidated statements of cash flows, consolidated statements of comprehensive income and consolidated statement of changes in equity, for each of the years in the three-year period ended 31 December 2010 and the effectiveness of internal control over financial reporting as at 31 December 2010, which report appears in the 31 December 2010 Annual Report on Form 20-F of HSBC Holdings plc.

Our report refers to a change in the method of accounting for certain financial assets in the year ended 31 December 2008 following the adoption of 'Reclassification of Financial Assets (Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures)'.

/s/ KPMG Audit Plc

KPMG Audit Plc
London, England
8 March 2011

The Board of Directors
HSBC Holdings plc

I, Estella Chiu, consent to be named as valuation actuary of the HSBC Group Hong Kong Local Staff Retirement Benefit Scheme in the 2010 Annual Report on Form 20-F of HSBC Holdings plc and inclusion of references to us under the heading "Experts" in the registration statements (nos. 333-10474, 333-92024, 333-102027, 333-103887, 333-104203, 333-109288, 333-113427, 333-127327, 333-126531, 333-135007, 333-143639, 333-145859, 333-155338, 333-158054, 333-158065, 333-162565 and 333-170525).

25 January 2011

/s/ Estella Chiu

Estella Chiu

Fellow of the Society of Actuaries

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MMC MARSH MERCER
GUY CARPENTER OLIVER WYMAN

The Board of Directors
HSBC Holdings plc

I, Jennifer Jakubowski, consent to be named as valuation actuaries of the HSBC North America (US) Retirement Income Plan in the 2010 Annual Report on Form 20-F of HSBC Holdings plc and inclusion of references to us under the heading "Experts" in the registration statements (nos. 333-10474, 333-92024, 333-102027, 333-103887, 333-104203, 333-109288, 333-113427, 333-127327, 333-126531, 333-135007, 333-143639, 333-145859, 333-155338, 333-158054, 333-158065, 333-162565 and 333-170525).

February 1, 2011

/s/ Jennifer Jakubowski

Name and signature

TOWERS WATSON

Colin Singer
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London Road
Reigate
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UK

The Board of Directors
HSBC Holdings plc

I, C G Singer, consent to be named as valuation actuary of the HSBC Bank (UK) Pension Scheme in the 2010 Annual Report on Form 20-F of HSBC Holdings plc and inclusion of references to us under the heading "Experts" in the registration statements (nos. 333-10474, 333-92024, 333-102027, 333-103887, 333-104203, 333-109288, 333-113427, 333-127327, 333-126531, 333-135007, 333-143639, 333-145859, 333-155338, 333-158054, 333-158065, 333-162565 and 333-170525).

24 January 2011

/s/ C G Singer

Name and signature